LIBERTY
International Investment Management

MARKET UPDATE

Q1 | March 31, 2018

IN THIS ISSUE:

1 **Year-to-Date Performance:** Performances for stocks, currencies, bonds, and preferred shares.
7 **Fun with Math:** RESP strategies.
9 **Client Q&A:** David Driscoll answers your questions.

YEAR-TO-DATE PERFORMANCE

1 Equity Markets
4 Currency Markets
5 Bond Markets
6 Preferred Shares

The Markets – January 1st to March 31st, 2018

Aside from Brazil, country equity markets in the first quarter of 2018 were negative in their own native currencies. With stock valuations already stretched, it was inevitable that we began to see a price-earnings multiple contraction in equities.

Equity Markets

2018 Q1 Returns

COUNTRY	STOCK INDEXES	TOTAL RETURN (with dividends re-invested in native currency)	TOTAL RETURN (with dividends re-invested in Canadian Dollars)
Brazil	Ibovespa	+ 11.73%	+ 14.58%
United States	S&P 500	- 0.76%	+ 2.21%
India	S&P BSE Sensex 30	- 3.20%	- 2.77%
China	Shanghai Composite	- 3.38%	+ 2.72%
Australia	S&P / ASX 200	- 3.86%	- 2.71%
Europe	Stoxx 600	- 4.02%	+ 1.06%
Canada	S&P/TSX	- 4.52%	- 4.52%
Japan	Nikkei	- 6.36%	+ 2.02%
Mexico	Mexican Bolsa	-6.54%	+ 4.01%

Data Courtesy of Bloomberg LLP

© 2018 Liberty International Investment Management Inc.

Back in the 1970s, investors could have bought stocks and earned roughly a 6% dividend yield, far higher than the average 1.75% dividend offered by the S&P 500 Index today. However, investors shunned stocks then because they could buy a risk-free asset like government bonds, GICs or Treasury bills and earn coupons that rose from 7% all the way up to 21% in 1979.

At the bottom of the market in 2009, investors also saw dividend yields of 6% to 10% (the Canadian banks all yielded 10% then). The difference from the 1970s was that interest rates were at an ultra-low zero percent in 2009, making equities extremely attractive. Naturally, investors piled into the stock market.

Today, interest rates are higher than in 2009 and climbing further still, creating competition for stocks from the bond market. On a risk-adjusted basis, bonds are half as risky as stocks so if the yields earned from bonds are the same or better than stocks, investors are better off owning bonds.

For example, consider the stocks and bonds issued by BCE Inc. Its shares currently yield 5.33% and its 10-year bonds yield 3.85%. BCE's stock price year-to-date has fallen 10%, close to double the TSX Index's return.

If the stock market falls 20%, the BCE bonds would hold their value but the equity would drop 20%. In these cases, the total return for the bonds would be 3.85% but for the stock, it would be -14.67%.

This is called earning bond-like returns (5.33%) with equity-like risk (a potential loss of 20%). In cases like this, investors should own the bonds, not the stock.

Sectors that are interest-rate sensitive include utilities, telecoms and real estate investment trusts (REITs). Beware having too high a concentration of these stocks in your portfolio as interest rates rise.

At Liberty, we prefer the opposite - to have equity-like returns with bond-like risk. That's the reason for our focus on consistently growing free-cash-flow companies as their likelihood of insolvency is minimal but the opportunity exists for better-than-average growth.

It's just another reason why we're not fans of the Canadian stock market and prefer to have over 80% of our equities in other countries and currencies. The TSX has a huge exposure to resource stocks whose free cash flows, if they have any at all, fluctuate wildly.

Generally speaking, owning resource stocks means you make all your money in the good times and lose it all during the bad times, leaving you with little long-term returns. That's why we prefer to own companies like CN Rail (CNR CN)or Toromont Industries (TIH CN) as they do business in the resource sector but aren't exposed to the volatility of commodity prices like the commodity producers.

To give you an idea of Canada's stock market underperformance on the global stage, here's a comparison of the TSX Index versus the US S&P 500 Index and the MSCI Global index for the last 1, 3, 5 and 10 years. It includes dividends re-invested and the market sell-off in 2008:

% INDEX PERFORMANCE	1 YR	3 YRS	5 YRS	10 YRS
TSX Index (Canada)	9%	6%	8%	3%
S&P 500 Index (USA)	22%	11%	15%	8%
MSCI World Index (Global)	23%	10%	11%	4%

Data Courtesy of Bloomberg LLP

A 3% annual return like investing in the TSX may keep up with inflation but that's all. An investor's spending power hasn't increased one iota.

We're still not out of the woods yet

Despite rising corporate earnings, Price-Earnings multiples remain above the historical norm. As a result, the stock market could do one of two things:

1. We could see a market correction of up to 30% over the next 3 years or
2. The stock market could go sideways over that time span.

© 2018 Liberty International Investment Management Inc.

Price/Earnings Multiples			
INDEX	**COUNTRY**	**P/E RATIO** Estimated	**P/E RATIO** Before Outstanding Items
S&P TSX	Canada	17.52	16.46
S&P 500	United States	21.29	23.80
Euro Stoxx 600	Europe	15.61	15.82
MSCI World Index	Global	18.86	19.78

Data Courtesy of Bloomberg LLP

On a price-earnings basis, investors could have purchased $1 of profits for $6 to $10 in 2009. Today, the number has risen to $25 to $50, making it vastly overvalued.

The other problem we see with the data above are the number of stock analysts who use adjusted earnings as their benchmarks instead of Generally Accepted Accounting Principles (GAAP) earnings. The latter should be used when evaluating companies, not adjusted earnings, because those profits are open to interpretation and give companies a lot of leeway when reporting their numbers.

Since downside risks remain great and real, we're still holding to our current cash policy of 20% times the equity allocation. For example, if the asset mix is 60% equities and 40% fixed income, the cash weighting will be 12% (60% equities x 20% cash). If it's an all-equity portfolio, the clients will hold 20% cash.

Performers / Non-performers

For the Liberty global stock portfolio, the 5 best/worst performers in the first quarter of 2018 were:

Year-to-date Price Performance (in native currency and dividends not included) As of March 31, 2018.			
TOP 5	**% GAIN**	**BOTTOM 5**	**% LOSS**
Dassault Systemes	+ 25%	**Cognex Corp.**	- 15%
Heico Corp.	+ 15%	**Novozymes A/S**	- 12%
Rollins Inc.	+ 10%	**Novo-Nordisk NV**	- 11%
Thermo Fisher Scientific	+ 9%	**Intertek Group plc**	- 10%
Roper Technologies	+ 8%	**Paychex Inc.**	- 10%

Data Courtesy of Bloomberg LLP

For the first quarter, our equities ended up in positive territory compared to the negative returns of most stock market indexes.

Here are some comments on the individual stocks noted above:

→ **Dassault Systemes (DSY FP)** is a French software company that provides design technology using CAD/CAM systems. A company can use Dassault's software to design the most efficient and least-costly way to build a product. They're also using Artificial Intelligence and machine-to-machine technology to improve its software and make it more relevant for its clients.

→ **Heico Corp. (HEI US)** makes and designs parts and systems for the aerospace industry. Unlike Boeing Inc., that may suffer from Chinese tariffs, Heico does no business in Asia. Most of its sales are domestic, leaving it to benefit from the low US corporate tax environment and government trade policies.

→ **Rollins Inc. (ROL US)** is a global pest control company that is best known under its Orkin brand. It, too, benefits from the cut in corporate taxes. Little known by investors, Rollins has few large competitors, strong pricing power, a progressive dividend policy (up 22% in the past year) and it has also paid an additional special dividend each year since 2012.

→ **Thermo Fisher Scientific (TMO US)** wants to enable its customers to make the world healthier, cleaner and safer. It helps its customers accelerate life sciences research, solve complex analytical challenges, improve patient diagnostics, deliver medicines to market and increase laboratory productivity.

→ **Roper Technologies (ROP US)** may be described as a "serial acquirer" that has grown by purchasing firms. Its product line is mostly computer software

© 2018 Liberty International Investment Management Inc.

for hospital medical systems and radio frequency identification (RFID) tag systems for toll roads in New York state, Florida, Texas and the Middle East.

The company's acquisitions have created excess cash flow that is greater than its net income. This keeps the company flush with cash to pay down its debt quickly and provide the leverage to do even larger acquisitions.

On the negative side:

→ **Cognex Corp. (CGNX US)** is a robotics firm that makes cameras (the eyes of the robot) that can read information along the assembly line or read barcodes at airports to direct luggage to the proper carousel.

  We first purchased the stock in January, 2016 and it quintupled from $14 a share to its high of $72 and became an average weight in client portfolios of 6%.

  Also, it traded at a beta of 1.76, meaning that for every $1 the S&P 500 Index went up or down, Cognex's share price moved $1.76, making it 76% riskier. In other words, if the stock market fell 20%, Cognex's shares would drop 36%.

  Since it became a 6% weight overall in client portfolios and traded at an excessive beta, it was time to re-balance the shares by selling half. It has since fallen to $50 a share as technology stocks undergo a sizeable P/E multiple contraction.

  Over a 10-to-20-year time horizon, re-balancing helps enhance performance by 1% to 2% compounded annually. It also helps take the emotion out of the decision.

Speaking of multiple contractions, the other four stocks in negative territory (Novozymes, Novo-Nordisk, Intertek Group and Paychex) have seen declines in their P/E multiples from essentially 30 times earnings to 20 times earnings.

We continue to own all the stocks on the list and are buying more – although half-positions only for new accounts.

Currency Markets

Canadian Dollar vs.			
CURRENCY	**DEC. 31, 2017**	**MAR. 31, 2018**	**GAIN/LOSS %**
Swedish Krona	$0.1534	$0.1532	- 0.5%
Australian Dollar	$0.9812	$0.9895	- 0.8%
US Dollar	$1.2574	$1.2887	- 2.4%
Swiss Franc	$1.2898	$1.3475	- 4.3%
New Zealand Dollar	$0.8910	$0.9316	- 4.4%
Danish Krone	$0.2026	$0.2126	- 4.7%
Euro	$1.5088	$1.5853	- 4.8%
British Pound	$1.6978	$1.8074	- 6.1%
South African Rand	$0.1017	$0.1088	- 6.5%
Norwegian Krone	$0.1531	$0.1644	- 6.8%
Japanese Yen	$0.0112	$0.0121	- 7.8%
Mexican Peso	$0.0640	$0.0709	- 9.7%
Average Loss			- 4.9%

Data Courtesy of Bloomberg LLP

The chart to the left is determined as follows: On December 31st, 2017, one US dollar bought $1.2574 Canadian Dollars. By March 31, 2018, it bought $1.2887 Canadian dollars, meaning the Canadian Dollar fell by almost 3% against the U.S. dollar.

In the first quarter of 2018, the Canadian dollar fell an average of 4.9% versus its international counterparts, leaving Canadian investors with less spending power.

The currency's stress is being caused by the following factors:

→ Interest rates are rising at a faster pace in the United States than in Canada. This means that, to earn a higher return, foreign investors would sell their Canadian government bonds to buy US Treasuries. Currently, the US 10-year bond yields 2.74% versus its Canadian counterpart that yields only 2.09%.

© 2018 Liberty International Investment Management Inc.

By making the switch, foreign investors have to sell Canadian dollars to buy US dollars.

- The Canadian economy is weakening. Higher interest rates and mortgage rule changes are causing a slowdown in the housing market, thus weakening the Canadian dollar against other currencies.
- US corporate tax rates are now at 21%, below the 30% corporate tax rates charged in Canada. As a result, many US companies are considering selling their Canadian operations.

  For example, NextEra Energy, a public utility mostly with operations in Florida, has decided to sell its Canadian wind and solar assets and repatriate the money back to the US where the firm can invest it and pay lower taxes and earn higher profits.

  If this becomes the norm, the Canadian dollar may stay under pressure.

Bond Markets

10-Year Bond Yields		
COUNTRY	MOODY'S SOVEREIGN CREDIT RATING	CURRENT YIELD
Turkey	BB-Low	+12.13%
Indonesia	BBB-Low	+6.62%
Brazil	BB-Mid	+4.87%
Greece	B-Low	+4.26%
Russia	BB-High	+4.49%
Argentina	B-Mid	+6.65%
Mexico	A-Low	+4.13%
New Zealand	AAA-Mid	+2.70%
Australia	AAA-Mid	+2.60%
United States	AAA-Mid	+2.74%
Canada	AAA-Mid	+2.09%
United Kingdom	AA-Mid	+1.35%
Germany	AAA-Mid	+0.49%
Japan	A-High	+0.03%

Data Courtesy of Bloomberg LLP

In the global bond world, there were two credit rating changes:

- Greece's credit rating was raised from CCC (High) to B (Low), helping the government's plans to continue a bond-market comeback this year.

  "Greece's growth and fiscal outlooks have improved alongside a labor market recovery and amid a period of relative policy certainty," wrote Standard & Poor's. "The positive outlook on Greece reflects further upside rating potential from the policy and financing environment over the next year."
- Argentina also saw its credit rating raised as it recovers from virtual bankruptcy.

  Argentina's credit rating was raised one level by Moody's Investors Service as President Mauricio Macri's macroeconomic reform began to take hold, bolstering optimism about the nation's long-term prospects.

  While Argentina must still contend with high fiscal deficits, stronger and balanced growth will strengthen its fiscal and external positions over time, Moody's analyst Gabriel Torres said in a statement. The Macri administration has announced plans to reduce the fiscal deficit and tax, pension and labour reforms.

  "Economic growth appears to be more sustainable than prior consumption-led booms," Torres wrote. "After years of stop-and-go economic growth, Argentina is poised to grow two years in a row in 2017-18, the first time since 2011."

© 2018 Liberty International Investment Management Inc.

In the United States, the gap between two-and-ten-year US treasury bonds narrowed recently to 47 basis points (1 basis point equals 0.01%), the lowest since 2007. A narrowing yield curve is usually associated with an economic slowdown and an inversion typically predates a recession. As the US Federal Reserve continues its rate hike plans, the gap should lessen further.

The implication is that it makes the cost of capital for corporations more expensive, causing them to cut back on research and development and job hiring.

Speaking of the US job market, joblessness currently stands at 4.1%. Back in 1966, it fell as low as 3.6%, the same rate that Federal Reserve policy makers see the US hitting at the end of 2019.

This is important because that's when inflation began to rise, virtually doubling over 1966 to 3%. Similar to now, fiscal policy was pumped up by tax cuts and deficit spending.

“This reminds me of the late 1960s when we experimented with low rates and fiscal stimulus to keep the economy at full employment and fund the Vietnam War,” Paul Tudor Jones, founder of hedge fund Tudor Investment Corp., said in comments to Goldman Sachs Group Inc. published Feb. 28. “We are setting the stage for accelerating inflation, just as we did in the late ’60s.”

Meantime, the implementation of trade tariffs is also inflationary because they work like an added tax to consumers. The US deficit is expected to surpass $1 trillion by 2020, two years ahead of estimates.

This is why clients have 5% of their portfolios in inflation-protected bonds. The “real” yields are slightly positive but the point is not to trade them. They're in the portfolios to protect against inflation during the clients’ lifetimes.

Both the Canadian Government Real Return Bond (RRB) and the US Treasury inflation protected security (TIPs) earn a fixed coupon which is increased each year by the inflation rate.

For example, the Canadian RRB pays 3% plus the rate of inflation each year until it matures in 2036. If inflation stays around 2% this year, the total payout in 2018 will be 5%.

If inflation ever spiked to, say, 10%, the total payout would be 13%, keeping the investor's spending power ahead of the ravages of inflation. Regular bonds do not provide this protection. If inflation ever rose 10% as we saw in the 1970s and 1980s, their prices would collapse.

Preferred Shares

TYPE OF PREFERRED SHARE	YEAR-TO-DATE PRICE CHANGE
Canadian Perpetual Preferred Shares	- 2.01%
Canadian Variable Rate Reset Preferred Shares	- 1.44%
BMO US Preferred Share Index ETF (in USD)	- 2.35%

Data Courtesy of Bloomberg LLP

Rising rates have caused negative returns for perpetual preferred shares as they follow the similar price sensitivity as bonds. When interest rates rise, prices fall and vice versa.

Even the Canadian rate-reset preferred universe saw a decrease in prices as the Bank of Canada didn't raise rates after the Federal Reserve did in March.

Also, preferred shares are deemed to be “quasi equity” so when the stock market corrects, preferred shares usually react negatively.

© 2018 Liberty International Investment Management Inc.

Determining the Best RESP Strategy

Here's some RESP advice from Liberty's CFO, Brett Girard, CPA (*brett@libertyiim.com*).

> “
> In the case of RESPs, it is important to match the asset mix ... to the investment time horizon.
> “

Anyone who has attended a post-secondary institution can agree that university or college costs are not cheap. Even if a student elects to commute to school (and avoid the housing and food costs), there are significant expenses faced, such as tuition, textbooks, lab fees and other ancillary charges.

According to the Canadian Centre for Policy Alternatives, average tuition and compulsory fees for Canadian undergraduate students have tripled since 1993 and will continue to rise over the next four years (current tuitions averaged about $7,590 in 2018). At this rate, four years of undergraduate studies could total over $30,000 before room and board.

For those planning to start a family or those with young ones now, saving early and allowing investment gains to compound is more favourable than trying to fund an education in the year it occurs. In addition to personal savings, the government also offers assistance.

Registered Education Savings Plans (RESPs) are accounts that allow investments earmarked for education to earn returns on a tax deferred basis. Specifically, contributions to RESPs are made by parents or relatives (subscribers) with after tax dollars.

Funds grow in the RESP tax-free and when education expenses need to be paid, the student (beneficiary) can withdraw the investments to cover these costs. Withdrawals, while taxed, are done so as income to the beneficiary at what should be a low tax rate.

A key component of the RESP is the Canadian Education Savings Grant (CESG). This is a grant from the federal government that supplements RESP contributions. In any calendar year, the CESG will add 20% to contributions up to $2,500. In other words, the government will provide $500 annually on each RESP contribution of $2,500. The lifetime maximum of the grant is $7,200.

Let's look at three different strategies for how in invest in the RESP.

© 2018 Liberty International Investment Management Inc.

Strategy 1:

Maximize the annual CESG by contributing $2,500 and receiving a grant of $500. This contribution amount should be repeated each year until the child is 13. At age 14, only $200 of grant money will remain (of the $7,200 limit) requiring a $1,000 contribution.

Total Contribution by subscriber: $36,000 (Ages 0-13: $2,500 p.a., Age 14: $1,000)

Total Grant from Government: $7,200

Strategy 2:

This Strategy is similar to Strategy 1 in that annual contributions of $2,500 are made for the child to age 13, followed by $1,000 in the 14th year. This contribution schedule maximizes the CESG at $7,200.

Additionally, the CRA has set the lifetime maximum subscriber contribution for an RESP at $50,000. In light of this, there is $14,000 that will never be matched by the CESG (this is based on the math that the government will match 20% of contributions up to $7,200 or $36,000 of contributions).

Since funds in the RESP can compound with the tax deferred, taking advantage of the $14,000 of subscriber contribution room that will never be matched may be contributed in the first year the plan is open.

Total Contribution by subscriber: $50,000 (Age 0: $16,500, Ages 1-13: $2,500 p.a., Age 14: $1,000)

Total Grant from Government: $7,200

Strategy 3:

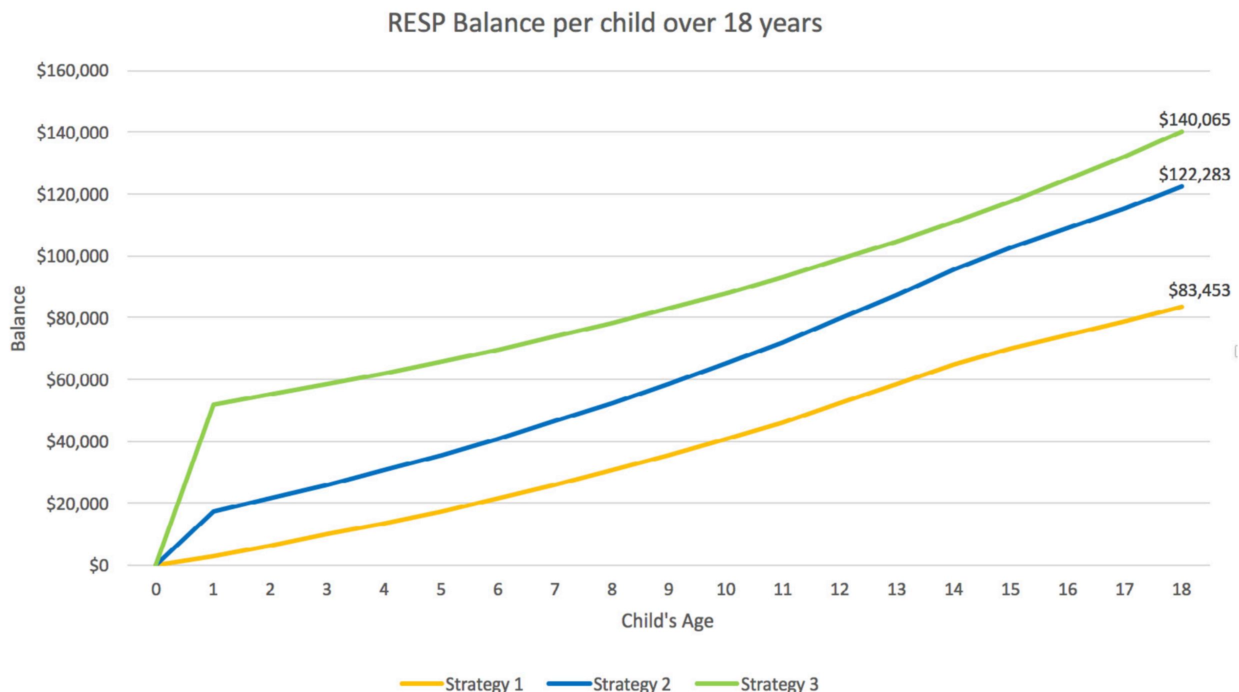
For those impatient and wanting to immediately take advantage of the tax deferred compounding in the RESP, this strategy requires the subscriber to contribute $50,000 (this is the lifetime maximum a subscriber may contribute to an RESP as set by CRA).

Under this strategy, the CESG is only given in years when the contribution in made (i.e. there is no carry forward), so only the first $2,500 of the $50,000 will be matched at 20% ($500).

Total Contribution by subscriber: $50,000 (Age 0: $50,000)

Total grant from government: $500.

How do the Strategies compare?



 © 2018 Liberty International Investment Management Inc.

The chart above depicts how the three Strategies would fare at a 6% annual return.

Strategy 3 (with the $50,000 contribution in year one) is the best performer, even without the annual CESG from the government.

Next is Strategy 2, with $14,000 (the non-matched portion of the RESP limit) contributed in year one plus $2,500 contributed each year to maximize the CESG.

Meanwhile, Strategy 1, largely due to the lack of a lump sum contribution early in the child's life, has the lowest ending balance. The news isn't all bad, however, even if Strategy 1 is pursued, as there will be over $83,000 when the child is 18 and ready to attend school.

In the case of RESPs, it is important to match the asset mix (allocation to equities and to fixed income) to the investment time horizon (i.e. when the funds are needed).

If your child is in diapers, the longer investment horizon allows for more growth-oriented holdings. If, however, your child is just a few years away from attending university, then capital preservation is important and the focus should be on a more balanced asset mix.

CLIENT Q&A

QUESTIONS

9 Why don't you buy stocks that offer higher yields?

10 Why are my costs higher than the published fee?

10 Why do you buy stocks with such small yields?

Why don't you buy stocks that offer higher yields?

Companies that offer higher yields can usually be in some form of turmoil. If the stock price plummets, the yield will rise. *Enbridge Inc. (ENB CN)* is a perfect example. In the last year, the stock has fallen from its mid-$50s price to its recent close of $40, a 20% tumble. Its yield is now 6.68%.

Four things accounted for the stock drop: A fall in earnings that was worse than analyst expectations, a hefty debt-load (about $60 billion after its $37 billion acquisition of Sempra Energy), rising interest rates (making its cost of capital go up) and a ruling by the US Federal Energy Regulatory Commission (FERC) that cancelled an accounting credit on its MLP investments for income taxes that they don't pay.

In this case, investors must always be aware of the 3 Ds of investing: Debt Doesn't Disappear. It has caused bankruptcy for many companies that are awash in debt as the higher interest costs aren't offset by higher revenues.

Investors must do their homework when investigating companies with regard to their dividend payments and debt loads:

→ Ensure the debt-to-cash flow ratio stays under 2 times. This means a company can pay off its debt within a two-year timeframe, even in recessions (which often have a duration of two years). Ratios greater

© 2018 Liberty International Investment Management Inc.

than three are a “red flag” as the added leverage could cause financial distress if the economy weakens or goes into a recession.

- Ensure the dividend payout ratio (cash dividends paid divided by free cash flow) is not too high and never exceeds 100%. If the latter, the company would have to continue to borrow money or issue equity to make the payment (a disaster in the making) as the debt-load could snowball out of control.
- Compare a company's return on invested capital (ROIC) to its weighted average cost of capital (WACC). If a company can't make more than it pays when investing its capital, it becomes a losing proposition.

This is the current situation for Enbridge. According to calculations by *Bloomberg LLP*, Enbridge's WACC is 7.9% and its ROIC is 5.3%, meaning asset sales should be forthcoming, albeit at lower prices than they may expect. Here's the “Buy High, Sell Low” philosophy at work that all investors and CEOs should avoid.

Why are my costs higher than the published fee?

As stated on the website, our fees don't include trading commissions for the securities that we buy or sell. The client must absorb them as a cost of doing business.

Currently, the commissions are $15 if traded at our custodian, National Bank, or $20 if we trade with another broker (and get a better price than National may offer).

When putting together a portfolio of stocks, bonds and preferred shares for new clients, they may incur trading costs of a few thousand dollars. After that, the excess costs fall because our turnover rate is less than 10% a year (we're not active traders) and we usually hold our bonds to maturity and our preferred shares in perpetuity.

Why do you buy stocks with such small yields?

Long-term investment success comes from rising dividends and the re-investment of those dividends. In fact, about two-thirds of total performance comes from dividends, not share price movement. The reason most investors get “locked in” on the stock price is because it is readily available each day. A company's stock price is only relevant on the day of purchase or sale.

Many of the Liberty stocks have small yields because they're still in their growth phase. Most of the profits are going back into the business for future growth. However, they shouldn't be ignored because the yields are small.

A.O. Smith (AOS US) is one of our stocks that sells residential water heaters and commercial boilers in North America and China. They are also in the water purification business in North America, China and India.

By ignoring the company because of it's tiny current yield (1.14%), investors miss out on the growth in the dividend. In the past 15 years, its dividend per share has risen from $0.10 to $0.72, a seven-fold increase, or an average growth rate of 44%.

And as the dividends have risen, the share price has, too, as it has jumped an average of 30% a year. It's also up 5% this year while stock markets are down.

As in the previous question about Enbridge and its high yield, investors should not follow the practice of “chasing yield”. Instead, they should be more focused on the annual growth in the portfolio.

Around the world, the average dividend increase by the 250,000-odd publicly-listed companies is about 7%. Using the “Rule of 72” (72 divided by the rate of increase) equals the number of years it takes to double your money, or in this case, double your income. As

© 2018 Liberty International Investment Management Inc.

such, a 7% dividend increase doubles your income in 10.2 years (72 divided by 7%).

An investment in Sun Life Financial, with a 10-year average growth rate of 3%, means you'll double your income in 24 years. Tack on a historical inflation rate of 3% and there's no dividend growth. As an investor, are you willing to wait that long to double your income? We aren't.

For Liberty clients, the average dividend growth rate has historically been between 10% and 20% a year. This year it will be 14%. At that rate, the income doubles every 5.1 years. For retirees, it can be considered their pay raise.

For clients still working, it goes a long way to provide the income needed in retirement without having to touch the capital and ensure they shouldn't run out of money in their lifetime. If that happens, the capital can be used as an inheritance for the next generation of investors in the family.

IN SUMMARY:

With increased volatility in the market and most major indices in negative territory in 2018, it's important to:

- **Understand the difference between risk and reward —** Avoid investments that have bond-like returns but that carry equity risk.
- **Re-balance when necessary —** If stock valuations are at all-time highs, it's prudent to take some profits off the table. We've already done so with the re-balancing of Cognex shares.
- **Don't chase dividend yields —** Instead, focus on the dividend growth rate, not the yield. Companies that consistently raise their dividends above 10% annually may be considered stocks of the highest quality.
- **Pay attention to important financial metrics —** Debt-to-cash-flow / Interest coverage / Dividend-to-free-cash-flow can help you avoid bad investments. Since you only need 30 stocks to round out a fully diversified portfolio, it's easy to turn your back on companies with poor financial metrics.
- **Avoid portfolios of individual stocks that also hold ETFs and mutual funds —** all you are accomplishing is paying fees on fees. If this is what your advisor does for you, have a talk with them, or better still, fire them. They're not working in your best interests.
- **Valuations are nearing all-time highs —** Keep some cash available in the event of any market meltdown. Twenty percent of your equity component is appropriate.

If you have any further questions, let me know.

David Driscoll

President & CEO
Liberty International Investment Management Inc.

The commentary in this newsletter should be considered general commentary only. The above language is intended for informational purposes only and is not intended to constitute accounting, legal, tax, or investment advice. You should consult directly with a Liberty professional before acting on any information in this newsletter.

 © 2018 Liberty International Investment Management Inc.