Parliment Building Products, Inc.
*You Can Rely On Us*

# THE PARLIMENT PAGES

*October, 2018*

## *TARIFFS, MARKETS, AND OTHER SUNDRY STUFF -*

On September 24th, 2018 there was a 10% tariff implemented on all Chinese goods that we buy i.e. rod chairs, anchor bolts, tie wire, etc. Also announced, this tariff will further be increased to 25% on January 1, 2019. Obviously, these tariffs could change at any time, though we do expect the 10% tariff to stick. We will keep you informed as the year progresses.

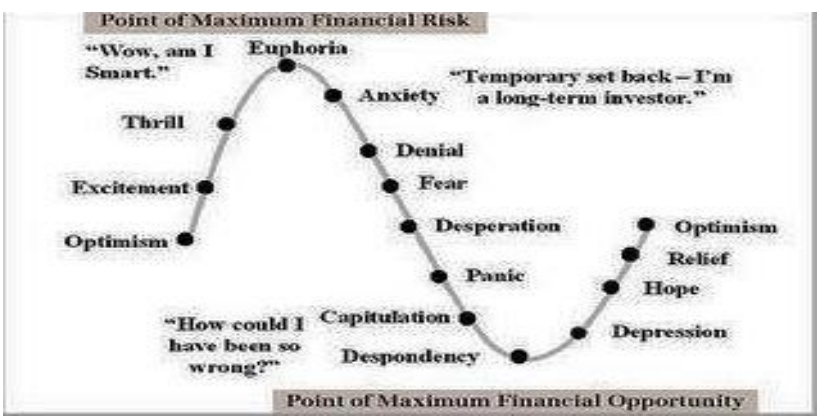
Rebar has also been dramatically affected by tariffs. Most imported bar sold in our market comes from Turkey. At this time there is currently a 50% tariff on all Turkish rebar with no other viable alternatives in the near future.

On the domestic rebar front, CMC's merger with Gerdau should be completed by year's end. This will leave two domestic steel mills in the USA, CMC and Nucor. When you go from the big three to the giant two, it would likely mean higher prices in 2019.

Housing starts are beginning to increase again and we believe there could be a shortage of rebar late in the 4th quarter of 2018. Build inventory now!

## *THE LINEAL THINKING CONCEPT –*

We all know and acknowledge at some level, that there are innumerable cycles at work at all times. Human body cycles, sunspot cycles, baseball batting cycles and economic and business cycles. For entrepreneurial owners, the business ownership emotional cycle is one that we live with 24/7. That business ownership emotional cycle is best illustrated as follows.




I know you recognize this. Just before the last crash, everyone in the industry was raking in record profits. Banks were doing crazy stupid things. Speculators were making fortunes. All of us believed this was the real definition of euphoria.



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This is the same chart with "lineal thinking" lines inserted. Quite simply, as things are going up, you believe they will go up forever and conversely, when things are going down, you think they will continue to go down all of the way to the bottom.

We all remember the euphoria that existed just days prior to the last crash and we all remember the dark days following when we wondered if we would ever recover.

One of the most important skills of an entrepreneurial owner is recognizing this chart and accurately predicting where we are at any one time in this business cycle. Home Depot took a several billion-dollar write-off because of all of overpriced acquisitions they made just prior to the crash when everyone was thinking that this was just going to go on forever. Many companies surrendered just before the downturn ended. Entrepreneurial owners must recognize and understand when the curve changes and not get fooled by the concept of believing in the lineal straight up or straight down path.

***SO, WHERE ARE WE TODAY, BIG PICTURE? –***

I am a voracious reader subscribing to numerous financial, economic and political newsletters. (I hate to think how much I spend annually on those subscriptions.) In the 20 years or so that I have been trying to keep up-to-date and interpret my readings, I have never seen such a divergence of opinion. And most troubling, even the "fence sitters" seem to be falling off in one direction or the other.

The economic headlines are mostly positive. The stock market remains on a tear and is up substantially in the past couple of years. Unemployment is at a generational low. New job creation continues at a high pace. Work force participation is still low but steadily rising. Finally, we are also seeing some wage increase. Corporate earnings are strong and reflected in the rising share price. The significant corporate tax cut has produced an influx of capital back into the US. This capital is available for expansion, stock buy-backs, increased wages and bonuses. Small Business owners are showing high levels of confidence and are reporting plans to grow their businesses through additional capital investment and new hires. Consumer confidence is at a 12-year high with retail sales booming.

Clearly, if you take in everything mentioned above and look at the chart on page 1, you would see that we are very close, if not already there, to the euphoric stage. The optimists believe this line is going to continue up and up.

This might be where the negative pundits step in. They are shouting as loudly as they can that we are at the peak and financial disaster is right around the corner as the curve moves downward. They support their argument with both big picture and industry specific arguments.

One argument that seems to always persist is the government's bias in how statistics are derived and communicated. There is no doubt in my mind that the bias does exist. However, I think that bias needs to be partially discounted as at least it is consistent. Since it is consistent, it is possible to better see trends and not individual numbers. When you look at trends, the message eventually comes out as a mostly unbiased conclusion. The trade war with China and other significant economies has put a lot of doubt into the future. We addressed this in detail in a previous newsletter. I believe the final innings have not been played and we still need more time before we can predict what, if any, impact this will have.

The other potential "macro" flare-up is the entire stability of the Presidency and the relentless attacks that are taking place. What will be the impact on the elections, possible impeachment, and continued fighting? In the primary elections we are seeing even more divisiveness as the Democrats are electing Progressive Socialists and the Republicans are moving solidly right.

***SO, WHERE ARE WE TODAY, OUR INDUSTRY? –***

There is a lot of very troubling news that is coming down the pike. Existing home sales continue to drop. We all know this is a very strong leading indicator to new sales. While we are accustomed to seeing month to month fluctuations, we now are seeing six straight months of not hitting projected targets. After dropping for 36 straight months, we have seen foreclosures increase each of the last three months.

Housing starts, which is what we care about the most, fell 7%, 12%, and 1% in each of the last three months. While this is not good, it is even worse when you realize that projections had called for an average increase of 5% for that three-month period.

Consumer spending is skyrocketing. While this is a good thing for the economy, it does take away funds that could go to home purchases. The average "household net worth" is increasing, but so is the level of debt. As debt goes up, individuals, despite income growth, lose financial flexibility if things turn bad.

We have talked in prior newsletters about the student loan headwinds. Those headwinds are now becoming better defined as we are seeing an increase in defaults. Presently that default rate is approaching an unprecedented 12%. To better understand that, compare it to the subprime auto loan business which is one of the least credit worthy loans made. Their rate of default is 5.6%. Student loan debt is 80% larger than all credit card debt with the average monthly payment of about $450. For a husband and wife who may both have debt, they have to take $900 per month out of their take-home pay. Clearly that headwind is becoming severe and can't help but negatively impact home sales.

Last quarter we addressed interest rates and the effect they could have on mortgages and affordability. However, since then, the Federal Reserve has issued a much more aggressive forward policy and it is likely that we will be seeing more increases. Inflation and wage growth have picked up and that is the message the Fed needed to get aggressive. While we are still a year away from interest rates hitting a resistance level, I now believe they will be a factor that must be considered.

I think the big picture positives have some basic flaws. There are a lot of bubbles out there right now. Arguably the stock market is the biggest bubble of all. If it weren't the weakness of everyone else, the US Dollar would be the biggest bubble. Commodities are in a bubble. And many believe that housing has entered the bubble phase as well. Furthermore, I believe we are very susceptible to any one of a number of events, political or economic, that could cause any one or more of these various bubbles to pop. And typically, when one bubble pops, it is not long before all of the others follow suit.

***<u>HOW DO I MANAGE RISK IN TODAY'S ENVIRONMENT? –</u>***

When I look at risk management, I always ask myself what are the biggest threats in the event of a crash or severe downturn. The biggest threat of all is not seeing it coming. A friend once told me that he would rather be a year too early than a day too late. I would never suggest that I am so clairvoyant that I can predict the future. That is your responsibility as much as anyone else's. Don't put your head in the sand and miss the clues.

The second biggest threat is debt whether it is bank debt or trade debt. Nothing gives you more freedom than being debt free. Reduce your trade debt by cutting back on your inventory levels. Instead of truckloads, buy pallets. Select vendors who can help you keep your inventory levels low as. Sure, it is more expensive, but it will reduce your accounts payable. Most of your bank debt will either be tied to your receivables and inventory or capital purchases such as equipment. Get aggressive on collecting receivables. Get tough on credit. It may cost you some sales, but lost sales are better than write-offs. Delay any new capital purchases.

Analyze your day-to-day operating expenses. They can be adjusted when necessary. Instead, make sure you are focused on the very best customer service possible. That customer service will help you charge higher prices and increase your margins.

***<u>15 YEARS OF WRITING –</u>***

For over 15 years, I have pulled out my volumes of research, scratched my head, played with my Ouija Board (remember those from high school) and sometimes rolled the dice to come up with this newsletter. During that time, we have accurately predicted many of the industry trends and have missed a few along the way. Fortunately, I think we were right far more than we were wrong.

As I am personally getting to the end of my professional career, I have come to realize that success in business is impacted to an extraordinary degree by one's ability to manage risk. From something as simple as "do I hire this person", to something more complex such as "do I stock up or reduce my inventory," it is all about risk management. After this issue, I will be turning over the authorship into the capable hands of Chuck and the rest of his staff

***<u>FINAL FAREWELL FROM JIM -</u>***

While I hate for my final newsletter to be somewhat negative, I am of the age where I have personally experienced more downturns and crashes than I would care to remember. The most important thing I have learned is that downturns are tremendous opportunities for those who recognize and prepare. However, as they say, forewarned is forearmed.

**Thanks to all of you for your loyal readership and continued support of the great people at Parliment. We would not exist if it wasn't for you. A million thanks.**

***<u>ON A PERSONAL NOTE FROM CHUCK –</u>***

I want to thank Jim Bleech for being my business partner for the first eight years of Parliment Building Products, Inc. It is hard to believe we have been open for 16 years. We would not be where we are today if he was not involved from the beginning. Enjoy your hard earned and well deserved retirement. ***<u>SAIL ON!!!</u>***