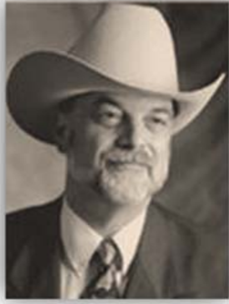

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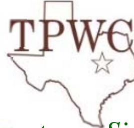

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX) closed out the week today at 2,384.20, up 1.51% for the week. For better or worse, it is still a bit below its recent high of 2,401, but is still up about 6.5% year-to-date and over 15% for one year. Gold was down 1.31% and the ten-year Treasury yield rose just a bit to 2.29%.

If you have followed the news this week at all the minimal movement in the SPX may be surprising. The news media has spent much time and ink on various descriptions of a "tax plan" released by the White House. Central to that tax plan was cutting corporate tax rates by more than 50%. If the market had assumed that plan would have a chance of success, the Index should have risen by double-digits. Instead, it was clear that the gains this week were almost completely a result of better than expected earnings reports by leading S&P 500 companies.

The Economy

Apparently, the biggest economic news this week, at least based on the media coverage, was the President's Tax Reform plan. We don't get it. Attached to this letter you will find a copy of the entire one page White House document that was handed out at the press conference. On the top of the handout is a drawing of the white house, but, very notably, it does not include the official Presidential letterhead or a date. It is all on a single page, and that page is double and triple spaced. What is impressive about it is not what it proposes, but what it doesn't.

Here is a breakdown of what the proposal says, and comments on what it does not say.

Individual Reform: The proposal states the tax code should have three individual tax brackets, 10%, 25%, and 35%, but does not state at what income levels those brackets would start or end. It goes on to double the standard deduction used by people who do not itemize their deductions. As currently there are 12 levels of standard deductions, there could be some confusion over which or how many of those are to be doubled. Currently the standard deduction for a couple filing jointly is $13,850. The next bullet point is "Providing tax relief for families with child and dependent care expenses". The plan does not specify what that means or if it would be for all income levels.

The next title is, "Simplification". The first bullet there is, "Eliminate targeted tax breaks that mainly benefit the wealthiest taxpayers". The tax break that is of the most benefit to the wealthy is the long-term capital gains rate, but it also benefits a lot of other people. The last time we killed that tax treatment was 1987, followed by a market crash. We are unaware of anything in the tax code that states "To lower taxes for the wealthiest…" so that is a puzzling goal. Also under "Simplification" is a bullet point to keep the mortgage interest rate and charitable tax deductions. Then it goes on to ask for a repeal of the Alternative Minimum Tax, which is among those that most benefit the wealthiest, and to repeal the "death tax" (estate tax). This is actually a scary set of bullet points. If one assumes that the long-term capital gains rate is to be eliminated, and upper income earners are to be taxed on capital gains at 35%, the stock market is in trouble as are land and small business owners who will see the tax on the sale of their property more than double.

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Under "Business Reform" the proposal is to lower the business tax rate to 15%, but does not indicate whether that means just the corporate income tax rate or income taxes on small businesses that are not corporations. It asks for a "One-time tax on trillions of dollars held overseas" but does not name a tax rate or to whose money that applies. As it is written it appears to indicate that if someone has money outside the United States, the U.S. government should tax that money one time, but says nothing about bringing the money home. Actually, the average tax that has already been paid on the overseas money is about 15%, so we cannot figure out what that bullet point actually means. The final proposal is, "Eliminate tax breaks for special interests." Again, we haven't the least idea what that means. The mortgage tax deduction is a tax break for a special interest as is the charitable gift tax deduction. Municipalities have a special interest tax break in that they can issue bonds that are federal income tax exempt.

That is the whole proposal. It does not address individual deductions, the capital gains tax rate, the levels at which the tax brackets would kick in, 401(k) deductions, or anything else. In short the document says very little and what it does say would take us into financial insolvency in a couple of decades. Given the current level of government spending, the tax proposal, as it was presented, has been analyzed by at least one tax watchdog organization to add $5.5 trillion to the national debt over the next ten years when compared with the current tax law.

The key take-away is that by the close of business the stock market did nothing. If, for example, the corporate tax rate was to drop to 15%, analysts have calculated that corporate earnings would rise 12% next year over what they would be under the current law. The apparent conclusion of investors is that the proposal will be ignored. If one throws in the budget proposal submitted by the White House earlier this year, this tax plan would result in something approaching a doubling of the national debt over the next decade. In short, the "tax plan" was, in actuality, a rehash of a campaign promise that is very, very unlikely to become law.

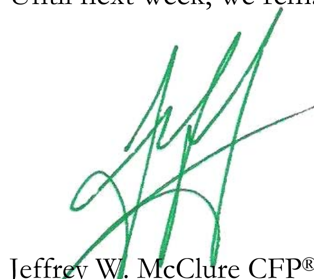
Real Economic News

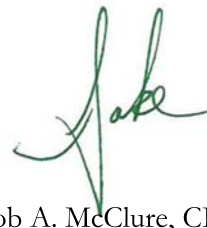
Caterpillar, a bellwether of American heavy industry reported surprisingly high earnings as sales increased year-over-year for the first time in several years. It's stock promptly rose as did other heavy industry manufacturers. At the other end of the economic spectrum, McDonald's Corp also reported record earnings as its sales rose 4% in the first quarter. Amazon reported a whopping 41% first-quarter profit gain. Alphabet Inc, the parent company of Google reported its net revenue rose 22% from a year earlier and up 29% in the first quarter.

All of that is real news that the U.S. economy is kicking into a higher gear. GDP for the first quarter is still likely to be anemic, but the GDP numbers, while consistent in their own way, sometimes do not reflect the economic reality of what businesses and the rest of us are experiencing.

Every indication is that the underlying businesses that drive our economy are in good shape and are growing steadily as the global economy emerges from the shadow of the Great Recession. Europe is creeping toward a full recovery and the rest of the world is largely there. We are optimistic. The only thing that appears to be damping out more growth is that old devil, *political uncertainty*. Rather than raising optimism, this week's tax announcement increased uncertainty.

Until next week, we remain your faithful servants,





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