Kindred spirits

It may not feel like it to some, but most Americans did get a tax cut.

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Linda Duessel, CFA, CPA, CFP
Senior Vice President
Senior Equity Strategist

This week I traveled through Atlanta and its suburbs, Greenville and Charlotte. In each city, I met with Barron's Top 100 female advisors, kindred spirits all. Beginning on April 15, there were many discussions concerning last year's so-called tax cuts and American taxpayers' actual experience. The Atlanta advisor couldn't wait for the season to end, as many of her well-to-do clients experienced "sticker shock." Surveys show most Americans aren't convinced their taxes were cut at all and many actually perceive their tax bills went up. Part of the problem was a delay in early refunds because of the government shutdown; also, 20% of Americans who did file early ended up owing money, according to NerdWallet. But the biggest issue is withholding adjustments that a majority of taxpayers didn't make. Because the new law increased after-tax take-home pay but canceled out the refund many were accustomed to receiving, the IRS warned taxpayers early on to review their withholding for potential adjustments. But only an estimated 17% did so. Furthermore, while the standard deduction was raised, the new tax code eliminated personal exemptions and capped deductions for mortgage interest and state & local taxes (SALT) at $10,000. This cost roughly 8% of filers a collective $65 billion in 2018, although that arguably is overstated. First, the SALT cap only significantly pinched filers above $200,000 in income. That's not surprising, as the Tax Cuts and Jobs Act significantly expanded the standard deduction, resulting in far fewer itemized returns. SALT is an itemized deduction. Second, even most filers hit by the cap still saw a net tax cut. Evercore ISI says the cap lowered tax cuts for 9.8 million, raised taxes for 1.4 million and flipped tax cuts to tax hikes for 2.3 million.

Even though the vast majority of Americans did get a tax cut, the media's had a field day with the confusion. To wit: an article in the April 12 New York magazine entitled, "Tax refunds are down. That's a threat to Trump—and the economy." It observes "this reality is reflected in opinion polling—a new CBS survey finds that nearly three out of four Americans believe the Trump tax cuts either raised their taxes or left them unchanged." Tax unfairness is a cornerstone of many Democratic candidate platforms. If Democrats were to sweep the 2020 elections, Strategas Research believes tax increases are all but certain. Possibilities include a hike in the corporate tax rate to 25% —a level the Business Roundtable representing 500 CEOs had lobbied for before the previous 35% rate was cut even further to 21%—and an increase in the top marginal individual tax rate that was lowered to 37% in the final days before a vote on the bill. New brackets also could be added for income over $50 million, and given the debate over share buybacks and investment income relative to workers' pay, the capital gains tax may be targeted, too. As for inheritance taxes, it's expected Democrats will change the tax treatment so that when heirs inherit assets, the cost basis is carried over rather than stepped up, i.e., raised from the old level to the current level, as is currently the case. This could result in a significant tax bill.

Is near-term consolidation looming? Global equities have rallied 14% year-to-date, well above the average 8% in the first four months around a bottoming in the manufacturing PMIs as we may be experiencing now, UBS observes. Then again, equities have risen an average of 25% in the 12 months after PMI-related troughs. Breadth is bullish, and the Institutional Strategist sees a building scenario for a blow-off phase, with the market expecting the Fed to cut rates by year-end, the European Central Bank already easing again and China in full reflation mode. The S&P 500 is testing the underside of the 2,916 February 2016 trend line that was violated in Q4 2018 and is inching closer to October 2018's record intraday high of 2,940. JPMorgan says the shallow and short-lived nature of pullbacks suggests a very healthy trend. What could get in the way? Disappointing earnings? So far, results have come in better than downwardly revised expectations. A worse-than-expected China trade deal? The news so far has been relatively encouraging; the bigger issue could be subsequent trade talks with the European Union. An aging expansion? "Is the U.S. economy overdue for a recession?" is the No. 1 question Capital Group hears from financial advisors. As an advisor in Alpharetta, near Atlanta, told me, he believes "an alarm will go off in the media this summer, once the current expansion becomes the longest ever." In Greenville, I breakfasted with another Barron's top 100 lady, who said possibly the nicest thing anyone's ever said to me —"you're not a boomer." My travels finished the week in Charlotte, lunching with one more Barron's top 100 female advisor—classy ladies all. On my final day, a delightfully straight-shooting advisor related his discussions with clients during the fourth-quarter's painful drawdown. "I explained to my client that the market was falling for no fundamental reason. When I told him it was algorithmic trading, he freaked out!" It seemed as if all of his thoughts mirrored mine—only he's a man and way, way younger than me. Debating the wisdom of holding certain FAANG (Facebook, Amazon, Apple, Netflix and Google) stocks, he said, "Whoever can figure out how to get rid of robocalls, I'll buy that stock." My true, true kindred spirit!

POSITIVES

- **U.S. soft landing watch** March retail sales jumped more than expected. The surge was led by autos and gas, but all categories sported gains, suggesting winter's slump has ended. Bank of America said the report is evidence that the delay in tax refunds pushed spending into March, particularly among lower-income households. Also, March leading indicators rose above consensus, and February's trade gap narrowed sharply, largely on a spurt in exports, prompting the Atlanta Fed to raise its Q1 GDP growth forecast from 2.3% to 2.4%.
- **More China green shoots** Reported Q1 GDP expanded at a better-than-expected 6.4%, the latest in a string of upside surprises out of China that also includes March industrial production and retail sales. It's encouraging to see China growth inflecting higher, but the GDP bump was driven by a surge in first-quarter exports that typically reverse within a quarter, making it too early to deem it a sustainable upturn.
- **More hopeful signs for housing** Builder confidence rose again in April, its third increase in four months, led by increasing buyer traffic. Lower mortgage rates,

moderating prices, rising household incomes and millennials in prime home-buying years are providing momentum as the spring season gets underway.

NEGATIVES

- **U.S. soft landing watch** Markit's initial take on April activity disappointed, with its composite gauge coming in well below expectations on a slowdown in services. Manufacturing was flat, as it was in the March read on industrial production. While the Empire survey of manufacturing activity in New York climbed to a high for the year, its companion Philly Fed gauge, viewed as a better read of national activity, fell more than expected.
- **Deflation is one of my biggest worries** Inflation is slowing around the world—China's GDP price deflator is now running at just 1.4% year-over-year. Here in the U.S., Evercore's proprietary survey of over 50 CFOs shows a significant decrease in the percentage of them expecting faster wage growth.
- **CFO optimism continues to fall** It hit its lowest level since 2016's third quarter in the latest Duke survey, the fourth quarterly decline in a row, indicating a steady erosion of sentiment about macro conditions. Almost four in every 10 CFOs believe the U.S. will be in a recession by next year's first quarter, and 84% expect a recession by Q1 2021.

WHAT ELSE

It's tough to beat an incumbent in a strong economy Rasmussen polls show that people are feeling better about the economy, with 38% believing it's moving in the right direction. This may not appear to be a strong number, but it is above the 10-year average of 31% and well above the 29% seen during Obama's 8-year term. At 51%, Trump's approval rating also is above the 10-year average, suggesting voters are relatively optimistic.

If there is a bright side to the Notre Dame cathedral fire …It's the work of architectural historian Andrew Tallon, whose digital 3D-mapping in 2015 means it's possible the iconic building may be able to be restored to its former glory in near-perfect detail. He painstakingly created an exact digital replica of the structure, using lasers to map the entire cathedral, measuring the time the laser takes to reach the target and return to create a precise image.

The Pens got swept! In Greenville, I met with a full-blooded Italian advisor. Half Italian myself (unless you asked my Dad), I found him a true kindred spirit—I wish he were my bff! His partner was out of town, which was my luck, for in his prior life he worked with the Islanders and then as general manager of the Rangers when it last won the Stanley Cup.

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DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

The Markit Composite PMI is a gauge of manufacturing and service activity in a country.

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