

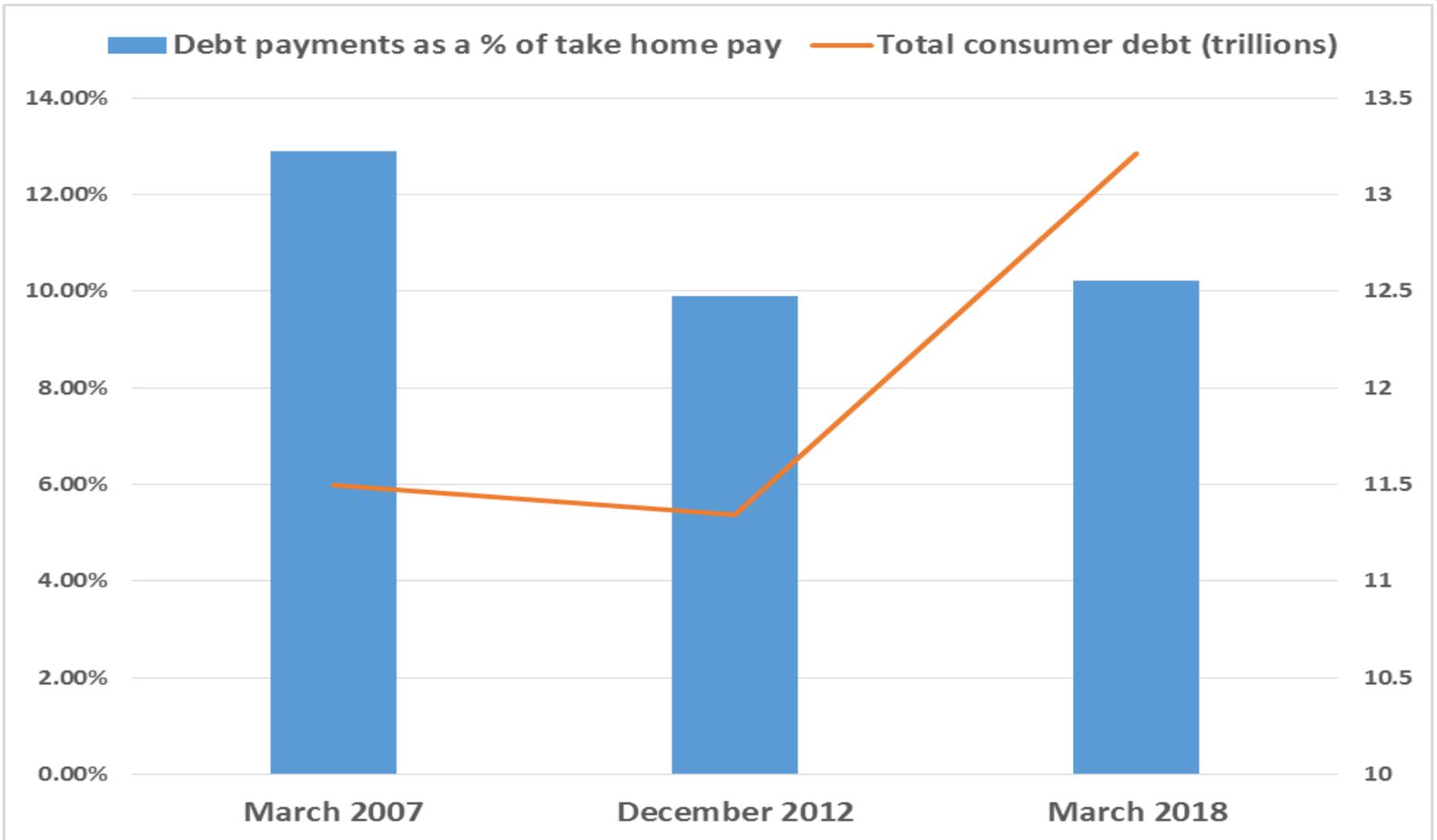
# ECONOMIC IMPACT OF TAX REFORM

Dave Isaacson, Chief Investment Officer

# Expected Economic Impact of Tax Reform – Individual

- ▶ Estimated tax cut for individuals \$1.126 trillion over 10 years
- ▶ Effective marginal tax rates on wages will be reduced by 2.5%
- ▶ Estimated individual tax cuts expected to be \$300 billion in the first two years
- ▶ Will Americans spend, save or reduce debt?
  - Assuming 60% of the savings goes towards consumption, real economic growth would grow .30% and .20% in 2018 and 2019 respectively
  - This does not take into consideration the multiplier impact of spending which could increase economic growth

# Consumer Debt



Source: St. Louis Federal Reserve and New York Federal Reserve

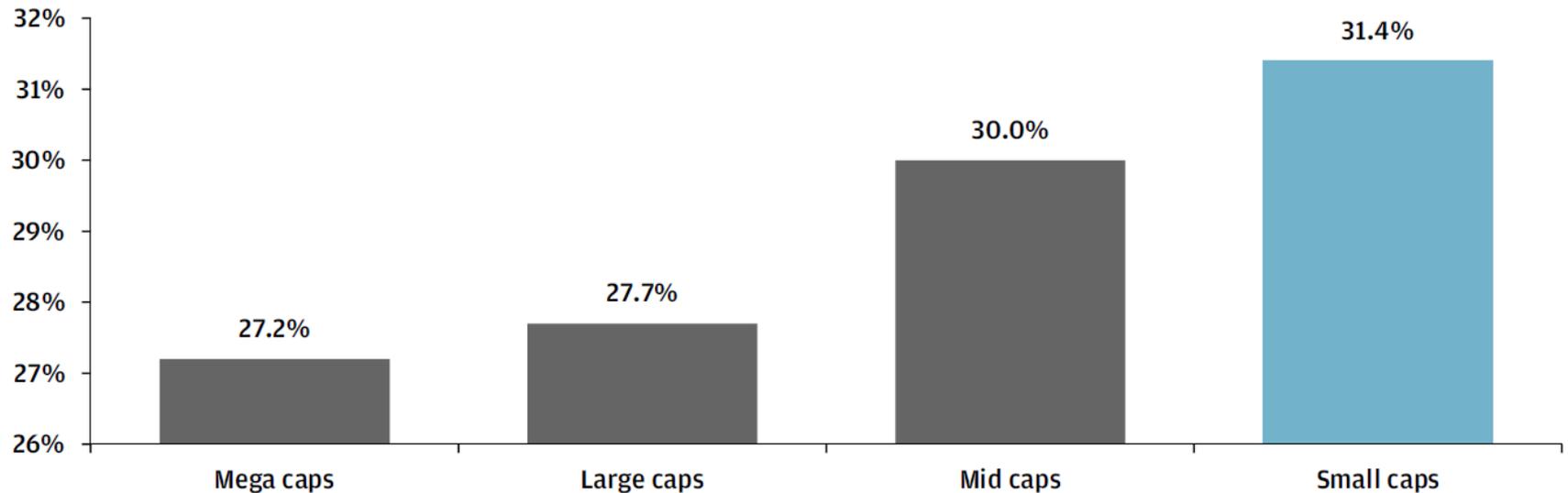
# Expected Economic Impact of Tax Reform – Corporate

Impact on US economy is difficult given it is predicated on corporate behavior

- ▶ Will the ability to expense the cost of depreciable assets accelerate planned capital expenditure?
  - Incentive to capitalize on this given the five-year window
  - Increases the return on investment capital
- ▶ Repatriation of accumulated foreign earnings will likely be used for share repurchases and dividend increases like we observed in the 2004 repatriation tax holiday (\$312 billion was repatriated in 2004)
- ▶ Impact on economic growth in 2018/2019 expected to be 0.3 – 0.4%

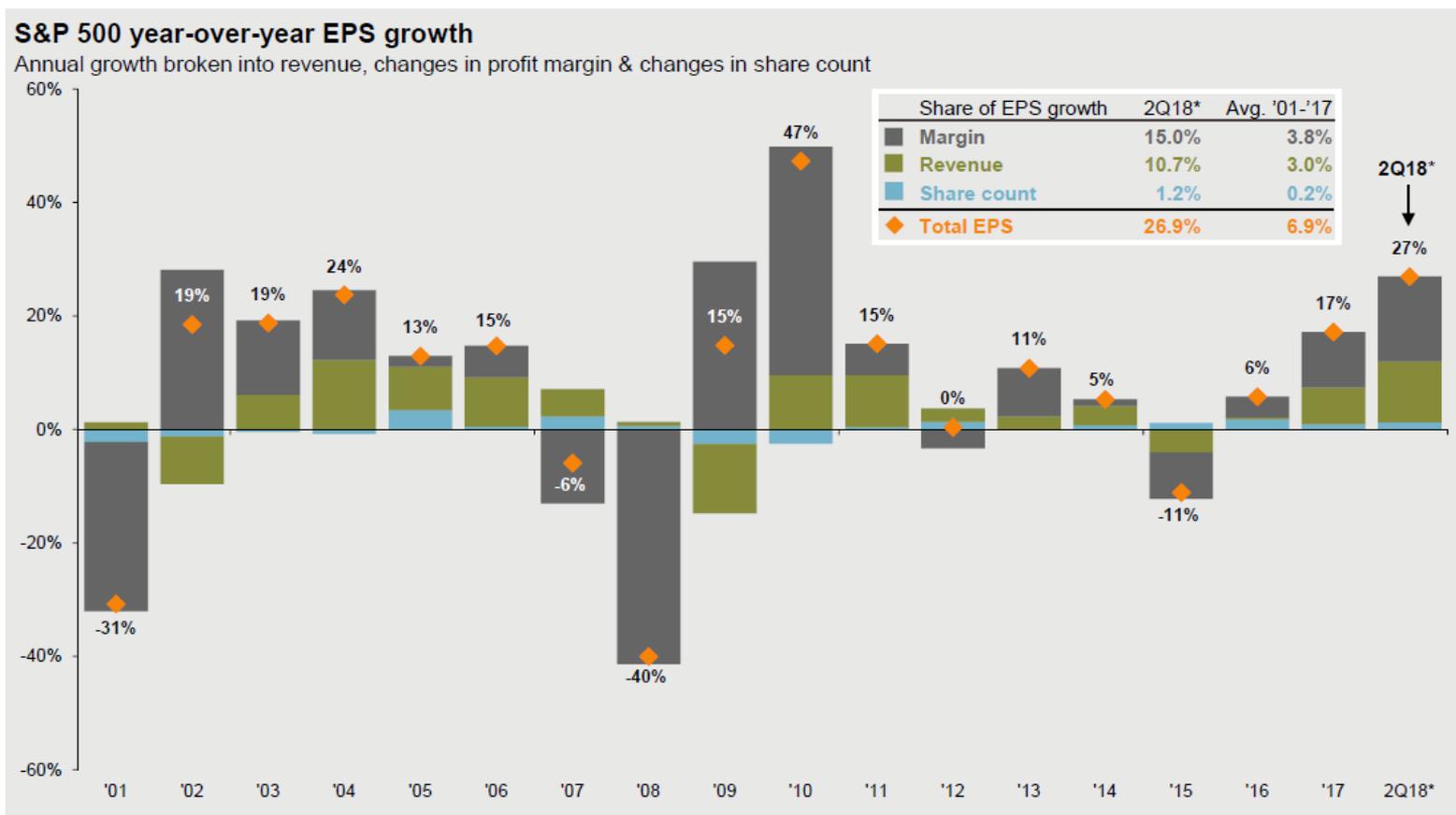
# Smaller companies receive the largest tax relief

EXHIBIT 7: MEDIAN CORPORATE TAX RATE BY MARKET CAPITALIZATION



**Source:** FactSet, Standard & Poor's, J.P. Morgan Asset Management. Mega cap stocks are represented by the S&P 100, and are a subset of large cap stocks; Large cap stocks are represented by the S&P 500; Mid cap stocks are represented by the Russell Mid-cap; Small cap stocks are represented by the Russell 2000. Data are as of December 20, 2017.

# Source of profits

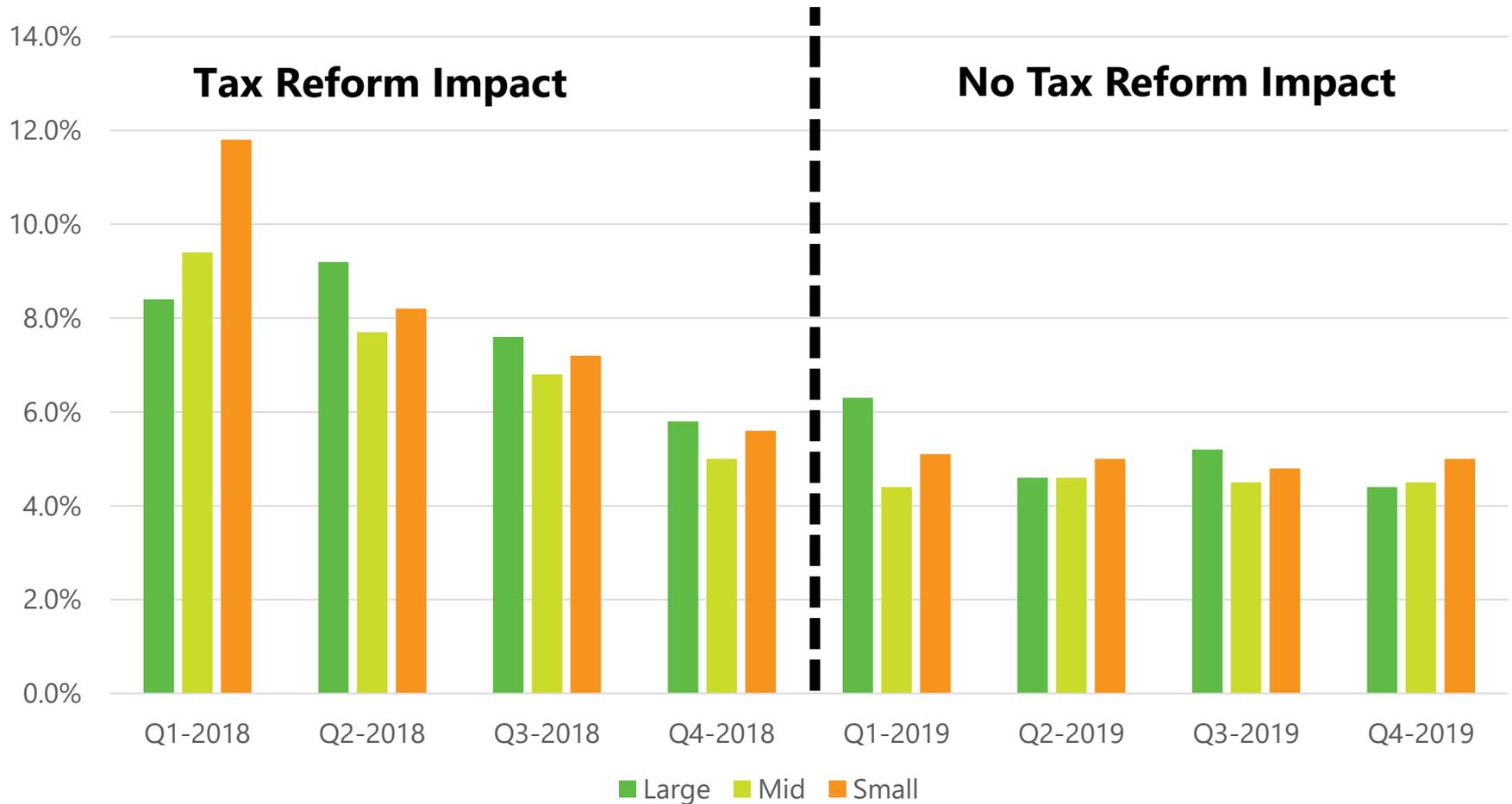


**Source:** Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.

EPS levels are based on annual operating earnings per share except for 2018 which is quarterly. \*2Q18 earnings are calculated using actual earnings for 97.8% of S&P 500 market cap and earnings estimates for the remaining companies. Percentages may not sum due to rounding. Past performance is not indicative of future returns.

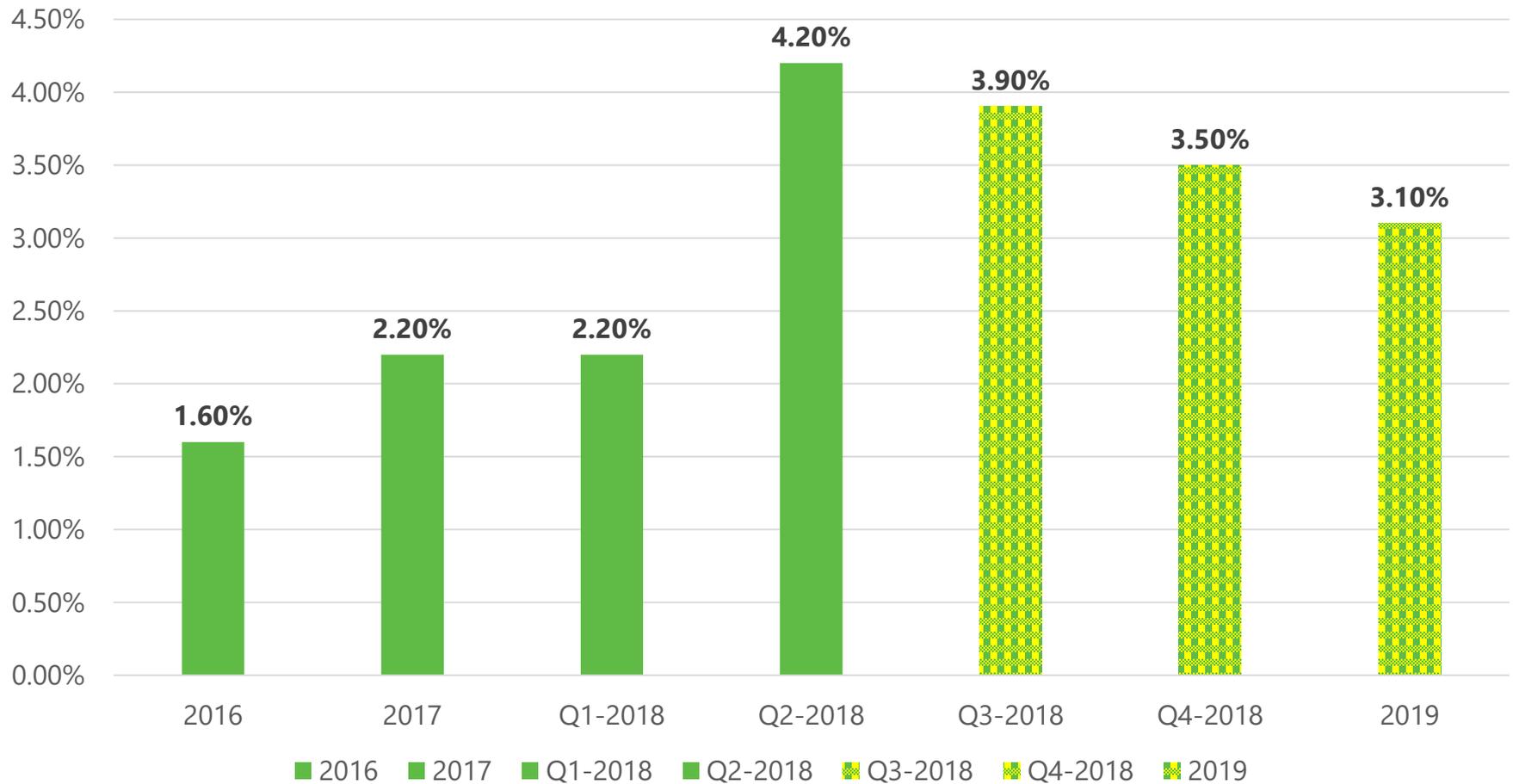
*Guide to the Markets – U.S. Data are as of August 31, 2018.*

# U.S. Equity – Earnings growth



Source: Thomson Reuters

# U.S. GDP – Annual real growth and estimates

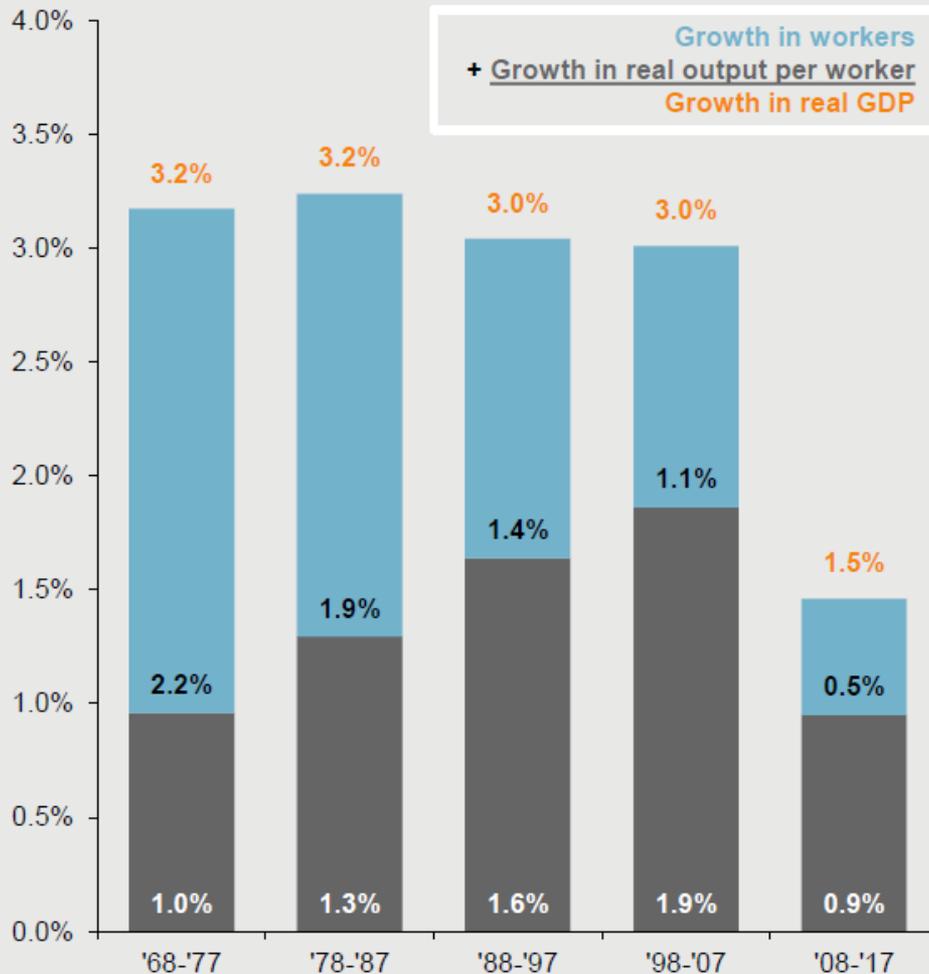


Source of estimated GDP growth: The Conference Board

# U.S. GDP: Why it will be lower

## Drivers of GDP growth

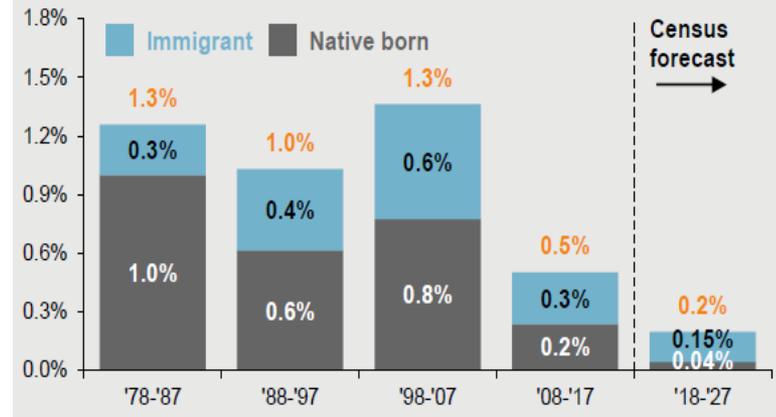
Average year-over-year percent change



The U.S. needs thoughtful immigration reform to bring in additional workers OR Americans need to have more children. Otherwise longer term GDP growth will be in the 1.5% – 2.5% range.

## Growth in working-age population

Percent increase in civilian non-institutional population ages 16-64



# Is the market too expensive?

S&P 500 Index: Forward P/E ratio



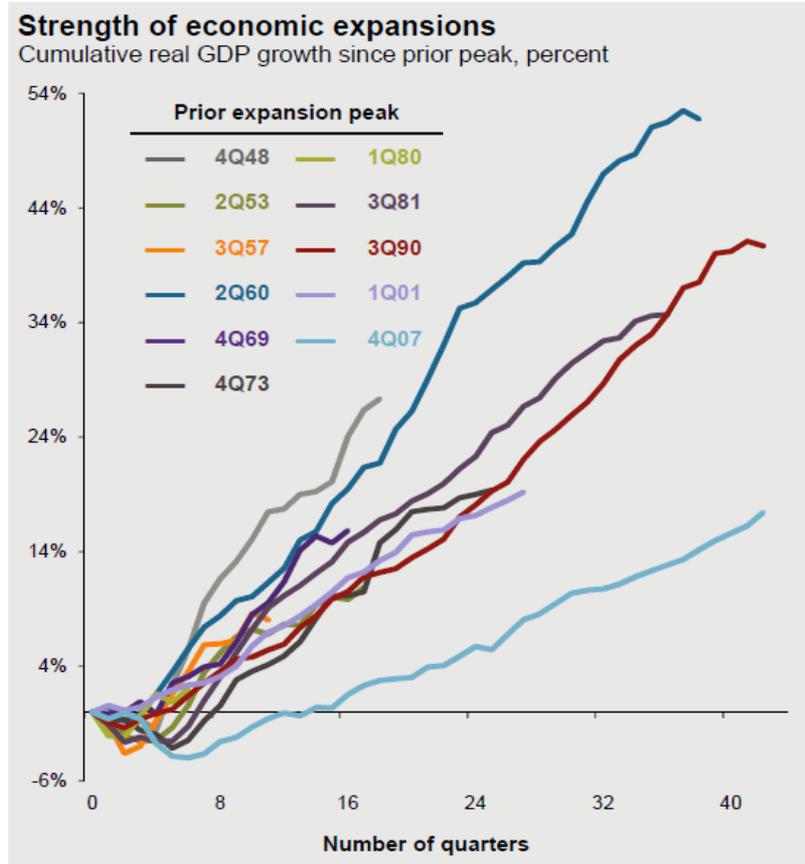
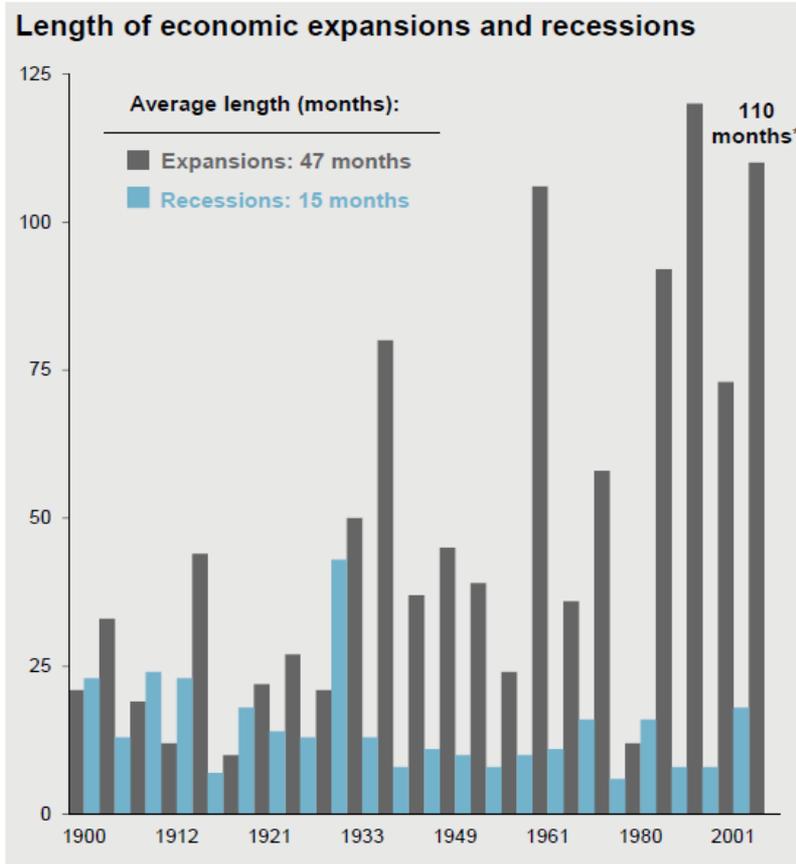
**Source:** FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.

Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since December 1989, and FactSet for August 31, 2018. Average P/E and standard deviations are calculated using 25 years of FactSet history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-month consensus dividend divided by most recent price. Price to book ratio is the price divided by book value per share. Price to cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. Over-/under-valued is calculated using the average and standard deviation over 25 years for each measure.

\*P/CF is a 20-year average due to cash flow data availability.

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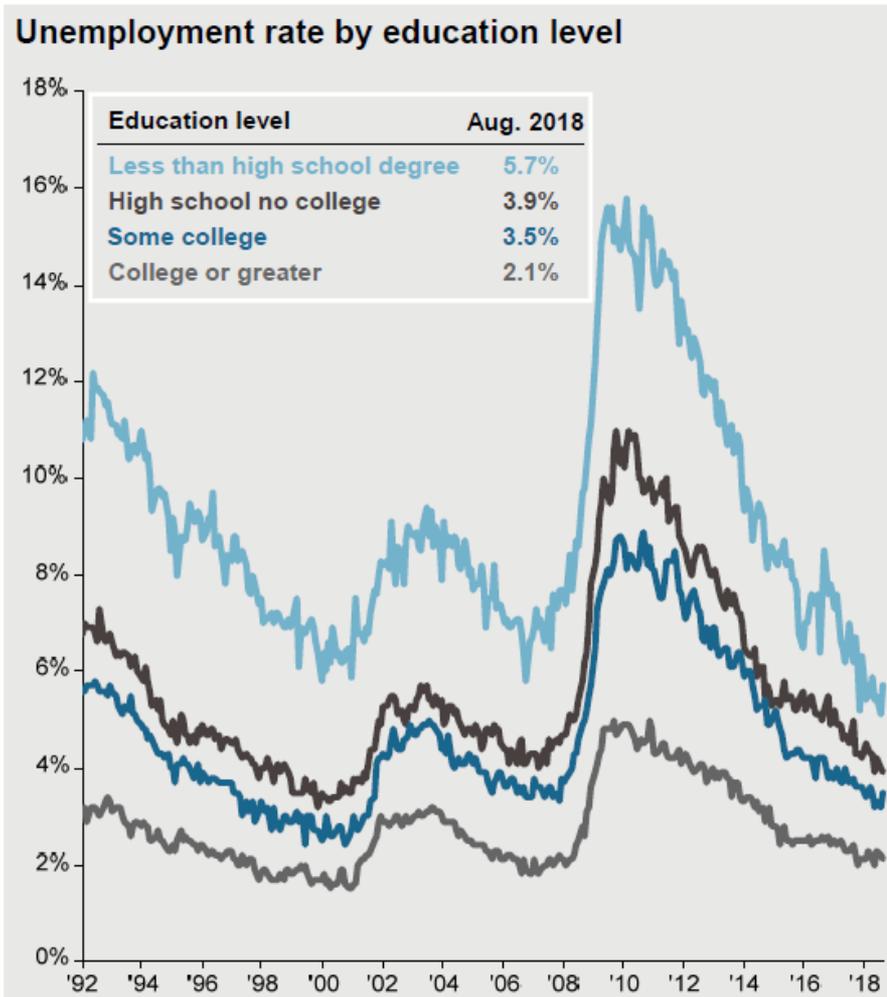
# Current economic expansion



**Source:** BEA, NBER, J.P. Morgan Asset Management. \*Chart assumes current expansion started in July 2009 and continued through August 2018, lasting 110 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at [www.nber.org/cycles/](http://www.nber.org/cycles/) and reflect information through August 2018.

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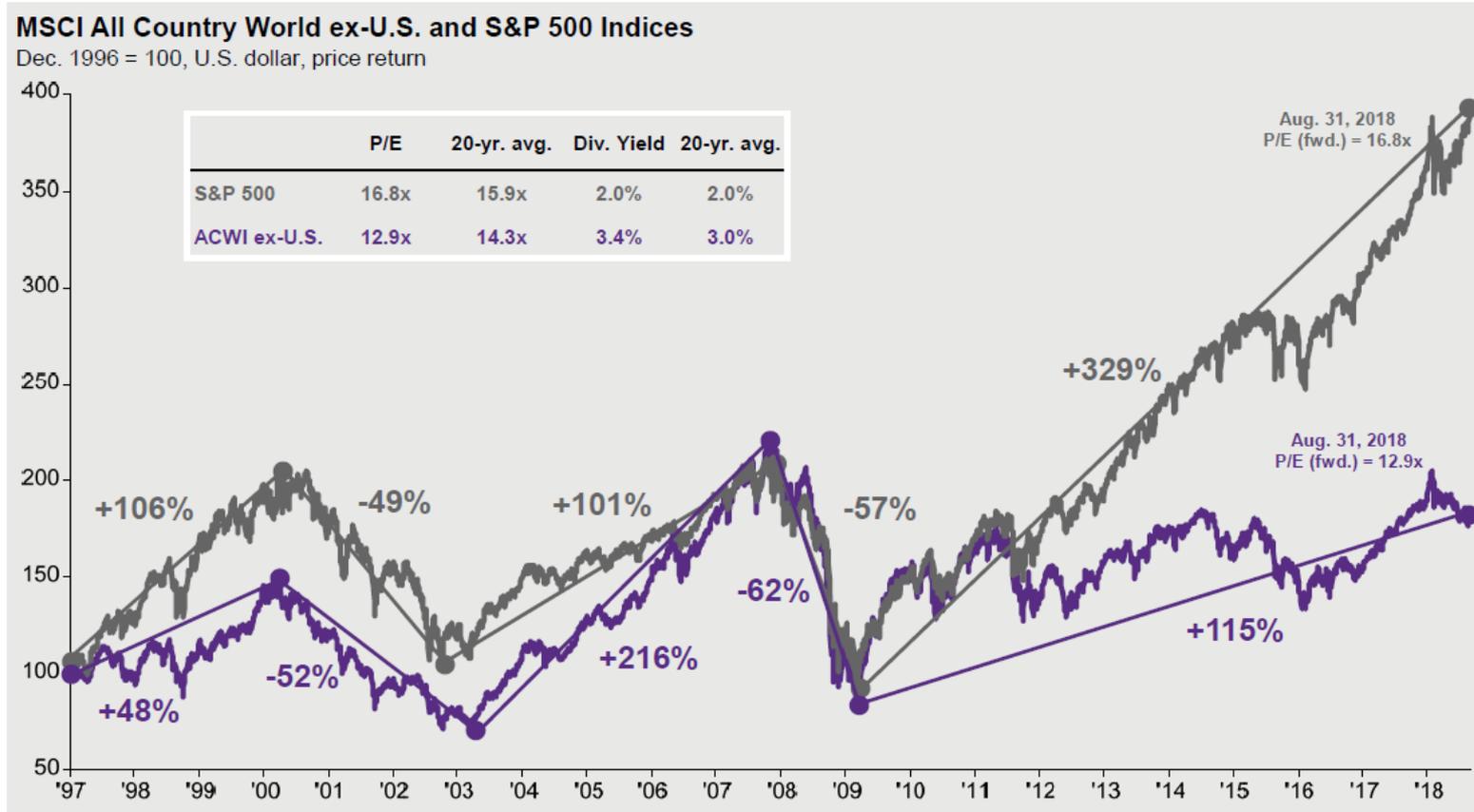
# U.S. Unemployment



- ▶ Broad based employment participation
- ▶ Labor force participation has decreased from 67% to 63% largely due to the retiring baby boomer generation
- ▶ Unemployment is 3.7% and is expected to be 3.5% by year end
- ▶ Unemployed: 6.2 million
- ▶ Open jobs: 6.9 million

Source: Bureau of Labor Statistics

# International valuations

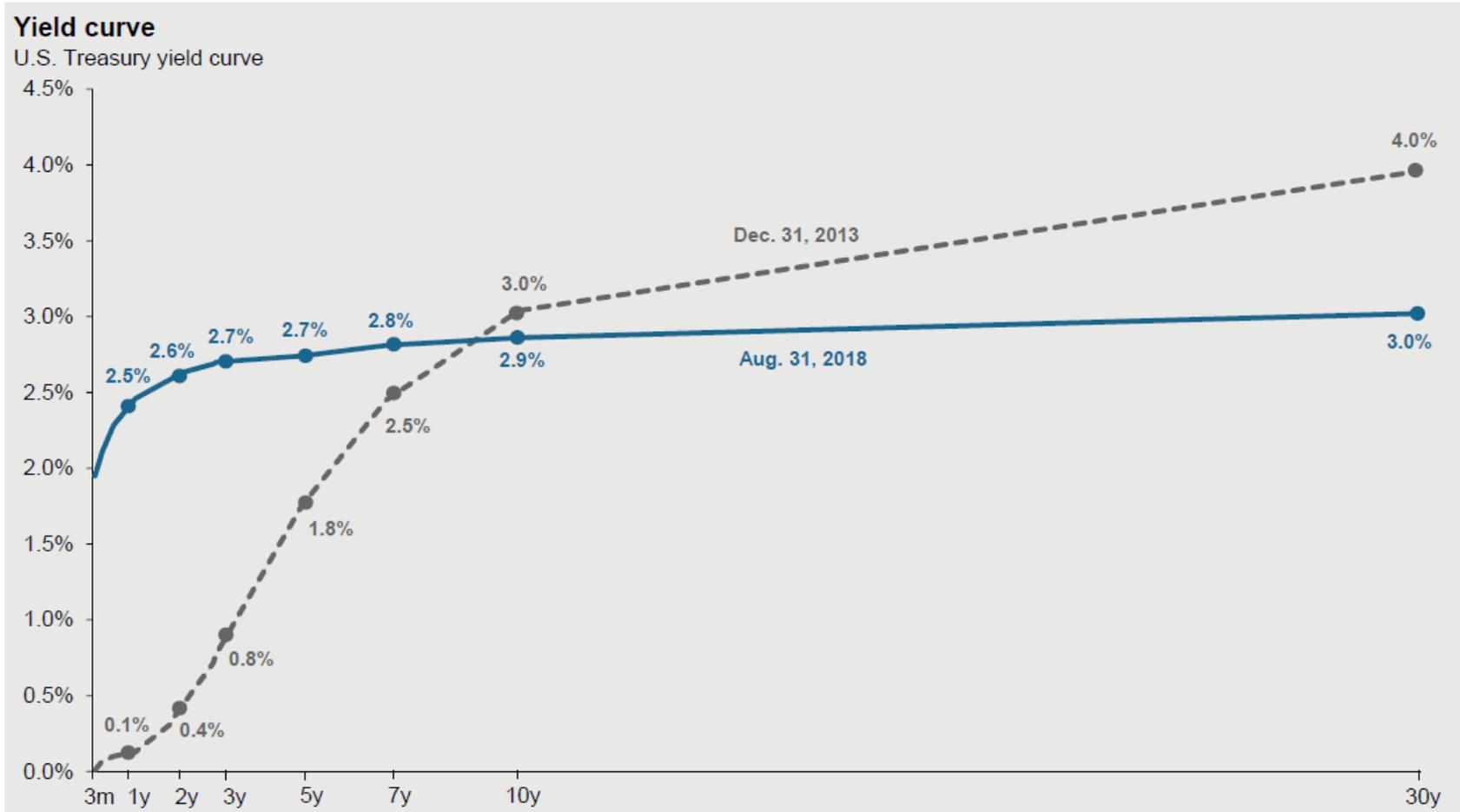


**Source:** FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.

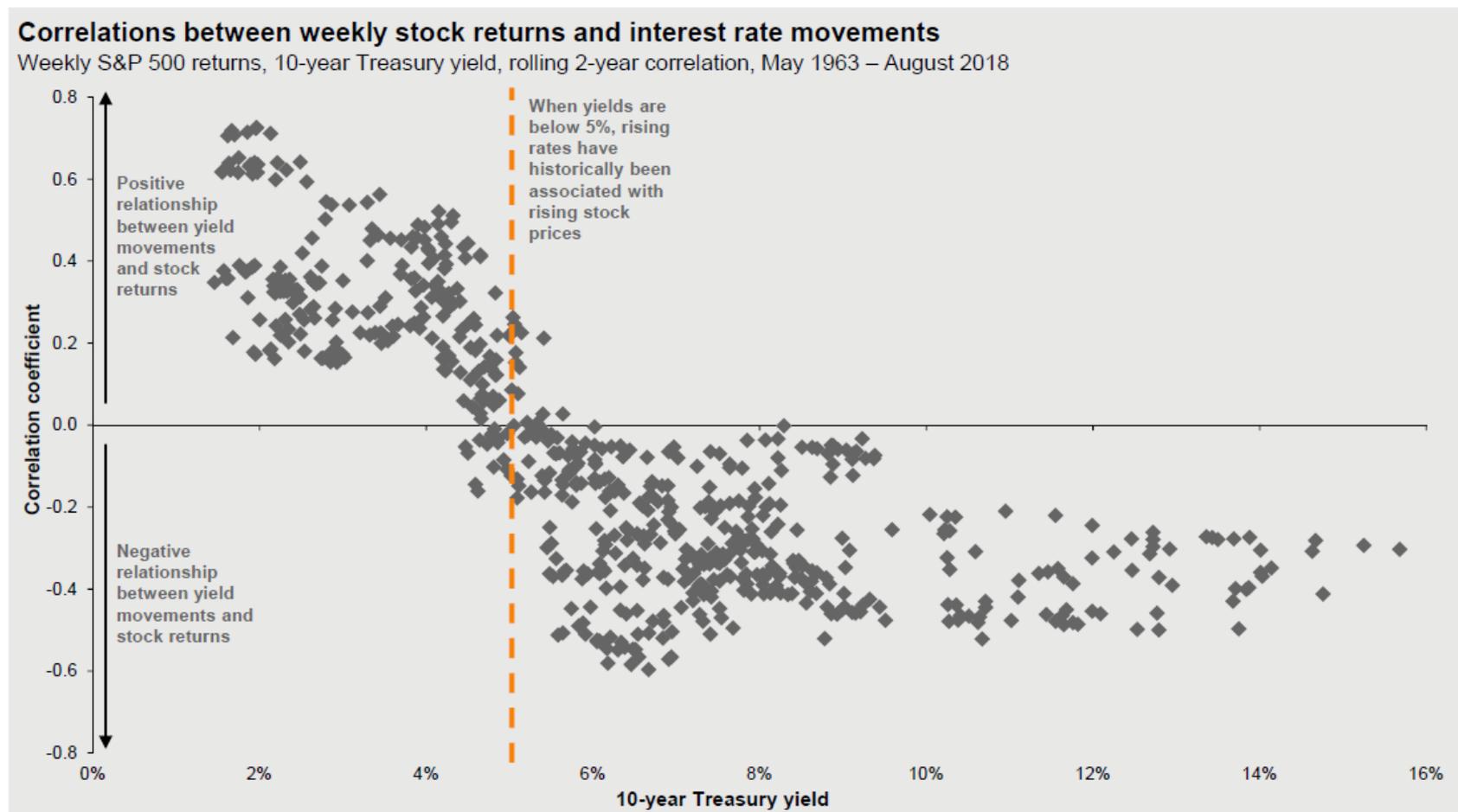
Forward price to earnings ratio is a bottom-up calculation based on the most recent index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on price movement only, and do not include the reinvestment of dividends. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by FactSet Market Aggregates. Past performance is not a reliable indicator of current and future results.

*Guide to the Markets – U.S. Data are as of August 31, 2018.*

# U.S. Interest rates

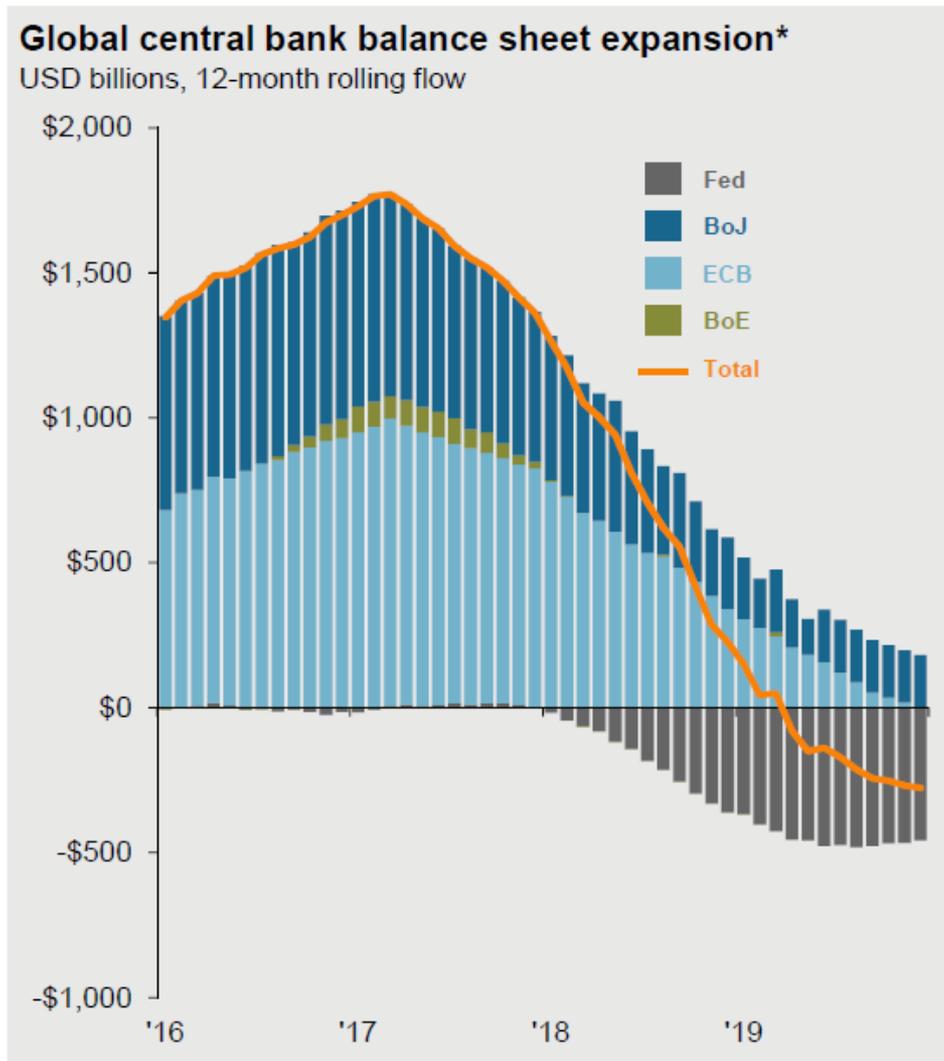


# Rising interest rate impact on equities



**Source:** FactSet, FRB, Standard & Poor's, J.P. Morgan Asset Management.  
Returns are based on price index only and do not include dividends. Markers represent monthly 2-year correlations only.  
*Guide to the Markets – U.S. Data are as of August 31, 2018.*

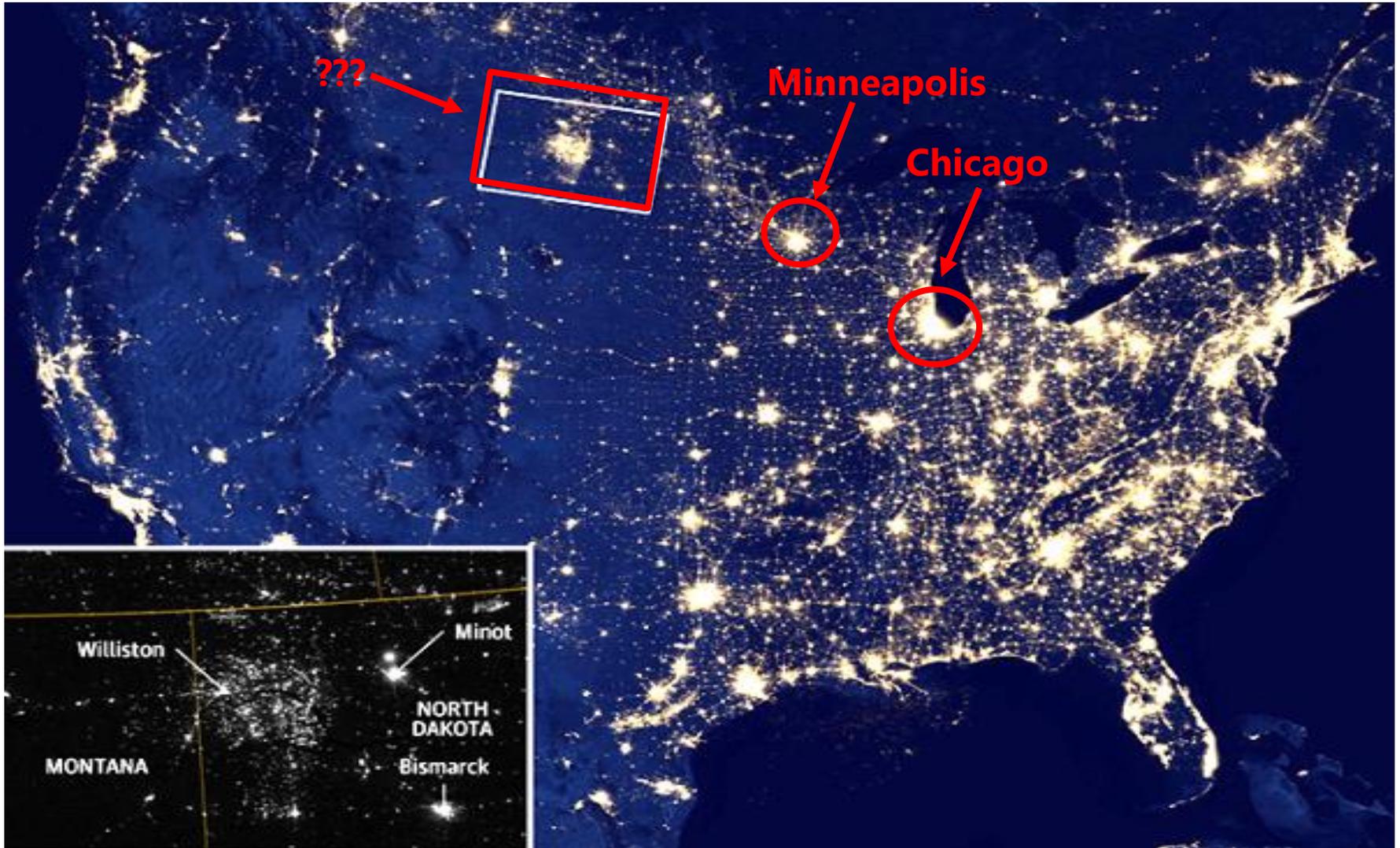
# Why interest rates are going up?



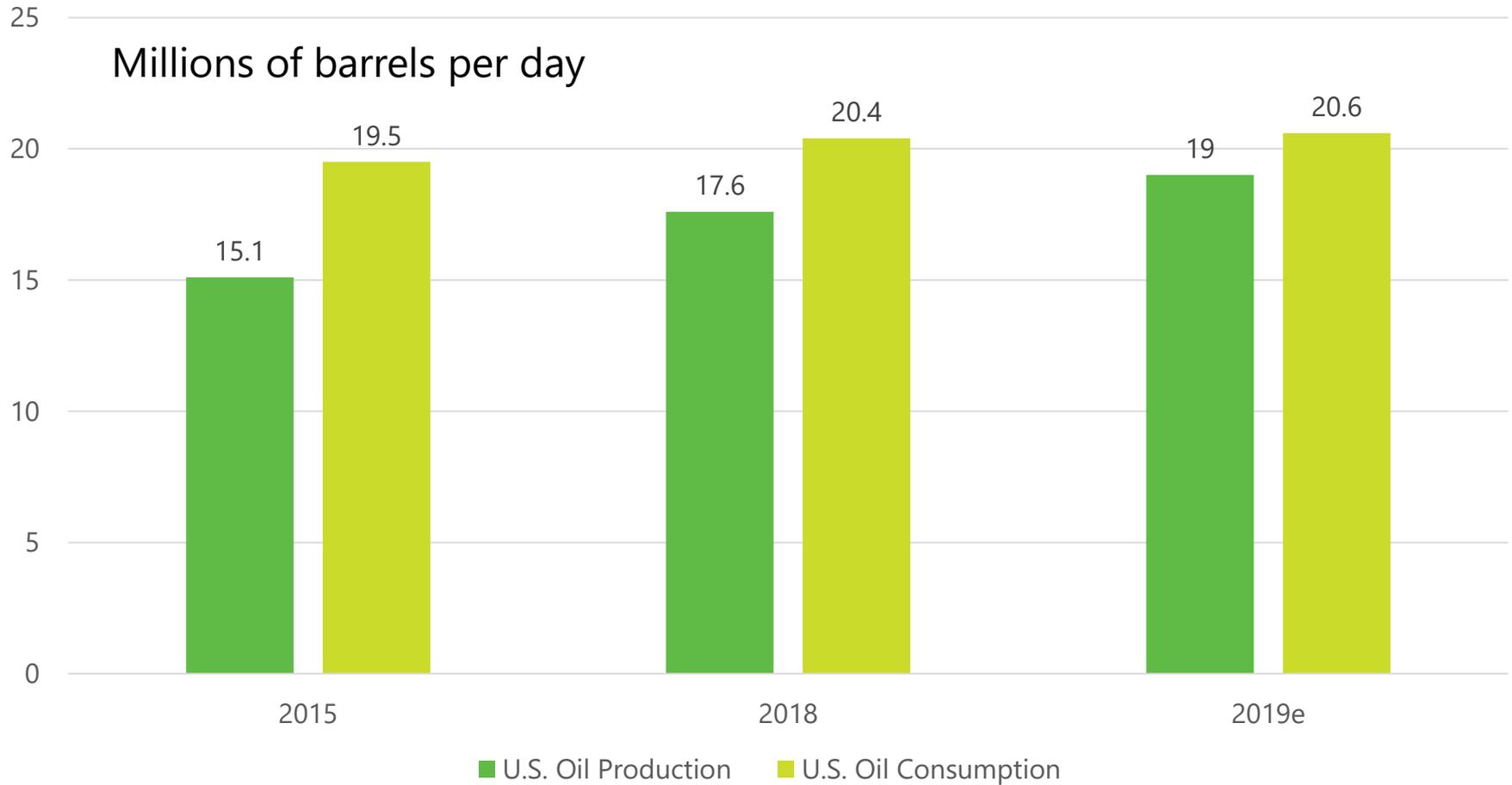
- ▶ U.S. Federal Reserve is gradually moving rates up to head off unhealthy inflation
- ▶ The Fed is planning on reducing their balance sheet by \$50 billion per month starting in October
- ▶ Global central banks are looking at unwinding their respective balance sheets
- ▶ Continued strength of the U.S. economy

**Source:** central banks (U.S. Fed, BoJ, ECB, BoE)

# U.S. energy independence



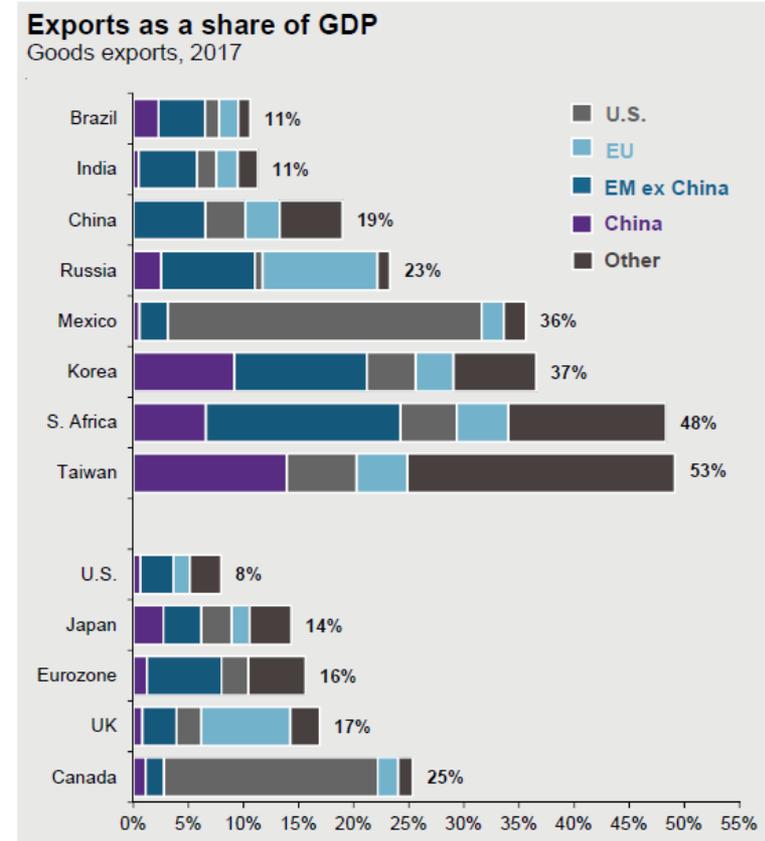
# U.S. energy independence



Source: MDPI & EIA

# Trade in perspective

- ▶ U.S. & Mexico have agreed upon a trade agreement (pending congressional approval) with expectations that Canada will either join or create a separate agreement with the U.S.
- ▶ The U.S. has a small trade surplus with Canada
- ▶ Exports only represent 8% of U.S. GDP
- ▶ Canadian Trade Issues
  - Dairy tariffs (200-300%) by Canada
  - Fast track trade dispute resolution (chapter 19)
  - U.S. imposed tariffs on steel and aluminum



ANY QUESTIONS?



# Thank you!

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