MONTHLY
NEWSLETTER

The Advisor

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I am happy to present this month's market commentary from our Investment Team. The goal is to give our clients and friends a simple way to see everything they need to know about the financial markets on a weekly basis, in 5 minutes or less. After all, investing should be simple, not complicated.

TAX REFORM

The Internal Revenue Code resembles an encyclopedia, it's massive set of laws have grown by leaps and bounds over the years. There is a reason it takes CPAs and tax attorneys to decipher it's complexity for their clients.

The American tax system has become so convoluted and complex that reforming it has been an ongoing issue in Congress and a frequent campaign promise for years. Suggestions for a flat tax, or at least a more simplified filing process that takes a page or two, have been principal goals. Reforming it to help stimulate the economy, help moderate income Americans and simplification are all current goals.

The last time major tax reform took place was when President Ronald Reagan signed the Tax Reform Act into law on October 22, 1986. At that time, the tax code was less than 30,000-pages long. It is more than twice that long today. Since 1986, there have been a number of changes to the profile of businesses, the economy and taxpayers that require change.

Knowing the complexity of the tax system, better than most, president Trump had made tax reform one of his primary campaign promises. The president's tax reform goals also included corporate taxes, which have caused many U.S. firms to keep large sums of capital in other parts of the world. Repatriating that money would benefit the U.S.

Goals and Hopes for Tax Reform

Some provisions of the tax code overhaul being worked out in the Congress by Republican lawmakers include lowering the corporate tax rate, keeping the deductions for charitable giving and mortgages and doubling the standard deduction. The current proposal would also include a reduction in the number of marginal tax rates from seven to three; 10 percent, 25 percent, and 35 percent.

These changes are meant to help the average taxpayer while other proposals are aimed at corporate taxes. U.S. corporations pay the fourth highest tax rate in the world. In the “developed” world, the U.S. corporate tax rate is the highest. Competing in a global market is made more difficult for this reason.

The hope is that more capital is kept in the U.S. because companies do not have the incentive to relocate to other countries. There is currently no incentive to bring profits earned in other countries back to the U.S. because of current tax rates. The thought is that bringing these funds back to the U.S. would also offset any reduction in tax revenues. The goal of current tax reform would be to bring

the corporate rate from 35 percent down to 20 percent or even 15 percent.

Not only would a lower corporate tax help repatriate dollars but it would also be a catalyst for creating more U.S. jobs

For tax reform to become a reality, it requires a meeting of the minds on Capitol Hill. Republicans are primarily in sync on this issue, including both the speaker of the House and the Senate majority chairman. Also, the White House is interested in accomplishing passage of a new law as well. Getting Democrats and their leadership on board would be the clincher. If a budget can be agreed on, then real tax reform is then possible.

FEDERAL RESERVE; INTEREST RATES AND BALANCE SHEET CHANGES

The Federal Reserve, the U.S.'s central bank, has had two primary areas of discussion at its most recent meetings. It had to survey America's economic landscape and determine what to do with interest rates and it needed to address its balance sheet after six years of dealing with the last financial crisis.

Inflation is something that the Federal Reserve's Federal Open Market Committee (FOMC) — which is the monetary policymaking body within the Fed — monitors closely. It is a major determinant in what decisions the Fed makes about interest rate changes. The FOMC also looks at the state of unemployment, which also factors into decisions about interest rates. They even review regional economic conditions.

At its most recent meeting, in September 2017, the Fed decided to leave rates unchanged. The Fed's benchmark federal funds rate will remain between 1 percent and 1.25 percent.

At a press conference, after the FOMC meeting, the Fed's chair, Janet Yellen, said "We think the economy is performing well." She further indicated that economic activity had been rising moderately during the year. In a statement, the Fed indicated that it felt that household spending had been increasing and business investment has picked up.

The Fed also indicated that core inflation, excluding food and energy prices, had declined during the year and was below 2 percent. Unemployment was only 4.4 percent in August, which plays heavily in the Fed's monetary decisions.

Major storms, which impacted the U.S. mainland and territories are expected to have some short-term impact on the economy. Gas prices could be impacted, creating some additional inflation that would otherwise not have been present.

Looking Ahead

For the remainder of 2017, Fed officials have hinted at one rate increase. They also forecast three rate hikes during 2018, which would bring the federal funds rate to between 2 percent and 2.25 percent by years end. The Fed's interest rate activity, and predictions, are particularly important to bond traders.

To help America recover from the financial crisis of 2008, the Federal reserve engaged in a systematic program of quantitative easing, which saw it buy trillions of dollars' worth of U.S. Treasury and mortgage securities. This was done to keep borrowing costs low and support weak economic growth. Quantitative easing ended in 2014. Despite this, the Fed reinvested the proceeds on their balance sheet as they matured.

During the news conference, after the FOMC meeting, it was revealed that the Fed would reduce its balance sheet by $4.5 trillion. This would be done at the rate of $10 billion a month initially, rising to $50 billion a month over the next year.

As was the case in 2016, looking ahead at rate changes for this year, the intentions and the reality may be slightly different. Economic factors are fluid and the Fed's decisions must respond to the most recent set of economic factors they have before them. A geopolitical event could upset the apple cart, so the best guess in the short term is to watch what the central bankers have to say after their meeting in December.

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K Richard Douglas has worked in the financial services industry for 26 years, with an additional 10 writing about financial and economic topics. He’s a former series 9, 10, and 26 registered principal and series 6, 7, and 63 registered representative. Richard has held many financial service industry designations, especially in the retirement planning and compliance mechanism areas.