StraightTalk
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"Tariffs and Taxes and DOGE, Oh My!"

The title of this edition of my newsletter is a play on the famous line in the classic movie, "The Wizard of Oz." When walking along the yellow brick road, Dorothy, the Tin Man, and Scarecrow discuss chances of encountering scary animals along the way…and Dorothy says, *"Lions and tigers and bears, oh my!"* That movie seems apropos for where we find ourselves today, thus the title above.

So, let's address the first of those – tariffs, and the recent stock market correction. The stock market selloff is not because of tariffs. If it were, why are multiple industrial and consumer cyclical stocks that have significant exposure to global supply chains and tariff costs up so far this year? And, why are large technology companies that import nothing (companies like Google and Netflix) down double digits, when tariffs don't affect their business model? Further, one of the bright spots since January has been international stocks, which are up double digits as I write this. Logic presumes, given the massive size and economic strength advantage of the U.S. economy compared to the world, that those markets would suffer more than ours in an all-out trade war – so why are they up if tariffs are the culprit?

The answer regarding the selloff, is that the Trump administration's planned chaos has created uncertainty in the short term. Certainly tariffs – or the on-again, off-again threat of them – play into this uncertainty, as do scores of executive actions, the specter of taxes rising for everyone at year end, and the constant inability of Washington, D.C. to fund the government for more than six months at a time.

The reality is that you could have cited any number of catalysts for the selloff. We were simply overdue for a "tech correction," as these market leading stocks had prices that were a bit ahead of their earnings reality. Layer on top of this normal price pullback, a growing fear by the investing public, and you get a bout of profit taking. In years after a newly elected President, it is fairly routine to have market weakness in February and March due to policy uncertainty from the incoming administration. The current President's style is chaotic, marked by wild statements, and frequent policy reversals – which only serve to make even the most steadfast investor question what is happening in the short term.

That having been said, in my opinion we are not headed for an all-out trade war with every trading partner worldwide. My expectation is this is an attempt to exert pressure for more fair trading terms, or some other geopolitical goal like border security or protecting our intellectual property. This President is going about it in a shockingly inelegant way, but it may yet prove successful – we will have to wait and see. I suspect the tariff picture will become clearer by this summer, providing the market with a bit more economic clarity.

One thing we will not have to wait to see is whether or not the Great Companies can manage their way through all this tariff uncertainty…they can. History is replete with examples of bad policy, but the long-term track record of the Great Companies is undeniable.

According to data from Standard & Poor's, going back to 1926, the index has been positive 73 times, and negative just 23 years. For your investing timeline however, a period of two decades is more relevant than that long history. Using groups of those twenty year periods, you begin to see an x-ray of market history – what is referred to as rolling time periods. Starting with December 31st last year and going back to that same day twenty years earlier, then choosing December 30th and going back twenty years, and then continuing this for every business day twenty years back over that long history – you total roughly 25,000 rolling twenty-year periods.

How many of all those periods are negative? **Zero**. As in a gain, 100% of the time. The old story that someone lost all their money in the stock market is just not backed up by the facts. A diversified portfolio of the Great Companies does fluctuate in price, but over any twenty-year period, that fluctuation has *always* been

positive. If you shorten the timeline to rolling fifteen-year periods, the result is positive 99.7% of the time. And even using rolling ten-year timeframes back to 1926, the results were positive in 94.7% of those periods. Only the ill-advised behavior of selling during turbulent headlines (like the threat of tariffs) make losses a reality for the long-term investor.

Turning to tax uncertainty, without action by Congress, the 2017 tax act will sunset at year-end, and income tax rates will rise for every American. The bottom three income tax brackets all face a 3% hike, which conversely means “the tax cuts for the rich” were actually tax cuts for everyone. The 12%, 22% and 24% brackets will move up to 15%, 25% and 28% respectively, causing some budget strain for lower- and middle-income earners. For those reading this that are middle- and higher-income earners, not only do those income tax brackets go up, but the standard deduction is also reduced, as is the AMT exemption, meaning more AMT taxes levied on portfolio income. The current thinking is that one way or another, a deal will be reached to keep these tax levels from increasing, but the ugliness of the deal-making will likely spill into the public domain later this spring.

This could continue to make markets nervous, and the battle lines will be drawn, with each side advocating their opinion. However, in the words of the former Democratic Senator from New York, Daniel Patrick Moynihan, *“You are entitled to your opinion, but you are not entitled to your own facts.”*

A recent Wall Street Journal article detailed that the top 1% of earners paid 45.8% of income taxes last year, the top 10% paid 75.8%, and the top 25% paid 89.2% of the tax burden. A non-partisan reading of that data would conclude that the rich do, in fact, pay most of the income taxes. I am sure the legislative discussion will be vigorous, but at some point soon, the tax picture for the next few years will become clearer, removing another bit of uncertainty for markets.

What about DOGE? While most of us seem to support the idea of reducing waste and fraud in government spending – the methodology that the Department of Government Efficiency is employing is beginning to look reckless. The counter argument is if cost reduction was approached the way it always has been, the results would be likely be minimal. Here are just two examples: in 1993, President Clinton offered government employees buyouts in the effort titled “Make Government Work Better and Cost Less.” A decade and a half later, in 2010, under President Obama, Senators Simpson and Bowles were tasked with creating a commission to reduce the deficit. Called the “National Commission on Fiscal Responsibility and Reform,” it created a six-point plan to cut government spending. Both efforts had some success, and millions of printed words were written arguing the particulars of each – yet, here we are today, stacking $37 trillion in government debt up like a toddler does with Legos.

So, a decade and a half later, DOGE is trying something different to slow government spending, currently at an unsustainable 25% of our economy. Some of this will be blocked by the courts, and some will be blocked by Cabinet members overseeing their agencies. Likely, DOGE will soon wear out its welcome with the public, and this administration. But it’s also likely to result in some shrinking of payrolls, wasteful programs and inefficiencies.

However, there is a far less controversial opportunity to close some of this fiscal gap. The I.R.S. reports that there is a $1 trillion gap between taxes owed and taxes collected each year – a gap of 20%, higher than any other developed country. Our tax code is now over 100,000 pages long and is all but incomprehensible for most of us. This complexity creates a systemic flaw, compounded by the I.R.S. still using a technology platform from the 1960s! The combination of unnecessary complexity and archaic technology leads to a months-long tax filing season for most Americans.

The answer lies in using A.I. to help with automation in call centers, flag inconsistencies and auto-fill forms. In Sweden, for example, tax forms are already pre-populated and can be reviewed and filed by the taxpayer in 5 minutes. I think this could offer bigger savings than DOGE with far less heartburn. (Let’s hope the I.R.S. is reading this newsletter!)

At the end of the day, we have some uncertainty in these three areas, which is likely to subside sooner rather than later – as will this price correction. Try to limit your TV news, and remember, this too shall pass….

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