FINANCIAL FOCUS

PETERSON FINANCIAL SERVICES

Limited Liability Company ◆ Registered Investment Advisory Firm

DECISION TIME: DO WE WANT TO CONTINUE ECONOMIC GAINS?

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- Quarterly Market Recap
- We citizens ultimately determine how well our lives will go through the ballot box. The policy prescriptions of the two political parties couldn't be more opposed.

Third Quarter 2018

October 1, 2018

QUARTERLY MARKET RECAP

Historically the third quarter of the year is the worst performing one for the stock market. But that's not the case this year, as nice gains were made across the board beating this year's sluggish first quarter. As has been the case for quite a while, our portfolios have maintained positive relative strength to the indexes. For the third quarter, the DJIA added 9.01%, the S&P 500 gained 7.20%, the NASDAQ cooled in September but rose 7.14% and is still the leading index, and the small-cap Russell 2000 moved ahead 3.26%. But foreign equities lagged the US again declining 0.03%. The Federal Reserve continued to raise rates and maintained its expected course but the Dow Jones Corporate Bond Index added 1.43%. The job market is booming at levels not seen for almost half a century. For the second quarter in a row GDP growth has exceeded the 4% annualized mark. Our only lingering economic concern is this misguided trade war, but at least so far it's being taken in stride by the markets.

Political issues can always unsettle markets and we're coming up on mid-term elections, the outcome of which could lead to the reversal of the very pro-growth policies that are moving growth and employment forward. That would definitely upset investment performance just two years after getting things back on track.

IT'S THE ECONOMY, STUPID! LET'S NOT STRANGLE THIS NEW ECONOMIC RECOVERY IN ITS CRIB

Here are the statistics: Jobless claims are at a 49-year low and there are more job offerings than people looking for work. For the last half a year, GDP growth has annualized over 4% - a level almost triple the average of the Obama years, and the previous two quarters were over 3%. The last National Federation of Independent Businesses Small Business Optimism survey hit a record high. And consumer sentiment is at an 18-year high. Wage growth is soaring after a decade of stagnation and is near the 5% year-over-year level. Tax receipts are also up *after* the rate cuts due to the increase in economic activity those new incentives spurred on (more on this later). The dollar is strong. By any and every measure this economy is booming. And it's not because of riding the coattails of a global economic expansion. It's in spite of the global economy's lackluster tapering performance. Why is this happening?

It's simple. The free-market principles of limited government and capitalism, which we've long championed, work. For years we've said if we'd just get back to these proven policies, the ingenuity of the American people will pull us from our slump. Economic freedom equals prosperity. Period.

As polarizing as he is, President Trump's *policies*, notwithstanding is personality, for the most part adhere to this formula. Between signing executive orders reversing suffocating rules and regulations and the current Congress passing bills he signed into law, we're on fire.

One key component of this policy shift is the tax rate reductions now in effect. A principal criticism of this is that these cuts are causing deficits. We've been over the historical truth debunking this myth so many times we won't rehash it. But we will give evidence of this lie with respect to this round of rate reductions.

Every month the Treasury Dept. tallies up federal spending and revenues. The fiscal year runs from October 1 through September 30 and the most-recent report covers August so this includes all but one month of the last fiscal year. For this 11-month period, the federal deficit hit an unacceptable $898 billion which exceeded the same period of the prior year by $224 billion. However, during this period revenues totaled $2.985 trillion which is $19 billion more than the prior period.

So, even with lower tax rates the Treasury got $19 billion more revenue, so the increased deficit must be attributed solely to higher spending. Just because deficits occur after tax rates are cut, doesn't mean it's because of those cuts. In fact, it can't be if the result is higher income! If you believe cutting tax rates has resulted in this higher deficit, then you must believe that these deficits are caused by increased revenue. The problem is that our government spends amounts of money wildly in excess of its income. The fact is, if those tax rates hadn't been reduced spurring the growth that brought in that higher income, and spending was the same (it would be higher with more unemployed), the deficit would be at least $19 billion higher. This always happens. When will we get this through our collective thick skulls?

Everything that the proponents (including us) of these tax rate cuts advocated is coming true. Lowering corporate tax rates has accomplished two things: the repatriation of overseas profits and the increased investment in the American workforce. By bringing home money that was stored offshore to avoid confiscatory taxes, we have now collected revenue. Taxing something at a lower rate when it actually gets taxed brings in more money than having a higher rate on income that is sheltered and doesn't get taxed.

Immediately after this tax reduction law passed we heard reports of companies giving their workers bonuses, pay increases, and richer benefit packages. More money in paychecks net of tax withholdings allows workers to spend and invest more. This causes demand that is satisfied by other companies. That demand requires new workers to provide for it. Those new workers now earn money and pay taxes. This is how the economy gets stimulated and new wealth created. And this is why the result is higher tax revenue. But if our politicians turn around and take all that increased revenue and spend it – and then some – we'll always have increasing deficits. This is where the fiscal failure comes in. It seems that the only thing the two parties do agree on is spending our money.

In this election cycle, the Democrats are using the increased deficit as an excuse to raise taxes – ostensibly because of the deficits. But two things would happen if we did this. First, the nascent economic recovery would die, and second, the recent higher revenues would reverse. And, they still will spend even more money, because they always do. There is no period in recent history when the government spent less than it did the previous year, no matter what the fiscal or economic conditions were. So, if we eliminate the current tax rates, as they want, and revert to the previous ones – or worse, higher ones – we'll reduce our revenues and still increase our spending, further exacerbating the deficit and debt. And along with that, it will slow down the economy, throw people out of work again, and crater the stock market. Not a good idea.

This is what the Democrats promise they'll try to do if they take control of Congress. We will take them at their word, and believe it. But what we should do right now is make these tax rate levels permanent because under the compromise law that had to be drafted in order to gain enough support to pass it, they'll expire in a few years.

"If you put government in charge of the Sahara Desert, in five years there would be a shortage of sand." - *Milton Friedman*

ABOUT PETERSON FINANCIAL SERVICES, LLC

As an aside, we wish to remind our clients of our various services. While we've specialized in portfolio management over the last several years, we continue to provide financial planning and insurance services. Longtime clients may have forgotten this, and newer clients may not be aware of this. Additionally, we build our business through referrals, and much appreciate them. Please keep us in mind as you come across friends, family and colleagues who might benefit from our financial services. We appreciate your business.

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