John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday May 26, 2021

The legendary economist, Thomas Sowell says competition breeds competence. He goes on to say that competition has done more to benefit consumers than any government program. Apparently, President Biden and many of his fellow Democrats have not been reading Thomas Sowell's many books and articles. Biden and company want to crush competition at home and abroad.

The $1.9 trillion pandemic stimulus spending bill included a provision that states that received stimulus funds could not then reduce tax rates. Red states, those run by Republican governors and legislatures, generally are in much better fiscal shape than blue states run by Democrats. Businesses, jobs, and people flow into the red states and out of the blue states. The "no cutting tax rates" provision is designed to impose federal regulation on red states to reduce or eliminate the tax rate competition. The provision said states cannot use their share of the stimulus funds to "directly or indirectly offset a reduction in net tax revenue."

Ohio, which is slated to receive $5.5 billion from the stimulus bill, went to federal court and sued to invalidate that provision as an abuse of Congress' power under the Spending Clause. In a preliminary opinion last week, federal judge Douglas Cole found that Ohio has a "substantial likelihood of success on that argument."

Judge Cole went on to add that the federal takeover of states' fiscal policy is likely unconstitutional. There is a long way to go before the issue is decided by the Supreme Court, but Judge Cole's opinion is a signal the courts will protect states' rights to adopt fiscal policy without interference from the federal government. Let the competition among states go on. Taxpayers are the winners in that competition.

The Biden Administration also does not like tax competition from other countries. Ireland, for example has a low corporate income tax, 13%. Businesses, including some U.S. companies, have moved operations to Ireland to take advantage of the favorable tax rate. Ireland also has a well-educated, available work force. As a result, Ireland has benefited from job creation that lowered unemployment and increased overall tax collections.

The Biden Administration wants to impose a form of alternative minimum tax on profits earned overseas with a statutory rate of 21%. As the editors of *The Wall Street Journal* say, “Even the progressives manning the Biden barricades realize this will throttle U.S. competitiveness if other countries don’t impose similar taxes.”

So the Biden Administration has been pressuring the OECD to follow suit and impose a similar tax on its members. The immediate problem is that while the OECD is considering such a tax, the rate they propose is 12%-13%, close to Ireland’s current tax rate and far below the Biden Administration’s proposal.

Officials in Ireland, Hungary and the Czech Republic - all of whom will have to agree to an OECD proposal before the European Union can adopt it - have said recently that an OECD rate of 21% would be unacceptably high.

“The Biden Administration is hoping for political and economic cover from the OECD for its tax grab. It now looks like help may not be on the way. Congress should bear that in mind as lawmakers decide if they want to impose a tax increase that will hamstring American companies in the global marketplace." (*The Wall Street Journal*, May 20.)

What a sad set of tax proposals. It is disappointing, to say the least, to see our President attempting to crush tax rate competition at home and abroad. Hopefully both attempts will fail and the competition among states and countries will go on. After all, we all should want the competence that follows competition.

Another corporate policy that has come under attack from politicians like Elizabeth Warren is stock buybacks. She has talked about eliminating corporate stock buybacks. Share buybacks have been common in the United States. Not so in Europe, where dividends have been preferred. The difference is startling when it comes to stock market performance. Over the ten years to 2020 the S&P 500 rose 237%. The Stoxx Europe 600 index rose 57% over the same period. That huge difference in returns is adding support for a new attitude about stock buybacks among European companies.

Roland Kaloyan, head of European equity at Societe Generale points out, "In 2020, a lot of companies were forced to cut dividends, which is very painful. Buybacks, it's a way to return cash to your shareholders, if you don't want to commit too much and too soon to higher dividends in the coming quarters."

European companies are flush with cash, thanks to the developing recovery. However, they are reluctant to raise dividends because that is a long-term commitment, and the future is still looking bumpy and unpredictable. So far this year 56 European companies have announced stock buyback plans.

The rising tide of stock buybacks in Europe is clear evidence that politicians like Elizabeth Warren are out of touch with financial reality. But that should not be surprising.

Liz Ann Sonders, chief equity strategist at Charles Schwab, recently wrote a long article about inflation. She wrote, “Inflation is the topic du jour; with raging debates as to whether it’s a short-term (or transitory) effect of the pandemic, or something more sinister and longer lasting.”

In the article she points out that the M2 measure of the U.S. money supply did surge as Congress flooded the economy with stimulus money and the Federal Reserve kept buying bonds. The surge in the money supply is why some economists are warning that inflation is going to be a long-lasting challenge. Liz Ann goes on to point out that, “money velocity remains on the floor. Velocity denotes the rate of turnover in the money supply and is a gauge of economic health. When it’s low, it suggests a preference for saving over spending……. If velocity does not pick up, it would lend credence to the view that current elevated inflation readings are transitory.”

So, now we have one more data point to watch: the U.S. money velocity rate.

I will have the next market review and update one week from today on Wednesday June 2, 2021.

All the best,

John Dessauer