There was some good news about the federal government’s deficit in June. The government runs on a fiscal year running from September to October. June was the ninth month in the current fiscal year. The deficit in June was a slim $8 billion, down 90% from June last year. The government spent $342 billion in June, a decrease of 12% from last year. Tax receipts were $334 billion up 6% from a year ago.

Some politicians do not know the difference between tax rates and tax collections. Senator Kamala Harris, who is running for president, was asked about how she would pay for the expansion of public benefits she proposes. Her response was: “I hear that question, but where was that question when the Republicans and Donald Trump passed a tax bill that benefits the top 1 percent and the biggest corporations in this country?” She obviously is ignoring the facts about tax revenue. The tax cuts did not result in declining revenues. Quite the opposite - receipts from individuals climbed 2% in June. Tax receipts from corporations rose 32%. For the first nine months of this fiscal year tax receipts are up 3%.

The prime cause of the government deficits is spending, not tax receipts. Spending in the first nine months rose 7%. Raising tax rates does not always result in an increase in tax receipts. The government has imposed a 70% income tax rate twice in my working life. Both failed and were reversed. The high tax rate slowed the economy and tax collections went down. The rich paid more, but the cost was higher unemployment,
fewer workers and lost payroll tax revenue. It is frustrating that so many of today’s politicians have learned so little from past tax experience. Even after Trump’s tax rate cuts, tax receipts are at an all time high for the first nine months of this fiscal year. With the economy strong and tax collections at a record high the federal government should not be running a deficit. But the Congressional Budget Office projects a deficit of nearly $900 billion this fiscal year. President Trump has tried and failed to bring the spending down. Democrats in the House want to increase spending on programs they believe will win them votes. Social Security and Medicare are politically all but impossible to retrain. Both are growing, providing an intractable spending core. Hopefully voters will reject the proposals for massive increases in federal government spending.

The stock market operates on a calendar year. For the first half of this year the S&P 500 stock index rose 16.9%. But the second quarter was much rockier than the first. In the first quarter the S&P 500 rose 13.1%. The second quarter started off well with the S&P 500 up 3.9% in April. May was a different story with the S&P 500 down 6.6%. That brought out a crowd of pessimists forecasting a devastating trade war, slumping corporate profits and a further decline in stocks. But June fooled all the pessimists. The S&P 500 rebounded, up 6.9% in June.

Argus Research points out that when the first half of the year is strong - up more than 10% - the odds are that the second half will also be strong. Since 1980 the S&P 500 has averaged a full-year gain of 9.7%. But for years like 2019 when the S&P 500 mid-year gain exceeded 10%, the full-year gain was 22.6%. On average for years since 1980, when the mid-year gain was more than 10%, the full-year gain was 15.8%.
Argus also points out that there have been exceptions to the historical stock market data. In 2018, for example, the stock market fell sharply towards year end. Argus concludes: “Assuming Washington can sustain at least an uneasy truce on trade, we see room for further advances in the half-year ahead.”

Editors at The Economist seem puzzled by the U.S. stock market’s first half performance. In the latest issue, July 20, there is an editorial titled: “Soaring Stock Market, peaking profits.” The subtitle is: “After years of plenty America Inc. is struggling to crank out higher earnings.”

The editors clearly see the remarkable history of American businesses adapting to rough times and enjoying the good times. “Over the past 25 years America’s stock market has soared. Far from being built on thin air, this long bull run has rested on a boom in corporate profits. The worldwide earnings of all American firms, whether listed or not, have risen by 455% over this period and are now 35% above their long-term average relative to GDP. America Inc. mints $1 billion every five hours.”

This is an amazing record. The 25 years takes us back to 1994. The period includes the dot-com bubble busting and the devastating financial crisis of 2008-2009. How many times during this period did pessimists come up with convincing reasons you should be out of stocks and in cash? We know from mutual fund data that many investors fell prey to the pessimists’ miserable analysis and lost out on the terrific period of earnings and stock market growth.
The editors also point out: “American is the home of the bottom line: firms based there account for 33 cents of every dollar made by listed companies worldwide.” That is another eye-popping data point.

So why do the editors feel so gloomy about the future? They say: “The underlying trend is one of stagnation. The members of the S&P 500 index of big companies are forecast to say that second-quarter earnings per-share dropped by 3% compared with the prior year, the second consecutive quarter of mild decline.”

Wait a minute! Corporate profits have been soaring. Year-over-year comparisons are now quite tough. It is not unusual for profits growth to come in spurts and then slow down. The editors try to make a case that things have become more difficult for America Inc. both globally and at home. But America Inc. has demonstrated an ability to cope with difficult times. The last 25 years are proof positive of that. In my opinion America Inc. deserves more credit. Odds are that America Inc. will continue to grow profits in coming decades.

I will have the next market review and update for you one week from today on Wednesday, July 31, 2019.

All the best,

John Dessauer

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