



SACAJAWEA & COMPANY, LLP
Economic & Financial Research

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Dear ,

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DONALD TRUMP, it is a name that elicits an emotional response from most of us. It certainly has been a primary source of conversation for months. However, we have no interest in discussing politics here. We do want to discuss how the policies Donald Trump is promoting have affected the stock market and may affect the economy. Trump has three positions that we believe have helped the stock market rise since his election: reducing taxes, reducing government regulations on business, and increasing jobs for Americans. Although we think all three of these are impacting the stock market, the recent run-up has also been impacted by improved corporate earnings and strengthening European economies. It is hard to determine how much each has contributed to the recent rise.

Trump has proposed drastically reducing the corporate tax rate from 35% to 15%. At 35%, the U.S. corporate tax rate was one of the highest in the developed world. This distorts companies' businesses as they try to shift profits away from the high rates in the U.S. into countries with lower rates. This has caused many U.S. corporations with businesses overseas to set up foreign subsidiaries to manufacture and recognize profits offshore, thus avoiding U.S. taxation and improving profits. Another example of how our high corporate tax rate is distorting business is the recent wave of domestic companies merging with foreign companies from low tax countries. The domestic company then moves its headquarters to the low tax country and again reduces its U.S. tax bill and improves profits. We agree with Trump that reducing our corporate taxes is a good idea. Where we differ is in the magnitude of the cut. We would recommend that the rate be set at a little below the average for developed countries, perhaps 20%. We would also consider eliminating some (or most) of the corporate tax deductions, such as the deduction of bond interest and depletion for oil companies. The more deductions you eliminate the more one could lower the corporate tax rate. In addition, there are many other forms of taxes, such as import duties, Value Added Taxes, property taxes etc. that businesses need to consider as they decide where to locate. It is the sum of all of these taxes that should be evaluated and compared with the other developed countries.

In addition to a corporate tax cut, Trump is proposing a revision/simplification of the personal income tax code. Again, we are all for a simplification of the tax code. Special interests and politics have made the U.S. tax code ridiculously complicated. However, Trump's proposal caters too much to the richest people in our country. He does have some ideas we agree with such as eliminating the ability of hedge fund partners to pay capital gains rates on their fees, instead of the higher income tax rates most people pay. It may be extreme, but our starting point for changing the tax code would be to reduce the marginal rates and eliminate all deductions over a five to seven year period. Taxes are supposed to pay for "public goods," goods such as national defense, clean air and police. These are goods everyone has access to, everyone benefits from, and the use by one individual does not deplete them for others. Let's separate taxes from government efforts to influence peoples' behavior. For example, if you want to encourage retirement savings, set up a contribution match program similar to many corporate 401(k) plans. Keeping such programs out of the tax code will make it much easier to change and improve the program as needed.

Trump's platform also includes a reduction in corporate regulation. We agree with this in principle as well. Speaking from first-hand experience, the hours Sacajawea and Company spends on compliance with government regulations increases every year. We now have to hire outside consultants to remain compliant. I can say with confidence, none of the extra regulation has helped our clients one bit. We agree the government needs to regulate the financial industry to protect the consumer. What frustrates us is that

there are some pretty simple regulations that would achieve the desired result for consumers and the country, but they are not the ones enacted. Unfortunately, the lobbyists that the deep pockets in D.C. hire are very effective, often resulting in poor regulations. Examples of two good regulations might be to re-enact Glass-Steagall and to require anyone creating a security or making a loan to hold a percentage of that security. An example is when community banks used to make and then hold a mortgage loan. The mortgage officer had to be sure the borrower would repay the loan. Now, because banks rarely hold the loans, they just have to be sure they can sell it to someone else. By forcing the originators to own some of what they create, they would be much more careful with what they create.

Finally, we all want more and better jobs for residents of the U.S. Trump preaches that he can create more high paying, middle class, manufacturing jobs. He proposes to do so by taxing imports of manufactured goods. There is little evidence this will help. First, taxing imports causes the price of those imports (and the domestic goods that compete with those imports) to rise. This hurts the consumer and the domestic manufacturers that buy supplies from outside the U.S. In addition, if we tax imports from Mexico, Mexico will retaliate by taxing our exports. Such a change would likely impact exchange rates and the value of the dollar. This type of reciprocal import tariffs may have caused the Great Depression. Suffice it to say, there are many factors that impact foreign trade and it is not clear that taxing imports will create jobs, or help Americans.

The biggest risks to U.S. job growth are demographics, automation, and artificial intelligence. First, the U.S. has an aging population with the baby boomers reaching retirement age. There are going to be fewer workers so it will be difficult for employment will grow significantly over the next 10 years. Second, the types of jobs Trump is promising to bring back, the manufacturing jobs, were often low skilled labor. Technology is improving and many of the very jobs Trump is claiming he will bring back are being automated out of existence. For example, even before his inauguration Trump strong armed Carrier to stop it from closing a factory in Indiana and move the manufacturing to Mexico. Carrier agreed not to move the assembly line to Mexico (for tax incentives) and Trump crowed he had saved over a thousand jobs. However, the next day the CEO said that Carrier would invest \$16 million in the domestic plant to automate the assembly line, eliminating many jobs anyway. Not only is automation eliminating simple jobs, artificial intelligence is booming. As it improves, it will allow more sophisticated robots to replace ever more skilled workers. A great example are truck drivers. Right now, there is a dearth of drivers. If you have a truck driver's license and are willing to spend your life on the road, you can probably find a well paid job. However, in 10 years, self-driving trucks may eliminate the need for drivers at all. Unfortunately, throughout history, when technology replaces workers, the jobs that those workers find are usually lower quality, lower paying jobs. It is not a pretty picture for this segment of our population. What we need to do is find a way to retrain displaced workers as best we can, improve systems to address those that cannot find better jobs, and be sure to train the younger generations for the jobs of the future.

Since the election, the equity markets have rallied strongly. Quarterly corporate earnings are strong relative to a year ago. What some fail to notice is that a year ago earnings were declining and very low. Strong improvement from these low levels is routine. Europe is also coming out of its long slump. This helps domestic companies with large international businesses. So where does this leave us? The market is fully priced, but not outrageously overpriced. We think the markets have overvalued the benefit of what Trump can do for the U.S. economy. As that realization spreads, the markets will probably fall and return to more reasonable valuations. We are not sure when or how much markets will correct, but your portfolios are in a defensive posture and ready to take advantage of a decline when it happens.

Sincerely,

William H. Wrean Jr.

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