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The Dow: Almost, but not Yet; Prospect for Corporate Tax Reform

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I arrived back home last night from a week's family vacation to Maui. Local chatter was dominated by the closing of the last sugar cane processing plant in Hawaii in December (located in Maui), an industry that had been operating since the 19th century. Yet, the island state is far from hurting; tourism is on an upsurge due to travelers seeking a Zika-free place for a beach vacation. Shortly after I wrote my last commentary (Friday, January 6), we left for the airport. I soon received a call from CNBC informing me that the Dow had climbed within 25 points of 20,000. Over the last two weeks the network had wanted me to be available when the milestone was reached. Indeed, they interviewed me from the American Airlines lounge as the Dow climbed to within 10, then, 5, and finally to within one-half point of 20k. But it couldn't get over the barrier, and the venerable average struggled the following week.

As the Trump inauguration approaches on Friday, investors will be concentrating on the rising tide of fourth quarter earnings reports. Although most firms will beat the consensus forecast (as usual), many will be hard put to offer accurate forward guidance. Fourth quarter GDP is shaping up to be just over 2% and the early read on this quarter is the same. But impending corporate tax policies will be a big unknown.

There are many versions of the new tax code the House Republicans are formulating and none is close to being adopted. The most radical reform includes "border adjustments," the exemption of income generated from foreign sales from taxable income but the non-deductibility the cost of goods that are imported. It is my opinion that this plan has a very low probability of passing; mostly because it is a radical reform that could cause a sharply higher dollar and dramatically hurt those who import. Other reforms stand a much better chance, including total or partial exclusion of the deductibility of interest costs, immediate expensing of capital expenditures, and, with virtually a 100% certainty, a cut in the statutory corporate tax rate. The biggest question is how much net corporate tax reduction will there be? Some of the tax losses will be made up by faster GDP growth (dynamic scoring), but big tax cuts are not (self-financing). It should be noted under current House rules, any new tax plan that cannot be paid for cannot be passed as permanent legislation by the reconciliation process (no filibuster). However, it is my understanding that the filibuster rule does not apply to the nearly $500 billion (over 10 years) in taxes (many on capital) that would be eliminated by the repeal of ObamaCare, which is one reason why the Republicans want to repeal this legislation quickly. All this is good for the stock market.
