John Dessauer's market review and update as of Wednesday April 13, 2016.

***The Economist* is a London based weekly magazine. In my view its editorial board is always tilted slightly to the left. So, I found the editors' reaction to Obama's latest attack on American business deals a shock. On April 4, Obama's Secretary of the Treasury Jack Lew announced a new, aggressive crack-down on "inversions" - mergers that include moving the corporate headquarters to a more tax friendly country. *The Economists'* editors headlined their article: "Pfiasco." And followed that with this statement: "Open warfare breaks out between the White House and America's tax-shy multinationals." Jack Lew's actions erased any doubt that the Obama administration is anti-business. *The Economists'* editors are spot on with their sharp criticism. The U.S. corporate tax laws are old, out of date, obsolete and harmful to the U.S. economy. Instead of attacking mergers, the government needs to reform the tax code, especially as** it **applies to business.**

The merger that exposed the administration's true anti-business policy was between Pfizer - an American company - and Allergan - an Irish company. The merger would have moved the combined companies' headquarters to Ireland where taxes on business are far lower than in the United States. On April 6, two days after the treasury secretary's attack, Pfizer cancelled the deal. Allergan investors howled with anger as they lost $13 billion in the 48 hours after the deal was cancelled. Officers and directors of other European multinationals panicked because of fear that they might become collateral damage in America's war on business. The Obama administration's attack on corporate

“inversions” targets more than mergers; it also includes new rules on intercompany debt. And that is forcing foreign companies with business in the United States to reevaluate their strategies. For example, foreign companies with businesses in the United States often assign debts to those U.S. subsidiaries. They do so mainly to reduce currency risks. But there also are U.S. tax consequences. The debt service costs reduce American taxable profits. The Obama administration’s new attack includes proposals to change the rules on how companies account for debts and assets. The total debt that foreign companies have allocated to their American operations is $550 billion. The Obama administration’s new rules may well force an expensive realigning of foreign companies’ American balance sheets. It is almost unbelievable that any U.S. administration would send such a strong anti-business message around the world. It says that the United States is hostile to businesses, domestic and foreign. The treasury secretary might just as well post a big sign staying to all foreign businesses, “stay away from the United States”. Jack Lew and the Obama administration are not alone. Presidential candidate Bernie Sanders has been attacking GE. And Hillary Clinton once said, don’t tell her that corporations create jobs. It is sad that political ambitions override common sense and the good of the economy. On the other side, the Republican candidates are busy trying to destroy each other. Their battle highlights the intense, hyper-partisan nature of American politics. Privately, just about everyone agrees on what needs to be done to make the U.S. business friendly. However, with the country so divided, real reform that would encourage investment in the U.S. and help to create higher wage jobs seems almost impossible.

The headline U.S. corporate tax rate is 39%, roughly where it was in the late 1980s. Since then, other developed rich countries have reduced their corporate tax rates.

The average among those countries today is 25%. Clearly, the U.S. tax rate needs to come down for America to be competitive in a global economy. Reducing the top rate would not mean less tax revenue for the government. First, the average paid by all U.S. firms is 33%. Among the top 50 companies the actual tax rate paid is 24%. A logical question is: how is it that American companies pay a tax far below the headline rate? The answer is that over the years, companies have paid billions of dollars to lobbyists to create loopholes (currently American businesses spend $3 billion a year on lobbying). The tax code has become overly complex, with more than four million words. Between lobbyists and tax lawyers, American businesses, especially the larger ones, have been able to take advantage of the complexity to keep their tax payments well below 39%.

The last time there was comprehensive tax reform was in the 1980s when Ronald Reagan was president. Here is what *The Economists* editors recommend for U.S. tax reform: "Slash the headline rate to 25-30%, ditch all the loopholes and charge American tax only on American profits. That would cut complexity, prod American firms to bring profits home and keep tax revenues steady at about 2% of GDP."

Currently the United States taxes global profits for American companies. In response, American multinationals have been keeping profits earned abroad in foreign accounts. It is too expensive to bring the money home. If the U.S. changed policy, and taxed only American profits, that cash would be able to come home and be paid to shareholders as dividends, or be invested in growth opportunities. The amount stranded abroad at the end of 2015 was $2 trillion. If that were paid out as dividends, the U.S. government would get its share through the individual income tax code. It is difficult to understand why the government stubbornly clings to a corporate global profits tax policy,

and as a result misses out on tax revenue that would be collected if the stranded cash came home.

For all who think there is nothing government can do to improve the rate of domestic economic growth, this is a lesson. The economy desperately needs more investment. Corporate tax reform would release the trillions of dollars that are now stranded abroad. That cash would then flow back into the economy for investment as well as dividends. In addition, reform would make the United States friendly for foreign investment. If there are any who doubt the current policies are hurting investment and therefore the economy, the Jack Lew attack on business should be an eye-opener.

Meanwhile there continues to be good news from the U.S. department of labor. The unemployment rate went up! It went up not because people lost their jobs; it went up because labor market conditions have improved and discouraged workers came back looking for work. In other good news, oil prices were up 6% last Friday. The price surge is a sign that we may be near, if not at, the end of the oil price decline. And last, the dollar has come down. All this good news indicates the headwinds that have been retarding growth in corporate profits are winding down. Stocks remain our best investment choice.

Special note: The next market review and update will be two weeks from today on Wednesday April 27, 2016. In a few days I will be flying to Zurich and then on to visit a handful of European countries. During this trip I expect to learn a lot more about what is happening in the euro region and how that impacts our portfolios.

All the best,

John Dessauer

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