EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR MONTHLY ECONOMIC UPDATE

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SPENDING, TAXES, AND VOLATILITY

Democrats in the United States (US) will do what Democrats do, that is, spend more (mostly on the "not rich") and tax more (mostly on the "rich"). In the past, we discussed the proposed $1.75 trillion infrastructure plans that President Joe Biden has, as a clever way of increasing the long-term returns (gross domestic product (GDP) growth) of the US economy. But, in the last few weeks, we were introduced to a new spending package – Biden's "Build Back Better Framework" – a $2 trillion package that will see greater investment into childcare, education, healthcare, and the fight against climate change over the next decade.

One can probably argue the effectiveness of US government spending, but I believe that they are likely better at it than most. However, with Democrat leadership they, once again, seem to be leaning too much towards redistribution (socialism) than towards wealth creation (free-market capitalism). This is true especially if one considers where the money will come from to pay for these lavish ideals of supporting the "not rich". Some silly legislators forgot that they were in the US and proposed what was coined a "billionaires' tax", a wealth tax that would target the 700 US billionaires. This new tax would be levied as a percentage of an individual's capital, irrespective of whether the capital is used (re-invested) or converted to cash to live from. This legislation ran into hard opposition and will probably not be heard of again any time soon.

This leaves capital gains tax, dividend tax, corporate tax, and, of course, personal income tax, most of which we believe will be tinkered with over the next couple of years, as the Democrats enjoy their time in power. Among corporate taxes, we have already seen an aggressive attempt to tax the "rich", those large US-based multinationals. In the proposal, US corporations who report more than $1 billion in profit to shareholders would be taxed at a flat rate of 15% – a clever deviation from the standard corporate taxes that are sidestepped to reduce the effective rate that corporations end up paying. The idea is that a flat rate of this nature will close the loopholes, which multinationals use to reduce their corporate tax responsibilities. For this reason, changes to corporate taxes will probably get a little bit more support, especially if one considers that it will rake in anywhere between $30 billion and $40 billion in tax revenues annually.

Something else that stood out during October was global market volatility, driven by changes to long-term fundamentals. A lot of uncertainty over inflation, tapering, and interest rates made the markets restless. Investors were initially concerned that inflation would be too high, something that we have been cautioning against for more than a year, but then the very next week markets made a rapid recovery, seemingly having made peace with higher inflation. Not even concerns about higher energy prices (gas prices doubling and oil reaching new highs), persistently higher wages, or disappointing US economic growth figures could upset Wall Street's earnings optimism. We would, however, caution against persistently higher inflation levels, not because we are worried that central banks will act too quickly (they are much too conservative), but because of the impact that higher inflation can have on earnings. We thus encourage you to ensure that you are exposed to active managers who invest in companies that can enjoy higher sale prices without having to lose out on the benefits of higher costs.

Something else that made the markets restless was the Chair of the US Federal Reserve (Fed), Jerome Powell, who turned considerably more hawkish, reversing the long-term trend of easy money. Although committee members are split between raising interest rates in 2022 or 2023, it seems that tapering is imminent, and will, most likely, come to an end in 2022. Even the overly cautious European Central Bank's (ECB's) monetary policy took a slightly more hawkish outlook during the latter part of October. The ECB now believes that near-term inflation will last longer than expected (supporting what we have been saying for a long time), and that the net asset purchases under its Pandemic Emergency Purchase Programme (PEPP) will end by March 2022.

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