Brendel & Fisher

FINANCIAL ADVISORS

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Greetings:

The news for autos, manufacturing output, orders for durable goods, retail sales, and housing starts has been at best unimpressive. Today's initial reading on first-quarter GDP was a paltry 0.7 percent annualized, the worst quarter in three years. Still, two-thirds of business economists expect a rebound in the second quarter and growth over the next four quarters of 2.1 to 3 percent versus 1.6 percent in 2016. Some investors must be skeptical. The financial futures market anticipates one more rate boost this year and only a slight chance of a second one -- never mind what the Fed says.

Back to the good news. Earnings reports are coming out every day and there are mostly positive surprises including this week from Dow Industrial stocks United Technologies, MMM, Boeing, DuPont, McDonald's and Caterpillar. More than 76 percent of S&P 500 companies reporting have topped analyst's estimates, and first-quarter S&P earnings are expected to rise 11.2 percent. Impressive, considering the economy's weakness. Earnings growth is the mother's milk of a bull market. It needn't be at a double-digit pace, which cannot possibly be sustained, but there needs to be growth. Management, even the most adroit, cannot make something out of nothing, so the economic pie itself must grow faster than the two percent we've seen for a decade. Hello tax cuts.

Good things happen when taxes are cut. That was true when a reluctant Kennedy cut them and very much the case when Reagan did -- annual GDP growth averaged 4.8 percent over the six years following his 1981 tax cuts. Before them there were better days under Harding and Coolidge, and investment took off in the 1990s when Clinton and Gingrich agreed to cut the capital gains tax. This week President Trump proposed slashing the corporate tax rate from 35 to 15 percent. That will increase business investment and soon afterward productivity, a long-missing key to growth. Foreign earnings currently held abroad ($2.6 trillion) could be repatriated at a 10-percent tax rate. Many billions will return, likely more than a trillion. There are cuts for individuals, too, though few for top earners. And no more estate tax or AMT. Many items on Trump's tax wish list are there to be traded away to secure the most important elements (rate cuts). That's called negotiating.

In the news:

Becton Dickinson -- Becton is buying C.R. Bard for cash and stock worth $24 billion to further solidify its position for oncology and surgical devices and supplies. The deal should close in the fourth quarter and be accretive to earnings from the start. Annual dividend increases will continue. I had considered Becton to be a potential takeover target. No longer.

Verizon -- Revenues fell 7.3 percent in the first quarter and earnings were off 20 percent, both worse than expected. For the first time ever there was a quarterly decline (307,000) in the number of retail cell phone customers. That underscores the degree to which competition in the mature cell phone market has heated up. Verizon has said it's open to talking to Disney or Comcast about a merger. Interesting.

Procter & Gamble -- Earnings were better than expected though sales were not, in good part due to the dollar's first-quarter strength, which has now reversed, but also because men are growing beards (not I) and don't need Gillette razors. The dividend was boosted by three percent to an annual $2.76.

One has to be impressed with how well corporate America is doing in a lackluster economy. Cost cutting helps and so do share buybacks, but up to a point. Economic growth needs to pick up. Less regulation and lower marginal tax rates in a business- and investor-friendly environment are keys. The pieces are falling into place, and according to Goldman Sachs it's happening worldwide. They see global growth this year topping 4 percent, twice last year's pace. Good news.

Sincerely,

John J Brendel, Jr. AAMS
Managing Partner