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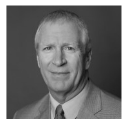
APRIL 2019



Corporate Cash Conundrum

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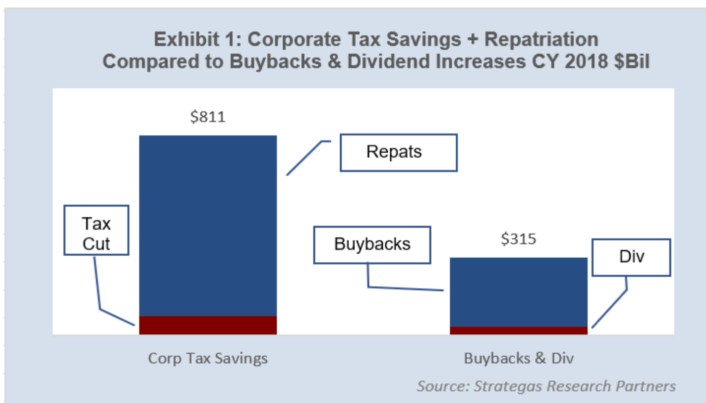
While there is little debate about the cash windfall that companies realized in 2018 from tax cuts and repatriation, there is considerable debate about what corporations did with it and whether or not it was well spent. The latest political target is companies buying back stock. The belief is that U.S. corporations used nearly all of the savings from tax cuts for share buybacks even though they were "supposed" to use it to increase wages and invest in capital. But what is the reality of the situation? Exhibit 1 below shows an estimate of the corporate benefit compared to the return of capital activity that is under scrutiny. Yes, a significant amount of the repatriations were returned to shareholders but this analysis shows a difference of almost $500 billion that was used in some other fashion. While some of windfall went to pay down debt, there was also a significant uptick in investment. The year over year increase in 2018 capital expenditures within the S&P 1500 was $115 billion, a 15% increase (Exhibit 2), almost four times the $32 billion increase in 2017, and the largest since 2011. This uptick was led by the Communication Services sector, with Energy, Finance, and Information Technology also experiencing significant acceleration in activity.

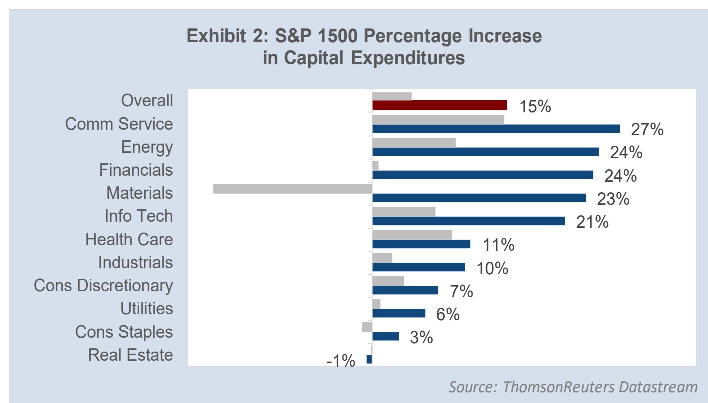
Since the bulk of the offshore cash hoard was in Communication Services, Information Technology, and Health Care companies, one might think that some of that cash went to higher research and development. After all, R&D for those three sectors is roughly the same size as capital expenditures and innovation is their lifeblood. In fact, Communication Services companies did up their game (Exhibit 3) but the 11% increase in R&D by Health Care and Information Technology companies was little changed from 2017. The $40 billion aggregate R&D increase for S&P 1500 companies was higher than the $30 billion uptick last year but falls far short of the increase in capital expenditures and does little to explain how companies used their tax windfall.



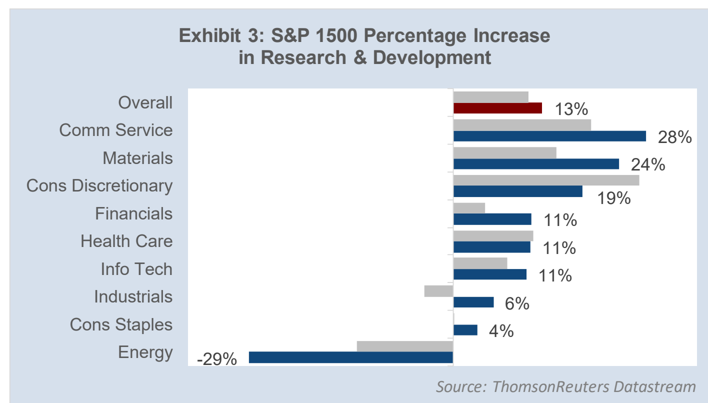
Source: Strategas Research Partners

As hoped for by the change in the tax code, private wage growth has picked up. Total private wages reported by the Bureau of Economic Analysis were $348 billion higher in 2018, which was a $118 billion uptick from the growth rate in 2017, representing a 4.9% increase. About half of employment growth is attributed to small businesses and thus should not be included in the corporate tax benefits calculation. Consequently, about half of the $118 billion (or $59 billion) uptick should be included as a use of corporate windfall from tax cuts and reparations.

One could say that the tax bill was successful in stimulating some of the things it was intended to boost. But even using a very generous estimate of buybacks, increases in dividends, R&D, capital expenditure, and an uptick in wage growth, the total of these categories does not come close to accounting for where the



Source: ThomsonReuters Datastream



Source: ThomsonReuters Datastream

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full corporate tax benefit was allocated. Thus **there is still buying power in corporate America**. With both capacity and the employment pool tightening there is still a need for investment in both physical and human capital. What is holding that investment back from fully realizing its potential is confidence. Both the NFIB and CEO confidence survey readings have slipped from the peaks achieved last year. Both are now at about their long-term average. While the spike in economic policy uncertainty we noted last quarter has moderated, some of the indicators are still at relatively high levels. In this environment business managers are more likely to invest on an as needed basis as opposed to being forward looking. In that regard, a resolution to trade tensions around the world would help. The ongoing soap opera of Brexit is not helping confidence in policymakers and it looks like there will continue to be questions around the U.K. relationship with Europe for some time to come. Muddling through is a good, if not generous, way to describe the current situation.

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