Tortoise Credit QuickTake Podcast

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, senior members of Tortoise provide a timely update on trending topics in the market.

Welcome to the weekly Tortoise credit podcast. I'm Greg Haendel, Senior Portfolio Manager at Tortoise. We've made it through another holiday season, probably with our bank accounts a little smaller and our waistline a little bigger. While we may be looking at ways to reverse the effects of the holidays, for corporate America the holidays and the party continue strongly into 2018 with corporate tax reform. Unfortunately our politicians in Washington D.C. continue to act like spoiled children during the holidays refusing to sit down with the entire family for a holiday feast unless they get their way. In today's podcast we will discuss some of the positive effects of corporate tax reform, specifically some antidotes from recent corporate tax reform announcements. In addition we will discuss the government shutdown and its potential effects on the economy.

By the time you are listening to this podcast or reading this transcript the so-called government shutdown has come and gone. We use the preface "so-called" to describe the shutdown today as it's a bit of a misnomer given that a large portion of the government now stays funded and open due to improved contingency plans as well as a vast expansion of what government services are considered essential and hence immune. As it relates to the current shutdown, which began at midnight on Saturday morning and ended Monday, there appears to have been little disagreement by both parties on core spending issues while the bones of contention remained DACA and border security.

Irrespective of the issues, we didn't believe the shutdown would last more than a few days to a week or two given the public blame and political backlash during an election year that can affect incumbents regardless of political party. Further, it would be a political nightmare should the shutdown have continued through President Trump's first State of the Union address on January 30th. Using history as a guide, there have been 18 shutdowns since 1976 ranging from 1 to 21 days with the last shutdown occurring in October 2013 and lasting for 16 days. At that time the Obama Council of Economic Advisers concluded that it had a short-term effect on confidence, industrial production, employment and consumer spending consistent with a 25 basis point hit to real GDP growth had it persisted the entire quarter. Fortunately it only lasted 16 days, economic activity quickly recovered after the shutdown was over and while the S&P 500 fell a cumulative 1.6% in the first week of the 2013 shutdown, it began growing again thereafter. Further, Morgan Stanley and Deutsche Bank currently estimate roughly a maximum 20 basis point hit to real GDP growth per week should a shutdown have persisted although much of that hit would be regained in subsequent time periods.

The government shutdown ended up being very short lived and had a minimal effect on the markets and the economy. The real political showdown that can and has historically had an effect upon the markets will be the debt ceiling which must be addressed by mid-March.

After what appeared to be a mad rush in December 2017 to push through tax reform, President Trump signed into law sweeping tax reforms on Dec. 22nd, 2017. As discussed in numerous previous podcasts, we believe that in general corporate America will be the largest beneficiary of the tax overhaul. However, that is not to say that the benefit will accrue solely to corporate America given we believe there could be a significant multiplier effect depending upon how companies spend their increased cash flow as a result of lower taxes and repatriated overseas earnings.

Many companies have been reported in the news to be sharing a portion of their improved cash flows from tax reform through one-time bonuses to employees to increases in their minimum wage. For example, American Airlines and Southwest Airlines have said they will be giving $1,000 bonuses to virtually every employee. Wells Fargo and Fifth Third Bank have said they will increase their hourly minimum wage to $15 while Walmart announced plans to increase their starting wage to $11 per hour while also giving eligible employees cash bonuses of up to $1,000. In fact, there are well over 100 large U.S. companies that have announced plans to give "Trump Bonuses" to their employees after the passage of the tax plan according to the Washington Examiner. However, there have been fewer companies that have announced permanent wage increases as a result of the same tax plan. Regardless, these bonuses and wage increases should help boost consumer spending and potentially add a little boost to average hourly earnings going forward.

The multiplier effect from increased wages and bonuses is certainly important, however we believe the bulk of the increased cash flow from lower corporate taxes and repatriation will go toward returning cash to shareholders, capex investment and M&A activity, with balance sheet deleveraging very low on the priority list. In fact, on the overseas cash repatriation front, JP Morgan estimates S&P 500 multinational companies hold roughly $1.2 trillion in cash abroad and at least half could be returned to shareholders over the next 24 months. However, much of this overseas cash is concentrated among a few technology and pharma companies. JP Morgan estimates over $700 billion of overseas cash is held within 10 companies, with Apple leading the charge with roughly $246 billion in overseas cash.

As a result of deemed cash repatriation, Apple recently stated that they anticipate paying $38 billion in taxes (over 8 years), expect to invest over $30 billion in capital expenditures in the U.S. the over the next five years, create 20,000 new jobs and issue a bonus of $2,500 worth of restricted stock units to most employees worldwide. Bank of America, on a recent earnings call, cited high optimism among their clients as a result of tax reform however also stated that they expect most of the benefit from tax reform to flow through to the bottom line through dividends and share buybacks. Lastly, during a recent Amgen company presentation, the company referenced roughly $39 billion of overseas cash to be repatriated and further discussed spending that cash on R&D, M&A and returning excess capital to shareholders.

Increased cash and a lower after tax cost of debt should cause corporate M&A activity to sky rocket from the relatively low levels seen in 2017, potentially exceeding the record setting M&A volume experienced in 2015. We have already seen increased M&A activity and speculation over the last couple months from the likes of Disney and Fox, Viacom and CBS, ADM and Bungee, Wyndham and La Quinta, Xerox and Fuji Film, and Broadcom and Qualcomm to name a few.

Returning to the analogy we started with, the holidays and party for corporate America has just begun. What has yet to be seen is how much of that will spill over onto Main Street and onto corporate balance sheets. While we do believe there should be a decent multiplier effect on the real economy through capex investment, consumer spending, wages and job creation, we also expect minimal results to accrue to corporate balance sheets. Further, we hope the spoiled children (also known as our politicians) don't ruin this holiday feast.

Thank you for listening, we'll talk to you again next week.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseadvisors.com.