Mitch on the Markets

Will Tax Cuts Jumpstart the Economy?

By Mitch Zacks
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The phrase you hear a lot these days is that tax cuts are essential to 'getting the U.S. economy moving again'…that a tax break is what's needed to jumpstart growth and to get people working again.

While I agree that broad tax cuts can provide a nice tailwind to workers, consumers, and corporations, I do not quite understand the narrative that tax cuts are crucial to moving the economy 'again'. Where does the 'again' part come from? The U.S. economy has been expanding modestly but sturdily for the better part of *eight years*. The S&P 500 has delivered gains of over 230% (as of this writing) and the U.S. economy has generated 80+ consecutive months of job gains, which puts the unemployment rate down to a very healthy 4.1%. U.S. Real GDP grew from $14.54 trillion in 2009 to $16.85 trillion at the end of 2016. That's over $2 trillion of added output!

Even still, many folks continue to disapprove of this economic expansion and bull market. But there's little reason to feel that way, in my view – it's been one of the longest economic expansions and one of the biggest bull markets in history. And at the rate we're going, it could become #1 in both categories before the business cycle ends.

It's the Business Cycle – Not Policy – That Matters Most

Policymakers like to believe that the U.S. economy is at the mercy of what happens on Capitol Hill, but the reality, in my view, is that lawmakers aren't as important as they like to think they are. *Business cycles are a force of their own*, and the ebbs and flows of economic activity are the sum of numerous factors like interest rates, foreign growth, bank lending, capex, consumer spending, and many 'invisible hand' forces that cannot be labeled or quantified. It is the sum of all of these factors moving and changing at once that ultimately drives the business cycle.

To be sure, the government can very much get in the way, over-regulate, or as in the case of tax reform, institute policy that has the potential to provide support to the business cycle. But, no single policy is likely to make or break economic progress. There have been instances in history when the government has instituted pro-growth policies and the economy contracted, and times when the government has raised taxes as the economy surged. Again, business cycles often have a mind of their own.

My overarching point here is that even without tax cuts, the economy probably would have done just fine in 2018, and notched another modest growth year. Global economic fundamentals are about as strong as we've seen them in several years, and we're optimistic heading into the new year.

The deal only gets sweetened with tax cuts, which are all but certain at this stage. The biggest tax cut in the entire package goes to corporations, which should benefit corporate earnings and thereby play well for equity investors. It is unclear how corporations plan to use their tax breaks, but in many cases, it could materialize in the form of share buybacks, increased dividend payments, private fixed investment, wage growth, or simply improvement of capital positioning. Some may hoard the cash in preparation for the next downturn or invest in research and development. In any of these outcomes, shareholders should see value flow through in some form or another. In my opinion that is all the more reason to stay invested if your objectives allow for it, and perhaps even seek out companies that might benefit most from the tax cuts.

Bottom Line for Investors

In my separating business cycles from policymaking, I don't mean to suggest that tax cuts are worthless or unnecessary. In my view, cutting the corporate tax rate by nearly half will boost corporations' capital positions and likely result in material boost to shareholder equity – both good for investors. The one distinction I will make, however, is that it is really the economic and business cycle that drives businesses' and stocks' growth and investment, not temporary tax tweaks. In other words, if you're bullish, be bullish because the economy is on firm footing and the corporate earnings outlook is strong. In my view, that's the case today with or without tax cuts.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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