

The First Tee...

Compulsory Compensation Cache...S&P 500 companies received a \$30 billion wind-fall from the new corporate tax cut...what are they doing with the added savings?:

- The administration expected the tax savings to be used for investment and job creation:
 - Despite being early in the process, companies have stuck to their previous spending trends to-date:
 - Changing corporate behavior is typically a long-term process...it appears this trend will be no different this time around.
- Examining segments impacted by the tax-cuts shows current corporate spending trends:
 - **Capital Expenditures:** spending on new offices, factories and equipment is forecast to rise to \$641 billion this year:
 - Despite the nice 18% gain in cap-ex spending, the amount matches the percentage of what companies have allocated during the past three years as a portion of free cash flow (about 43%)...cash flow is key measure of core profits.
 - **Stock Repurchases:** S&P 500 company share buy-backs have accelerated by 34% to \$178 billion:
 - **Dividends:** during the first quarter companies increased dividend payments by 8% to \$116 billion:
 - Despite the gain, the dividend percentage increase is little changed from the average seen during the past four quarters...which has tracked at about 46% of trailing 12-month free cash flow.
 - **Job Gains:** payrolls have averaged of 207k monthly gain so far this year, compared to the 172k average job gain seen during the first five month of 2017...the unemployment rate has averaged 4.0% this year, versus 4.5% during the same period in 2017.
 - **Wages & Benefits:** companies were handing out one-time employee bonuses at the beginning of the year:
 - The payments helped total compensation to rise by 2.7% during the first quarter, its best performance since 2008:
 - Wage gains remain moderate, still trending at the post-recession annual rate of 2.2% (the lowest of any recovery since WWII).
 - **Cash on Hand:** corporate liquidity has hit record levels this year, rising to \$1.78 trillion...despite the new high, the 4.6% increase in cash accumulation is running slightly below the average quarterly gains seen last year.
- Time will only tell if the long-term benefit of the tax-cut...it has already become evident government tax receipts are down and federal debt loads are on the rise.

Fuller Employment...already considered at full employment, the U.S. job market could move into rare territory as forecasts of unemployment below 3% are expanding:

- The unemployment rate has not been below 3% since 1953...the labor force was small due to the Korean War:
 - Ominous sign?...65 years ago, GDP began the year at +7.7% and finished the year at -5.9% and in recession.
- Tax-cuts and spending increases have provided a booster shot for the economy:
 - Businesses have had to become creative in ways to find and utilize labor...including hiring retirees, immigrants and homeless persons, while also retooling some of their processes to be less labor intensive:
 - Although, there is speculation there is more-slack in the labor market than the unemployment rate indicates:
 - The level of employment relative to the size of the population (the employment rate) has only recovered 40% of its decline from the previous economic cycle's peak...it is anticipated the labor force participation rate will remain close to forty-year lows as the re-entry of discouraged workers in the labor force will be offset by the retirement of Baby Boomers.
- If the jobless rate continues to decline, the economy overheating will become a concern:
 - An aggressive tightening of monetary policy could derail the recovery and set the stage for the economy to contract:
 - Ramping-up rate increases would take the Fed away from removing excess stimulus from the economy to overtly acting to slow growth with a restrictive policy stance...most of economic expansions have come to an end due to monetary policy becoming restrictive.
- The slow pace of wage growth continues to be a critical variable in the labor picture:
 - Fed Chairman Powell has stated further strengthening of the labor market can take place without causing inflation...this has been true as unemployment moved below 4%, not so sure if the jobless rate tests sub 3%.

At the turn...

The Back Nine...

Lingering in Financial Hospice...giant mortgage-finance companies, Fannie Mae and Freddie Mac, remain under government stewardship with no end in sight:

- Fannie and Freddie have been in the conservatorship of the Federal Housing Finance Agency since their \$187.5 billion bailout financed by tax-payers in 2008 (the height of the financial crisis):
 - The companies purchase mortgages from lenders, convert them into securities, and provide loan guarantees to investors to protect against defaults...the companies back \$5 trillion in mortgages:
 - The U.S. Treasury is committed to providing the companies with as much as \$254 billion to cover losses.
- FNMA & FHLMC are now profitable and have paid back to the government \$279 billion:
 - The companies can retain up to \$3 billion each in capital to protect against small operating losses:
 - The remainder of Fannie Mae's and Freddie Mac's profits are sent to the Treasury Department (sounds like Socialism tendencies)
 - The FHFA is proposing the companies have a combined \$181 billion capital cushion if allowed to become independent:
 - The capital buffer is intended to protect tax-payers from having to provide a bail-out if there is another housing collapse:
 - The \$181 billion capital requirement represents 3.5% of Fannie and Freddie's total assets and off-balance sheet guarantees.
- Pull the plug?...the government is still debating whether to keep Fannie and Freddie operational:
 - Senators Bob Corker and Mark Warner were working on a bill to preserve a majority of the companies operations while allowing for new competition...the Senators have stated efforts to end government control are dead this year:
 - Treasury Secretary Mnuchin has stated he will focus on the Fannie/Freddie issue following the November elections.
 - Besides tax-payer exposure, a key concern of the FNMA/FHLMC debate is disruptions and fall-out to the housing market...there is a strategy to have the companies raise fees and lower maximum mortgage limits to reduce the size of their footprints.

Shelter Shutout...rising home prices are squeezing-out first-time buyers:

- Millennial's (who are late to the home buying game) are faced with an annual average housing inflation growth rate of over 7% during the past five years...over triple the pace of annual wage growth:
- Strong demand, low supply, rising mortgage rates and higher material costs are boosting home prices:
 - New tariffs on lumber are increasing the cost to frame a house...home framing is about 15% of total construction costs:
 - The cost of construction inputs (materials used to build a house) are rising at their fastest pace in almost 8 years...the price of lumber increased by 16% during the 1st quarter (the hurricanes and wildfires last year added to the demand for building materials).
 - There is not a lot of relief in sight for home borrowing rates as the Fed continues to normalize interest rates and the acceleration of inflation is placing upward pressure on the rates investors demand to purchase longer dated bonds

19th Hole...

Insanity is often the logic of an accurate mind overtaxed.

Oliver Wendell Holmes

Ross Elford, First Vice President

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