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CLIENT BULLETIN

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➢ *Tax Deduction Changes?*

Last week the House of Representatives cleared a budget blueprint in hopes that a bill overhauling the tax code can be approved in both chambers by Thanksgiving. Making financial or investment decisions based on ***proposed*** tax law changes is typically a fruitless effort. After going through the grist mill of tax writing committees, proposed tax law changes rarely come out looking like they do as initial proposals.

➢ *Tax Deduction Changes?*

Additionally, releasing details of the proposed changes will unleash a lobbying frenzy. It is easy to see which groups would be most affected by how loudly they cry when their favored deduction is targeted for elimination. In this case, it is high income earners in California and New York who are crying the loudest. One of the provisions in the current blueprint eliminates the federal tax deduction for state and local taxes. Taxpayers in California and New York utilize 33% of the deduction (by dollar). Predictably, 11 of the 20 Republicans who voted against the recent proposal (no Democrats voted for it) were from California or New York (Source: Internal Revenue Service).

➢ *National Debt, Annual Deficit*

The numbers are in for fiscal year 2017 (which ended on 9/30/17) for the United States government. For the year, the budget deficit (outlays in excess of income) was $660 ***billion***. This total brought the national debt (the accumulation of all past deficits) to $20.245 ***trillion***. (Source: United States Treasury).

➢ *Not a Lot of Wiggle Room*

Addressing the national debt/deficit situation going forward will be challenging - 74% of the projected spending of the US government over the next ten years is either “entitlement” spending (Medicare, Medicaid or Social Security) or interest on the $20.245 trillion of debt. Defense spending, considered a “discretionary” spending category, has declined from 43% of the budget in the ‘60’s to just 15% last year (Source: Congressional Budget Office).

➢ *From Goods to Gigabytes*

Top 10 Largest Companies in the MSCI ACWI by Market Cap

1997	2007	2017
General Electric	Exxon Mobil	**Apple**
Coca-Cola	General Electric	**Alphabet (Google)**
Microsoft	Microsoft	**Microsoft**
Exxon	AT&T	**Facebook**
Merck	BP	**Amazon**
Royal Dutch Petroleum	Procter & Gamble	Johnson & Johnson
Intel	Chevron	JPMorgan Chase
NTT	Vodafone	Exxon Mobil
Philip Morris	HSBC Holdings (GB)	Nestlé
Toyota	Johnson & Johnson	Wells Fargo

Idea companies prevalent in the TOP 10 in 2017

Source: MSCI and RIMES. The top 10 companies for 1997 and 2007 are as of December 31 for each year; for 2017, they are as of 8/29/17.

Investors often think of the largest multinational companies as old-line behemoths in the oil, finance or industrial sectors, but a host of new global companies is rapidly emerging as services are being digitized and manufacturing is being automated. The knowledge economy is gaining momentum, and this is giving rise to a new breed of global giants that are "idea" companies – think Amazon or Alphabet (Google's parent). These companies are creative, nimble and leverage technology to their advantage. It's no wonder that the composition of the world's most valuable companies by market value has changed dramatically over the past decades as the accompanying chart shows.

➢ *Investment Implications*

With the Internet, there are no real borders, which creates a paradigm shift in the way companies are organized and in how products are consumed. Product adoption can be swift and distribution costs limited - the smartphone or tablet is the delivery mechanism. As borders blur, the flexibility to invest in companies anywhere in the world has become important as investors seek to benefit from globalization. Despite recent protectionist rhetoric, it's hard to see globalization reversing: it's embedded in the way many companies do business, set up supply chains and products are manufactured. Apple is an obvious example - its supply chain spans 30 countries, and it is a master of using geography to its advantage, sourcing suppliers that can turn out cost-effective parts that adhere to its quality requirements.

➢ *Misunderstood "Tech" Giants*

Speaking of Apple, they along with Alphabet, Facebook and Amazon, are referred to as being part of the "tech sector" of the US economy. In reality, the bulk of the revenue generated by these companies comes from budgets that have nothing to do with corporate technology spending. Apple generates revenue primarily by selling replacement iPhones to consumers, and anyone who has misplaced their phone for a day will tell you that a phone is a consumer staple, not a technology purchase. Likewise, Alphabet's Google is a sort of digital yellow pages that generates revenue from advertisers paying to reach customers when they are researching items to buy. Facebook is like a TV channel that shows content from your friends and family and generates revenue from advertisers who are guessing what might influence you when you're seeking to be entertained or informed. Finally, most of Amazon's revenue comes from its retail business. Lumping these companies into the "tech sector" is grossly missing fundamental changes in the US economy.