First Trust
Monday Morning OUTLOOK

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Watch the Spending

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President-elect Trump wants a Race Horse Economy, not a continuation of the Plow Horse we've had for the past several years.

Out of all of his proposals, the one that should help the economy the most is corporate tax reform, in particular a big cut in the tax rate on profits to 15% or 20% from 35% at present. Typically, corporate profits are subject to two layers of tax: first, when the company earns the money; second, when that same money flows to shareholders in the form of dividends or capital gains.

So, for example, a dollar of pre-tax profits is reduced to 65 cents at the corporate level and then 49.5 cents if the profits are distributed to high-earning taxpayers. (The 65 cents are taxed at a 23.8% rate, including the Obamacare-surcharge.) In effect, these earnings face an effective tax rate of just over 50% (not even considering state income taxes), likely on the wrong side of the Laffer Curve.

In addition, cutting the top tax rate on regular income should help spur economic growth, as many entrepreneurs and partnerships face very high tax rates as well. Lower tax rates will support a game-changing build-out of domestic energy infrastructure.

But tax policy isn't the only fiscal game in town. Investors need to watch government spending as well. Cutting taxes without getting control of government spending is not a recipe for long-term economic growth. Instead, reducing spending will help entrench expectations that lower tax rates would remain in place.

Every dollar the government spends ultimately has to be paid for by taxpayers, either through taxes today or debt, which simply obligates future taxpayers to make payments to bondholders. Either way, there's no free lunch.

Spending hit a 30+ year low in 2000 at 17.6% of GDP. Now federal spending is at 20.9% (and that doesn't include how Obamacare shifts public spending to private insurers, the true cost of student loans, but does include payments from Fannie Mae and Freddie Mac). We see the heavier load of government as the overweight jockey weighing down the private sector, preventing it from moving faster.

In the next year or so, we'll be looking for entitlement reforms that reduce long-term spending commitments in Obamacare and Medicaid as well as reductions in non-defense "discretionary" spending.

Back in the 1980s, President Reagan not only cut taxes but cut spending relative to GDP as well. President Clinton also cut spending. By contrast, spending went up during the presidencies of both Bushes and under President Obama as well.

So far, President-elect Trump has talked a good game on taxes but has been sending mixed signals on spending. Investors need to pay attention to both.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-3 / 9:00 am	ISM Index – Dec	53.8	**53.6**	54.7	53.2
9:00 am	Construction Spending – Nov	+0.5%	**+0.6%**	+0.9%	+0.5%
1-4 / *afternoon*	Total Car/Truck Sales – Nov	17.7 Mil	**17.5 Mil**		17.8 Mil
afternoon	Domestic Car/Truck Sales – Nov	13.7 Mil	**13.6 Mil**		13.9 Mil
1-5 / 7:30 am	Initial Claims – Dec 31	260K	**262K**		265K
9:00 am	ISM Non Mfg Index – Dec	56.7	**57.0**		57.2
1-6 / 7:30 am	Non-Farm Payrolls – Dec	180K	**156K**		178K
7:30 am	Private Payrolls – Dec	170K	**145K**		156K
7:30 am	Manufacturing Payrolls – Dec	0K	**-2K**		-4K
7:30 am	Unemployment Rate – Dec	4.7%	**4.6%**		4.6%
7:30 am	Average Hourly Earnings – Dec	+0.3%	**+0.2%**		-0.1%
7:30 am	Average Weekly Hours – Dec	34.4	**34.4**		34.4
7:30 am	Int'l Trade Balance – Nov	-$44.7 Bil	**-$44.9 Bil**		-$42.6 Bil
9:00 am	Factory Orders – Nov	-2.3%	**-2.9%**		+2.7%