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INVESTMENTS

December 22, 2017

Tax Reform

Yesterday, Congress passed the Tax Cuts and Jobs Act, which is now being sent to President Trump's desk for a final signature. Some notable provisions affecting corporations are listed below.

- Lowers the corporate tax rate from 35% to 21% permanently, beginning in 2018.
- Allows corporations a one-time repatriation of overseas cash.
- Moves the United States from a worldwide tax system to a territorial tax system.

As noted above, corporations will be allowed a one-time repatriation of overseas cash that will be taxed at 8% for profits invested in real estate and other hard assets abroad and 15.5% for profits in cash, stock, and other liquid assets. Below is a list of the top 20 S&P 500 companies in terms of the size of their overseas cash position with companies that are owned in one or more of our models highlighted in green:

Company Name	Ticker	Cash Overseas	Share of Total Cash Overseas
APPLE INC	AAPL	$252.3b	94%
MICROSOFT CORP	MSFT	$127.9b	96%
CISCO SYSTEMS INC	CSCO	$67.5b	89%
ORACLE CORP	ORCL	$54.4b	82%
ALPHABET INC	GOOGL	$52.2b	58%
JOHNSON & JOHNSON	JNJ	$41.3b	96%
AMGEN INC	AMGN	$35.9b	94%
GILEAD SCIENCES INC	GILD	$27.4b	85%
PFIZER INC	PFE	$22.5b	90%
MERCK & CO. INC.	MRK	$21.9b	85%
COCA-COLA CO/THE	KO	$20.2b	83%
PEPSICO INC	PEP	$15.2b	94%
PROCTER & GAMBLE CO/THE	PG	$15.0b	98%
INTEL CORP	INTC	$13.6b	43%
PRICELINE GROUP INC/THE	PCLN	$12.6b	91%
ELI LILLY & CO	LLY	$9.8b	87%
VISA INC	V	$8.7b	59%
AMAZON.COM INC	AMZN	$8.6b	33%
EBAY INC	EBAY	$8.2b	74%
UNITED TECHNOLOGIES CORP	UTX	$8.1b	85%

Source: Company data, Bloomberg, Credit Suisse estimates

According to a 2017 BofAML Corporate Risk Management Survey, 65% of those surveyed would use the repatriated cash to pay down debt, some of which has likely been issued in lieu of being able to bring their own cash back to the U.S. in a cost-effective manner. Share repurchases (46%) and mergers & acquisitions (42%) were the next two most-favored categories, which may bode well for stock prices.

In addition to repatriation, the tax bill changes the U.S. from a worldwide tax system to a territorial tax system. In the previous system, the U.S. would tax companies on their worldwide income, regardless of where the income was earned, with credits for taxes paid to other countries. This income, however, would not be taxed until it was repatriated, causing these companies to make inefficient financial decisions. If a company earned income in a country such as Ireland, which has a top tax rate of 12.5%, that company would face an additional 22.5% tax if it were to bring those earnings back to the U.S. This additional tax makes mediocre foreign investments relatively more attractive even though the company may have more lucrative investment opportunities in the U.S. This system of taxation has also prompted numerous “corporate inversions,” where companies move their corporate headquarters overseas to avoid the domestic tax system.

The new territorial system is meant to prevent the issues of corporate inversions and the offshoring of income. Under the new system, the U.S. will tax companies on their domestic income alone. Since it considers the location of profits rather than corporate residence, this significantly reduces the benefit of corporate inversions. This also means that U.S. companies would no longer have to pay additional tax on overseas profits when bringing them back to the U.S., promoting domestic investment and expansion.

These benefits have resulted in analysts raising their S&P 500 earnings targets going forward. Analysts from Credit Suisse and JP Morgan have raised their 2018 S&P 500 targets to $3,000 on earnings in the range of $143-155 per share, which represents about 12% upside compared to the close on December 20, 2017*. We are seeing modest increases to 2018 GDP growth forecasts as well, which stood at 2.2% prior to the passage of the reform according to analyst consensus as reported through Bloomberg. In sum, we expect moderate fiscal and economic impacts in 2018 and a potential increase in M&A activity. The market may have priced much of this in already so a return to normal volatility should also be expected after the initial excitement surrounding the new legislation is absorbed.

Please call us if you have any questions and we want to take this opportunity to wish you and your family a happy holiday season.

Sincerely,

Todd Walsh & the ACI Portfolio Management Team