Wentz Weekly

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President Biden Proposes "American Families Plan"

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President Biden made his case on why he wants to raise the capital gains tax for the wealthy to help pay for free preschool, two years of post-high school education, and other socially focused programs. The $2 trillion American Jobs Plan was followed up last week in Biden's address to the joint session of Congress with a $1.8 trillion American Families Plan. The proposal includes $500 billion for education (free pre-k and first two years of college), $450 billion for childcare programs and paid leave, $420 billion to expand the child tax credit, and additional funding for the IRS for stronger enforcement. The plan is to raise $1.5 trillion in tax increases, mostly on capital gains, to partially fund the cost of the proposal. The plan calls for an increase in the top ordinary tax rate to 39.6% from 37%, and for those earning over $1 million raising the capital gains and dividends tax to the ordinary rate of 39.6%, plus the 3.8% Medicare investment surcharge. In this scenario, these individuals would pay more in taxes on investment gains than they would on labor for the first time ever.

Any amount of infrastructure spending from the government should have a positive impact on the economy, but not as big of an impact as the last three pieces of major legislation. In fact, about 34% of all personal income in the past year has come from the U.S. government thanks to the multi-trillion-dollar stimulus bills. The latest package drove personal income higher by 21.2% in March for the largest monthly gain ever, when many of the $1,400 stimulus payment were disbursed. There are still 8 million fewer people with a job than before the pandemic, but those with a job are seeing wages increase at a much faster pace, evident by the 1.0% increase in the month, the strongest gain since 2007. Americans spent some of that money as personal consumption rose 4.2% in the month, the strongest gain since 2009. Spending was strong in items like vehicles, recreational items, and food service accommodations. Americans have a lot of cash to spend as well. The personal savings rate surged to 27.6%, the second highest ever only second to last April's 33.7% savings rate and compared to the pre-pandemic average of 7%. This should support spending for the months ahead, especially on services which are well below pre-pandemic levels and especially with the substantial amount of pent-up demand.

The sharp increase in personal spending drove gross domestic product 6.4% higher on an annual rate in the first quarter. The headline number understates the strength of the U.S. economy in the quarter. Consumption makes up roughly 70% of the U.S. economy and Americans spent 10.7% more in the first quarter than the quarter prior which contributed 7.0% to the headline GDP number. Spending on consumer durable goods such as vehicles and furniture rose 10.8% while spending on services rose 2.2%, typically a strong rate but still below pre-pandemic levels due to continued restrictions in some areas. Investments in residential and non-residential projects rose 10.8% and 9.9% respectively. Inventories, reflecting shortages of key components, and net exports, reflecting strong domestic demand, put downward pressure on the headline number impacting GDP negatively by 2.8% and 0.9% respectively. However, private domestic final purchases, a better measure of domestic demand, rose at a very strong 10.6% pace.

We are now over halfway through earnings season and companies are crushing estimates. As of Friday, 86% of companies are reporting earnings results above estimates, a record, with earnings 23.9% above expectations, which would be the highest earnings surprise on record. In addition, 78% are reporting revenue above estimates, also above the historical average. Earnings are now expected to grow 45.8% in the first quarter, compared with 33.8% a week ago, and 23.8% when the first quarter ended. However, stock reactions have remained muted and some companies have reacted more favorably than others, suggesting much of this has been priced in after strong market gains in the first quarter and some areas of the market have more room to run. As Wells Fargo notes, large cap companies that have beaten earnings estimates have outperformed by just 0.06%, with 51% of those companies underperforming even when exceeding expectations. On the other hand, small cap companies that beat estimates have outperformed by 0.77%, reflecting the likelihood there is more room to go with small caps, another reason we remain overweight small cap U.S. stocks.

Political power and population growth is shifting to states in the South and Northwest and away from the Midwest reflecting population shifts in the U.S. The latest Census data showed the U.S. population stood at 331,449,281 on April 1, 2020 and growth slowed to 7.4% over the last decade for the lowest rate since the Great Depression. The once per decade reapportionment required by the Constitution will result in 13 states losing or gaining seats in the House of Representatives; Texas gains two seats and Colorado, Florida, Montana, North Carolina, and Oregon gain one, while each California, Illinois, Michigan, New York, Ohio, Pennsylvania, and West Virginia will lose one. The new Census data will also be used to determine Electoral College votes, federal funding, private investment decisions and different analysis.

Company News

- Caterpillar said in its earnings call that the semiconductor shortage affecting vehicle production could also affect the company's ability to keep up with customer orders. It is spending more on freight to get goods to factories on time and expects surging prices on steel and other raw materials, but said that is also a positive for its business and as a result refrained from providing profit guidance.
- Nikkei reported Apple is cutting AirPods production by at least 25% due to increased competition. Separately, Apple exceeded estimates in its latest quarter in all business segments.
- Roku saw weakness last week after a report that the company removed the YouTube TV app due to a contract dispute. Axios reported the companies came to a disagreement after claims Google made anti-competitive demands.

The Week Ahead

The calendar remains busy this week with another round of earnings and several economic data releases. On the earnings calendar at least 130 S&P 500 companies will be reporting their quarterly results. Notable reports will include; Estee Lauder and XPO Logistics on Monday; CVS, DuPont, Activision Blizzard, Pfizer, Zillow, Under Armour, and T-Mobile on Tuesday; GM, Uber, Hilton, Rocket Companies, and PayPal on Wednesday; Anheuser-Busch, Square, Expedia, and ViacomCBS on Thursday; and Cigna on Friday. On the economic calendar the week begins with several manufacturing indices along with construction spending on Monday. Then on Thursday the Department of Labor reports initial jobless claims for the week ended May 1. Friday is the most notable economic report of the week, when the Bureau of Labor Statistics releases employment data for April. The report is forecasted to show 938,000 jobs were added in the month, bringing the unemployment rate down to 5.8% from 6.0% in the prior month.

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow" is an index representing 30 stock of companies maintained and reviewed by the editors of the Wall Street Journal. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index. The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system. Every investor's situation is unique and you should consider your investment goals, risk tolerance and time horizon before making any investment. Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. Information contained herein was received from sources believed to be reliable, but accuracy is not guaranteed. Information provided is general in nature and is not a complete statement of all information necessary for making an investment decision and is not a recommendation or a solicitation to buy or sell any security. Investing always involves risk and you may incur a profit or loss. Keep in mind that individuals cannot invest directly in any index. Past performance does not guarantee future results. There is no assurance these trends will continue, or forecasts will occur.