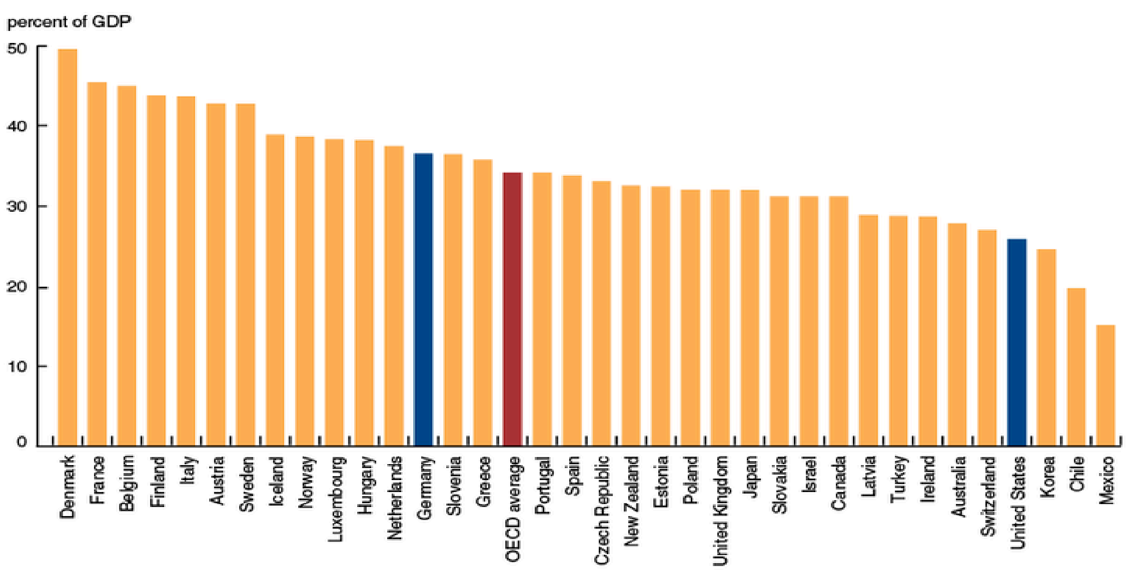
Our clients' attention is becoming increasingly focused on tax reform, as both Wall Street and Main Street digest the details of a tax plan whose details were made public just minutes ago. While the first question for taxpayer's will, understandably, be how the new plan will affect them, the question for investors is to what extent reform and/or tax cuts are already priced into the market.

The strong rally that ensued from the surprising outcome of last November's election was likely the result of increased expectations for, among other things, tax and regulatory relief. At least initially, that was surely the case. As the market has continued to rise throughout 2017, however, there is no discernable evidence that companies most levered to tax reform are outperforming, suggesting that the market is now looking for, at best, a watered-down, drawn-out version of what was originally promised – if it happens at all. In other words, we do not believe that failure to achieve meaningful tax reform would have a major impact on the market at this point. Stock prices are now being driven, not by expectations, but by fundamentals: stronger economic growth in the U.S. and abroad, rising corporate earnings, and a cautious and accommodative Federal Reserve.

There is a growing – and distressing – tendency in our public discourse to conflate tax *reform* with tax *cuts.* Few would argue that our tax code is in need of serious reform. It is maddeningly complicated and increasingly regressive. A simpler, fairer tax system is a noble, but elusive, goal. But there does need to be a serious discussion about whether tax *cuts* are necessary, or even desirable at this point.

Certainly, everyone thinks they pay too much in taxes, and wants their taxes cut. The President has repeatedly stated the need for "massive" tax cuts, both during the campaign and subsequent to taking office, and has consistently maintained that the U.S. is the "highest taxed country in the world."

1. Overall tax burdens in OECD nations, 2014



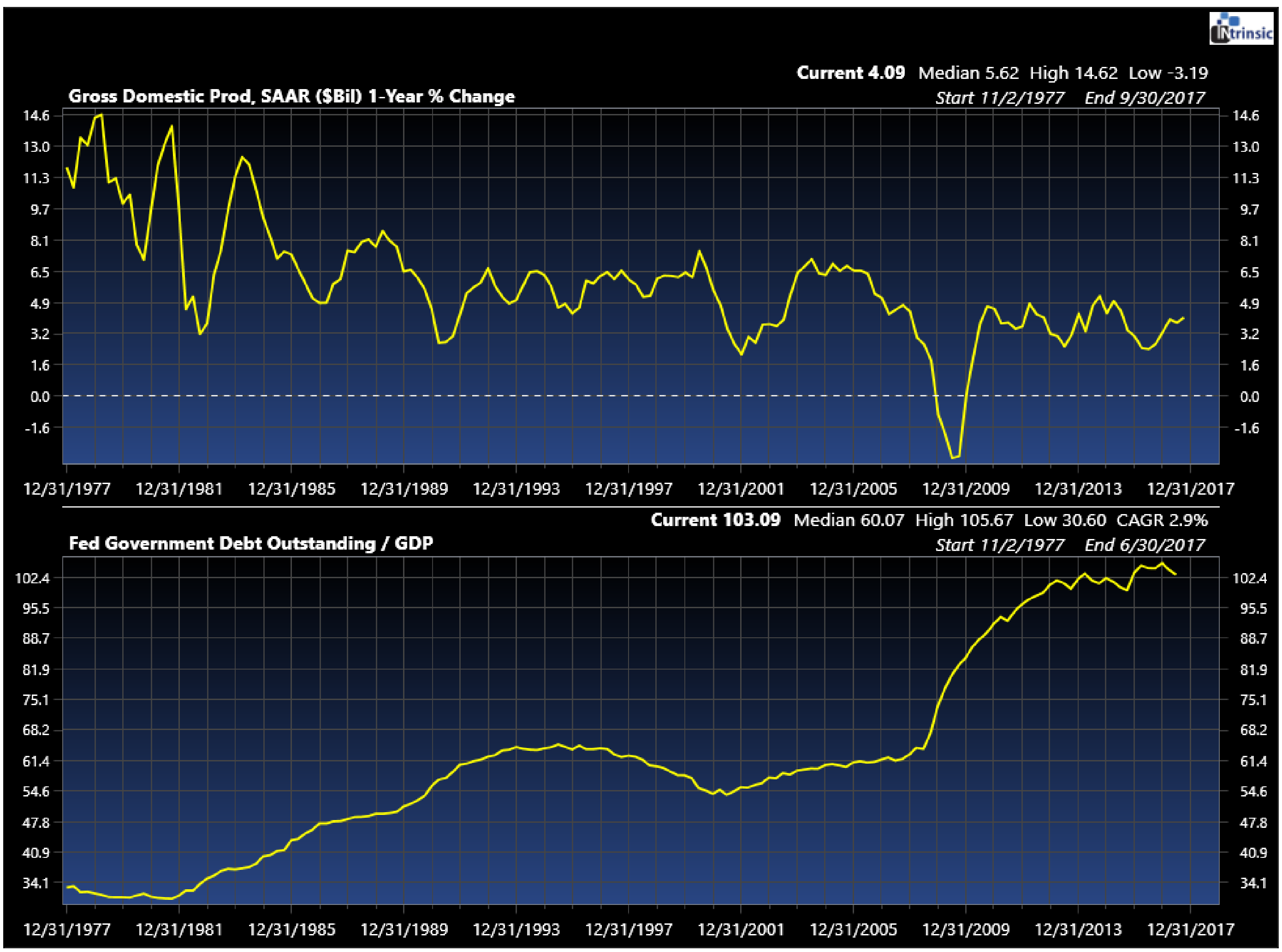
Note: Including social security contributions.
Source: Organisation for Economic Co-operation and Development (OECD).

The foregoing chart, However, showing the overall tax burdens of all of the world's major industrialized OECD nations, evidences the fact that not only is the U.S. not the highest taxed country in the world, but that its tax burden is, in fact, the 4th lowest, greater only than Korea, Chile, and Mexico.

As recently as last week, the President told assembled reporters that "We desperately need tax cuts to put our people back to work." But the fact is that we are already at full employment, and job openings are at record levels. Our biggest problem isn't creating jobs, it's filling them.

Morgan Stanley warned in a report this week that aggressively cutting taxes for individuals and businesses, so late in the business cycle, when we are already at full employment, risks overheating the economy, causing stocks to "boom then bust." The concern, not unreasonable, is that slashing tax rates now would only force the Federal Reserve to accelerate interest rate hikes, which would raise borrowing costs for consumers and businesses (and government!), and bring this economic and market expansion to a premature end.

We cite our concern about raising borrowing costs for government, as well as businesses and individuals, because history has taught us that promoting the supply side effects of tax cuts is a politician's fiction. Believers maintain that lower taxes result in greater economic growth and higher tax revenues. The fact is that tax cuts, even when enacted as a stimulus *early* in an economic cycle, have never paid for themselves. The charts, below, show that the Reagan tax cuts in 1981 and the Bush tax cuts in 2001 did, admittedly,



result in a short term acceleration of economic growth. The lasting effect, however, was to explode the deficit. Federal debt outstanding almost doubled relative to GDP from 1981 to 1993, from below 33% to greater than 61%. The rise in debt vs. GDP in the wake of the 2001 cuts was less dramatic, but their impact on growth was more muted, as well. And it is important to remember that this growth in our Federal debt occurred during a long period of declining interest rates and lower and lower borrowing costs.

To be fair, failure to control the growth of government spending, concurrent with previous tax cuts, contributed immensely to these deficits, but it is difficult to foresee increased spending restraint in the future with our infrastructure in disrepair, baby boomers retiring, and our security increasingly under threat.

Now, largely as a result of the economic and credit collapse of 2008-2009, total government debt outstanding has nearly doubled again since 2001, from 54% of GDP to more than 103%. We should consider the implications of needlessly increasing the Federal debt burden yet again, at a time when their beneficial effects would be minimal in the short term and undesirable in the long term, and at a time when the costs of carrying this growing burden would likely rise.

Responsible and progressive tax reform would be a smart thing to do for the long term health of our economy and our society. But that is different than the massive tax cuts that have been promised, which are expensive medicine to cure ills that don't exist. The President's push for stimulus comes at a time of growing and sustainable economic strength. Unemployment is at a 16-year low and job openings are at a record high. The stock market is soaring, and so is consumer confidence. The economy has enjoyed the best 6 months of growth in the last 3 years.

To all who believe their individual tax burden is too high, we hope that the new tax bill, when and if it is revealed, meets your expectations for fairness. But those investors who are bullish on stocks and the economy in anticipation of "massive" tax cuts should be careful what they wish for.

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