

MACROCOSM

## Drop the BAT and Run

Monday, July 31, 2017

Donald Luskin

In another week of Washington chaos, a protectionist barrier to tax cuts just got removed.

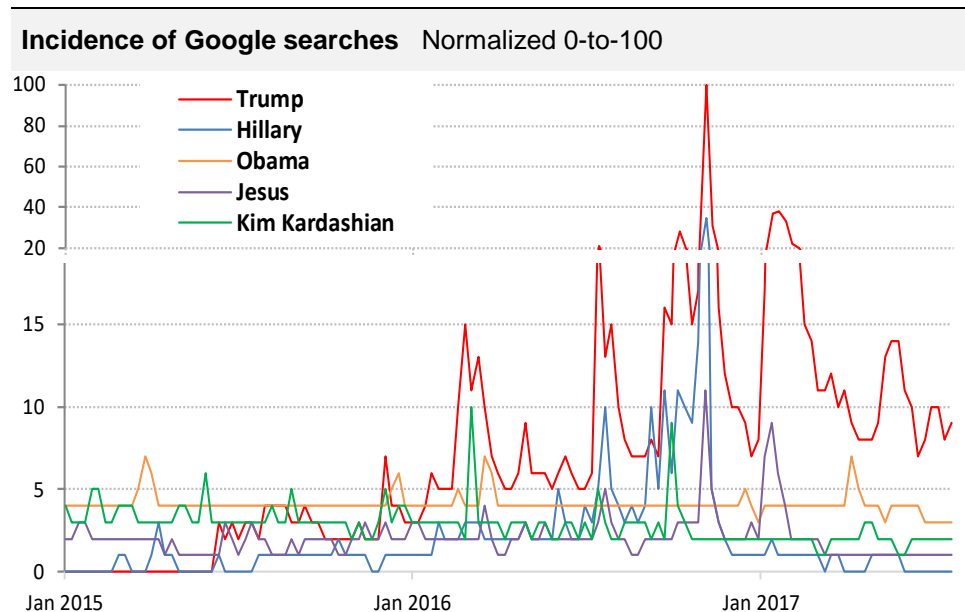
While you were distracted this week – by [Senator John McCain's \(R-AZ\) sinking](#) of what little was left of Obamacare repeal-and-replace, and the [sacking of White House Chief of Staff Reince Priebus](#) after ([or was it before?](#)) [White House Communications Director Anthony Scaramucci told](#) a *New Yorker* reporter, among other things, that White House Chief Strategist Steven Bannon is capable of [strange acts impossible to other men](#) – *you may have missed a critical development in the progress of pro-growth tax cuts. House Speaker Paul Ryan (R-WI) and Ways and Means Chair Kevin Brady (R-TX) announced on Thursday that they have, at last, formally abandoned their insistence on the “border adjustment tax” as part of tax reform.*

- [In a statement](#) Thursday afternoon, the “big six” tax reform working group said “there are many unknowns associated with it and have decided to set this policy aside in order to advance tax reform.”
- Good riddance. The protectionist BAT is disruptive and anti-growth (see [“For Free Traders, Trump's Corporate Tax Cut Is the Better Way”](#) January 18, 2017). We predicted all along that it would ultimately be dropped from tax reform (see [“The Border Adjustment](#)

### Update to strategic view

**US MACRO, FX, US STOCKS:** The “big six” tax reform working group announced Thursday that Ryan and Brady have officially given up the “border adjustment tax” idea, as we predicted they would have to. USD has made a round-trip from its May 2016 bottom when Trump clinched the nomination, having appreciated because of false fears of the BAT, and is now in equilibrium. Dropping the BAT eliminates a protectionist threat, and removes a major bone of contention in tax policy, which clears the path for tax cuts in Congress this year. This would be an upside surprise for markets. Despite seeming chaos in Washington, US stocks are on track for a 2017 total return of 20.9%, twice the historical average, and risk premia are lower. Technically, a correction is overdue. But risk-tolerant markets can handle the chaos of the Trump infamy ecosystem. It is informationally efficient to reveal distasteful processes that were there all along, but concealed.

[\[Strategy dashboard\]](#)




Source: Google Trends, TrendMacro calculations

[Tax and Its Victims](#)” February 10, 2017).

- By the way, it is notable that the US dollar – as we predicted at its early January top (see [“Our Contrarian View on the Dollar”](#) January 5, 2017) – has now made a round-trip all the way back to its May 2016 low, when Donald J. Trump first clinched the GOP nomination. In January, a key bull case for USD was that the protectionist BAT would increase overseas dollar demand and reduce domestic FX demand. But no BAT, no case. *At the moment, we have no reason to think that USD is not in equilibrium.*
- USD gradually giving up its “BAT premium” all year might simply have been an appraisal of the increasing likelihood that the protectionist idea would be dropped. But it could also be an appraisal that tax reform of any sort is increasingly unlikely, versus the heady expectations immediately following Trump’s surprise election victory, in which case the BAT would be thrown out with the bathwater. *This tends to reinforce our view, based on months of client conversations pointing in the same direction, that tax cuts are substantially no longer anticipated in market prices, so any type of tax reform or tax cuts would be an upside surprise* (see, among others, [“The Trump Trade is On, Not Ossoff”](#) June 21, 2017).
- *Such a surprise is far more likely now with the BAT gone. It was always a deeply divisive issue for the GOP, favored by a powerful coterie within the House, but loathed throughout the Senate. For tax reform, or just tax cuts, the road is cleared.*

“Cleared”? It seems that nothing is clear at all in the present cacaphonic environment in which Donald J. Trump has become without doubt the most famous person who ever lived (please see the chart on the first page). His fame is the heart of an ecosystem self-perpetuated by the lust for power by politicians on both sides of the aisle, and the lust for audience by the media both liberal and conservative. The [apex predator](#) in this ecosystem is Trump, who controls it all by following [Roger Stone’s rule](#) that “it is better to be infamous than not to be famous at all.” *That’s not a recipe for clarity. Indeed, it deliberately produces cognitive dissonance.*

- For investors, a key dissonance seems to be – based, again, on conversations with clients – that all of the pro-growth hopes and dreams that flourished right after Trump’s surprise election have now been crushed by [the swamp](#), and Trump’s own seeming self-destructiveness.
- Oh, really? The total return of the S&P 500 since the election is 17.2%. Stocks are still at all-time highs, and the S&P 500’s total return in calendar 2017 alone – while those hopes and dreams were supposedly being broken – is running at an annual rate of 20.9%. It might be a stretch to say that means *US stocks have been getting more, not less, enthusiastic about pro-growth hopes and dreams. More likely, in our view, it is a rational recognition that, since*



Donald J. Trump ✓  
@realDonaldTrump

Highest Stock Market EVER, best economic numbers in years, unemployment lowest in 17 years, wages raising, border secure, S.C.: No WH chaos!

7:28am · 31 Jul 2017 · Twitter for iPhone

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## Recommended Reading

### [The Turn to “Effective, but we don’t like it.”](#)

Scott Adams  
*Scott Adams’ Blog*  
July 30, 2017

### [Onion Fact Checks: Anthony Scaramucci’s ‘New Yorker’ Interview](#)

*The Onion*  
July 27, 2017

### [Health Care is a System, Not a Goal](#)

Scott Adams  
*Scott Adams’ Blog*  
July 28, 2017

### [House Conservatives Target Jobs at Congressional Budget Office](#)

Katrina Willis  
*Daily Signal*

Trump took office, many pro-growth hopes and dreams have already become reality.

- We're not trying to be either cheerleaders or partisans here. But it's a reality that a great deal of pro-growth [progress has been made](#). Don't fool yourself by falsely remembering that any of these things was easy to do, or could have been taken for granted in advance.
  - ✓ Nuclear option puts Neil Gorsuch on Supreme Court
  - ✓ Won four-for-four special Congressional elections
  - ✓ Deregulators in charge: Pruitt, DeVos, Perry, Scott, Pai
  - ✓ Approved pipelines
  - ✓ One-in/Two-out new regs order
  - ✓ Repealed 14 Obama-era regs with Congressional Review Act
  - ✓ Pulled out of Paris Accord
- There are more – some would be seen as positives, some as negatives, depending on your views on various social or geopolitical issues – but these are the *economically* important ones. At the same time, Trump's record on trade has been an upside surprise, all the more so because while he has kept one harmless protectionist campaign promise, he has broken a conspicuous one that would have been especially damaging.
  - ✓ Pulled out of Trans-Pacific Pact
  - ✗ ~~Declared China a currency manipulator~~
- So far so good (see ["Which Trump Will Americans Get?"](#) November 10, 2016).
- "Believe me," as Trump would say, we ourselves struggle with fear and despair every day amidst the [apparent political chaos](#). Sometimes we wake up in the middle of the night, knowing that stocks are at all-time highs and that risk premia, by some measures such as VIX, are at all-time lows, and that there has barely been a single 3% stock market correction since Trump took office (see ["A Trump Correction at Last?"](#) March 3, 2017). How can you not want to run for cover?
- To be sure, there's a strong technical argument that a correction of some sort is in order, for any reason or no reason. And we suppose we can think of reasons (see ["Some Thoughts on North Korea's Nukes"](#) July 10, 2017). But if we've learned anything after all these years, it's that those fearful impulses that wake us in the middle of the night are not very good indicators. Indeed they may be *contrary* indicators. But let's not go down that rabbit-hole of trying to stand outside one's self to use one's self as an indicator.
- We strongly caution against letting the cognitive dissonance that arises from the Trump infamy ecosystem induce undue fears.
- The Scaramucci call to *The New Yorker* is a good case in point. It's not unusual that a White House communications director would call

a hostile reporter trying to track down a leak. And it's probably not unusual for politicians to use strong profanities and personal insults against colleagues when speaking to reporters. We can tell you from personal experience that [the wildly profane but wildly hilarious television show Veep](#) is closer to reality than most people care to let themselves realize.

- What's unusual is for a reporter, who surely agreed that this conversation would be off the record, made it public nevertheless. This suspension of journalistic ethics is now [the new self-admitted norm](#), a version of martial law supposedly justified for [the media's self-avowed mission](#) against Trump. But whatever *The New Yorker* reporter's high-minded justification, betraying Scaramucci's confidence was simply a selfish economic necessity in the Trump infamy ecosystem.
- *What is happening here is that the swamp hasn't gotten drained yet, but we are seeing it more clearly than ever before.* You can tell yourself that things are actually worse now, but we think the truth is that you are just seeing for the first time distasteful realities that have been there all along. *What's changed is the economic equilibrium. Previously, it was in the mutual interest of politicians and the media to present a false image of calm and control – now, it is in their mutual interest to present an image of chaos, which may itself be just as false, or may be true at least to some extent, and yet no worse than the past.*
- In an efficient markets framework, we have to see these seemingly disturbing developments as a step-function gain. *How can it not improve informational efficiency to have, at the same time, less of the unsightly political process concealed, and more visibility on the intermediation process by which the media presents it to us?*
- We continue to believe that narrowing risk premia, in the face of so much apparent chaos, is an indicator of a sweeping cultural ["turning"](#) toward greater risk tolerance (see ["2017: It's Bigger than The Donald"](#) December 30, 2016). It is playing out in seemingly chaotic pro-growth political experiments here and around the world – including India, the United Kingdom and France, among others.
- This is why, while it may seem that the Not So Great Expansion following the Great Recession would seem to be overextended, stock markets globally have moved aggressively this year to all-time highs or recovery highs, and at the moment forward earnings are on a strong upward path everywhere but China.
- Sure, corrections are inevitable. Again, one is overdue. One could happen at any time for any reason, or no reason. But that's just noise. The signal is that you have a choice here, as you look in horror at the evening news each night. *Who are you gonna believe? The markets, or your lying eyes?*

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## Bottom line

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because of false fears of the BAT, and is now in equilibrium. Dropping the BAT eliminates a protectionist threat, and removes a major bone of contention in tax policy, which clears the path for tax cuts in Congress this year. This would be an upside surprise for markets. Despite seeming chaos in Washington, US stocks are on track for a 2017 total return of 20.9%, twice the historical average, and risk premia are lower. Technically, a correction is overdue. But risk-tolerant markets can handle the chaos of the Trump infamy ecosystem. It is informationally efficient to reveal distasteful processes that were there all along, but concealed. ▶