Boenning Morning Comment

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Stocks closed mixed on Friday. Once again, the leaders were tech and the laggards were energy as oil prices continued to fall.

All eyes this week will be on Washington where Republicans try to push through its version of Obamacare repeal and replace. Because of arcane Senate rules, to get a bill passed in the Senate by simple majority, the Republicans have to use a procedure labeled reconciliation which limits the scope of legislation strictly to content with fiscal implications. Moreover, the budgetary impact of those changes over the next 10 years has to be within a tight range. Simplistically, under the bill presented last week and likely to be scored by the Congressional Budget Office as early as today, the bill is likely to have a net positive budgetary impact over the next decade with the loss of revenues from tax cuts and tax credits offered to certain users offset by a sharp reduction in the level of Medicaid support versus levels that exist under current law.

As you might expect, the bill is highly partisan and statements made both in support and against the bill are both partisan and distorted. For instance, under the current proposal, which almost certainly will be modified as many amendments get offered and voted upon this week, Medicaid support will be higher a decade from now than it is today. However, it will be substantially less than it would be if Obamacare were left in place. Thus, conservatives make the point that they aren't trying to cut Medicaid while liberal opponents point to the sharp drop in Medicaid spending over the next decade if the bill passes. It is all a matter of words and spin. Moreover, the bill as designed will not kick in earnestly until 2020 or later. This is obviously intended to coincide with the election cycle. Voters vote less based on media rhetoric and more on their wallets. If they feel better off, they vote for incumbents. Thus, Republicans hope that the bill will offer more insurance choices while moderating the increases in health care and insurance premium costs between now and the 2020 election. Only time will tell whether they are right or not. Whatever one's current opinion of Obamacare may be, it certainly hasn't been successful in reducing premium costs and the Exchanges set up by the law aren't working as planned. On the other hand, many of the bills positives have been well received particularly by those with preexisting conditions and significant health care issues.

The current bill has its pros and cons, just as Obamacare did, and it will be viewed differently through different lenses. As everyone knows now, Republicans will get no Democratic support and, frankly, doesn't deserve any since Democrats were completely left out of the process of drafting the bill. Senate leadership, probably rightfully so, concluded early on that there wasn't a Democrat who would vote to repeal President Obama's signature legislation no matter what the bill included. Be that as it may, Republicans will take ownership of healthcare from here forward, for better or worse. It will be a central issue of the 2018 Congressional mid-term elections.

Right now, there are handful of Senators, mostly conservatives, who have said they cannot vote for the bill in its current form. There are also a handful of more moderate centrists who have expressed serious concerns. Obviously, amendments to placate the conservatives will only add to the angst of the moderates. Given the bill can't pass with three negative Republican votes, the jury is still out whether the party can coalesce the 50 votes needed for passage. For those Republicans who choose to vote "no", the alternative is to keep Obamacare in its current form unless, of course, the party circles back at some point with some other alternative. In Washington, you can put a lid on a coffin but you never nail it shut.

Economically, most don't expect the possible passage of the Republican bill to have a meaningful impact on GDP over the next few years. The benefits from high income and investor class tax cuts will be offset by reduced spending from those who get less government support to cover their medical expenses. To be sure, there will be winners and losers within the healthcare sector, but for all other industries, the impact will be muted at least for the next 2-3 years.

With that said, this bill does take on importance. The key fiscal reform the Trump administration is seeking is tax reform. As will the health care bill, Republicans will seek to use the reconciliation process once again in order for legislation to pass the Senate with just 50 votes. As with all bills using reconciliation, tax reform will be required to be scored close to revenue neutral. Given that the healthcare bill lowers entitlement spending from its current glide path and has included within significant tax cuts already, passage of the current bill will lower the bar for tax reform and make the process significantly easier to score the next bill in a manner that conforms with the reconciliation process. If that sounds a bit arcane, it is. But that is how Congress works. Unless Republicans comply, they will be forced to go the traditional route that requires 60 votes. One can argue that a strong bi-partisan bill might, ultimately, be a better bill but the reality of the moment is that Republicans and Democrats can't agree how to pronounce tomato much less solve a problem with even a smidge of difficulty.

Said more simply, if health care reform fails to pass, the odds for tax reform, infrastructure spending or any bill beyond the naming of a new post office decreases. Said in even more simple terms, if Republicans can't pass health care reform, we are back to the same old gridlock and Republicans will have to explain to constituents in the 2018 mid-term elections how a Republican controlled Senate, House and White House still can't get anything done. That isn't a good message and every Senate holdout realizes exactly what I just said.

Senate leader Mitch McConnell wants to hold a vote this week before the 4th of July recess. That is an aggressive target but not impossible. More likely is that the impasses will appear insurmountable, everyone will go home for a 10-day recess allowing time to hear from constituents, and then return to revisit the issue again in mid-July. That still leaves time for the Senate to vote and Congress to reconcile the House and Senate versions before the much longer August recess. If Congress can't complete healthcare by August, the bill may get delayed much further given the overriding importance in September to pass spending and debt limit expansion bills necessary to keep the government running past September 30. That would make any thought of tax reform this year much less likely.

Thus, the bill is very important, not for its direct impact on GDP but for its importance to move the Trump economic agenda forward. In Washington, it always looks darkest before the dawn and this won't be any different. For the next 2-3 days at least, all chatter will be negative…from both sides.

From an investor standpoint, if the bill passes, Wall Street will likely celebrate a little bit because the odds for tax reform will increase. But given that tax reform is not imbedded in stock prices today, failure to get it done by Friday may not lead to a violently negative reaction. As has been the case so far this year, Wall Street has looked through the noise in Washington and concentrated on what it views as most important, namely earnings, interest rates and inflation expectations. Earnings are doing fine, both here and overseas. Interest rates are relatively stable right now and inflation expectations have been falling. Perhaps the biggest short term risk isn't what happens in Congress this week but the recent decline in oil prices. If that accelerates in the weeks ahead and oil breaks below $40 in a convincing fashion, investors may fear a further reduction in economic activity that could feed into earnings once again as it did in late 2015 through early 2016. That isn't a prediction but a warning. In other words, while most eyes will be on Congress this week, keep yours focused where they need to be, on events that move markets.

Today, Ariana Grande is 24. Derek Jeter is 43.

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