

Boenning Morning Comment

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Markets were quiet on Friday as more traders were focused on Irma rather than stocks or bonds.

Irma certainly packed a wallop. As many as 8 million people lost power. Storm damage costs to private insurers will range into the tens of billions of dollars. Total storm costs may approach or exceed \$100 billion. Yet it could have been worse. Indeed, markets feared the numbers would be even higher. It seems perverse that stocks can possibly rally after such a devastating storm but, as we learn all too often, the stock market is about facts versus expectations. We have all seen stocks fall on good earnings that fell short of expectations or rise when the bad news was less bad than the forecast. This morning you will see the same principal in play again.

But after this morning, we have to, once again, take a longer picture. With all the pivoting and talk last week in Washington, the real question is, "What has changed"? So far, the answer is nothing. Congress is back in session and leadership is trying to talk up tax reform. As we discussed last week, however, the early conceptual thoughts that make so much sense get dissected when we see the details. So far, there are precious few details. Despite the fact that some, like Treasury Secretary Mnuchin or even President Trump promise details within a couple of weeks, at the moment there aren't any details.

In tax reform, there are obviously two sides, the tax cuts and the measures to raise offsetting revenues that will all some sort of balance. The cuts are the easy part. President Trump still talks about 15% for Corporate America and major cuts for individuals. No one, however, can square those numbers with any reasonable revenue offset. Since tax legislation starts in the House Ways and Means Committee, per the Constitution, early trial balloons for revenue raising often come from Ways and Means Chair Kevin Brady. His first attempt was a border adjustment tax akin to the value-added tax used so prevalently around the world. That died rather quickly as retailers and others dependent on imported goods screamed loudly. The most recent idea was to disallow interest costs to be deducted by corporations. That has generated almost immediate vociferous opposition. Indeed, you can bet that every revenue raising idea will see stiff opposition from some major group. Remember, my loophole is your deduction.

Some ideas haven't been totally discarded. Removing the right to deduct state and local taxes is still on the table. Capping mortgage interest is still an open idea. Taxing some or most pass-through income at non-preferred rates is another idea that might stick. But all of these and a few more are not enough to get tax rates down very far.

Republicans know they badly need to get something done. Indeed, Democrats know that if there are strictly obstructionist, that approach won't be well received either. At the same time, politicians have to listen to their respective bases. Obviously, the base of a Republican from the rural South is different than a Democrat representing a wealthy district in urban centers. But there are common grounds. Indeed, if tax legislation is to pass, it must be built on that common ground.

Essentially, there are three forces competing. The progressive Democrats want any tax breaks to favor low and middle income families. Conservatives want both lower taxes and lower spending. Low taxes are great but a balanced budget is even better. Finally, there is the populist core that elected Donald Trump. They have watched

the rich get richer for a few decades and feel that government hasn't been working for them. This is the core to which the message "Make America Great Again" resonates the most. They don't understand how cutting corporate taxes helps them. This is where the messaging comes in. They do understand, bringing jobs home, for instance. To them, the perfect recipe is more growth and less taxes for them, not just the companies they work for. In many ways, this populist core and the goals of the progressive Democrats aren't all that far apart. Perhaps that is why Trump pivoted, at least for the moment, last week. Trump isn't getting into bed with the Democrats. He was and is his own voice. But his ideas and those of the Freedom Caucus are far apart. At least when it comes to tax reform, bipartisanship may be the only solution.

Some suggest that Trump threw Speaker Ryan and Majority Leader McConnell under the bus last week. That is probably a huge overstatement. He certainly pulled the rug out from other them getting a bill passed quickly to defer the national debt and spending issues for a couple of months while getting at least some relief for storm victims. Trump has to know that, given the fact that Republicans control both chambers of Congress, they are still going to be in control of the legislative process. But with that said, he has tried to stay Republican for almost nine months with no tangible results and anyone could see the outsized power of the Freedom Caucus to squash legislation if one was going to pursue a Republican-only game plan. Not only does Trump agree with his populist center that they must be major beneficiaries of any tax reform but he strongly favors growth over deficit reduction. That puts him directly at odds with the Conservatives, so much so that it would seem unlikely that legislation could pass if the Conservatives as a block oppose the idea of raising the deficit in the early years of a program.

None of this makes tax reform any easier. So far, the writers of the game plan are a group of center-right Republicans. No matter how they begin, they will get almost instinctive opposition for both Democrats on the left and Conservatives on the right. They will also get strong lobby opposition from groups hurt by whatever revenue raising ideas they present. To withstand that pressure and move the process forward, they have to be unified and they will need both strong and persistent support from the White House. Tweets lambasting Congress for not getting something on Trump's desk to sign will get the same end result as healthcare reform. Stump speeches to his acolytes won't be enough either. Trump will have to stand up to the lobbyists, cajole votes from the center-left and from some more moderate Conservatives to have any chance at all. In other words, he has to be all in. There is no other way tax reform will pass.

Can this happen? Of course it can. But evidence to date doesn't support a lot of optimism. Trump has yet to show a desire or willingness to get involved in the nitty gritty details. He wants a win as much as anyone else. Perhaps this is the issue that will force him to change. History labels that a hope more than a prediction.

Today, Taraji Henson is 47. Harry Connick Jr. is 50.

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