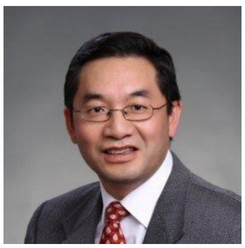
1/10/2018 Julex Capital Management, LLC. Volume 1, 2018

TACTICAL INVESTMENT INSIGHTS

IMPLICATIONS OF GOP TAX BILL FOR EQUITY SECTORS

Henry Ma, Ph.D., CFA
President and Chief Investment Officer



The GOP Tax Cuts and Job Act was passed in the Congress and signed into law by the Trump Administration. The bill marks the largest tax overhaul in thirty years since 1986. Although the timing and fairness of the tax cuts are debatable, the bill will provide a boost to corporate earnings, and thus the stock markets. The permanent corporate tax rate reduction from 35% to 21% and 20% deduction on passthrough income will help US businesses and shareholders. But the effect will vary across different sectors, industries and companies. In general, the companies that generate most of their profits domestically and pay the highest effective tax rates will benefit the most. However, some details of the act may have positive or negative impacts as well. Here are some of the implications for each sector.

Consumer Products: The bill is a win for the consumer products and retailers, especially the consumer discretionary sector. They pay some of the highest tax rates because many generate the majority of their income domestically. In addition, lower individual taxes will be likely to boost the demand for their products and services. The tax cuts for the wealthy may foster consumption on luxury goods and other discretionary spending.

Energy: Many oil/gas production and exploration firms may not be able to benefit much because they are not profitable. However, the energy infrastructure firms, often organized as master limited partners (MLPs) may benefit from the lower passthrough taxes.

Financials: Financial services firms normally pay high taxes because they mainly serve domestic customers. The corporate rate cut will help banks compete internationally. The repatriation of overseas cash may generate more M&A transactions and investment banking businesses. Asset and wealth managers are likely to see more money inflows because the bill reduces individual taxes.

Healthcare: The bill is not a clear win for healthcare. Health insurers and hospitals, normally pay high taxes, will get significant deductions. However, the removal of Obamacare individual mandate is likely to decrease the number of insured people, which means fewer paying customers for hospitals and other healthcare providers.

Industrials: Transportation and trucking will benefit the most. According to an economic study at New York University, the average effective tax rate for all the profitable firms is 35.96% for trucking industry and 33.29% for transportation.

Materials: Metals and mining companies are among the highest tax-paying firms. The bill is a clear win for them. On average, they are paying 42.30% effective tax rate.

Real Estates: The bill will reduce the limit of mortgage interest deductions from the loan amount of $1MM to $750K. In addition, the total combined deductions on state and property taxes will be capped at $10,000. These provisions may have negative impacts on the house prices especially in the areas like California, New York and New Jersey where the house prices are high.

Technology: Large tech companies like Apple, Microsoft and Google have the largest stockpiles of oversea earnings and cash. The bill will allow for one-time tax rate of 12% on cash returns and 5% on non-cash for corporate money repatriated from overseas. Many tech companies may take advantage of new rule and bring the money back to the States. It is likely to see more M&A activities in the tech industry.

Utilities: Lower corporate tax rates and new depreciation rules will make more capital available to utilities firms to invest in infrastructure. The bill includes a bonus depreciation extension that will allow companies to deduct 100% of the cost of capital projects from their taxes in the first year, rather than deducting smaller amounts over a few years.

Small-Cap Stocks: Small-cap firms normally generate larger part of their profits domestically relative to their large cap counterparts. According to BOA Merrill Lynch, small-cap companies in the Russell 2000 have an effective tax rate of 29.7%, compared with 26.9% in the S&P 500. It is expected that the corporate tax cuts will benefit small-cap companies more. However, there is one caveat here. The bill will limit interest expense deductions to 30% of adjusted income. On average, small-cap firms have higher leverage, and thus more interest expenses. The debt/equity ratio for Russell 2000 index is 121% vs. 95% for S&P 500 Index, according to the latest data on FactSet.

Julex Capital Management is a SEC-registered quantitative investment management firm specializing in tactical and factor-based investment strategies. The firm offers a variety of tactical unconstrained investment solutions aiming to provide downside risk management while maximizing the upside potentials using its unique Adaptive Investment Approach.

40 Grove Street, Suite 140
Wellesley, MA 02482
781-489-5279
Henry.ma@julexcapital.com
www.julexcapital.com

JULEX
CAPITAL MANAGEMENT