# THOUGHTS FROM THE FRONTLINE

# Thoughts from the Mailbox

By John Mauldin | May 4, 2018

*Photo: Getty Images*

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Since last week's letter, I have flown enough to send me over 100,000 miles on American Airlines this year and make Executive Platinum. That is not necessarily a good thing. But wow, I learned a lot between all those flights.

Today's letter will be a little different. First, I want to relate some of the conversations I've had over the last week in my travels—a little glimpse into the life of John. Then I'm going to reproduce some recent letters from readers, with some *mea culpas* and comments from me. I literally get dozens and sometimes hundreds of interesting letters each week. They make me think and I read as many as I can. I think you'll enjoy them.

People often ask what I do on my travels and what it's like to sit in dinners with serious market thinkers. So, let me tell you about my week. On Tuesday night, I had dinner with…

- Art Cashin of UBS and CNBC fame, the world's finest raconteur and senior statesman with exhaustive knowledge of all things markets. He was literally working on the exchange floor in the 1950s;

- Peter Boockvar, one of the best data slicer-dicers anywhere, who writes several letters every *day* covering markets and the latest economic data;

- Lakshman Achuthan, founder of the Economic Cycle Research Institute and *the* guru on economic cycles. Membership to his "club" costs well into six figures yearly. I went by to see him and some of his team before dinner;

- Randall (Randy) Forsyth, lead columnist at *Barron's* who has ably filled the venerable Alan Abelson's shoes;

- Barry Habib, who, according to Zillow, is the country's top housing and mortgage analyst;

- Brent Donnelly, Forex maven extraordinaire; and

- New friend Jonathan Golub, Chief US Equity Strategist at Credit Suisse.

I know you really wanted to be at that table, so let me tell you what I learned.

I like to ask questions when I can get a group like this together. First question, at least the one at the top of my mind: When will the next US recession start? The average prediction was for the second half of 2019—just in time for 2020 US elections. Jonathan was the outlier, being certain it will be 2022. There were a couple of late 2018 guesses. Lakshman thinks the economy is beginning to cycle down but probably not enough for a recession this year.

My own vote is for late 2019, though I may turn more bullish as medium-term data comes in. I don't foresee a recession beginning this year unless something new and serious happens.

Peter made an extraordinarily cogent comment that I'm going to use from now on: "We no longer have business cycles, we have *credit* cycles." That means we have to pay even more attention to Federal Reserve policy. Will they continue to raise rates and reduce their balance sheet, and thus shrink the global money supply? Most everyone at the table was unhappy to see the Fed reducing assets at the same time they are raising rates. Throwing two variables into the mix when we don't understand either's effects is too risky.

The Fed has put itself in a box. If they back off, maybe they can postpone recession for a while but not forever. However, staying on course will risk inverting the yield curve. If a recession does begin this year, I will blame the Fed for this double-trouble strategy.

Randy and I both agreed, and a few others nodded along, that debt and deficits are the bigger long-term issue. Few see the connections between debt and GDP growth, and we are getting to the point where it will start being a drag.

Though we mostly agreed that this recovery is closer to its end than the middle or beginning, some think we could see an upside market blow-off first. It would be a final gasp, similar to what happened after the yield curve inverted ahead of the last two recessions. Stock investors ignored it until they had no choice. And as I wrote last week, we don't *have* to see an inverted yield curve for there to be a recession.

So that was Tuesday night. The next morning, I had the honor of meeting Howard Marks of Oaktree Capital along with some of his team. I was blown away by what a nice guy he is, aside from being one of the greatest distressed debt investors ever. Howard will be at my conference next year, which I can already tell you will be the best ever. Put it on your calendar: May 13–16, 2019 in Dallas.

Then I met with Dr. Mike West and Al Franken (not the comedic ex-senator but one of Mike's board members at BioTime). We talked about Mike's relentless pursuit of Induced Tissue Regeneration. I truly believe the biotech revolution will restore older adults back to age 25, at least physically. Further, I think it will happen sooner rather than later, possibly within our lifetimes. The process will spin off many beneficial technologies and cures on the side, too. We spent three hours talking about their work and other issues. As you can tell, I have been Mike West's biggest fanboy for well over a decade, as well as a close friend. This meeting left me more enthusiastic than ever about this technology.

That night, I was supposed to meet Ian Bremmer, NYU professor and head of the Eurasia Group. The plan was for drinks after he got off a plane from London. But as I was in the taxi, he sent me an email saying he had just learned his book made the *New York Times* bestseller list, and his wife wanted to cook dinner and celebrate at their home.

So instead of getting maybe thirty minutes with Ian, I ended up being hosted for three hours. As I mentioned in my last ever *Outside the Box*, I think Ian's new book, *Us Versus Them*, is extremely important. You can read it in four hours and I insist you do. I don't pound the table about books very often, but this one is critical. It resonates with my own thoughts on our society's fragmentation and we need to wrestle with it.

We had a lot to talk about, but we especially celebrated getting that *New York Times* bestseller designation. Every author knows that is special. For those of us who sweat and labor over books, it validates our effort. I can tell you from personal experience, and talking with other writers, that the moment when you hear you made the list is truly emotional.

Iceland was amazing. I am paying more and more attention to the whole Bitcoin and blockchain world. It is still a young industry but already producing things like football-field-sized server farms—with much bigger ones coming all over the world. There's plenty of danger and downside, too. This needs a longer story and a whole letter.

## Trade Talks

So that was my week, in between flights. Now let's open Thoughts from the Mailbox. A couple of notes:

- We did some light editing for space and clarity.
- We *didn't* verify the factual assertions in these, so read with caution.

Some of these readers disagree with me. That's fine and I still appreciate them. I've been known to make mistakes before… and even when I'm right, being challenged keeps me on my toes.

This one responds to my April 20 letter, *China Plays it Cool*.

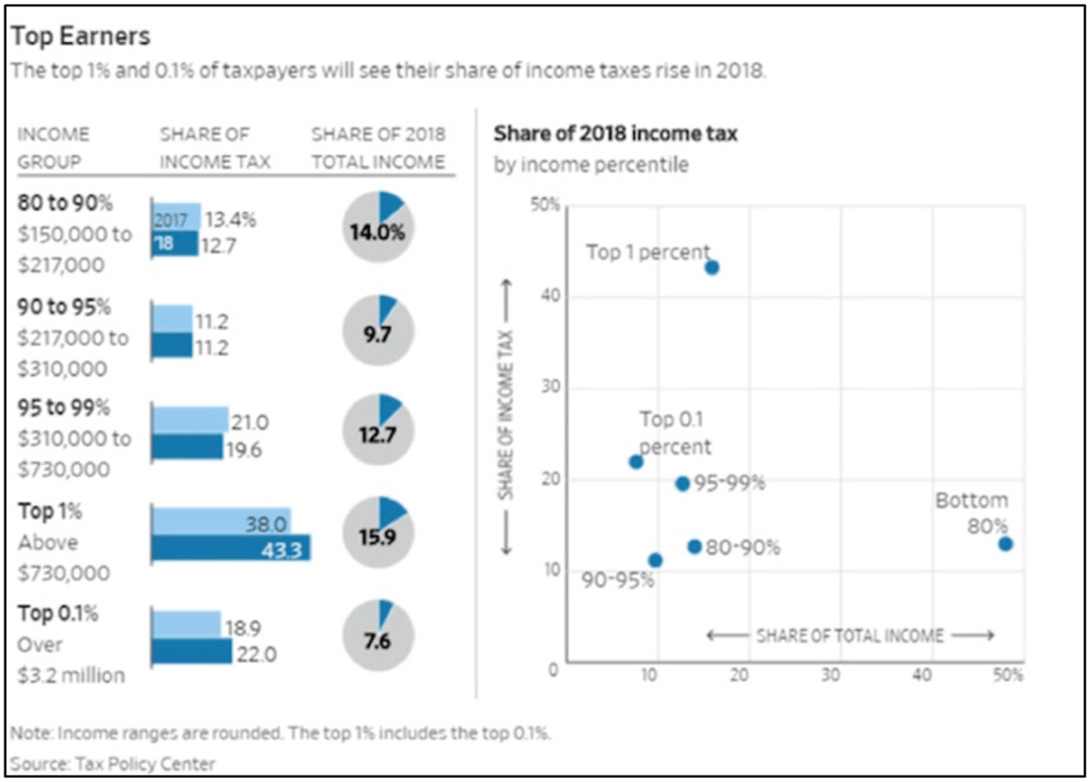
> *Dear John,*
>
> *What a thoughtful article! I invested in a cross-border venture capital fund in China years ago, and while I've not been active there recently, here are some supplementary observations for your consideration:*
>
> - *Chinese communal values are fundamentally different. You can never escape your family and your race. The population is predominantly Han Chinese. The idea of rebelling as individuals if faced with injustice is novel, while it does happen from time to time. This supports the long-term thinking you are describing.*
> - *The biggest underutilized edge we have is multiculturalism. This is also what keeps Silicon Valley ahead and why Silicon Valley pulled ahead of Route 128 in Boston.*
> - *Time is important, such as with WTO penalties for China. This is where US politics and economic ignorance plays a part. Today we have an advantage, but it is rapidly slipping away.*
>
> *Thanks as always for a fab newsletter! —**Faruq A.***

## Tax Trouble

This one came in response to my April 14, *How to Get Your Tax Weekend Back*.

> *John,*
>
> *I think you should explain a little more why you think the taxes of the top 1% will increase. Their rate dropped. Perhaps the ones living in New York and California will have higher taxes because of the loss of state tax deductions, but elsewhere they will be going down.*
>
> *Also, who owns the corporations whose taxes were cut? It's the wealthy. The cuts increase the value of their stock through higher earnings and the stock buy-backs enabled by the additional liquidity. I am an owner of a pass-through company. I've been told by my tax advisor that my taxes will decrease due to the pass-through deduction and a lower rate.*
>
> *The truth is that except for corporate rates on that part of their income that is not used for stock buybacks, there should have been no tax cuts. We are drowning in debt. If you check, adjusting for inflation, even after the 1981 tax cuts, the rates between 1982 and 1987 were far higher than today.*
>
> *Much of my work as a corporate lawyer before I retired involved converting privately owned C corporations that were doing quite well into Subchapter S corporations that are now doing fabulously better for their owners. The expansion of the availability of Subchapter S already created a huge tax cut for them. Now comes along an additional one.*
>
> *The trend since 1980 continues: Income tax cuts for the wealthy, acceleration of the disparity in income between the rich and poor, an infrastructure starving for upgrading because of the Republican pledge not to increase any taxes (including gasoline tax that hasn't been increased for generations), and massive increases in the public debt.*
>
> *Something small businesses would appreciate more than tax cuts is expansion of Medicare to persons 55 and older. This would drive down the cost of providing insurance to our employees, a cost that increased 30% this year. Increased medical insurance costs and higher interest rates are much more of a concern to us than tax rates.*
>
> *I would gladly pay more in personal income taxes and gas tax to expand medical care availability to working people, reduce the deficit, and rebuild our infrastructure. —* ***Howard M.***
>
> **John:** OK, Howard, I did a deep dive. Some pushback and a mea culpa or two.
>
> First, some of the rich do pay more. But as a group? Not so much, except for the REALLY high incomes. Let me repeat what I wrote in the letter.

Laura Saunders, writing for the [Wall Street Journal](), uses analysis from the nonpartisan Tax Policy Center to demonstrate that the very top earners will now pay an even higher percentage of overall taxes. The top 1% go from paying 38% of total income taxes to a little over 43%.




According to Saunders, the results show how steeply progressive the US income tax remains. For 2018, households in the top 20% will have income of about $150,000 or more and 52% of total income, about the same as in 2017. But they will pay about 87% of income taxes, up from about 84% last year.

By contrast, the lower 60% of households, who have income up to about $86,000, receive about 27% of income. As a group, this tier will pay no net federal income tax in 2018 vs. 2% of it last year.

After the income tax, the most important revenue raisers are for social insurance, such as Social Security and Medicare. They will provide about 34% of the total tax take this year, according to the Joint Committee on Taxation. Corporate taxes will account for 7% of revenue, down from 9% in 2017. The rest of the total comes from excise taxes, estate, and gift taxes, and other sources such as customs duties.

Roughly one million households in the top 1% will pay for 43% of income tax, up from 38% in 2017. These filers earn above about $730,000.

Now, I did an in-depth call with my tax accountant, Darrell Cain of Cain Waters. They do a few thousand tax returns, mostly dentists and their families. They have scores of accountants analyzing the new laws. Bottom line from their informed analysis:

- Those below $60,000–80,000 get a cut or pay no income taxes.
- Up to about $1 million, there's usually little change either way.
- Above that level, you see an overall slight increase.
- If you make more than about $5 million, your taxes start to go down.

So, the *really* rich do get a tax cut. The cuts are skewed toward the wealthy, but not all that much. The big winners are C corporations. That's why we are already seeing sub-S corps, especially larger privately-owned ones, converting to C-corp status.

## Border Checks

This letter is reacting to the immigration comments I added at the end of my April 14 tax discussion.

> *Hi John:*
>
> *I am a long-time reader of your newsletter and so appreciate your clear insights on current political and economic events and how they may affect us. I am a Democrat, used to be a Republican until Reagan's second term and deficits started piling up. I know you are a Republican, but you never get political. You just state how a policy from either party will affect the financial world. I greatly appreciate that.*
>
> *I am writing in complete support of your position concerning your maid. I got upset just reading about it, as it is so unfair and unnecessary. Casting politics aside, I don't understand why people don't see immigration as an economic necessity. We need workers! I used to be more opposed to immigration and wanted all illegals out of the country. At a company I used to own, we had quite a few workers who were most likely undocumented. However, they were all hard workers (a trait that still is hard to find), paid taxes, and just wanted to be model citizens. Why would I want them out when they were contributing so much? Our economy would collapse without them.*
>
> *The only part of your story I don't agree with is the swap of DACA for the $25 billion for the wall. Trump's main campaign promise was Mexico was going to pay for the wall. Trump is the one that ended DACA. DACA should not be a bargaining chip. It should be restored. The wall is a separate issue. It is shame on Trump only, not also Pelosi and Schumer.*
>
> *Thanks for listening, and thanks again for sharing your knowledge and experience. Sincerely, John D.*

> **John:** I actually hear you about the trade-off for the wall and DACA. I just would like to see DACA go through and if that is the trade-off, then it's okay with me. Not saying it is right. The wall will not work (sigh). It will simply re-route those wanting to come here and live the dream. So yes, it's a separate issue, but politics is compromise. Sometimes compromises are ugly.

## Chicago, Orange County, Raleigh, and Lemonade

My next trip will be to a private conference in Chicago for my friends Swan Asset Management. I'll also meet with old friend Raghuram Rajan, former Reserve Bank of India head and now on the Chicago Booth faculty. Then I fly to Orange County to do a speech for the CFA Society on May 17. The next week I go to Raleigh, North Carolina to see old friends and speak at The Investment Institute. Then at some point in June, I'll be in Cleveland for an overdue medical checkup with Dr. Mike Roizen.

As many longtime readers are aware, I spend much time thinking about the jobs of the future. One conclusion I've reached is the importance of raising kids to understand entrepreneurship, financial literacy, and starting their own business.

A good friend of mine in Dallas and a reformed hedge fund manager, Reid Walker, co-founded the Dallas branch of Lemonade Day. The organization teams disadvantaged kids with caring adults to learn about business by opening a Lemonade Stand. They have to create a business plan, borrow money from the bank to fund it, and then pay it back.

Since its founding in Houston ten years ago, Lemonade Day has spread to over 69 cities across North America with over 60,000 kids participating last year and one million since inception. Click here and see if Lemonade Day is in your city. Then go invest in a kid's future by drinking a few glasses of lemonade! Maybe consider tipping them and getting involved in their lives. You can watch a cool video here.

It is time to hit the send button. This time I am literally on the plane from JFK to Dallas. We are taking an extra hour to avoid weather... the glamour of travel. I am ready to be home for a while, and I just got a message that Pat Caddell is going to come spend a night next week.

Have a great week. I hope you enjoyed a little glimpse into my "normal" week. It was extraordinarily fun but exhausting…

Your feels like I'm living the dream analyst,

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