Basis Points July 3, 2018

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Above the Fold

Inflation has hit the Fed's target. The Fed's favorite and primary measure of inflation is the "PCE less Food and Energy Chain Price Index." The Fed's stated goal of a stable but growing price level of 2 percent is based off this index measure. As of the end of June, the year-over-year change in inflation has finally logged in at 2 percent. While inflation has ticked up this year, a 2 percent level is still very low, and the Fed is very focused on keeping their target inflation level steady.

General Motors stock fell 2 percent last Friday after warning that U.S. tariffs on imported vehicles, currently being considered by the White House, could "undermine" its ability to compete globally. GM told the Commerce Department that any new taxes could lead to a shrinking of the company and increased costs for consumers. GM stated that "Increased import tariffs could lead to a smaller GM, and a reduced presence at home and abroad, and risk less, not more, U.S. jobs." New EU tariffs in June came in retaliation to U.S. taxes on imported steel and aluminum, enacted earlier this year. China also has responded by taxing imports from the U.S.

Three Things

- The global mergers and acquisitions market reached $2.5 trillion in the first half of 2018, up 65 percent from last year, which is an all-time high in the volume of transactions. There have been 79 deals above $5 billion, which surpasses the previous year-to-date record set in 2007. There also have been a record 35 deals above $10 billion so far in 2018. J.P. Morgan's M&A team estimates that 66 deals could be struck this year greater than $10 billion each, which also would be a record high.
- Amazon is jumping into the healthcare business. Shares of drugstore companies tumbled last week after Amazon announced it was acquiring PillPack. PillPack is an online pharmacy that packages, organizes and delivers presorted doses of medications. What Amazon stands to gain from the deal is pharmaceutical licenses in 49 U.S. states, excluding Hawaii. PillPack also has a mail order contract with Express Scripts, which manages prescription drug benefits on behalf of insurers. Sources say that Walmart was poised to buy PillPack itself, before Amazon swooped in with a higher offer. Walmart was dragging its feet on making a final offer, and Amazon cut a deal quickly. Investors have long expected that Amazon would disrupt the pharmacy business, as more than 4 billion prescriptions are ordered in the U.S. every year, so it fits very well with Amazon's high-volume, consumer-focused delivery business. An estimated $300 billion was spent on prescription drugs by patients and insurance companies last year, and Amazon can now offer pharmacy customers same-day delivery of prescriptions through its well-developed Amazon Prime network. Consumers, however, may be nervous now that Amazon will have very broad and detailed information on the healthcare needs and purchases of consumers.
- The Fed released results of the recent "stress tests" for the large bank group, and the Fed gave 34 of the biggest banks the go-ahead to pay dividends and buy back stock. Citigroup said it would hike its dividend and buy back $17.6 billion of stock over the next year, and J.P. Morgan will raise its quarterly dividend to 80 cents from 56 cents a share, and buy back up to $20.7 billion. Of the major banks, Wells Fargo, Citigroup, Bank of America and J.P. Morgan Chase received approval for their capital return plans. The Federal Reserve objected to Deutsche Bank's proposal, while Goldman Sachs and Morgan Stanley received conditional approval but will only be paying out roughly what they did last year instead of boosting dividends or buybacks. The stress tests judge how the current capital levels at big banks will hold up under very dire economic conditions, worse than what was seen in 2008, so the banks that passed the test are in very strong financial shape.

Did You Know

A major change in geopolitical power in the energy market may be just beginning. Crude production in the U.S. has reached historically high output levels this year, due to the fracking revolution over the past 10 years. New drilling technology has allowed producers to tap production in areas that before now could not be reached profitably. This “energy renaissance” in the U.S. puts us on track to be energy independent by 2020, but the benefits of this independence may include more than just being able to produce our own oil and sell the surpluses on the world market. Another benefit is that the U.S. may not have to craft policy that is concerned with global volatility of political events, OPEC cartel movements, and unrest in the Middle East as much as in decades past. In prior presidential administrations, the White House had to constantly monitor the health of the Middle East and its energy production, as a spike in prices directly hurt U.S. consumers at the gas pump. In the past, we would have shied away from reinstating sanctions against Iran, as recently happened, because the lack of production from Iran could have spiked world prices. But now the U.S. is in a production position to pick up the slack, so it is in our interest to limit the Iran supply, rather than encourage it. This major shift in geopolitical power could prove very interesting over the next decade.