



Basis Points July 24, 2018

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Above the Fold

- Microsoft reported a strong earnings beat last week, and it is quite striking that such a huge company can show 15 percent revenue growth consistently. The company's results showed continuing strong growth in its cloud business, proving that the company is succeeding in moving its historic business model of selling licensed software to a subscription-based cloud model that could deliver more steady revenue and growth over time. In its just completed fiscal year 2018, MSFT reported \$100 billion in revenue for the first time, and its market cap now exceeds \$800 billion. Last week Walmart agreed to use MSFT cloud technology to power functions that could include algorithms for purchasing and sales-data sharing with vendors. Walmart is a rival to Amazon in the retail market, so is not a natural customer for Amazon's very hot Amazon Web Services business. MSFT remains in a strong position in cloud computing, as the #2 in the business behind only Amazon.

- This is the biggest week of the quarter for earnings releases, as 35 percent of all S&P 500 companies will report 2Q financial results in the next few days, including Facebook, Google and Amazon. AMZN stock declined yesterday after the administration again railed against AMZN's use of the Post Office as a delivery vehicle, mentioned that AMZN may be in violation of anti-trust laws, and repeated that the Jeff Bezos-owned *Washington Post* has treated the administration unfairly in its reporting.

Three Things

- Flying under the market radar this week was some very good news in the MLP sector. The Federal Energy Regulatory Commission (FERC) issued its final notice of proposed rule making related to treatment of income taxes for natural gas cost of service pipelines. The MLP group had a terrible first quarter of 2018, as in March the FERC stirred up the MLP sector when it issued a notice that essentially said that interstate natural gas pipelines organized as MLPs would no longer be allowed to recover income tax allowances that they previously could as a result of the tax reform bill. This change in tax treatment would have been very bad for the profitability of the sector. FERC issued a final ruling this week, earlier than expected, that modifies its previous tax stance. The details are complicated, but the news is extremely positive for the midstream space, and removes an overhang of worry about the sector. The group rallied last week, continuing strong gains for MLPs from the 2Q18.
- ISI Research noted a number of positive economic items in its weekend report. It feels that the economy has gotten off to a very strong start so far in the third quarter, as unemployment claims dropped to a 49-year low, the Philly Fed index rose almost 6 points, and railcar loadings are up strongly in July. They also see GDP growth not slowing down in the second half of 2018, growing at a 3.5 percent rate to finish out the year. The U.S. corporate operating rate is still fairly low at 78 percent and has plenty of room to run into the mid-80s before it reaches prior peaks. Company inventories are at five-year lows and need to be replenished. ISI's retail analyst feels that the "retail apocalypse" is over, as consumers are out spending their higher paychecks, and enough capacity has been taken out of the retail store chain base due to bankruptcies of the weak sisters in the industry. And restaurant sales are strong, as consumers are apparently eating the benefits of lower tax rates.

- From the “you can’t have your cake and eat it too department”: While the White House last week bemoaned the rapid rise in the Dollar this year, and highlighted the resulting negative effects on corporate profits from overseas revenue, it must be noted that the cause of the Dollar’s strength is precisely the fiscal policies that have been put in place over the last year. The boost to the economy coming from the tax reform bill has put upward pressure on the Dollar. The large repatriation of cash from overseas has driven demand for Dollars, as companies buy Dollars to move the cash back home. And demand for goods due to lower tax rates for both companies and consumers, relative to the growth rate in other countries, has put upward pressure on the Dollar. So, a large part of the upward pressure on the Dollar in 2018 has arisen from the very policies that the White House has championed and put in place since December of 2017.

Did You Know – The Power of Compounding

Our own Patrick Deniger notes that July 1 is known around the baseball world as Bobby Bonilla Day, and will be for a very long time. Although Bonilla is now 55 years old and has been retired from Major League Baseball for 17 years, every July 1 beginning in 2011 and lasting until 2034, Bonilla receives a payout of \$1.2 million from the New York Mets. The story began in 1999, when the Mets signed the former all-star to a contract, but then were sorely disappointed in the aging star’s performance. The Mets cut Bonilla, but still owed him \$5.4 million for 2000, even though he would never play a game for the Mets that year. Bonilla and his agent proposed a deal to the Mets owner that would defer the payment of the money for 10 years, with an 8 percent interest rate. After 10 years, Bonilla would then receive a yearly payment of \$1.2 million for the next 25 years. Bonilla will receive a total of \$29.8 million over time, instead of the original \$5.4 million. The deferral of the payment, compounded for a long time at a very healthy interest rate, will keep Bonilla financially secure, at least until he receives his last payment when he is 71 years old.

An interesting side note about this story: Fred Wilpon, the Mets owner who made this deal with Bonilla, was heavily invested with Bernie Madoff at the time. Wilpon thought he was receiving a 15 percent yearly return from his investments with Madoff, so he thought the 8 percent interest rate that he would pay to Bonilla was a huge win, as he could keep this \$5.4 million invested with Madoff and make a huge spread. When the Madoff Ponzi scheme blew up in 2008, Wilpon lost the hundreds of millions of dollars he thought he had with Madoff.

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