Basis Points – February 28, 2019

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Above the Fold

- Fed Chairman Powell spoke to a Senate committee on Tuesday and gave his semiannual testimony on the state of monetary policy. While his comments were mostly positive, Powell noted that the Fed is watching the economy closely and is prepared to adapt policy if warranted. Powell noted that “While we view current economic conditions as healthy and the economic outlook as favorable, over the past few months we have seen some crosscurrents and conflicting signals. Financial markets became more volatile toward year-end, and financial conditions are now less supportive of growth than they were earlier last year.” The Fed Fund futures market continues to indicate that there will be no rate increases in 2019, showing only a 2% chance of a rate hike this year.

- We have discussed in these pages the issue of the U.S. budget deficit and the ever-expanding national debt. Many prominent economists and politicians have come around to the stance that budget deficits and the national debt do not matter, as the U.S. Treasury can simply print more dollars to pay off the debts. Has Warren Buffett also changed his stance on the issue? Buffett made comments last Saturday in his annual shareholder letter indicating he has. Buffett is now more relaxed about the federal budget deficit, writing in his annual report: “Those who regularly preach doom because of government budget deficits (as I regularly did myself for many years) might note that our country’s national debt has increased roughly 400-fold during the last of my 77-year periods. Investors buying gold to try and protect themselves from the rising debt and the prospect of ballooning deficits would have made a mere fraction of what they would have earned in the United States stock market over the last 77 years. The magical metal was no match for the American “mettle.”

Three Things

- Many recent headlines have discussed the fact that tax refunds received so far are much less than consumers expected. But the reason may be different than is published in the story. Thanks to the changes in the tax code, most Americans received a tax cut in 2018 which showed up immediately in higher paychecks. However, the IRS revised its withholding guidelines to employers also, so many folks had less salary withheld for taxes in addition to seeing a bump in their take-home pay. The IRS attempted to find a sweet spot, where employers withheld enough from paychecks, but not too little. These adjustments have led to lower tax refunds, as fewer taxes were withheld from each paycheck. Tax season is far from over, so we will receive more information from the large group of taxpayers that file returns much closer to the April 15 deadline.
- Lower mortgage rates just in time for the spring real estate selling season may give a boost to housing sale numbers that slowed markedly last year when rates hit the important 5% level. Freddie Mac reported last week that the average 30-year fixed-rate mortgage cost dropped to 4.35%. With the Fed seemingly on hold for 2019 rate hikes, mortgage rates should stay steady or fall unless the economy heats up again and worries of inflationary pressures are seen again.

- The stock market is off to its best start since 1987, up 12% so far in 2019. But pension funds, mutual funds and individual investors have been selling shares over the past year and holding far more cash than usual. After a strong nine-year stock market run, traditional investors are skittish about a coming market correction and are hunkering down. Companies, however, are the big buyers of shares for their stock buyback programs over the past year. During the fourth quarter 2018 market downdraft, public companies took advantage of much lower stock prices and bought $240 billion of their own shares, a 60% hike from the 2017 level. Corporations are estimated to be large share buyers in 2019, spending about $700 billion for the year, while traditional investors like mutual funds, pensions, endowments and individuals are expected to be net sellers of about $400 billion in shares.

Did You Know

Do you remember him? Jeffrey Skilling, the former chief executive of Enron whose deception contributed to the scandalous crash of the Houston-based energy-trading giant, was released from federal custody last Thursday after serving more than 12 years in prison for fraud, insider trading and conspiracy. The Enron scandal that began in 2000 was wide-reaching and notorious, as Enron was found to have manipulated the state of California's electricity market, helping spark a crisis in the early 2000s that sent power prices surging to record levels, plunged hundreds of thousands into darkness and led to the downfall of a governor.

Skilling, 65, was one of the architects of Enron's phenomenal rise into an energy-trading powerhouse in the 1990s. He along with fellow executives such as Andrew Fastow assembled obscure financial instruments that became ticking time bombs, leading to the company's bankruptcy. The collapse of Enron cost shareholders billions and left thousands unemployed.

Kenneth Lay was also a prominent player in the rise and fall of Enron. Lay was convicted of a litany of Enron-related crimes but passed away in 2006 prior to his sentencing. Andy Fastow, the former CFO of Enron, was also convicted of Enron-related crimes, served six years in prison and was released in 2011.

The early 2000s were an active era for corporate fraud and led to significant new government legislation designed to ensure that fraudulent activity at public companies would not happen again in the future.

Bernie Ebbers, the "Telecom Cowboy," endured a meteoric rise and tragic fall in the span of a decade. The WorldCom scandal was, until the Madoff Ponzi scheme came to light in 2008, the largest accounting scandal in United States history. In 2005 a federal judge sentenced Ebbers to 25 years in jail. His conviction was upheld a year later and Ebbers drove himself to prison in his Mercedes in 2006. He remains confined to the Federal Corrections Institution in Fort Worth. The earliest date Ebbers can be released is in July 2028, when he will be age 86.

Dennis Kozlowski, former CEO of Tyco International, also became famous due to his fraudulent behavior and lavish lifestyle, paid by the company dime. Kozlowski became notorious for his extravagant lifestyle, supported by the booming stock market of the late 1990s and early 2000s. Tyco paid for his $30 million New York City apartment which included $6,000 shower curtains and a $15,000 dog umbrella stand. The disgraced executive was convicted of taking excessive bonuses totaling $430 million, tax evasion and stealing more than $100 million from Tyco. Kozlowski was convicted in 2005 and sentenced to eight to 25 years in prison. He was released in 2014.