Basis Points – March 19, 2019

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Above the Fold

- Shares of Boeing declined again yesterday and are now 16% below the recent high on March 1. The grounding of the company's popular 737 Max models after two recent fatal crashes whose causes seem related is the focus of the stock's recent swoon. While negativity is high on the stock after the recent tragedies, taking a longer-term vision of the company's prospects may allay some current market fears. Aerospace industry analyst Scott Lawson notes that costs resulting from the current crisis will most likely be contained and the non-recurring costs will not affect company finances over the longer term. Free cash flow at Boeing is growing at 10% a year and should reach $17 billion in 2020. The Boeing 737 model has an unmatched safety record over many decades, and if deliveries of new 737 Max versions are delayed this year, they will be delivered in 2020 after the model's issues are fixed. There is a greater than five-year backlog in orders at Boeing, so there could be some shifting of cash flow from one year to the next, but no long-term loss of revenue. Airline industry capacity is growing at 4-5% a year, while global air traffic growth of 5-10% means that there is a constant demand for more, new and energy-efficient planes in the industry. Global air travel is heavily related to income per capita of a country, as growth in income to a certain level makes air travel possible for those citizens. Air traffic growth is most robust in countries such as China, India and Indonesia, where billions of citizens are trying air travel for the first time as their economies grow and their incomes rise.
- There are reasons for optimism heading into the spring home-selling season, as mortgage rates are down more than 0.5% from highs of 5.0% a year ago, which should provide a lift to sales in the coming months. Also, the distribution of current sales suggests more focus on first-time buyers, and much of that strength was in new homes in the $200,000 to $400,000 price range.

Three Things

- Tax season is never a fun time of year, but it may make you feel better to know that although Americans grouse about filing their tax returns every year, the U.S. is among the world's leaders in what economists call the voluntary compliance rate (VCR), meaning a very high percentage of citizens feel the need or obligation to comply with established tax filing policy. The compliance rate in the U.S. sits at 83%, while Germany's stands at only 68%, Italy at 62% and Greece at 48%. What causes a high compliance rate? In general, it is the belief among a country's citizens that everyone else is paying taxes too. Social norms, democratic values, civic pride, and trust in leadership and fellow citizens all play a part in a high participation rate in paying taxes. The citizens of Greece are notorious for not trusting each other, so there is a tremendous shadow economy to avoid paying the government's high tax rates. Less than half of its citizens pay any income taxes at all. Greece's black market is the largest in the Eurozone, accounting for 22% of its total GDP, leading to huge budget deficits and economic chaos over the last decade.

- Dan Clifton at Strategas Research notes that although many newly minted 2020 presidential candidates talk about a move to “Medicare for all,” the reality of that move is much more difficult than the candidate’s stump speech talking points. House Speaker Nancy Pelosi knows that she does not have the votes in the house to pass such a bill and does not think it is a good idea either. Pelosi stated in an interview, “When they say Medicare for All, people have to understand this: Medicare for All is not as good a benefit as the Affordable Care Act. It doesn’t have catastrophic coverage, so you would have to go buy it. It doesn’t have dental. It’s not as good as the plans that you can buy under the Affordable Care Act. So I say to them, come in with your ideas, but understand that we’re either gonna have to improve Medicare for all, including seniors, or else people are not gonna get what they think they’re gonna get. And by the way, how’s it gonna be paid for?”
- Calpers, the California Public Employee Retirement Fund, is debating allocating a significantly larger chunk of its $356 billion investment fund to investments in private equity. The proposed measure before the board is to divert as much as $20 billion more over the next decade to new investments in technology startups and privately held businesses. Calpers CIO Ben Meng is in favor of the expansion, as it will help the system meet its 7% future return targets. Calpers currently has $28 billion devoted to private-equity bets. “We need private equity, we need more of it, and we need it now,” Meng said at last month’s Calpers investment committee meeting. Even after a 10-year U.S. bull market, many public pensions haven’t been able to solve their future funding challenges, and pension plans average only a 73% funding rate of the assets they need to fulfill future retirement promises to public workers. Private equity has been the California pension fund’s best-performing asset class over the past decade, producing annual returns of 11.4% as of December.