



Would Cash Repatriation Help Boost The Economy?

SYNOPSIS

- Cash repatriation has garnered significant attention throughout the presidential election, and investors want to know why.
- Congress's Joint Committee on Taxation estimates that U.S. companies are holding over \$2.5 trillion in cash overseas.
- Changes to the corporate tax code to allow companies to repatriate cash at a significantly lower rate would most likely benefit long-term investors.

Ironically, the government would probably be the biggest beneficiary of repatriated cash.

CASH REPATRIATION

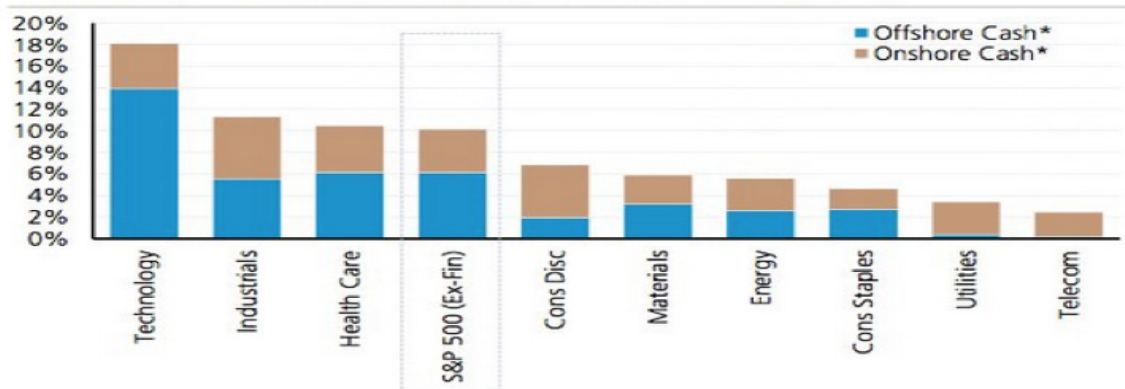
The subject of “cash repatriation” has garnered significant attention throughout this most recent presidential election. Investors have asked why this subject keeps coming up and how it matters to the economy and their nest eggs.

The easiest way to understand cash repatriation is through example, so let's assume that a U.S. based clothing store decides to expand to Paris. They sell a bunch of clothes over the course of a year, and the cash they earned gets placed into a bank account in France.

If the company wanted to move this cash from their French bank account to the one back home, they would need to convert the Euros into U.S. dollars and then transfer the funds to their “onshore” bank account. This process is referred to as repatriation.

Cash repatriation has become a political hot button thanks to the chart below, which shows the amount of cash held onshore and offshore for companies in the S&P 500 by sector.

Figure 3: S&P 500 Cash Breakdown by Sector, % of Market Cap



Source: Bloomberg, FactSet, Individual Company Filings, and UBS.
Note: Overseas cash figures collected from individual company filing footnotes as of FY 2015. In certain cases where the company does not explicitly disclose the figure, the approximate amount has been estimated.



Notice the dotted rectangle in the middle of the chart because this is what is causing all the commotion. The size of the blue bar (cash held offshore) is a lot larger than the brown bar (cash held onshore) for nonfinancial companies in the S&P 500. Meaning, companies are keeping a lot of cash in offshore bank accounts instead of bringing it back home to the U.S.

Technology companies have the highest amount of cash overseas due to the nature of the tech sector. Their products and services are more global when compared to other businesses such as a power plant.

In fact, the table below shows that the five largest offshore cash hoards in the S&P 500 come from tech companies (as of September 30, 2016):

Apple	\$216 Billion
Microsoft	\$111 Billion
Cisco	\$60 Billion
Oracle	\$51 Billion
Google	\$48 Billion

Source: Bloomberg, Global Financial Private Capital analysis

These cash balances are astronomically high. For scale, Apple's cash balance above is larger than the current market cap for 484 of the 500 companies in the S&P 500 index. Meaning, companies like Verizon, Pfizer, Coca-Cola, and Intel are worth less than the amount of cash sitting in Apple's offshore bank accounts!

Add it all up, and Congress's Joint Committee on Taxation estimates that U.S. companies are holding over \$2.5 trillion in cash overseas. Considering that our country's Gross Domestic Product (GDP), which is a measure of economic

activity, will be close to \$20 trillion in 2016, this cash hoard equates to right around 12.5% of GDP ($\$2.5/\$20 * 100 = 12.5\%$).

The problem is that this cash is just sitting in overseas bank accounts collecting dust when it could be used in so many better ways. Many investors question why a company would hoard so much cash, but the answer is quite simple.

Any company that repatriates cash back to the U.S. is currently subject to a 35% tax rate, which is the highest in the developed world. Companies like the ones listed in the table above are "cash cows," meaning their domestic businesses generate a lot of cash each year, so they do not need their overseas cash to fund operations back home.

Simply put, corporations keep their cash overseas to avoid paying the repatriation tax.

THIS IS A BIG DEAL

For years, Republicans and Democrats have wanted these companies to bring the cash back to the U.S., but neither party has made any effort to lower the tax rate to entice CEOs to repatriate.

Trump campaigned heavily to reduce this tax, and his victory gives him the opportunity to do something about it. The details of his proposed plan remain unclear, but if his administration were to convince companies to bring back even a portion of this cash, it could benefit our economy and long-term investors in three ways:

1. **Reinvest:** Companies could reinvest back into their business via research and development, buying competitors, hiring new employees, and raising salaries.



2. **Special Dividend:** Management could pay a special dividend and return the cash to shareholders, which could be a windfall in many circumstances.
3. **Share Buybacks:** The cash could be used to buy back company stock. By lowering the share count, the stock price could rise over time and increase shareholder wealth.

Admittedly, these advantages are predicated on the assumption that management teams will use this cash wisely. There is no doubt that a few bad actors could destroy value through poorly-timed share buybacks or bad acquisitions, but the net impact to the economy would most likely be very positive.

Some uses of cash would benefit the economy and shareholders faster than others. Paying dividends or buying back shares would be immediate whereas reinvesting back into the businesses may take several years to pay off. I would expect to see companies employ a mix of these options to not only reward current shareholders but to attract new ones as well.

For example, a pharmaceutical company could use half of its repatriated cash to fund research into new lifesaving drugs and pay its scientists more money, and then use the other half to pay its shareholders a one-time 10% special dividend.

Ironically, the government would be one of the biggest beneficiaries because they could collect hundreds of billions in additional tax revenues from:

- **Repatriation:** The government will not drop the tax rate to zero, so they can collect taxes on the initial repatriation back to the U.S.
- **Dividends:** Any special dividends or increases to existing dividends are taxed when paid to investors.

- **Consumer Spending:** The increase in consumer wealth from pay raises and rising share prices would most likely translate to more spending, where the government would collect even more revenue from consumption taxes such as the sales tax.

Let's use some math to highlight just how much the government could gain in additional tax revenues if they were to lower the tax to 10% in 2017. If that convinced companies to repatriate \$1.25 trillion, or approximately 50% of the total amount sitting overseas based on Congress's estimates, the federal government would collect \$125 billion to start.

That leaves \$1.125 trillion ($\$1.25 - \$0.125 = \1.125) for companies to put to work. If they paid out 25% to shareholders via a special dividend, which is taxed between 15% - 20%, then Uncle Sam would get an additional \$48 billion at a blended 17% rate ($\$1.125 \times 0.25 \times 0.17 = \48).

The additional taxes from consumer spending are too difficult to estimate, but even if we were to assume that they were zero, the government would still take home \$173 billion ($\$125 + \$48 = \173) in 2017 from just two forms of taxation.

The U.S. Treasury Department estimates that tax revenues for 2017 will be \$3.6 trillion, so the return of our hypothetical example, which is based on rather conservative assumptions, would be 4.8% ($\$173/\$3600 \times 100 = 4.8\%$).

If corporations repatriated more than 50% of their overseas cash, the tax revenues go up even higher. I cannot think of too many people who would balk at the opportunity to earn 4.8% or more next year for doing no extra work.

These numbers are a really big deal. For instance, Trump has signaled the desire to spend \$500 billion to fix roads, bridges, etc. The \$173 billion in our example above equates to roughly 1/3rd of the amount he wants to spend on infrastructure.

That means less government debt issued and less spending cuts elsewhere to pay for it all.

Sure, the initial tax rate must be lowered to convince these firms to repatriate their cash, but something is way better than the nothing they are receiving right now.

IMPLICATIONS FOR INVESTORS

Emotions are viruses that wreak havoc on an investor's financial future, and few emotions are stronger than political ones. Hence, we must check our politics at the door or else we introduce unnecessary risk into the investment process.

In this instance, whether we agree or disagree that the tax rate *should* be lowered is completely irrelevant. Keep these opinions reserved for mingling with friends and family at holiday parties because when it comes to an investor's financial future, the only thing that matters is what *could* happen if this tax rate is lowered.

Investors must also not act prematurely and assume that Trump will be successful at incentivizing these companies to repatriate their cash. His administration still needs to get any plan through Congress, and although the Republicans now rule, it is still dominated by politicians who have their personal interests in mind.

For example, history has shown that the government often takes two steps backward with every step forward, and a lower tax rate for repatriated cash may come with strings attached that change the projected economic impact. Hence, we must never bet on the direction of a government decision until we are sure of the outcome.

Lastly, if the current administration cannot do enough to convince companies to bring this cash home, it is by no means a devastating outcome for our country. We were doing fine before the election, and we will continue to grow if companies keep their cash hoards in place.

The bottom line is that changes to the corporate tax code to allow companies to repatriate cash back at a significantly lower rate would most likely benefit investors, but it is not necessary to keep this bull market alive.

Sincerely,



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