

Something to Think About



OAKWORTH
CAPITAL BANK

COMMON CENTS

This week, the European Commission (EU) ordered Apple, Inc., to pay the Irish government \$14.6 billion in back taxes it claimed the company owed. Interestingly, the Irish weren't asking for the money, quite the opposite. They were actively arguing otherwise. However, the powers that be, and in Europe there are a lot of them, determined a tax deal the country made with Apple amounted to an illegal state subsidy, and, therefore, was anti-competitive.

Make no bones about it, the whole thing was a tax avoidance scheme from the get go. No one can sensibly argue otherwise. Apple wanted to sell products in Europe, and didn't want to pay significant US taxes on profits it made overseas. While they were at it, why not get a little something out of the Irish who wanted the company to set up shop in Cork?

We can debate the ethics or morality of this until the cows come home, but it won't change the following: a deal with a sovereign entity is a deal with a sovereign entity. A contract is a contract, and one of the best ways to foster economic growth is the adequate enforcement of contracts and property laws. If the Irish government can't hold up its end of a deal, good or bad for the Irish people, is it really sovereign? So, are any EU nations truly sovereign if a commissioner in Brussels can invalidate their contracts?

That is the real issue here, and not whether Apple swipes a check for roughly \$15 billion. It can do so tomorrow, and not be that much worse for the wear. But what type of precedent does this set in Europe? Does it now mean other EU countries can claim damages and a whole slippery slope of other fun things? I mean, I am certain there is a company on the Continent willing to argue it would have been a raging success but for the deal Apple cut. Don't you think?

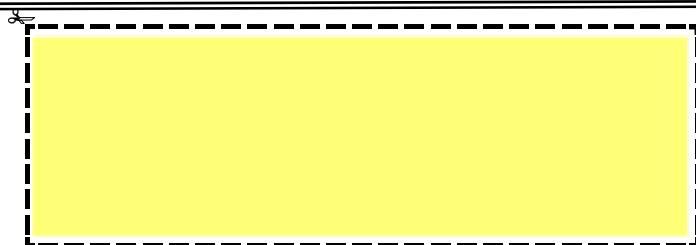
Taking a step back, why would US companies want to set up operations in Ireland, other than low taxes and pliant politicians? Perhaps proximity to the large European market and the English language would factor into the equation? I think they would. With this in mind, can you think of another country that has those things in common? Does the United Kingdom come to mind? If so, what did that country just vote to do? That's right, get out of the European Union, the co-called Brexit.

Currently, British corporate tax rates are scheduled to fall from 20% today to 17% in 2020. While still a little more than Ireland's stated 12.5%, it is less than half the US rate. So, do you think the UK will start aggressively courting US companies to move their European operations there? After all, once it is out of the EU, the British will be able to enforce their own contracts without any help from an EU commissioner in Brussels looking over their shoulder. Trust me, this will be a huge comparative advantage.

In the US, individual states do this type of thing all the time, without Washington coming in behind and declaring their actions null & void, for all intents and purposes. How would Alabama like it if some bureaucrat at the Department of Commerce did what the EU did this week? Sure, the tax revenue might be nice in a state with budget problems like ours. However, the loss of face and the loss of the ability to cut deals with companies, both foreign and domestic, would be a real long-term problem for our economic development efforts.

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In the end, it is kind of funny, ironic even. The European Commissioner for Competition ruled Apple must pay Ireland a lot of money in back taxes Dublin hadn't requested. In so doing, it has basically voided a contract the central government made with a US company. As such, this has made Ireland less competitive in the global economy moving forward, whether the ruling ultimately stands or not.

Trust me, when, not if, US companies start shifting employment to the UK, Irexit will be next. While the Irish don't particularly like the British, and perhaps with good reason, they will find they have more in common with their neighbors across the Irish Sea than with the rest of Europe.

Closer to home, this morning the Bureau of Labor Statistics (BLS) issued the Employment Situation report for August 2016. It estimated the US economy created 151K net new jobs last month, which is the economic equivalent of a tuna fish sandwich....but I like tuna fish sandwiches. The number was less than expected (180K), with the private sector accounting for only 126K. Of that latter amount, 34K were at 'food service and drinking places,' which are hardly the stuff of dreams.

In truth, you can scour the report from stem to stern and not find anything to get too agitated about, one way or the other. It was beyond mediocre, even beyond tuna fish sandwich mediocre. I mean we are talking about, I don't know, canned chicken & noodle soup mediocre, store brand even. Regardless, sometimes mediocre is good enough, if not preferable. You don't want to scarf down a meat lover's pizza and then run a marathon do you? Gobble up a plate of homemade biscuits & gravy and then drive 8 hours alone in the car? No thanks. Tuna fish and chicken broth will do just fine, thank you. Such was today's release.

You see, if the report had been awesome, say 300K net, new jobs, the markets would assume the Federal Reserve would take it as a cue to aggressively raise the overnight target. Had it gone the other way, like 0K jobs, uh oh, perhaps the economy is slipping into recession, and that isn't a good thing. But 151K jobs, 25K in government and 34K at restaurants & bars? Yeah, no worries. The economy is still growing somewhat, but the Fed doesn't need to be in a hurry to do anything drastic.

Frankly, as I told a client this week, I don't think the Fed is in a hurry to do much of anything drastic or aggressively. It should understand whatever it does will have global ramifications, whether it wants to admit it or not. Right now, the global economy is, in a word, meh. Perhaps even a little more meh than the domestic economy.

No, the Fed doesn't believe it HAS to be aggressive in tightening credit in the financial system. It is simply a policy making body, and it wants to make policy and have the latitude to make policy in the future. To that end, I am certain Janet Yellen, et al, would absolutely LOVE to take the overnight lending target to 1.00%, maybe even 1.50%, and be done with it....for a long time. This doesn't have anything to do with all the analysis it purports to do on the US economy, as much as just having the room to do something when something HAS to be done.

Yeah, that is about it. Look at the data, in aggregate. Is the entire US economy in danger of overheating? If that really is such a thing? While some markets are fire hot, maybe even bubbly, the entire equation is, again, a tuna fish sandwich. And you know what? That is okay...really it is. I mean it. Again, I like tuna fish, so perhaps I am a little biased.

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However, the Japanese and Europeans are largely ‘eating,’ in keeping with the present metaphor on economic activity, potted meat food product, which is nasty stuff.

Just what is potted meat? Basically, it is pet food for humans. No? Well, here is what a certain www.pk.org/pottedmeat.html claims are the ingredients for Hormel’s version of the stuff.

Ingredients: Beef Tripe, Mechanically Separated Chicken, Beef Hearts, Partially Defatted Cooked Beef Fatty Tissue, Meat Broth, Vinegar, Salt, Flavoring, Sugar, Sodium Nitrite.

Hey, this stuff is sustenance, and will keep you alive...until you have health complications from eating it or just simply decide to give up. Interestingly, or not, on Walmart’s website, you can buy an 18 oz. package (6 cans) of Armour’s version of potted meat for \$2.80, or 15.6¢ per ounce. By comparison, a 30 pack of Fancy Feast (Gravy Lover’s), an upscale cat food brand, can be yours for 17.7¢ per ounce. Seriously.

So, potted meat? Yep, that pretty much sums up Europe and Japan’s overall economic activity....maybe a little harsh, but not that much. Tuna fish? Sure, that is a pretty good analogy for the US. Which would you rather have? I imagine a majority would opt for the latter, but only because mediocre is better than not even up to mediocre.

There you have it....the week we just had. The US is doing okay...okay... and the Federal Reserve is going to do, or not do, its part to make sure it stays that way. On the flipside, Europe isn’t doing quite as well, and the European Union has done, and will continue to do, its part to make sure it stays that way.

Just ask Apple.