TAX THE RICH

He said that he would do it and indeed he did (with apologies to My Fair Lady).

A major part of President Biden's election platform was higher taxes to fund a myriad of benefit plans, and last week he started to deliver. He announced tax increases on the wealthy, as soon as next week, to pay for an increase in funding for childcare and education. The "American Families Plan" would reverse some tax cuts from 2017 and the capital gains tax for those making over $1M per year could nearly double to 39.6%. **Coupled with an added 3.8% tax linked to the Affordable Care Act, that's a potential 43.4% levy**. Also proposed is an increase in the top income tax rate to accompany the raise in the corporate tax rate to 28%, all to help fund major infrastructure spending. What actually gets passed by congress remains to be seen, but the proposed changes were touted as a major reason for a mid-week sell-off in equities. Despite a Friday rally, it was generally a down week for most major equities and sectors. The fact that we have witnessed an impressive rally since the beginning of the year, and by all measures shares prices look extended and a little "tired", may also have played a role in this week's weakness.

What was interesting was of the some 70 major equity indices, commodities, bonds and currencies that I follow every week, **the top seven were all potential harbingers of higher inflation**: corn, wheat, soybeans, copper, natural gas, the S&P Real Estate sector and, our perennial favorite weekly mover, lean hogs. Regular readers know I have been warning for many weeks that much higher consumer inflation, than economists and central bank officials expect, lies ahead. There are two new tidbits to add to my case: weekend news media reported on the shortage of new cars, high demand for used cars and, at many nationwide locations, a challenge to find a rental car; and if you are lucky in any of these searches, expect a nasty surprise in the cost.

Much of the recent media focus in recent weeks is on the ballooning government debt, not only from efforts to alleviate the effects of economic shutdowns, but also to help springboard a recovery. **How will we pay for all this debt is a common concern**. Well, at the moment it is not a problem. And while these are US numbers, the same would largely apply to Canada: The Federal Government's debt service costs remains historically low. Interest payments fell last year to $345 billion or only 1.6% of GDP, even after all the pandemic spending, plus 10-year Treasury yields that are the highest in more than 12 months. They're on track to shrink further in 2021, all because the government is rolling over bonds it sold years, even decades ago, when borrowing costs were much higher**. It would take Treasury yields averaging about 2.5% across all maturities — well above where they are now — to turn that trend around** (all calculations by Bloomberg)**.** Even then, U.S. debt service costs would be comfortably lower than they've been in the recent past.

So, as we edge into summer, expect the old tug of war to continue: on the one side stimulus, vaccines, upside earnings surprises and cash inflows from all those savings. Pulling on the other side are stretched shares prices and bullish sentiment indicators, tax hikes, worsening global coronavirus case trends, more inflation and elevated geopolitical tensions.