Basis Points – October 4, 2018

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Above the Fold

Amazon said Tuesday that it was raising the minimum wage it pays all U.S. workers to $15 an hour, a move that comes after the company has faced increasing criticism about pay and benefits for its warehouse workers. The new wage will start Nov. 1 and cover more than 250,000 current employees and 100,000 seasonal holiday employees. The company said it also will start lobbying Congress for an increase in the federal minimum wage, which is currently $7.25 an hour. “We listened to our critics, thought hard about what we wanted to do, and decided we want to lead,” said Jeff Bezos, Amazon’s founder and CEO. The complaints from some in Congress have become louder lately as the company’s market cap has surpassed $1 trillion, and the value of Bezos’ own shares in Amazon topped $150 billion. Amazon needs to hire a vast number of workers immediately to get ready for the crush of online orders this holiday season, so the new higher wages at Amazon may make it a preferred employer in this very tight labor market. And the wage hikes create friends out of Bernie Sanders and Elizabeth Warren, both of whom will be running for president soon.

But one may ask what Amazon’s true rationale for hiking their minimum wage to $15 an hour might be. In this very low unemployment market, it is very difficult to find skilled workers, especially for the upcoming holiday season. However, capital in this economy is very plentiful, and is readily available in both high corporate cash balances and through a still low-interest-rate bond market. Amazon seems to have decided to trade a good that is plentiful — capital — to buy a good that is scarce: available labor. Although in Amazon’s press release today Bezos stated that he hoped other large companies would join Amazon in hiking worker pay, a cynic may conclude that those wishes ring hollow. Why would Amazon want to give away its large edge in the labor market now that it has a competitive advantage with its much higher rate of pay? If other companies raise pay also, Amazon's labor advantage disappears. With its new higher wage scale, Amazon almost ensures that it can fill out its seasonal labor needs, which is very important to Amazon. Although it may give up a small amount of profit to higher wages, that profit means nothing if Amazon cannot deliver products on time during the holiday season. Amazon has always traded profits for customer satisfaction, and it continues to do so in this tight labor market. And they are receiving great praise from D.C. now for doing so.

Three Things

- Oil prices have risen sharply this year, rising from $60.50 a barrel at year-end 2017 to $75.00 today, or up 24.2 percent for the year. However, energy company stocks have not been part of the party, as the energy sector of the S&P 500 has only risen 8.3 percent this year. Production delivery bottlenecks in the Permian Basis may be holding back energy stock shares, as producers have not been receiving the full benefits of rising oil prices. Permian production is a big deal for the overall domestic energy sector. At 3.3 million barrels of oil per day, the Permian Basin produces about 46 percent of all the oil recovered from the 48 continental United States. The West Texas play also produces more than twice as much oil as the Gulf of Mexico and the North Sea, which both produced about 1.6 million barrels of oil a day as recently as March. Energy investors have been hesitant to risk exposure to a sector which will not see the benefits of new pipelines until the end of 2019.
- Fed Chairman Powell spoke at a conference on Tuesday and said that the Fed board has been able to stave off sharply higher inflation, even with low unemployment, by managing expectations. However, should those attitudes change, the Fed won't hesitate to respond. "Our course is clear: Resolutely conduct policy consistent with the FOMC's 2 percent inflation objective and stand ready to act with authority if expectations drift materially up or down," Powell said. The unemployment rate currently stands at 3.9 percent, near a 50-year low, and core inflation is right around 2 percent. Powell said the two numbers are part of a "very good" economy that boasts "a remarkably positive outlook" from forecasters.

- A surprising performance star in third quarter 2018 was the Health Care sector of the S&P 500. The sector rose 14.5 percent over the period, doubling the overall performance of the index itself, which rose 7.7 percent. Investors taking advantage of reasonable valuations in the sector relative to other sectors played a part in the sector's strength. In addition, with such strong growth in the economy and gains in the stock market, investors nervous about a slowdown may be positioning their exposure more toward defensive industries like health care, that can generate strong profits even in a challenged economy. There is a possibility for turbulence ahead, however, as the midterm elections next month could pressure pharmaceutical company shares, specifically, if a Democratic "blue wave" causes more focus on cutting drug prices and the cost of health care overall for the industry.

Did You Know

Bloomberg reports that donor-advised funds (DAF) are all the rage among the super-wealthy these days and are reshaping the landscape of U.S. philanthropy. DAF assets mushroomed to more than $85 billion at the end of 2016 from $30 billion in 2010. Where in the past wealthy donors may have given money and assets to private foundations, a large amount of giving these days is going to DAFs, due to the superior tax advantages and flexibility for the donor. Funds in a DAF grow tax-free in an individual account, and donors choose how it is invested. There is no requirement to distribute at least 5 percent of the assets every year, which is a constraint on a traditional foundation.

Most donations to DAFs are in the form of highly appreciated publicly traded stock, real estate or oil and gas leases. If the donor sold them, those assets could produce huge tax bills. If they're donated to a DAF, they bring huge tax benefits and a bigger pool of charitable funds than if they'd been sold and the proceeds donated. This tax-powered alchemy has been called "philanthropic fracking," a way to tease out more dollars from rich people's portfolios. DAFs offer greater tax advantages over private foundations. Donors who contribute privately held stock or real estate to their foundation must value it at cost basis, which is likely to be low for depreciated property or businesses started in a garage. The income-tax deduction is capped at 20 percent of adjusted gross income (AGI), which can be carried forward five years. If instead that asset is contributed to a DAF, an appraiser determines its fair market value before it is donated. That creates a bigger deduction, which can offset as much as 30 percent of AGI (and can also be carried forward five years). Since the DAF is a public charity, the donor pays no capital gains tax and neither does the DAF when it sells the asset.

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