

WEEKLY MARKET THOUGHTS

May 19, 2014

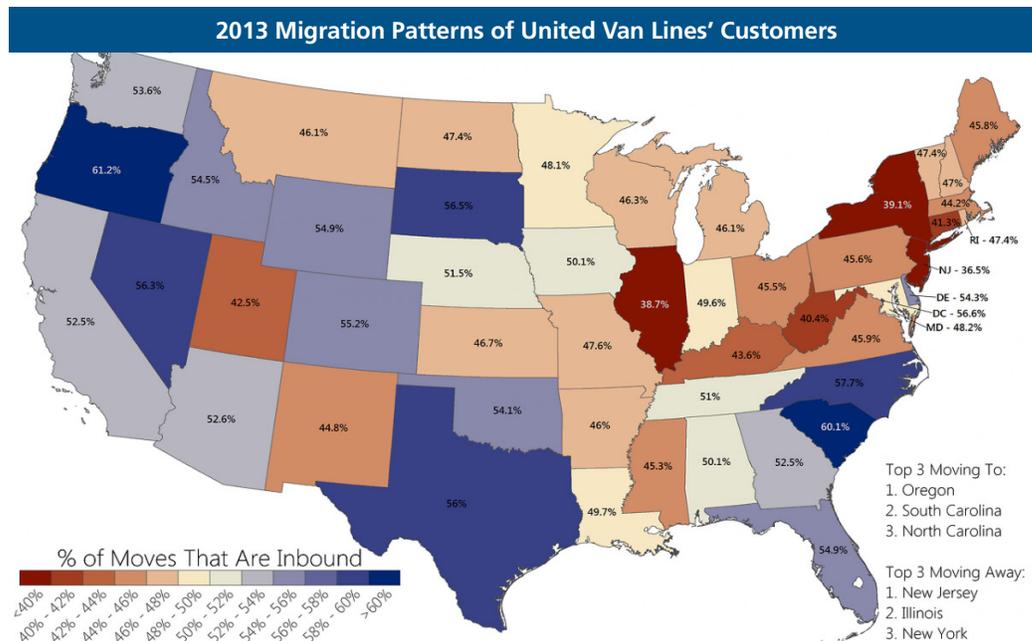
Economic Mobility

People and businesses are moving. This isn't news, as people physically move from one part of the country to another on a regular basis. A major economic benefit we Americans enjoy is our freedom to choose the part of the country in which we live. Business regulations, tax rates and overall social attitudes vary across the country. This variance allows us to gain comfort in our local environment. Many people talk a big game, but when they move from one part of the country to another, they are voting with their feet.

What makes news is when some of the United States' largest and most profitable corporations consider moving from their homeland to foreign shores. Why are these movements occurring? And from a micro standpoint, what parts of the country are people moving toward – and what parts are they fleeing?

Micro First – the Data

As can be seen from the map below, United Van Lines reported the percentage of moves, by state, that were inbound. In 2013, the top three states with a higher percentage of folks moving in rather than out were Oregon, South Carolina and North Carolina. The three states that saw the highest percentage of people leaving compared to moving in? New Jersey, Illinois and New York.



What about those folks who can't afford to hire a large moving company to help move them from one part of the country to another? U-Haul has released a report showing the highest and lowest "destination" cities in 2013 for those who move themselves. The data represents one-way truck and trailer rentals. Below are the 10 highest-destination cities for last year:

1. Houston Texas
2. Orlando, Florida
3. Las Vegas, Nevada
4. Chicago, Illinois
5. San Antonio, Texas
6. Austin, Texas
7. Brooklyn, New York
8. Philadelphia, Pennsylvania
9. Columbus, Ohio
10. Kansas City, Missouri

Interestingly, three of the top six destination cities are in Texas. While Chicago is on the list, at number four, it is the third most populous city in the country – so one might expect it to be in the top five. The same might be expected of New York, and yet Brooklyn is number seven on the list. Perhaps most surprising is the result for California. No California city made the top ten list – not one.

In a recent poll conducted by the Gallup organization, a simple question was asked. Pollsters asked if, given the change to move to a different state, would you? The following summarizes the responses by state:

Where the Most Residents Would Leave		Where the Fewest Residents Would Leave	
	% Yes, would leave		% Yes, would leave
Illinois	50%	Montana	23%
Connecticut	49%	Hawaii	23%
Maryland	47%	Maine	23%
Nevada	43%	Oregon	24%
Rhode Island	42%	New Hampshire	24%
New Jersey	41%	Texas	24%
New York	41%	Colorado	25%
Massachusetts	41%	Minnesota	25%

Macro Thoughts

The information above, while not surprising, is telling. In general, people apparently wish to flee the northeast portion of the country. Folks wish to stay put west of the Mississippi. I suppose individual reasons are varied, including bad weather and crowded living conditions. But I also suspect part of the reason is crumbling infrastructure (have you been to an airport in New York recently?), high costs of living (including high tax rates), poor public education options and weak economic prospects in general. From a quantitative standpoint, the states the most residents say they would leave sport an average state/local tax rate of 7.2%, while the states the fewest residents would leave have an average state/local tax rate of 4.0%, all according to the Tax Foundation. Coincidence? Perhaps, but please read on.

There are conflicts with some of the data above – people's wishes don't always match up with their actions. While California saw a net inflow of folks according to the United Van Lines' map, no California city made the top 10

destination cities according to the U-Haul information. Why is this? I don't know for sure, but I suspect younger, lower paid workers tend to move themselves while corporate moves usually incorporate a formal relocation service such as United. If this rationale is reasonable, perhaps some of the data in the U-Haul report is skewed toward younger workers. If so, the U-Haul report is even more telling, as youth immigration indicates where the economic growth is moving toward.

Corporations are Joining the Moving Parade

A recent disturbing development has occurred involving Pfizer Corporation, the venerable pharmaceutical giant. Pfizer has made a bid to acquire AstraZeneca, the British drug maker. This move is significant not only in the eyes of the drug industry, but also in the eyes of the IRS. With this acquisition, Pfizer is considering moving its headquarters, and its incorporation, to the United Kingdom from the United States. The officials at Pfizer have given a number of reasons they are pursuing this acquisition and incorporation move, but one major reason is federal taxes.

U.S. corporations face the highest statutory corporate income tax rate in the world – 39.1% when combining federal and the average state income tax rates. Companies headquartered in the 33 other countries represented within the OECD pay an average rate of 25%. Companies headquartered in the historically high tax countries in Europe pay lower taxes than U.S. corporations.

Let's do some simple math. Pfizer reported net income (before taxes and special items) of \$15.72 billion last year. If Pfizer was incorporated outside the United States in the "average" OECD country, it would have saved \$2.21 billion in taxes last year, roughly speaking. The board of directors at Pfizer, holding a fiduciary responsibility to shareholders, has decided \$2 billion tax savings per year is enough of an incentive to look at incorporating outside the United States. Pfizer paid \$4.3 billion in taxes last year. A portion of this annual tax receipt is now in jeopardy of vanishing from U.S. coffers if Pfizer decides to move its corporate location.

Pfizer is not alone in its action of looking overseas for tax relief. For example, Walgreens, the large drug-store company, is considering relocating to Europe. Walgreens purchased the Swiss-based Alliance Boots. This purchase would allow Walgreens to become a Swiss-based company rather easily.

Along with incorporation movements, companies have been sheltering foreign earnings from the U.S. taxman by retaining earnings within foreign operations. This earnings retention process has snowballed to the point where a total of \$2.1 trillion in earnings is now harbored outside the reach of U.S. taxation. A total of 547 corporations have expanded their foreign reinvested earnings overseas. The point? This practice is wide-spread and endemic and indicates a systemic taxation problem.

Tax avoidance is a sign of economic movement – be it individuals or corporations. For many reasons, tax rates need to be addressed at various levels.

Lessons Learned – People and Corporate Interests Alike

We are afraid corporate tax rates will not be adjusted anytime soon. The leadership dysfunction apparent in Washington appears very deep. We will risk losing the incorporation of some of our leading companies – and employers – to foreign shores. As this trend continues, some politicians will cry that companies are acting unpatriotically by moving to escape paying high tax rates.

This is how economic freedom works. People and companies move to where opportunities are abundant and their capital is treated well. People prefer areas where capital and freedoms aren't confiscated by extreme regulation and tax rates.

We will be back next week.

A handwritten signature in black ink, appearing to read "W B Greiner".

William B. Greiner, CFA
Chief Investment Officer
Mariner Wealth Advisors



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