

Trump Tax Plan. Chances and Consequences.

Sep 27, the Big Six presented a draft tax proposal representing President Trump's tax plan. This is a long awaited piece of reform with high market impact.

Trump Tax Plan:

Proposed Tax Changes: Corporation	Current	Proposed
Corporation Tax Rate	35.0%	20%
Expense of Capital Investment	Depreciated over time	Immediately expensed
Interest Expense	Deductible	Limited deductible
R&D Expense	Deductible	Deductible
Accumulated foreign earnings	Not taxed	One time tax
On-going foreign earnings	Tax on repatriation	Details yet to emerge
Repatriated profits	Taxed at corporate rate	Foreign subs dividends not taxed

Probability of House and Senate approval:

- The plan is the result of negotiations between the White House, Treasury, House Ways and Means Committee and Senate Finance Committee, so it has more weight than a unilateral White House proposal. Some of terms presented have therefore been pre-negotiated.
- The plan could increase the national debt by 1.5 trillion USD, or over 10% of GDP over the next 10 years. This could face opposition from fiscal hawks.
- The plan is less progressive and favours corporate America and the wealthy and will face opposition from the Democrats in the Senate. There is a risk of a filibuster.
- Generally, the Republicans are united behind this plan and while details are missing on some issues, there is sufficient detail and content to suggest that the Republicans have been presented and considered the plan. It is unlikely therefore to

find resistance or suffer from friendly fire.

- It is late in the year and almost all of President Trump's attempts at policy have failed, most recently the attempt to repeal Obamacare. The Republicans and the White House will be motivated achieve at least one major policy agenda item in 2017.
- That there are areas of great detail and areas of remarkable vagueness suggests that these areas will be open for negotiation.
- Expect that the tax plan will be approved in some shape or form with the broad characteristics largely intact.

Potential impact if passed:

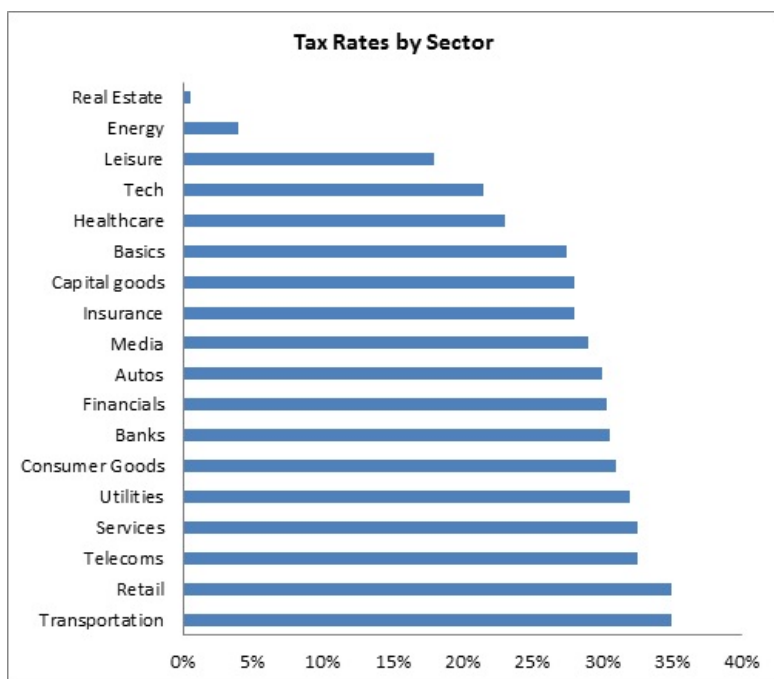
It is too difficult to both envisage how the plan may be amended amidst negotiations as well as forecast impact on the economy and markets. We have to assume that the tax plan is adopted without modification in our assessment of impact.

- The loss of tax revenue will be expansionary and inflationary. Growth will be boosted in the medium to long term.
 - A tax cut boosts aggregate demand and raises interest rates. Coupled with the Fed's rate hikes and balance sheet normalization, expect duration to underperform.
 - Higher growth and higher rates are supportive for the USD.
- The immediate impact will be a one-time boost to S&P500 corporate profits of circa 11% FY2018 (according to Goldman Sachs).
 - To see who gains most consider tax rates by sector in the chart below.
 - In addition to the current effective tax rates, Transport, Utilities and Energy are the most capital intensive and likely to benefit.
- Bad for rates but good for credit:
 - The inflationary nature of the tax cuts will force the Fed to hike rates more aggressively.
 - Reduced supply of corporate bonds. Companies will be incentivised to pivot to equity financing. High equity valuations and rising rates also favour the pivot. Interest expense deductibility repeal is a real risk to callable bonds.
 - Increased demand for yield. The less progressive personal tax code will

increase savings rates and capital seeking investments in yielding assets.

- Floating rate debt instruments will be in demand. Issuance will fall just as demand rises.
- Could even be good for bonds:
 - Repatriation of foreign profits needs to find a home. Dividends are one avenue. Share buybacks will be limited given valuations. Debt buybacks and reduction will be the most likely path given rising rates and thus interest expenses. This means reducing leverage as well as reduced issuance if not a significant rise in par calls.
- Strong USD and rising rates.
 - Negative for emerging markets, especially those with high USD debt.
 - Negative for commodities. US is not a high intensity consumer of industrial commodities and displacing growth towards the US will weaken support for commodities.
 - Positive FX impact on European and Japanese equities as hedging costs are low.
 - Neutral to negative impact

Tax Rates By Sector: (note that the Energy sector ETR is pulled down by MLPs. Big 4 Oil and Gas ETR is circa 24%.)



For information I include the proposed changes to personal tax:

Proposed Tax Changes: Personal	Current	Proposed
Tax Brackets	10.0%	12%
	15.0%	25%
	25.0%	35%
	28.0%	
	33.0%	
	35.0%	
	39.6%	
Passthroughs	Personal tax rate applies	25%
Estate Tax	5.49 million threshold	Not taxed
Alternative Minimum Tax		Repeal
Single		12,000
Married, Joint Filing		24,000
Child Tax Credit	Phased out at 110,000 (married)	
	75,000 (head of household)	
Deductions	Retirement savings	Retirement savings
	Education savings	Education savings
	Mortgage Interest	Mortgage Interest
	State and local taxes	May not be deducted