

Andy Friedman



THE WASHINGTON UPDATE[®]
FROM ANDY FRIEDMAN

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2016 Election



“I remember when I was The Donald!”

Income Inequality

“Economic disparities appear to be reaching extremes that are damaging to growth.”

Standard & Poor's (August 2014)

Income Inequality

- *The concern:* Income inequality is increasing.
- Wealth begets more wealth.

Market return since 2008: 250%

Wage increase since 2008: 15%

- Middle class is no longer the nation's majority.

Sources: *CNBC Nightly Business Report (March 9, 2016)*; *5 facts about economic inequality Pew Research Center, (Jan., 2014)*; *The American Middle Class Is Losing Ground, Pew Research Center (December 2015)*.

Income Inequality

- Percent of income earned by top income earners.

	<i>1980</i>	<i>2015</i>
One percent	8%	19%
Ten percent	32%	45%

- 2015 figures are down slightly from 2012, which were the highest levels ever recorded.

Source: *Fairness and Tax Policy, Joint Committee on Taxation (March 2015).*

Income Inequality – Democrats

- Government programs are necessary to reverse income inequality.
 - Higher minimum wage
 - Education programs
 - Jobs programs
 - Unemployment insurance
- Fund government programs with higher taxes on the affluent, who have gained economically in recent years.

Income Inequality – Republicans

- Focus on stronger economic growth, not bigger government.
- Reduce programs and regulations that hamstringing business growth.
 - Government intrusion thwarts economic growth and individual perseverance.
 - Government subsidies dis-incentivize working and foster dependency.

Income Inequality – Republicans

- The tax system is already unduly progressive. Increasing taxes thwarts economic growth and entrepreneurial spirit.
- Percent of taxes paid (percent of income in parentheses).

	1980	2015
One percent	19% (8%)	49% (19%)
Ten percent	49% (32%)	82% (45%)

Source: *Fairness and Tax Policy, Joint Committee on Taxation (March 2015).*

Trump's Plan

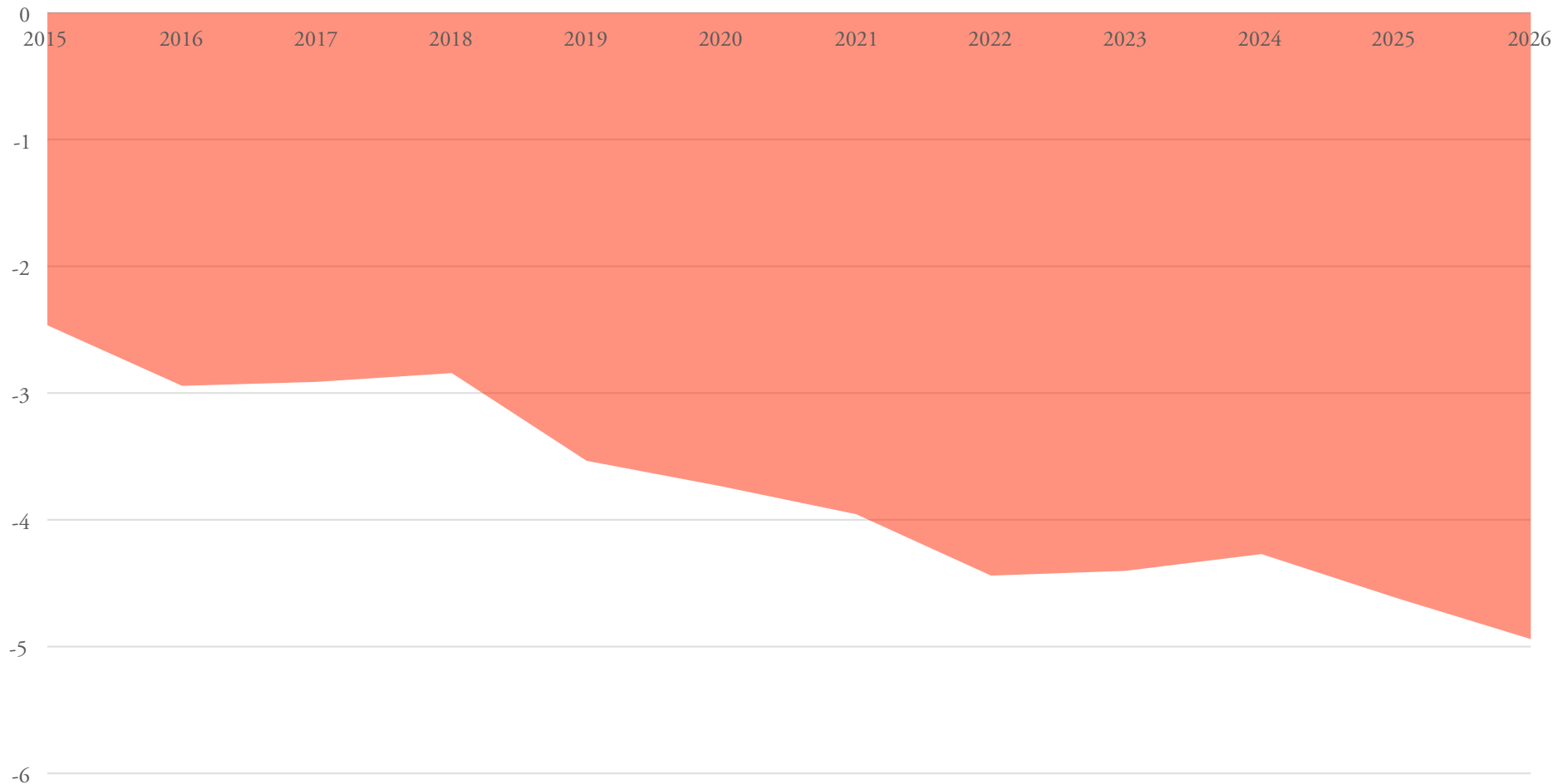
- Lower taxes
 - Less government revenue with dynamic scoring
- Reduce government regulation
 - And reduce size of government

Trump's Power

- Republican Congress
- Reverse Obama executive orders
- Checks on Trump power:
 - Senate filibuster rules (use of reconciliation procedure)
 - Deficit hawks in House

Fiscal Realities

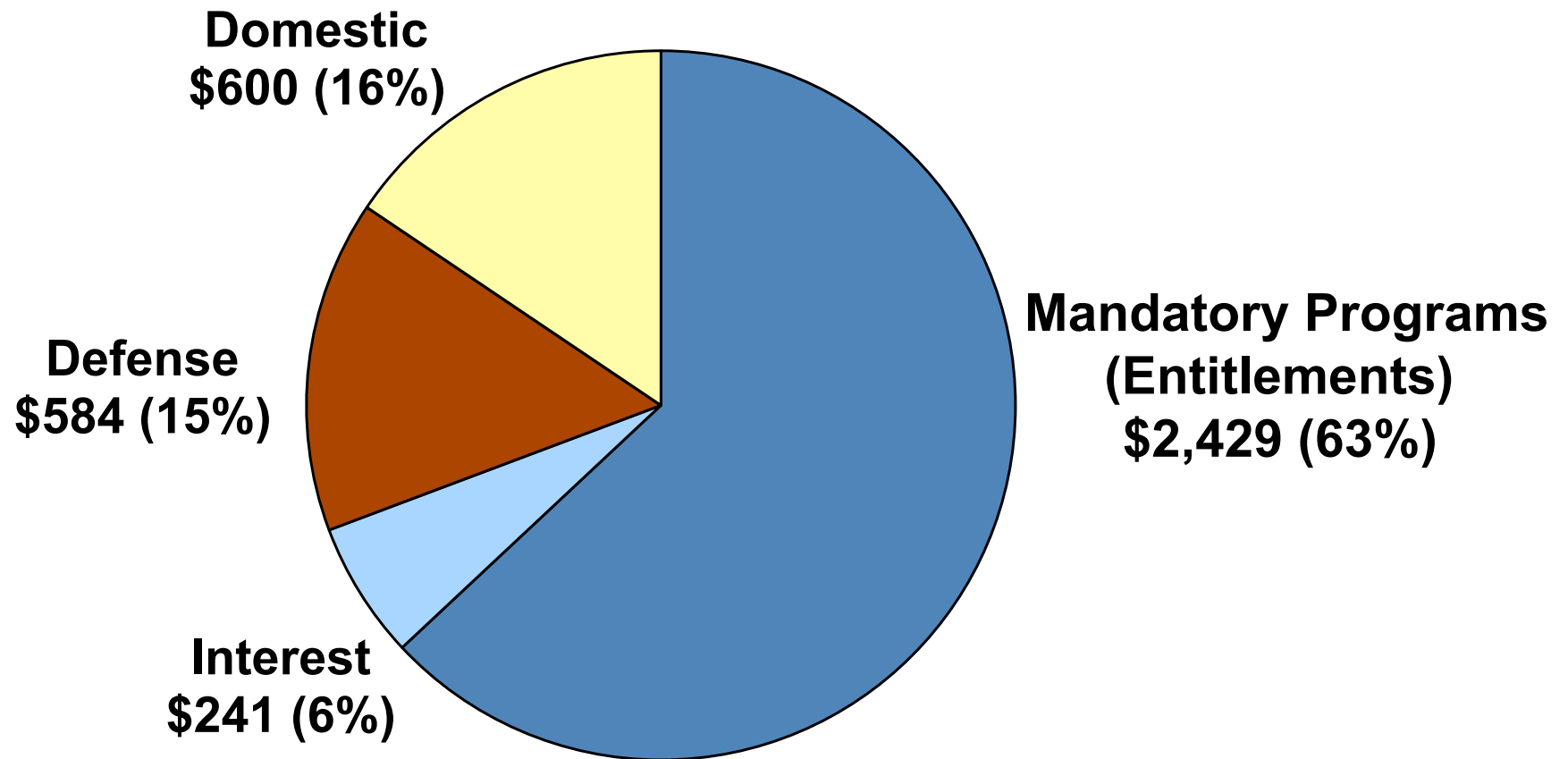
Annual Deficit as a % of GDP



Source: *The Budget and Economic Outlook: Fiscal Years 2016 to 2026*, Congressional Budget Office (Jan 2016)

Fiscal Realities

2016 Federal Spending (\$3.9T) (in billions of dollars)



Source: *The Budget and Economic Outlook: Fiscal Years 2017 to 2027*, Congressional Budget Office (Jan 2017)

Federal Spending

- Trump executive order calls for federal hiring freeze (except defense)
- Increase defense spending by 10% (\$54B)
- Reduce domestic spending by the same amount
 - Largest single cut since post-WWII.

Federal Spending Cuts

- Exempted: homeland security, federal law enforcement, veterans' programs, entitlement programs.
- Affected agencies preparing for at least 10% budget cuts. Layoffs a possibility.
 - EPA (20% cut), HUD (14%), Commerce (18%), State Department foreign aid among likely targets.

Federal Spending

- Fleshed out budget expected early April
 - Pushback in Senate likely (especially foreign aid)
- Infrastructure repair program (\$1T)
- ACA replacement cost uncertain
- Debt ceiling (March 16)
- Government funding (April 28)

Tax Reform

“This [preparing my tax return] is too difficult for a mathematician. It takes a philosopher.”

Albert Einstein

Tax Reform

“We have what it takes to take
what you have.”

Unofficial Motto of the
Internal Revenue Service

Tax Reform

- Reduce tax rates
- Eliminate “loopholes”
- Simplify the tax code
- Eliminate the alternative minimum tax

Tax Reform – Stumbling Blocks

- Must eliminate or cap some “sacred” deductions and exemptions to recoup revenue lost from reduced tax rates.
 - Dynamic scoring makes revenue neutrality easier.
- Cannot favor the wealthy, who benefit most from reduction in tax rates.
- Reform produces winners and losers.

Tax Reduction - Individual

- 33% top individual rate
- 20% top cap gain and dividend rate
- Repeal Obamacare 3.8% surtax
- Eliminate alternative minimum tax
- Repeal estate tax and GST
 - Repeal stepped up basis for estates > \$10M

Tax Reduction - Individual

- Cap itemized deductions at \$200K (Trump)
- Eliminate deduction for state taxes (House)
- Tax life insurance build-up for high earners (Trump)
- Loophole closers

Tax Reduction - Business

- 15% top tax rate on business income, including through pass-through entities
- Full expensing of capital expenditures
- Eliminate deduction for interest expense
- Possible repatriation holiday for offshore subsidiary earnings
- “Border adjustments” (House): Export sales not taxable, import expenses not deductible
- Tax sale of carried interest as ordinary income

Tax Reduction

“Simply put, any policy proposal which drives up costs of Corona, tequila, or margaritas is a big-time bad idea. Mucho Sad.”

Senator Lindsey Graham (R-SC)
(February 2017)

Trump Foreign Relations

- “America First” policy: “peace through strength”.
- Rejection of globalism, which has hurt American workers.
- Focus on domestic growth, not foreign involvement to spread democracy.
- Support nation’s right to protect borders.
- Bilateral rather than multinational treaty negotiations.

Trade

“[The problem is] more and more of our imports are coming from overseas.”

President George W. Bush (2000)

Trade

- Tariffs on imported goods
- Push back from House Republicans
- Executive action:
 - Counter currency manipulation
 - Correct balance of payments
 - Protect domestic industries injured by imports
 - National emergency or national security
- Negative effect on economic growth?

Obamacare

- Filibuster prevents complete repeal.
 - Reconciliation can be used to undermine fiscal underpinnings (individual mandate penalty, subsidies for insurance purchase, etc.).
 - 60 votes in Senate required for full replacement program.

ACA – Republican Proposal

- Replaces ACA subsidies used on government-run exchanges with refundable tax credits used to defray cost of insurance purchased in private markets.
- Medicaid transformed from federal entitlement to capped grants to states to cover Medicaid beginning in 2020.

ACA Republican Proposal - Questions

- What is the cost?
- What is the decline in number of people covered by insurance?
- Will the plan prompt enough healthy people to purchase insurance to prevent insurers from raising premiums significantly?

Financial Services

- Filibuster prevents full Dodd-Frank repeal.
- Trump executive order calls for sweeping review of Dodd-Frank regulations and enforcement with an eye toward removing impediments to “economic growth and vibrant financial markets and enabling American companies to be competitive.”
- *But note:* Trump ran as a populist against “crony capitalism” and so could make comments adverse to Wall Street interests.

Energy

- Goal: U.S. energy independence.
- Expanded exploitation of conventional energy sources. Climate change is not a concern.
- Repeal Obama environmental regulations limiting fracking; carbon emissions on power plants; and oil, gas, and coal extraction.
- *Boost for fossil fuels:* oil, natural gas, coal, shale.
- *Boost for domestic production:* offshore drilling, drilling on federal lands, stalled pipeline projects.

Economic and Market Consequences

- Fiscal stimulus, tax reform, reduced federal regulation should be favorable for economy and markets. Possible modulating effects:
 - Congressional curtailment of spending could disappoint markets.
 - Trade policy is wild card.
 - Inflation could be a concern; higher interest rates.
 - Trump unpredictability could cause concern.
- Longer term deficit growth could cause over-borrowing.

Economic and Market Consequences

- Corporate bond supply may be lowered by:
 - Repatriation holiday (source of cash)
 - Disallowance of interest tax deduction
 - Higher interest rates

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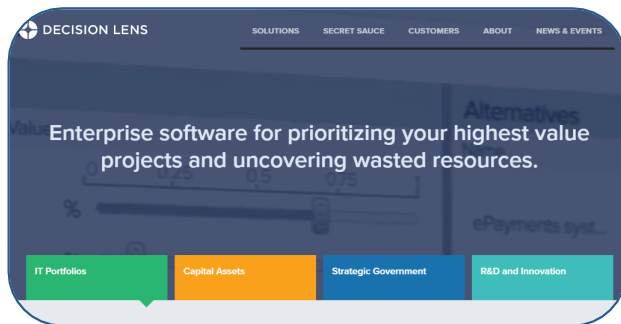


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