CIO View

Americas CIO View

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Marketing material

U.S. Elections 2024 & Fiscal Repair: Taxes, tariffs or a third choice?

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IN A NUTSHELL

— Presidential candidate debates: Many issues raised, few solid facts or proposals
— Biden's closing statements: A fair tax system, capped health costs, child credits
— Trump's closing statements: A strong US and secure border, cut taxes and regs.
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Presidential candidate debates: Many issues raised, few solid facts or proposals

Many important issues and questions were raised during last week's presidential debate, but few comprehensible answers or policy plans were presented. The first question posed, and cited as being the most important to voters, was about inflation and the economic well-being of Americans under each's term. It's very rare for candidates and voters to be able to compare actual circumstances as both candidates have been President. Yet, both blamed each other for high inflation and deficits. One of the economic issues that the candidates addressed with relative clarity and actual proposals was their fiscal policy plans.

Biden reiterated views that corporate and personal taxes should be raised for those earning over $400K. Trump reiterated his commitment to more tariffs to raise revenue and exert US economic power to influence the actions of other countries. Both candidates criticized each other for high deficits during their terms, but one implied the problem is inadequate revenue and the other blamed excessive spending. Biden backs continued specialized household tax credits and government support programs for individuals, industry and climate goals. Biden argues that high income and wealthy families don't pay their fair share of taxes. Trump argues his corporate and income tax rate cuts and deregulation spurred a great economy for all. We think the bond market wants a lower deficit one way or the other.

Biden's closing statements: A fair tax system, capped health costs, child credits

Biden's remarks during the debate and his closing statement suggest that he'll push for tax hikes. He seemed to imply that a wealth tax on those with $100mm that raises the effective rate paid on realized (probably) plus unrealized capital gain of 8% could be raised to 25% to solve the heightened deficit. He also suggested that payroll tax of 6.2% paid each by employees and employers be applied to income over the current $169K cap to assist social security. These things are possible, but we think it's more likely under Biden and Democrat- controlled or a balanced Congress that Trump tax cuts sunset and only the low income tax rates are preserved in new legislation (State and Local Tax (SALT) deductions unclear), which also raises the corporate tax rate to 25-28% possibly effective in 2025 (like in 1993) or over a few years.

Trump's closing statements: A strong US and secure border, cut taxes and regs.

Whenever possible, Trump's comments were about the southern border. He also remains fixated on using tariffs and US customs to raise revenue and influence other issues both at home and abroad. He suggests a 10% tariff on all imported goods, over $3trn a year, and says it won't cause higher prices because foreign producers will pay or cut prices. We are skeptical of this high risk approach to raising revenue and fear foreign relations risk. Whether more tariffs nor not, Trump is committed to extending his signature 2017 tax cuts.

A third choice (candidate)? Congressional compromise or discipline of markets

Markets are valued for liquidity, efficiency and signals, but feared and sometimes too harsh when forced to be the disciplinarian to stop excessive borrowing or poor use of savings. The US has a vast economy to tax if necessary, but tax hikes risk recessions and typically retard growth and prosperity. Taxes have become a very divisive issue in America, perhaps overly distorting our economy and politics and leaving very few with the sense they are fair. We think it would be unwise for the U.S. Federal Reserve (Fed) to commence rate cuts before more clarity emerges on US fiscal policy after the election. We expect the 10yr Treasury yield to fall to 4.25% in June 2025 on inflation staying under 3%, slow gross domestic product (GDP) growth and some fiscal tightening. Tariffs would bring too much inflation and fiscal uncertainty for the Fed to enact multiple rates cuts in our view after the election without clear signs of the US tipping into recession.

S&P 500 tax rates by sector/industry: We assume no changes at this time

Our S&P EPS estimates of $270 for 2025 and roughly $300 for 2026 assume no change to US corporate tax rates. A 28% corporate tax rate, would reduce S&P EPS by 7%, all else the same as the global blended tax rate provision would rise from about 20% to about 25%, causing companies to keep 75% of pretax profits rather than 80%. The hit is greater to domestic focused businesses like Financials and Retailers and small caps. Real Estate Investment Trusts (REITs) would be unaffected and most Utilities would pass it through in rates over time. Tech has more foreign profits than other sectors; while other Biden administration initiatives might weigh on Tech profits, we think taxes are less threatening than tariffs and retaliation to Tech. We think small caps, select Industrials, Energy and Materials would prefer tariffs over taxes.

Glossary

A budget deficit is created whenever the spending in a public budget exceeds the income within a given time period

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

The gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Liquidity refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

A Real Estate Investment Trust (REIT) is a company that owns and, in most cases, operates income-producing real estate. REITs sell like a stock on the major exchanges and invest in real estate directly, either through properties or mortgages.

A recession is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

The S&P 500 is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

The State and Local Tax (SALT) deduction permits U.S. taxpayers who itemize when filing federal taxes to deduct certain taxes paid to state and local governments.

A tariff is a tax imposed by one country on the goods and services imported from another country.

Tightening monetary policy refers to all actions undertaken by a central bank to slow down overheated economic growth. These include regulation of key interest rates, constraining monetary supply or increasing capital requirements for credit risks.

The U.S. Federal Reserve, often referred to as "the Fed," is the central bank of the United States.

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