

SOM Macro Strategies

State of the Markets: Strategies for Trumpanomics

Trade 1: Buy Equities

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April 2017

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- ***Step 1: Macro Theme: Trumpanomics***
 - The goal of Trump’s economic policy is to push real growth up to 3.5-4% and add 25 MM new jobs in the next 10–years
- ***Step 2: Fundamental Economic Framework***
 - Growth in the US is below historical norms because of slowing investment and productivity
 - Investment growth reflects in part the headwinds of US corporate tax policy and Dodd-Frank
 - Demographics and the impact of retiring baby boomers is a headwind to labor growth
 - Any policy must be massive to offset these hurricane force economic headwinds
- ***Step 3: Find Potential Catalyst***
 - If fully implemented, Trump economic policy would be massive enough to move the needle of economic growth
 - Corporate tax reform could push economic growth above 3% all by itself with relatively small increase in Federal debt
 - Dodd-Reform could push growth even higher by unleashing bank lending in housing and small businesses
 - Energy and infrastructure policy could add to this growth through a build out of US shale energy, particularly nat gas
- ***Step 4: Find Asymmetric Trade***
 - Trade 1; Buy US Equities
 - Trade 2: Buy US Regional Bank
 - Trade 3: Buy Mortgage Insurers
 - Trade 4: Buy Home Builders
 - Trade 5: Buy a Basket of Energy Infrastructure Equities
 - Trade 6: Higher Rates—Buy Payer Swaptions
 - Trade 7: Stronger Dollar—Buy Worst-of-Puts on Euro and Yen vs USD

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Step 3: Find Potential Catalyst

And That Force Could Be Trumpanomics

Massive tax reduction in combination with regulatory relief, trade reform, and lifting restrictions on American energy's

- ***Middle Class Tax relief and Simplification Act***
 - Number of personal income brackets reduce from seven to three, and with simplified tax forms
 - Corporate tax rate reduced from 35% to 15%
- ***Regulatory Reform***
 - Reduce the number of regulations
 - Reform Dodd-Frank
- ***End of Offshoring Act***
 - Seven point trade policy
 - Establishes tariffs to discourage companies from laying off workers in order to relocate in others countries and ship back to the US tax-free
- ***American Energy and Infrastructure Act***
 - Leverages public-private, and private investments through tax incentives, to spur \$1 trillion infrastructure investment over ten years
 - It is revenue neutral

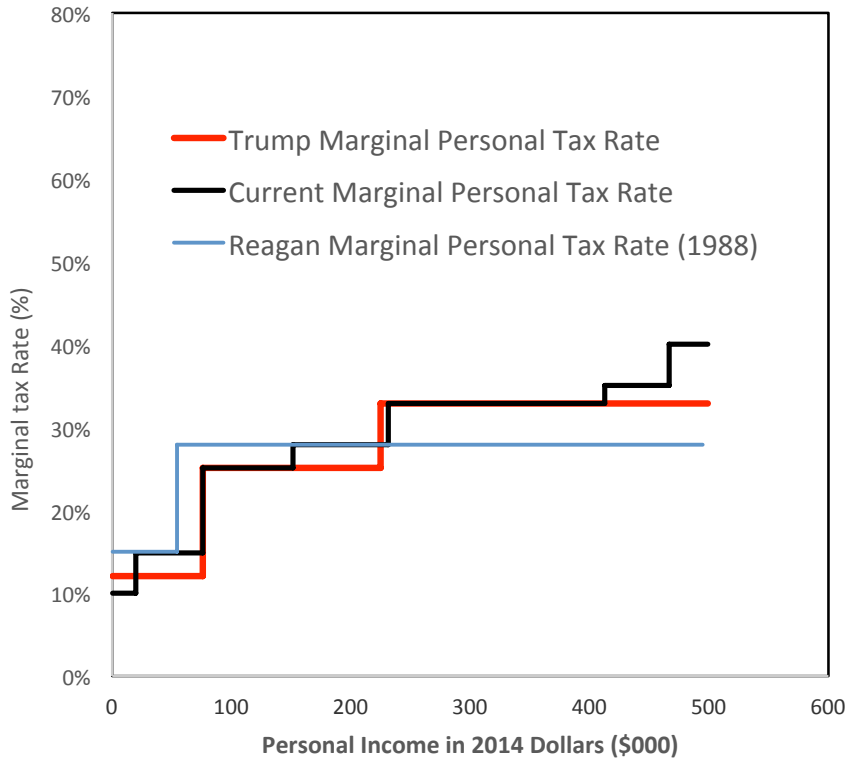
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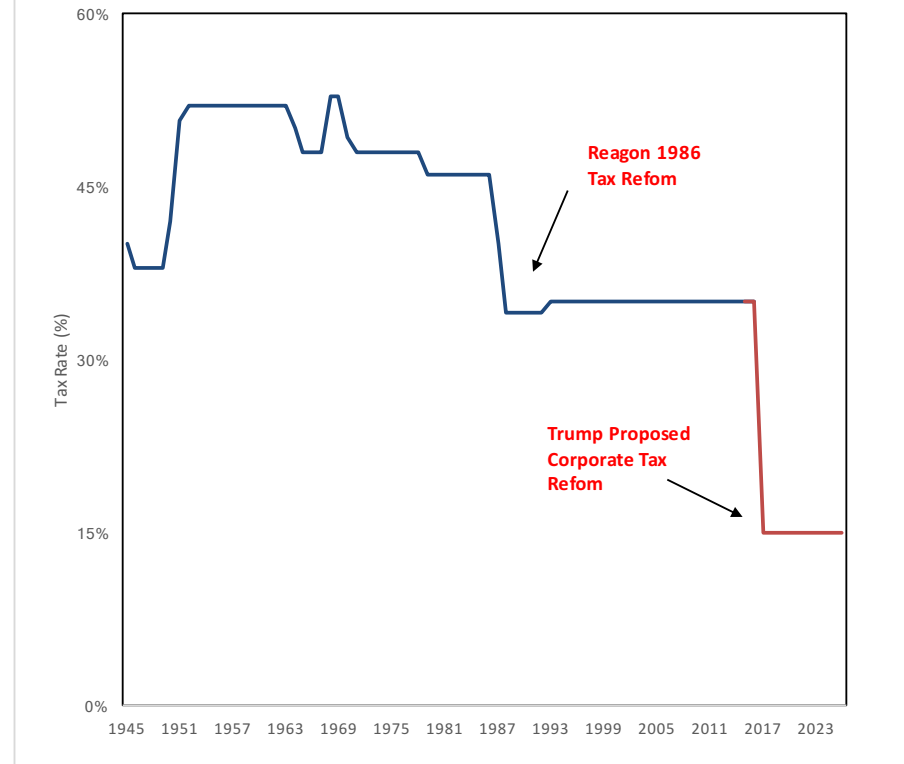
Step 3: Find Potential Catalyst

Trade 1: Buy US Equities--Catalyst of Corporate Tax Reform as Trump Becomes Reagan

Key Features of the Corporate Tax Plan¹



Corporate Tax Cut Significant vs Current and Vs Reagan^{1,2}



1. <https://www.donaldtrump.com/policies/tax-plan/>

2. OMB

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Step 3: Find Potential Catalyst

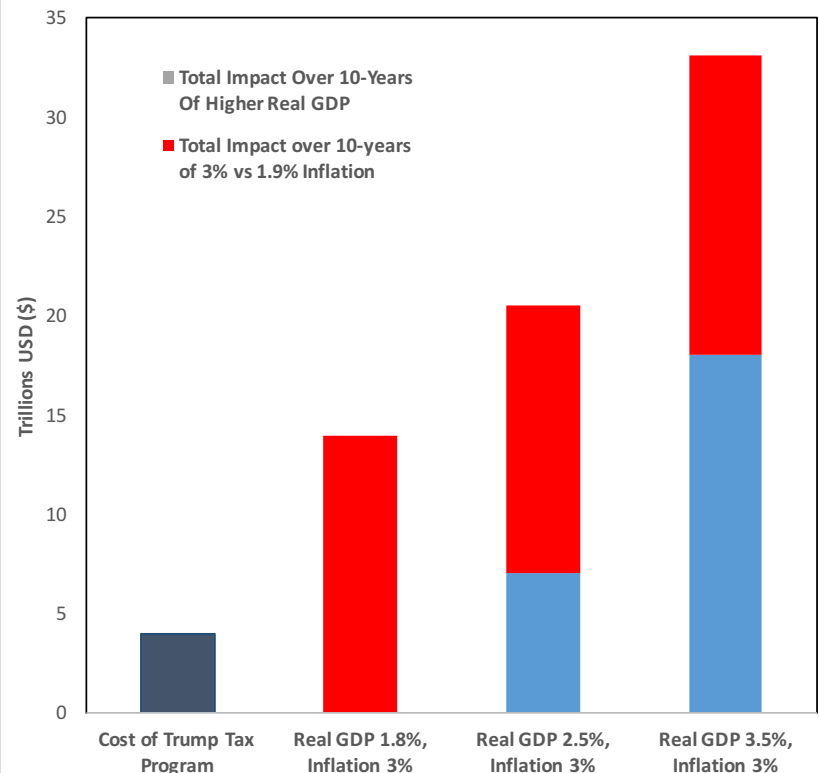
Trade 1: Buy US Equities--Catalyst of Corporate Tax Policy Could Achieve Reagan Era Growth

Tax Policy Of Trumpanomics Could Get Growth Over 3% ^{1,2,3,4}

- Policy could increase the Federal Debt by \$4.3 Trillion over the next 10-years
- Upside is that this could also increase real GDP by 68 bp per year and reduce the debt growth by 40%
 - Adding two of the House plan could achieve another 46 bp of growth with little increase in cost
- Taken together this could bring real GDP growth to almost 3% per year vs projections of 1.8%

Trump Tax Plan 9/2016	Cost In Federal Tax Rev Total Next 10 Years (\$bil)		Increase in Annual Real GDP
	Static	Dynamic After Impact on GDP	
Individual Tax Cut	-1400	-1200	0.09%
Corporate Tax Cut	-2100	-1000	0.40%
Partial expensing of capital investments	-300	-200	0.06%
Other	-500	-200	0.13%
Total	-4300	-2600	0.68%
Potential Provisions From House Republican Plan	Static	Dynamic After Impact on GDP	Increase in Annual Real GDP
Allow 100% expensing of capital investments vs Trump Plan	-1900	-700	0.50%
Border Adjust Business Tax	1000	900	-0.04%
Total With Provisions	-5200	-2400	1.14%

Increase In Federal Debt Seems Small Versus The Potential Upside ^{1,2,3,4}



1. Cole, "Details and Analysis of the Donald Trump Tax Reform Plan, September 2016", Tax Foundation, Sept. 2016
 2. Pomerleau, "Details and Analysis of the 2016 House Republican Tax Reform Plan", Tax Foundation, July 2016
 3. CBO Projections 2016-2027
 4. Authors calculation

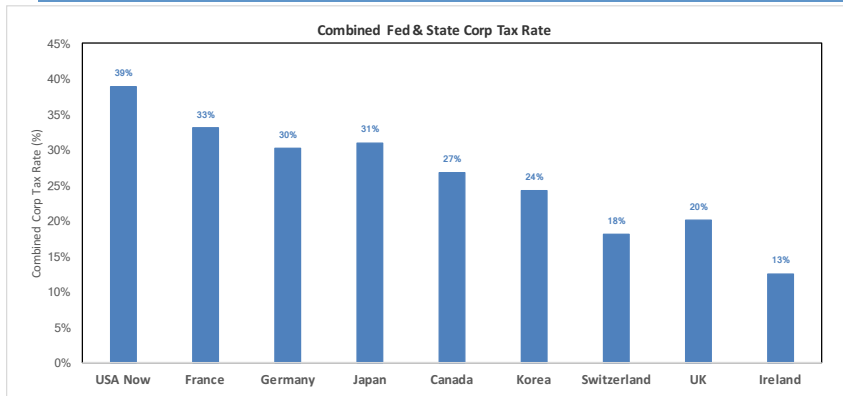
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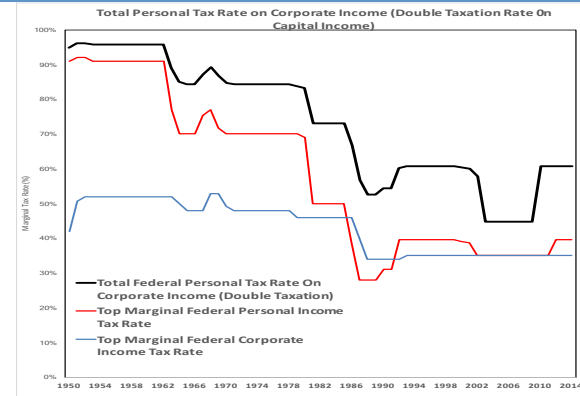
Step 3: Find Potential Catalyst

Trade 1: Buy US Equities--Current Tax Policy Is A Significant Headwind For Investing In The US

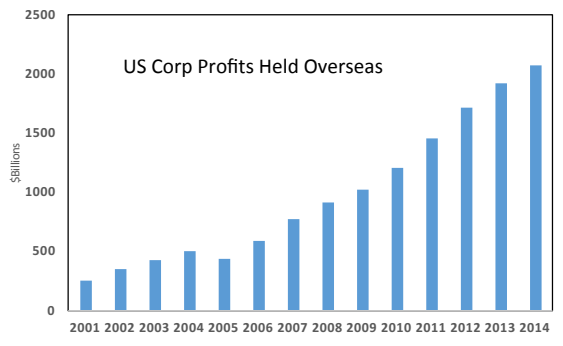
US Corporate Taxes Are The Highest in The Developed World ¹



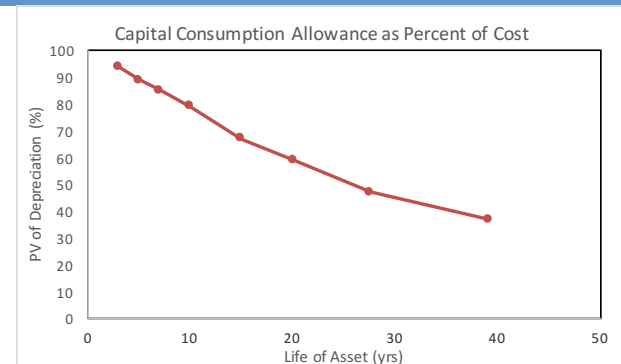
The Cost of Capital Is High Given Double Taxation ³



And Encouraged US Companies to Kept Their Profits Overseas ²



Depreciation Tax Policy Reduces the Incentive To Invest ⁴



1. KPMG
2. Credit Swiss Equity Research, "Parking A-lot Overseas", March 2015
3. IRS
4. Entin, Fellow, "the Tax Treatment of Capital Assets and Its Effect on Growth", Tax Foundation Background Paper, April 2013

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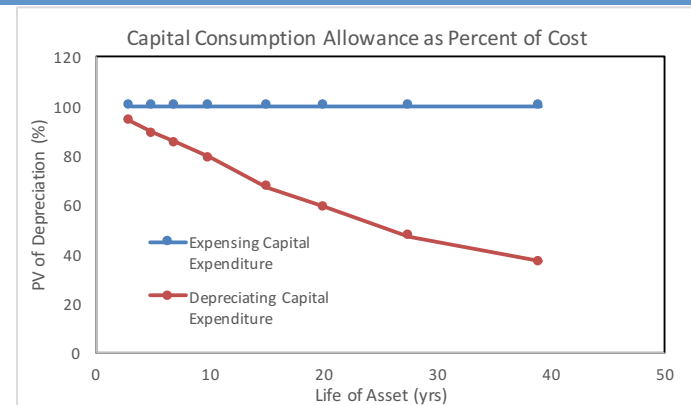
Step 3: Find Potential Catalyst

Trade 1: Buy US Equities--Corporate Tax Reform Could Remove Headwind And Spur Investment

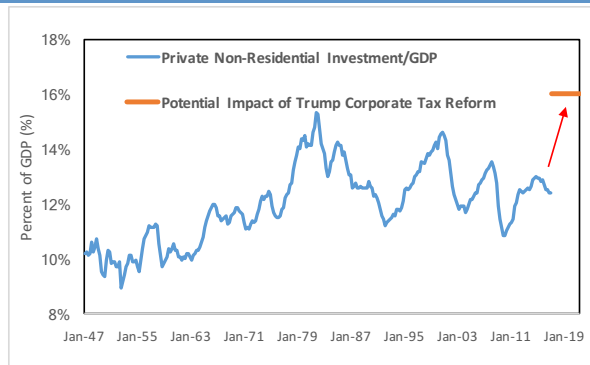
Trumpanomics Substantially Reduces Cost of Capital Investment¹

Category	Current law	Revised Trump plan	Change (percentage points)
Business investment	22.0	6.7	-15.3
Corporate	24.0	9.5	-14.5
Equipment	19.9	10.0	-9.9
Structures	27.9	10.0	-17.9
Intellectual property products	-0.1	5.1	5.2
Inventories	38.4	10.0	-28.4
Pass-through	18.9	2.6	-16.3
Equipment	15.5	3.2	-12.3
Structures	22.3	3.2	-19.1
Intellectual property products	-3.4	-2.5	0.9
Inventories	31.6	3.2	-28.4
Addendum			
Corporate (equity financed)	30.8	9.3	-21.5
Corporate (debt financed)	-7.4	10.1	17.5
Variation (s.d.) across assets	12.2	1.8	
Variation (s.d.) across industries	6.1	0.9	

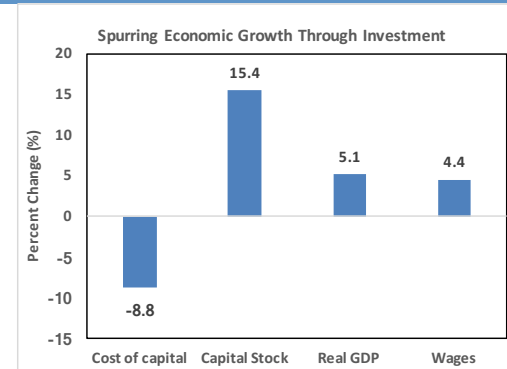
100% Expensing Could Reduce The Headwinds To Invest³



This Could Spur Investment Even Higher Than Reagan²



100% Expensing Could Provide Substantial Upside to Growth⁴



1. KPMG
2. Hufbauer and Lu, "Lessons for US Business Tax Reform from International Tax Rates", Policy Brief, Peterson Institute for International Economics, PB17.2, January 2017
3. Entin, Fellow, "the Tax Treatment of Capital Assets and Its Effect on Growth", Tax Foundation Background Paper, April 2013
4. McBride, "the Economic and Budgetary Effects of Full Expensing of Investment", Tax Foundation Blog, April 2014

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Step 4: Find Asymmetric Trades

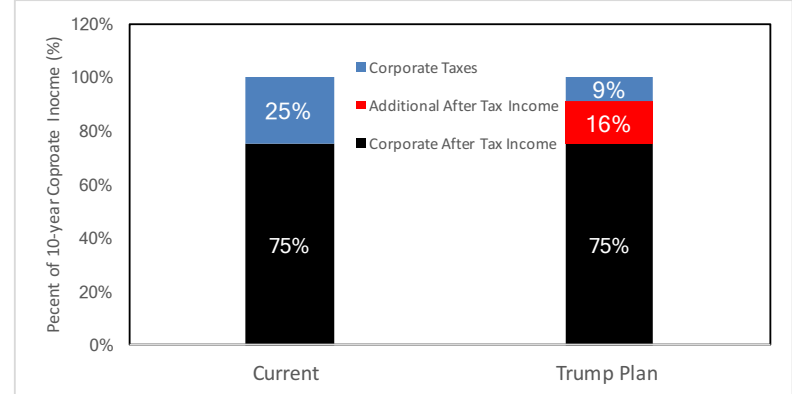
Trade 1: Buy US Equities—Positive Convexity of Trumpanomics + Underlying World Growth = Upside

If Passed, Trump's Corporate Tax Reform Will Reprice Equities

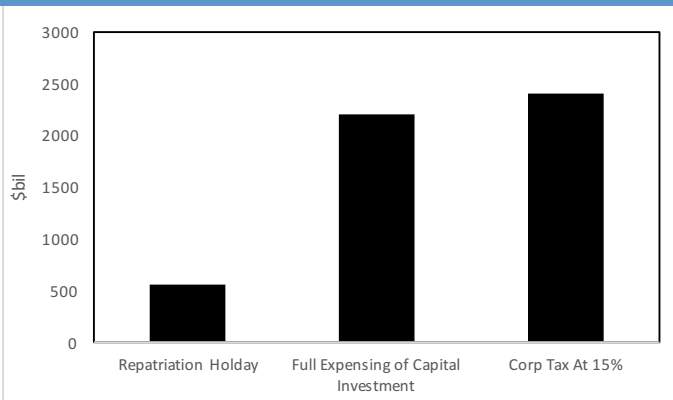
- Tax plan could add as much as \$5 trillion to after tax corporate income over the next 10-years
 - Tax repatriation holiday, \$0.5 trillion
 - Full expensing of capital investment, \$2.1 trillion
 - Tax cut from 35% to 15%, \$2.4 trillion
- Tax cut would add as much as 21% to after tax income
 - Could be more if economy grows faster from program
- Tax cuts could push equities substantially higher
 - Also push credit market tighter, particularly high yield

Risk is that nothing gets done

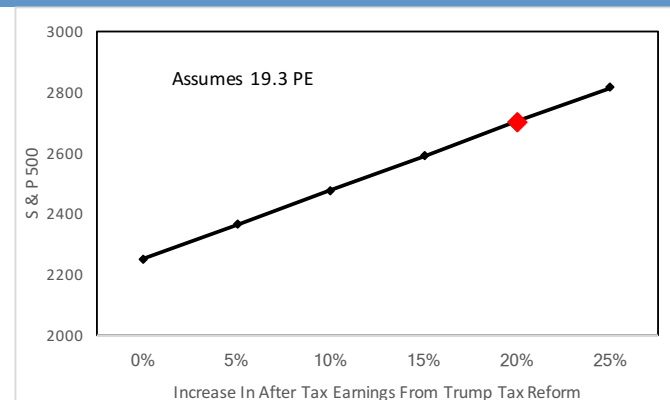
Fully Implemented, Trump Tax Plan Adds 20% to After Tax Income ^{1,2}



Tax Savings From Trump Corporate Tax Plan Over 10 Years ^{1,2}



Potential Impact of Trump Corporate Tax Reform on Equities



1. Jim Nunns, Len Burman, ect, "An Analysis of Donald Trump's Revised Tax Plan", Tax Policy Center, October, 2016
 2. Entin, Fellow, "the Tax Treatment of Capital Assets and Its Effect on Growth", Tax Foundation Background Paper, April 2013

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