



Trump's tax plan the trigger to watch

By Dan Purves (<https://investmentmagazine.com.au/author/dan-purves/>) | 15/02/2017

Investors need to identify the political and economic trends that will tell them whether globalisation is continuing apace, slowing down or going into reverse. These triggers will have profound implications for the performance of markets.

This was the advice Standard Life Investments chief economist Jeremy Lawson gave delegates at Portfolio Construction Forum Markets Summit in Sydney on February 14.



Corporations have done well out of globalisation. The trend has helped corporate profits consistently grow more quickly than nominal world gross domestic product. If globalisation goes into retreat, and the policies that support an open market go into retreat, corporate earnings growth will necessarily slow as well, Lawson told the summit.

“And if corporate earnings growth slows significantly, then the returns on equities are likely to slow significantly as well,” he explained. “This is going to have implications for what you as investors can expect from returns on your own investments and how you allocate across asset classes.”

Trump's tax trigger

One of the key triggers will be how US President Donald Trump's plan for tax reform shapes up.

The US has one of the highest corporate tax rates in the world, at about 40 per cent, KPMG says. However raises comparatively little tax revenue because of the number of exemptions in place. These disproportionately benefit large corporations, as they are able to afford the legal expertise to make use of the loopholes – something small businesses can rarely do.

Trump wants to reduce the corporate tax rate and remove exemptions, primarily to make the country more domestically business-friendly. The exact rate has not been decided, though Trump has floated the idea that should be between 15 per cent and 20 per cent.

Another aspect of his proposed plan is to introduce tax incentives to promote exports while applying tax penalties on imports – in effect a trade tariff. This could dramatically decrease the bottom line of companies that rely on imports, as well as potentially spark a trade war with other countries.

What stands in Trump's way

There are four threats to Trump's plan for improving the US economy, professor Niall Ferguson told the summit via video link.

The first is Trump's standing in the polls. His first day in the Oval Office was the height of his popularity to date, and he entered that as the least popular incoming president since polls began. This unpopularity will bring pressure to change his plans, from both his cabinet and the other branches of government, said Ferguson, a senior fellow at Stanford University's Hoover Institution.

Arizona Senator John McCain was deemed the second biggest threat to Trump. He is arguably the biggest antagonist against the president's agenda within the Republican Party, having already opposed many proposals. McCain is also likely to pursue Trump's connection with Russia to the bitter end, making him one to watch, in Niall's analysis.

The third threat comes from the headwinds in the economy. Trump aspires for a growth rate of up to 6 per cent, but the consensus among economists is that it will be nowhere near this. The Federal Reserve System is predicting growth of up to 2.3 per cent. This stems from secular stagnation that threatens to override any gains that would be made under Trump's proposed reforms.

The fourth threat Ferguson cited was the level of the deficit. If growth does not pick up and the tax reforms do not generate new revenue, then the deficit impact could become much more than the predicted increase of \$1 trillion-\$2 trillion over 10 years. This, again, could severely curtail Trump's plans for change, by limiting his options.

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