



STRATEGAS

Capital Investment Advisors

**Governing & Campaigning
In a De-Leveraging Environment**

September 2012

Daniel Clifton
Head of Policy Research
Strategas Research Partners

Key Policy Themes

- The US Is Undergoing A Once In 70-Year Deleveraging Process
- Austerity Is Not A Winning Political Issue
- Fiscal Cliff Is A Symptom of the Larger Issues
- The Bill Comes Due In '13 & Congress Will Be Forced To Act On Tax/Spending
- Energy Becomes The New Jobs Policy



STRATEGAS

Election 2012 Themes

- Trajectory of the Economy Is Key
- Presidential Approval Rating Is Best Indicator To Watch
- Approval Rating Has Been Tied To Unemployment Rate
- Equity Market Is Pricing In An Obama Victory But Headwinds Remain
- House Likely To Stay GOP
- Senate is 50/50 At This Point



Mapping Out The Policy Landscape

- 1. 2012 Pre-Election**
- 2. 2012 Election Outcome**
- 3. 2012 Lame Duck Congress**
- 4. 2013 Policy Implications**



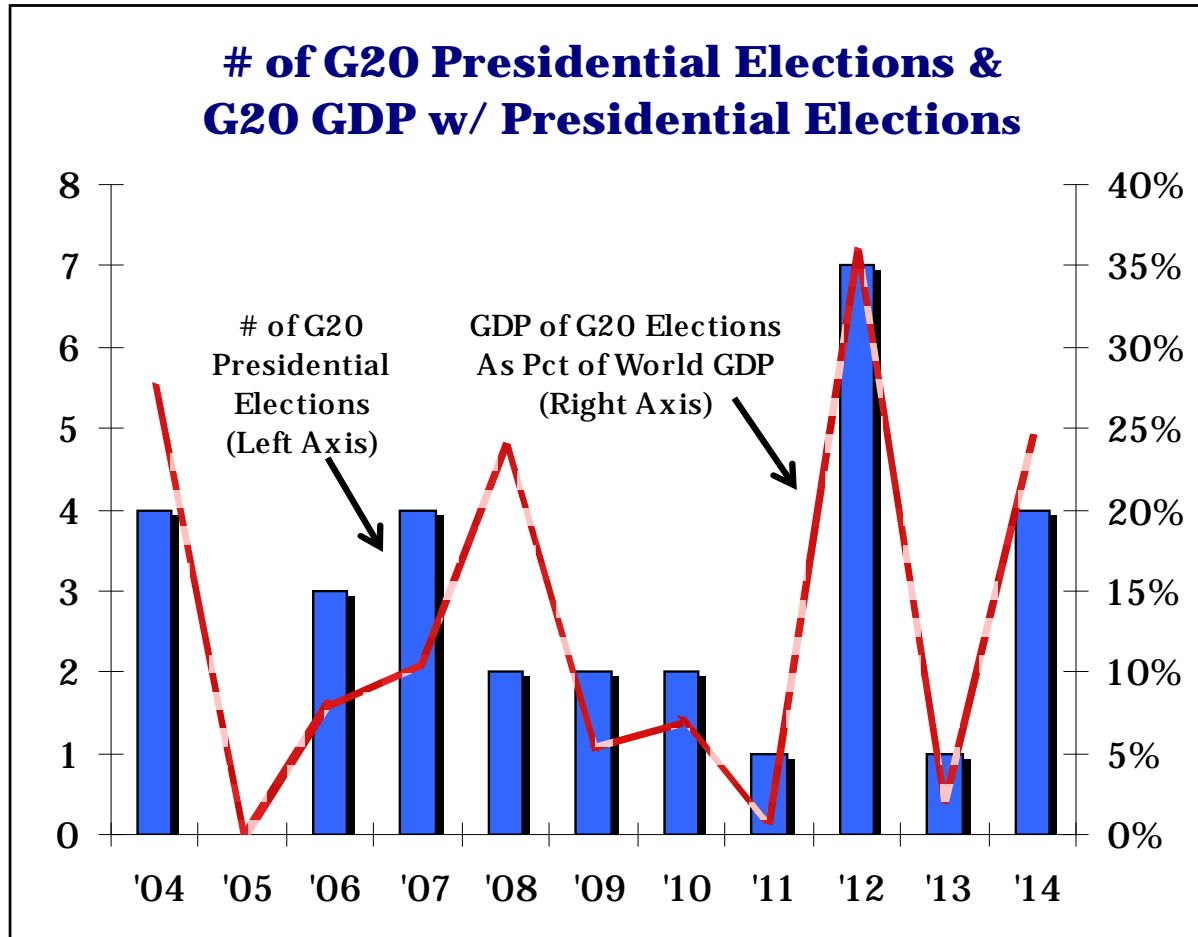
STRATEGAS

2012 Pre-Election



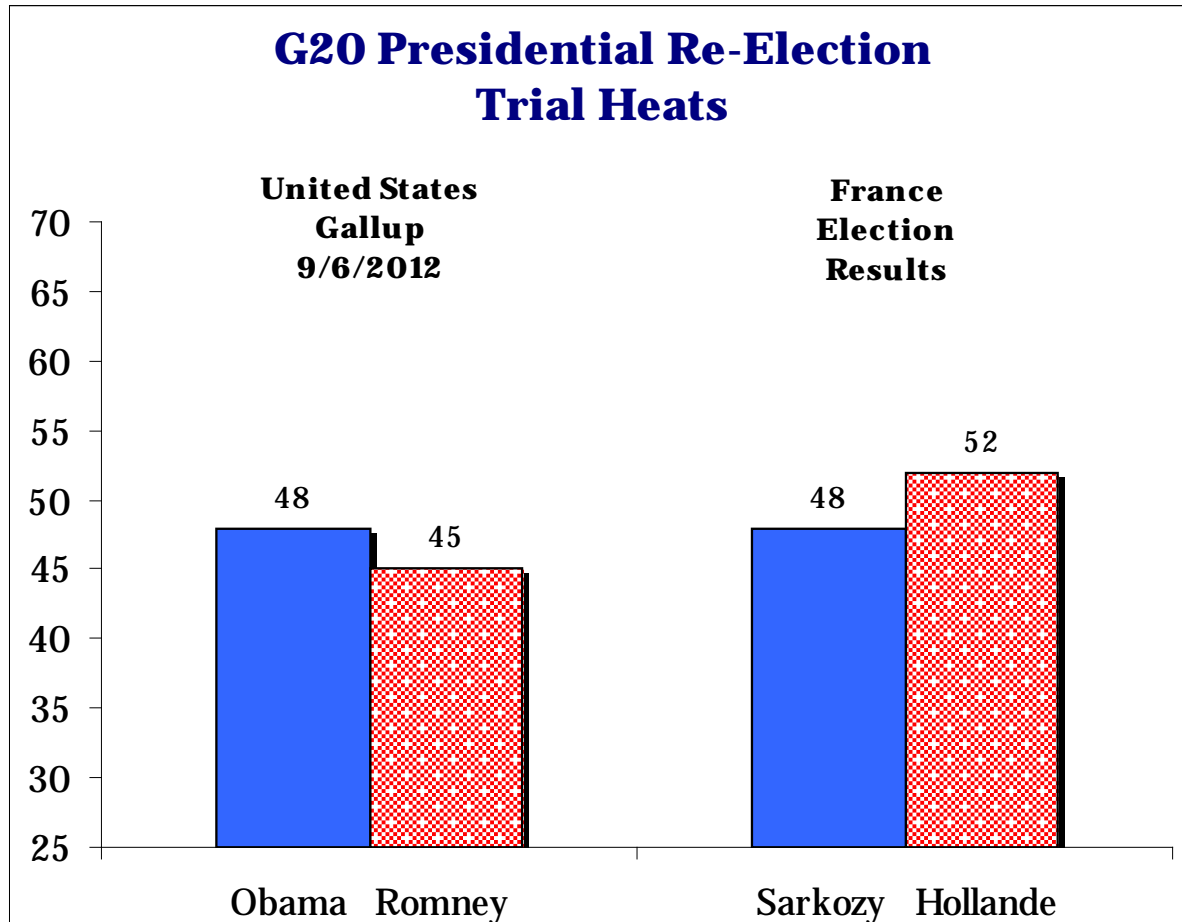
STRATEGAS

Countries Representing 50 Pct World GDP Changing Presidencies



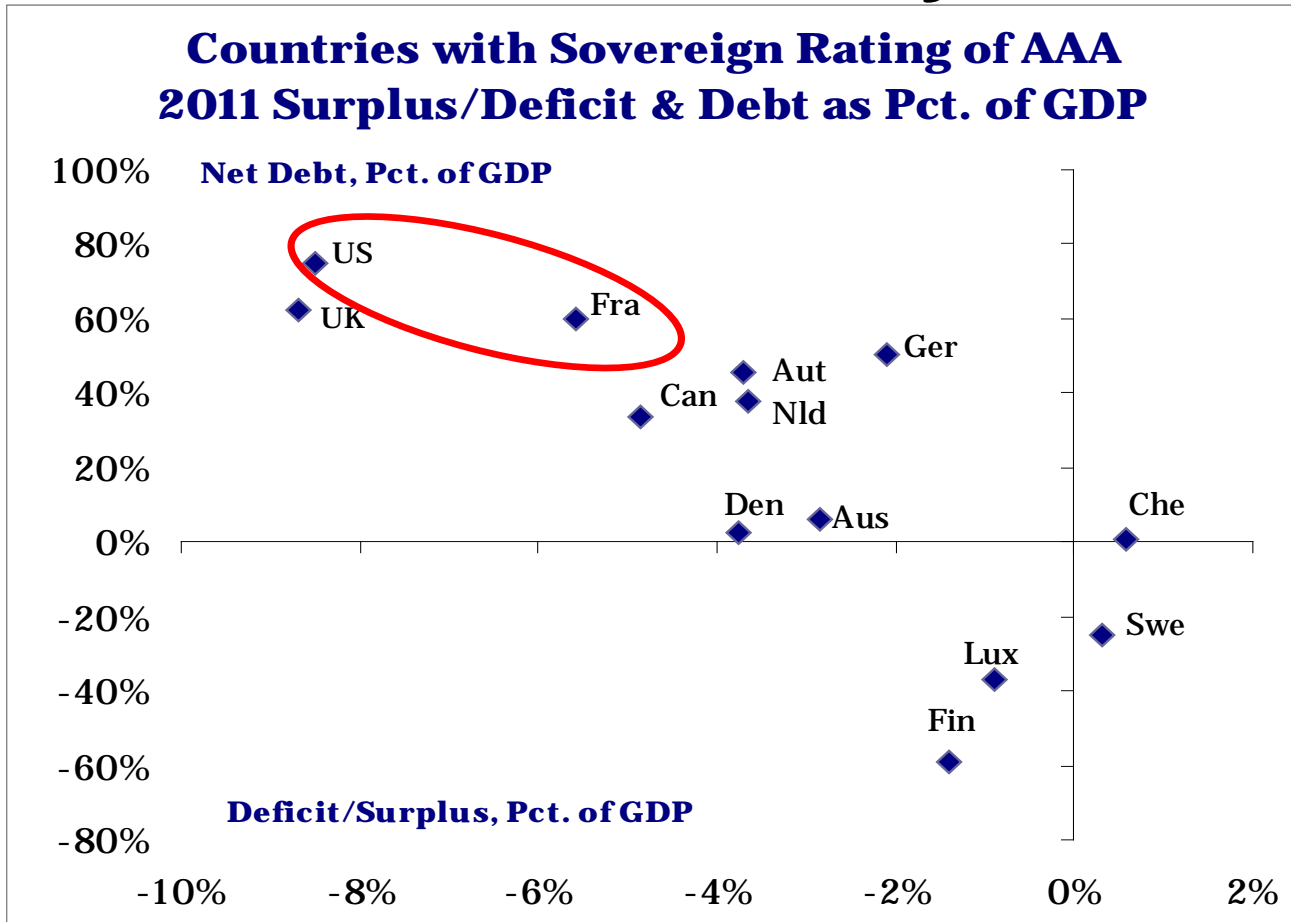
STRATEGAS

Struggling Economy = Unpopular Incumbents

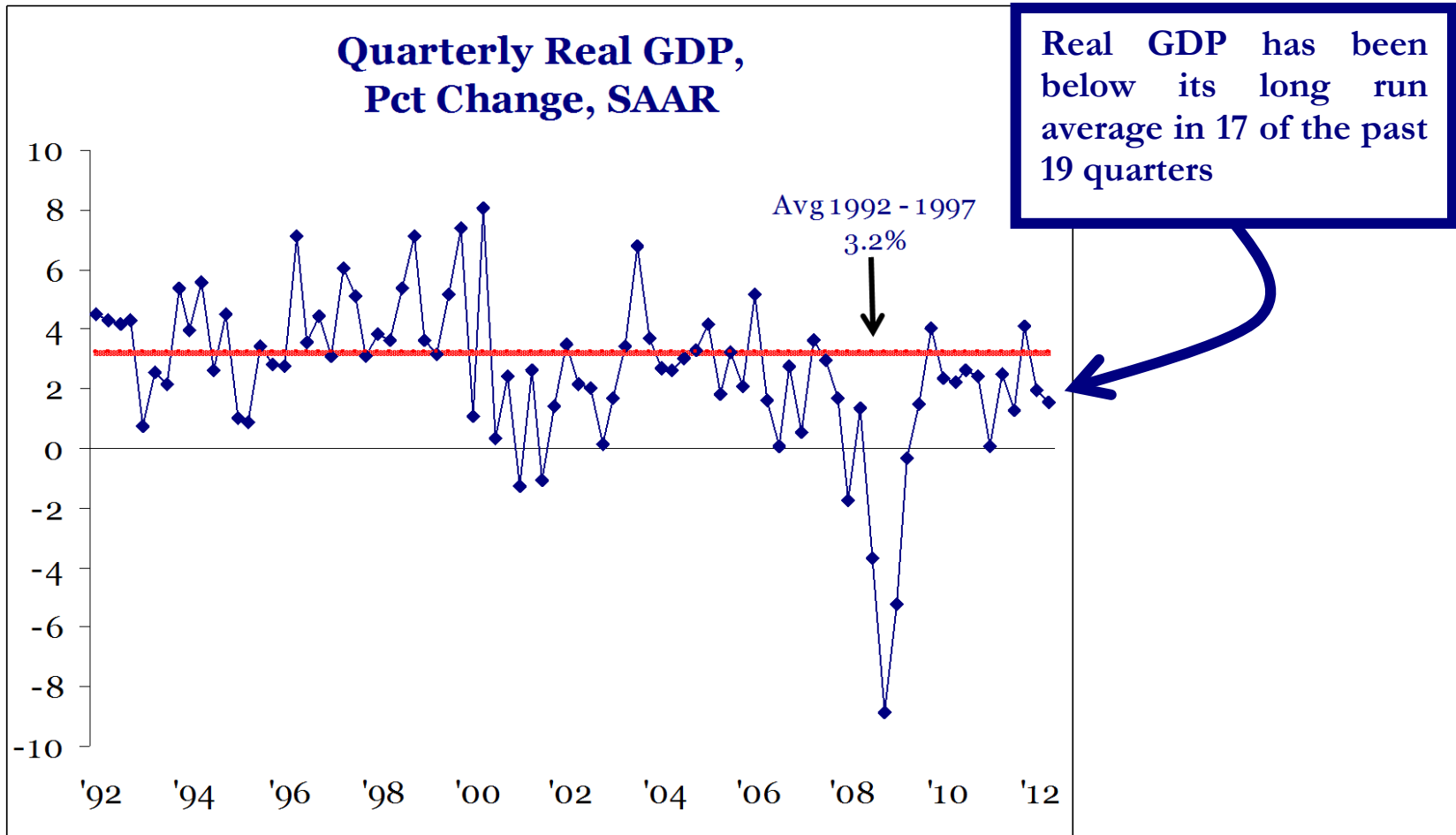


STRATEGAS

Large Budget Deficits & Debt Limit New Fiscal Policy Stimulus

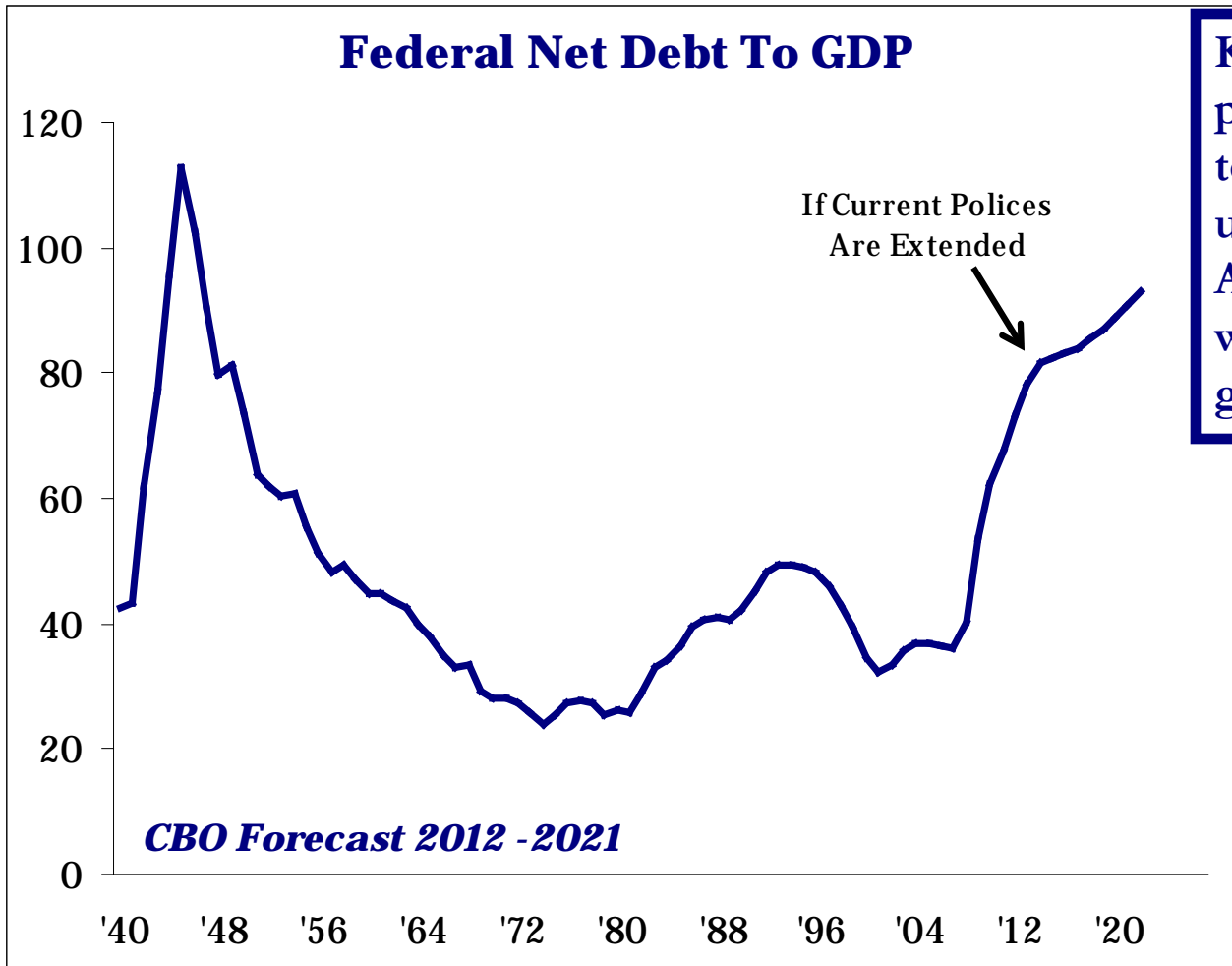


The Challenge for Policymakers: Below Trend Economic Growth...



STRATEGAS

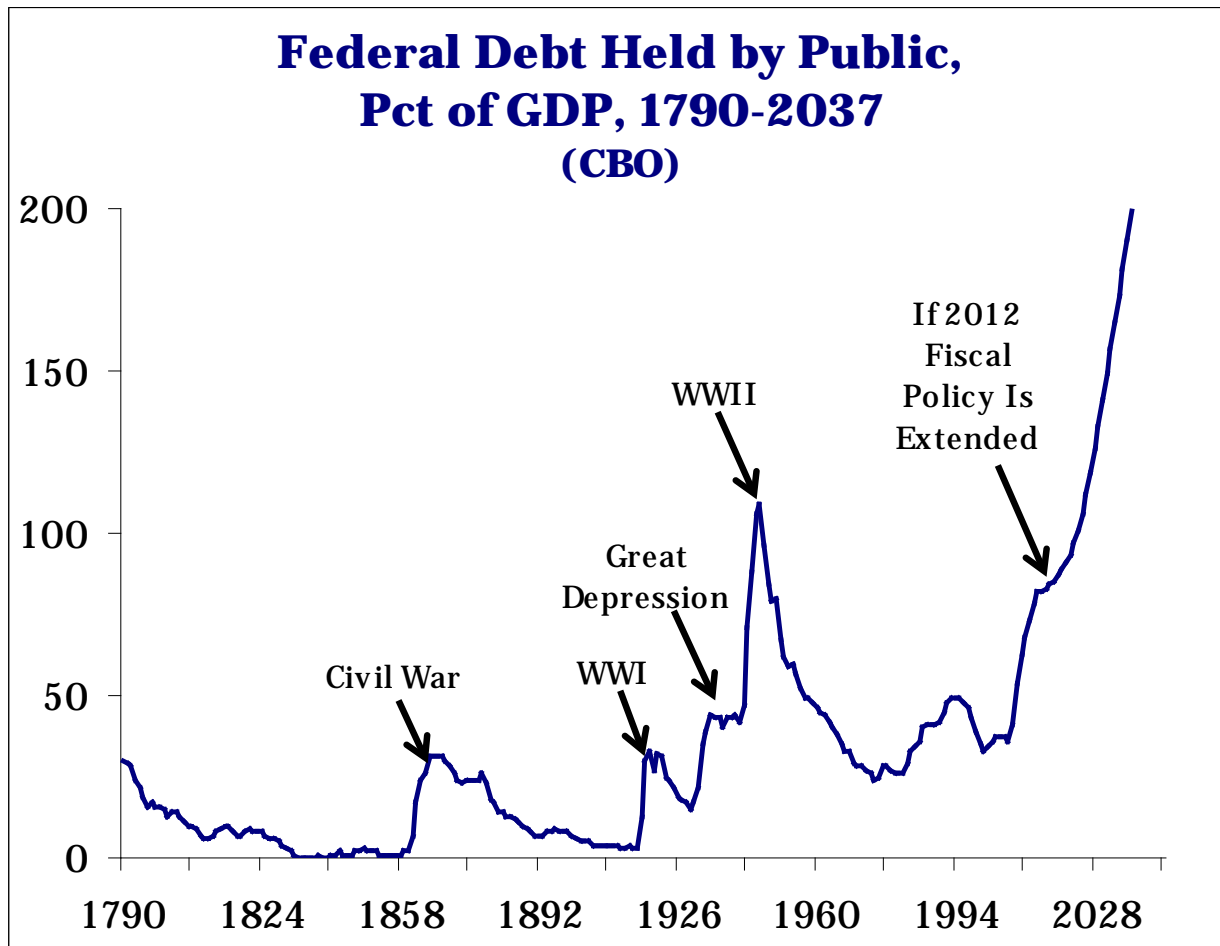
With A Rising Debt to GDP Ratio



Keeping 2012 laws in place will send Debt to GDP to unsustainable levels. Austerity has to occur while the economy is growing below trend.

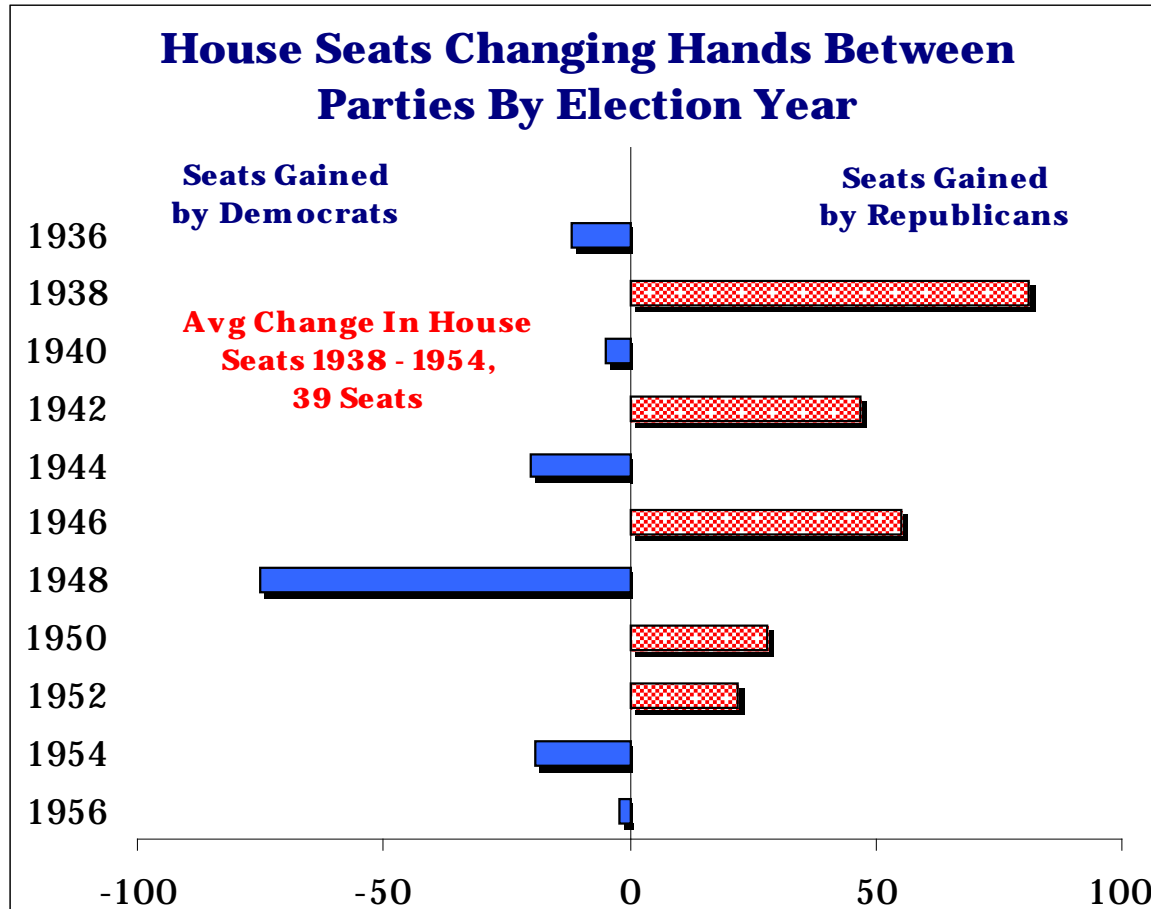


Placing In Context The US Budget Challenge



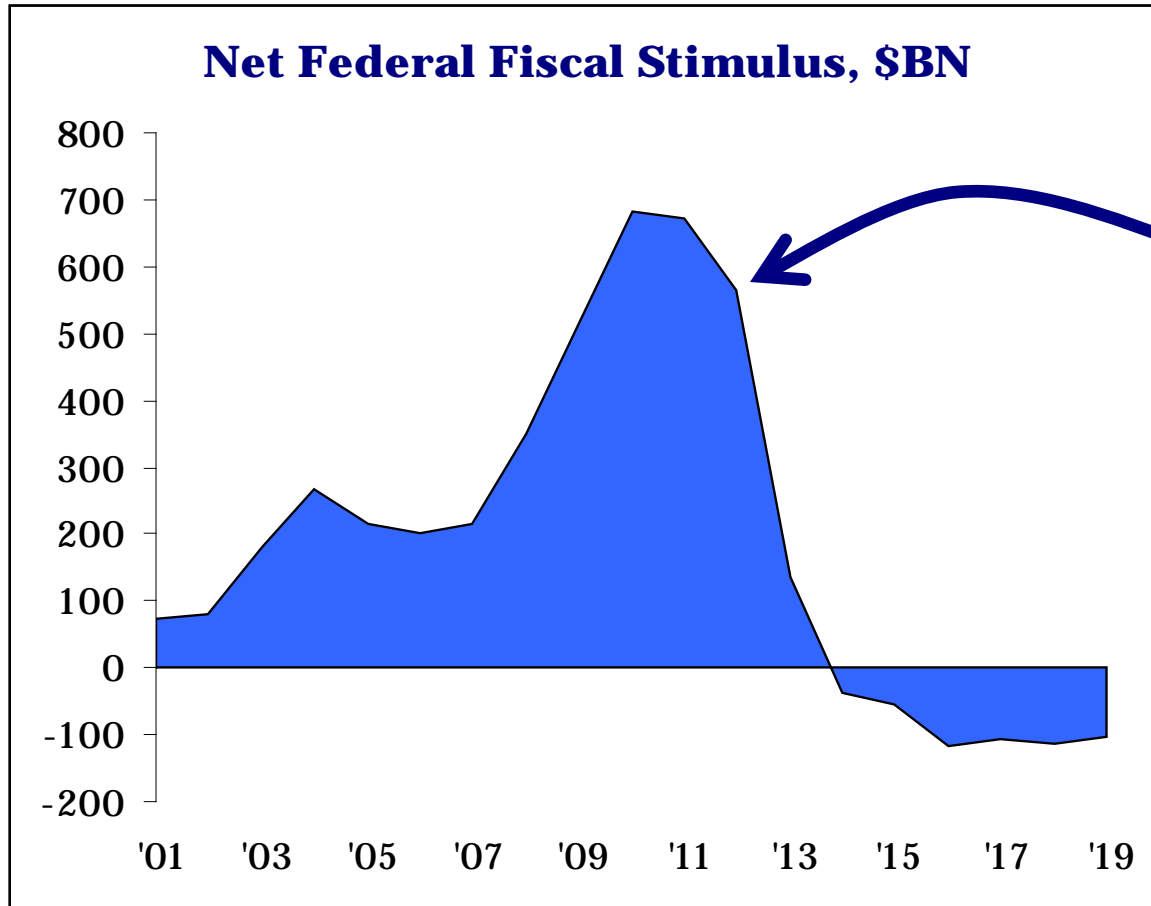
STRATEGAS

And Austerity Is Needed, Which Is Not A Winning Political Strategy



STRATEGAS

The Bill Comes Due Post-Election



The fiscal cliff approaching is about \$537bn in 2013. The election will have an outsized impact on how the issue is resolved. But we are skeptical the entire drag can be offset in 2013.

Forecast 2012-2021, Joint Committee On Taxation, Congressional Budget Office, Strategas



STRATEGAS

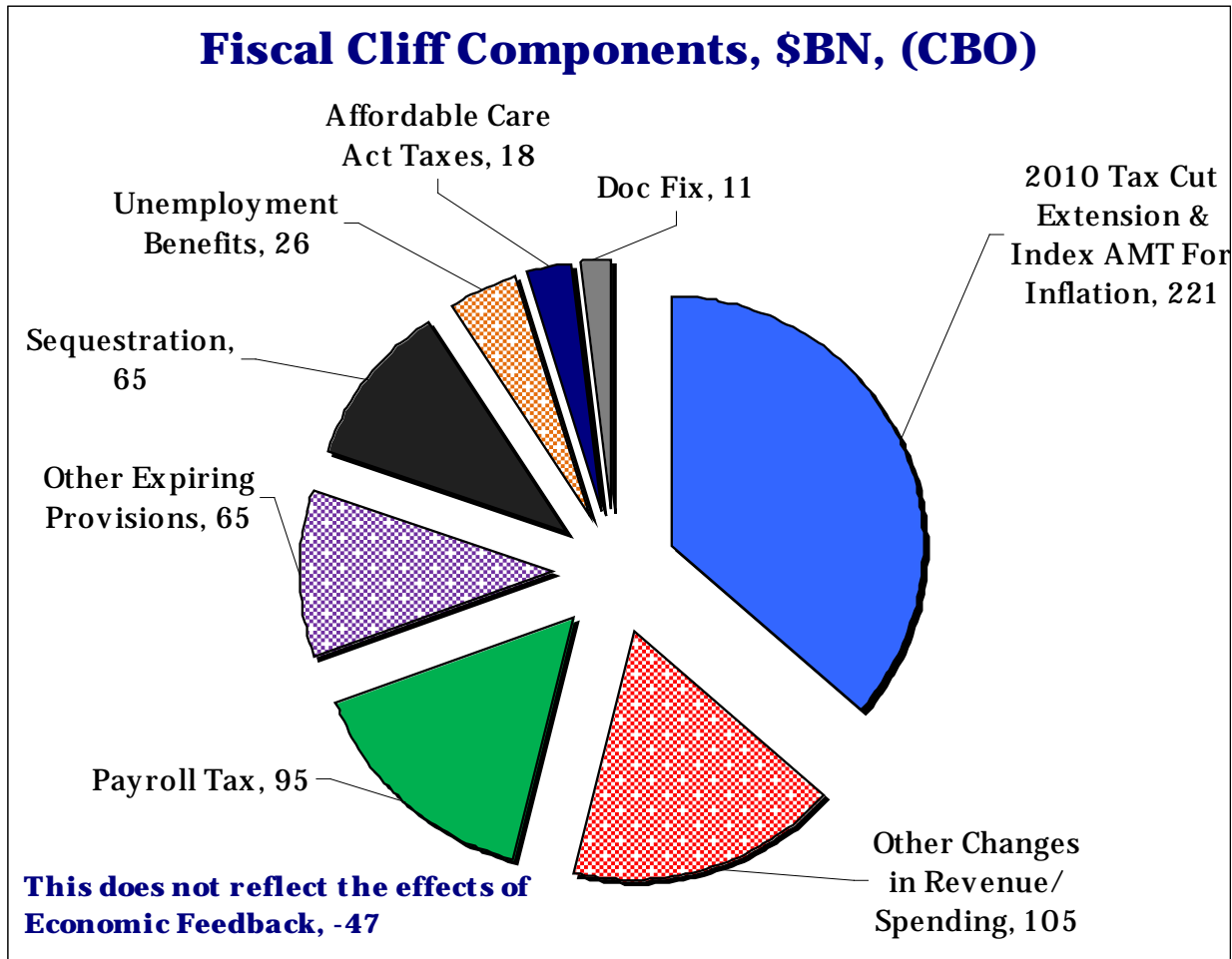
The Fiscal Cliff Could Serve As A Catalyst For A Grand Fiscal Deal

- **Expiration of the Bush Tax Cuts**
- **Expiration of the AMT Patch**
- **Expiration of the Payroll Tax Cut/UI**
- **Obama Healthcare Tax Increases Begin**
- **2009 Stimulus Spending Rolling Over**
- **Sequestered Spending Take Effect**
- **Debt Ceiling Will Need To Be Raised**



STRATEGAS

Components of the Fiscal Cliff



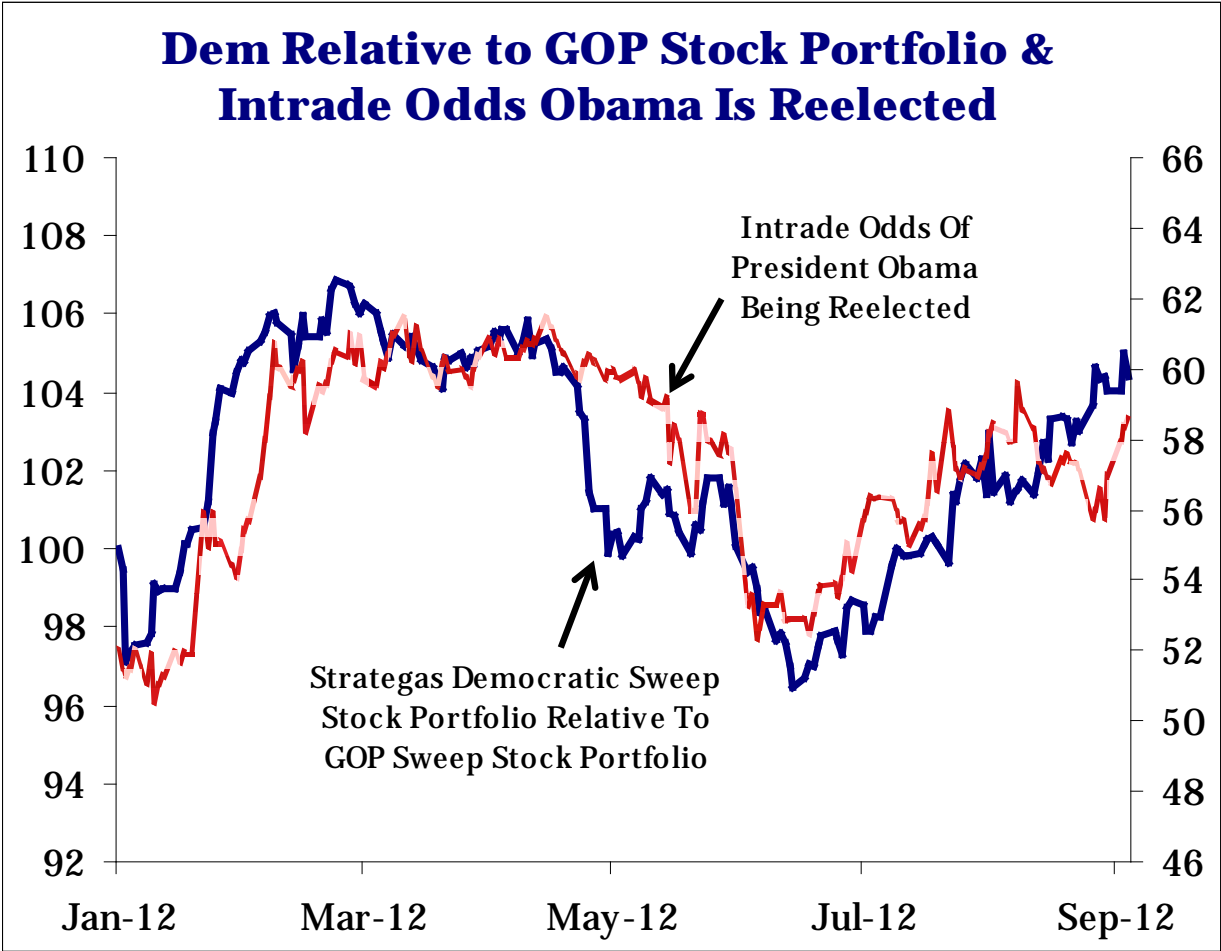
STRATEGAS

2012 Election



STRATEGAS

Equity Market Is Pricing In An Obama Victory



STRATEGAS

Framework For Analyzing The 2012 Election



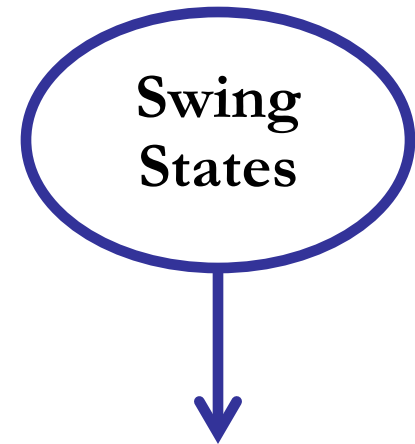
Which Is It?:

- Retrospective Referendum
- Prospective Choice



Trajectory:

- Jobs, Gas Prices
- Real Per Capita Disposable Income



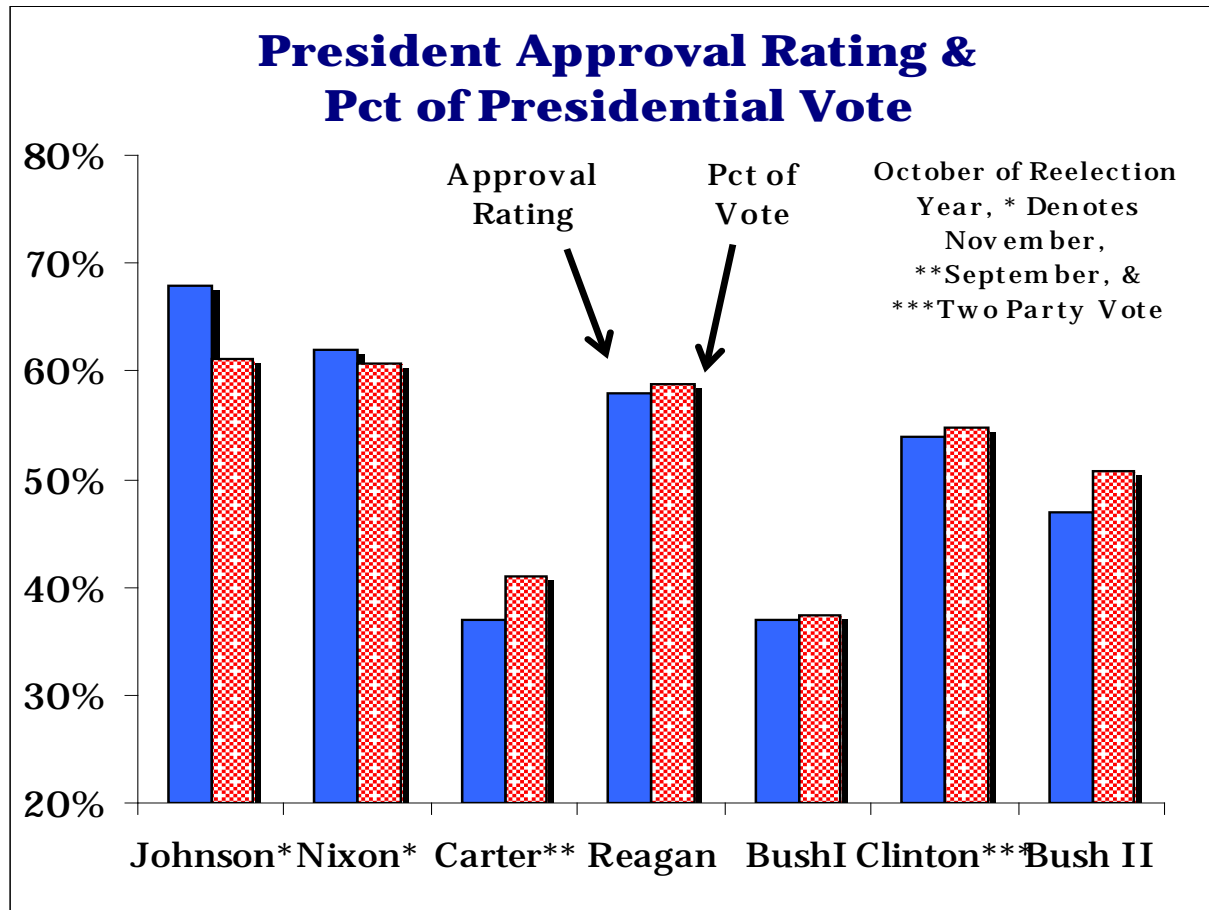
State By State

- State Economy
- Demographics



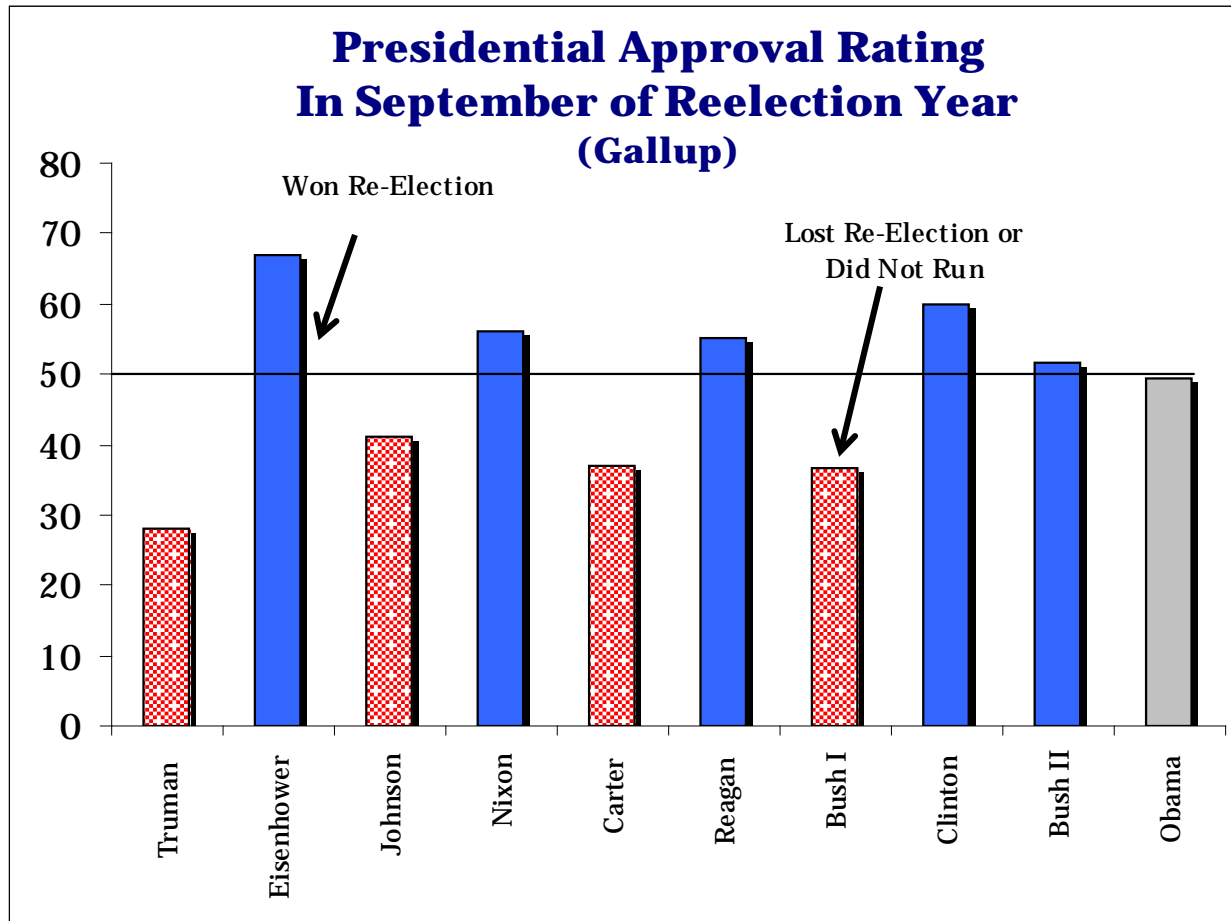
STRATEGAS

Approval Ratings Dictate The Percentage Vote For An Incumbent



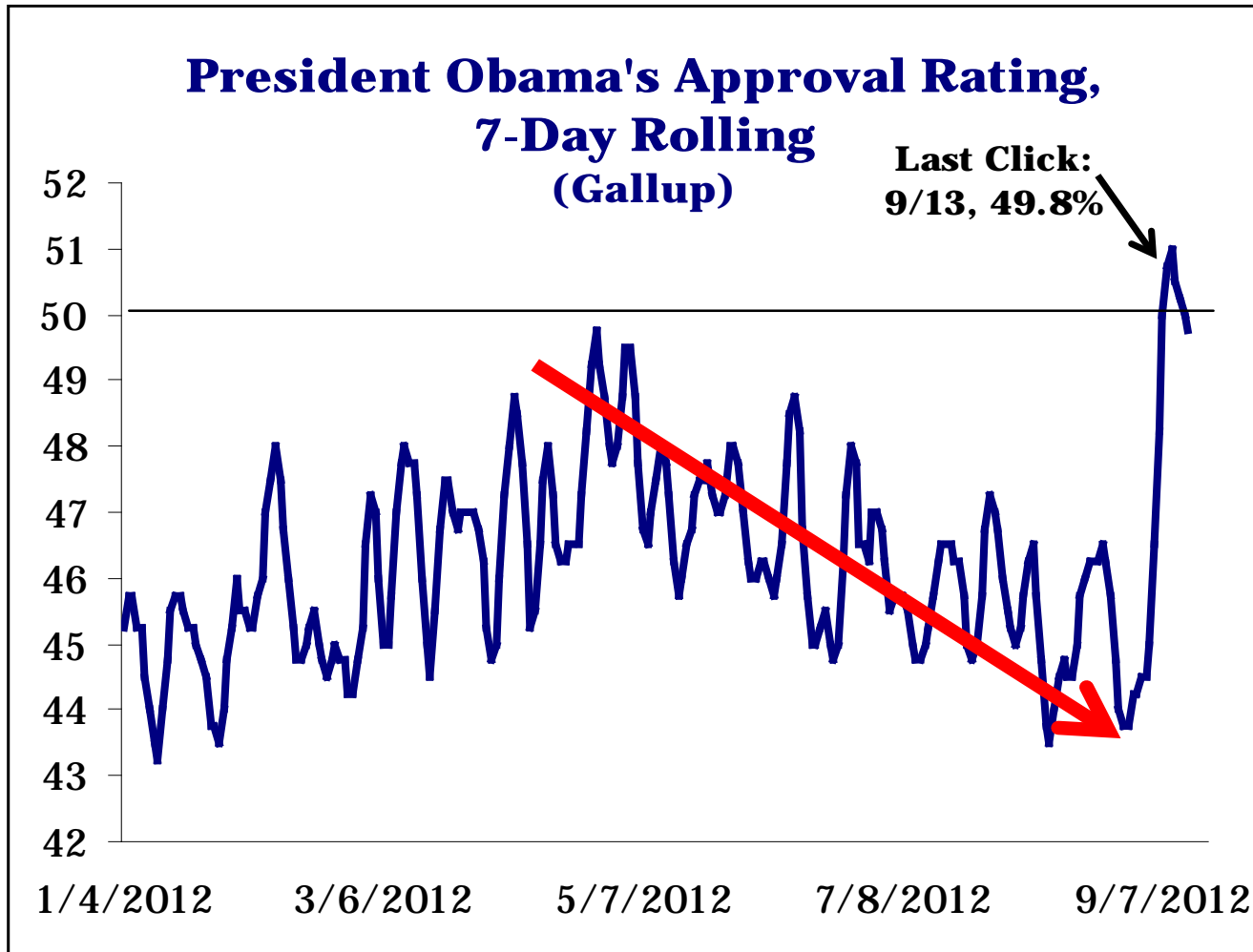
STRATEGAS

Approval Ratings Are Key: Obama In A Grey Area



STRATEGAS

Will The Convention Bounce Last?



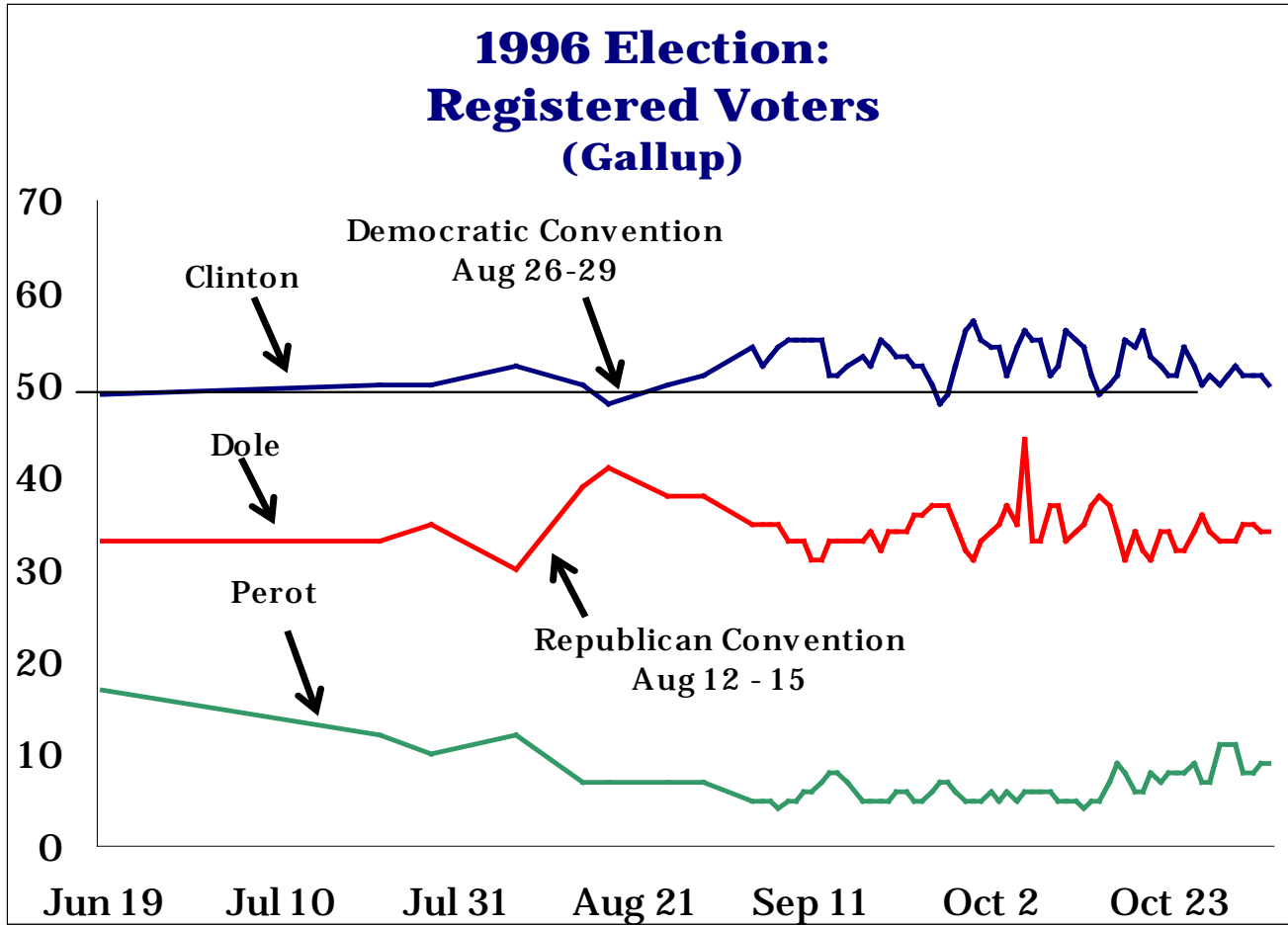
STRATEGAS

Ultimately, The Economy Is Driving The President's Approval Rating



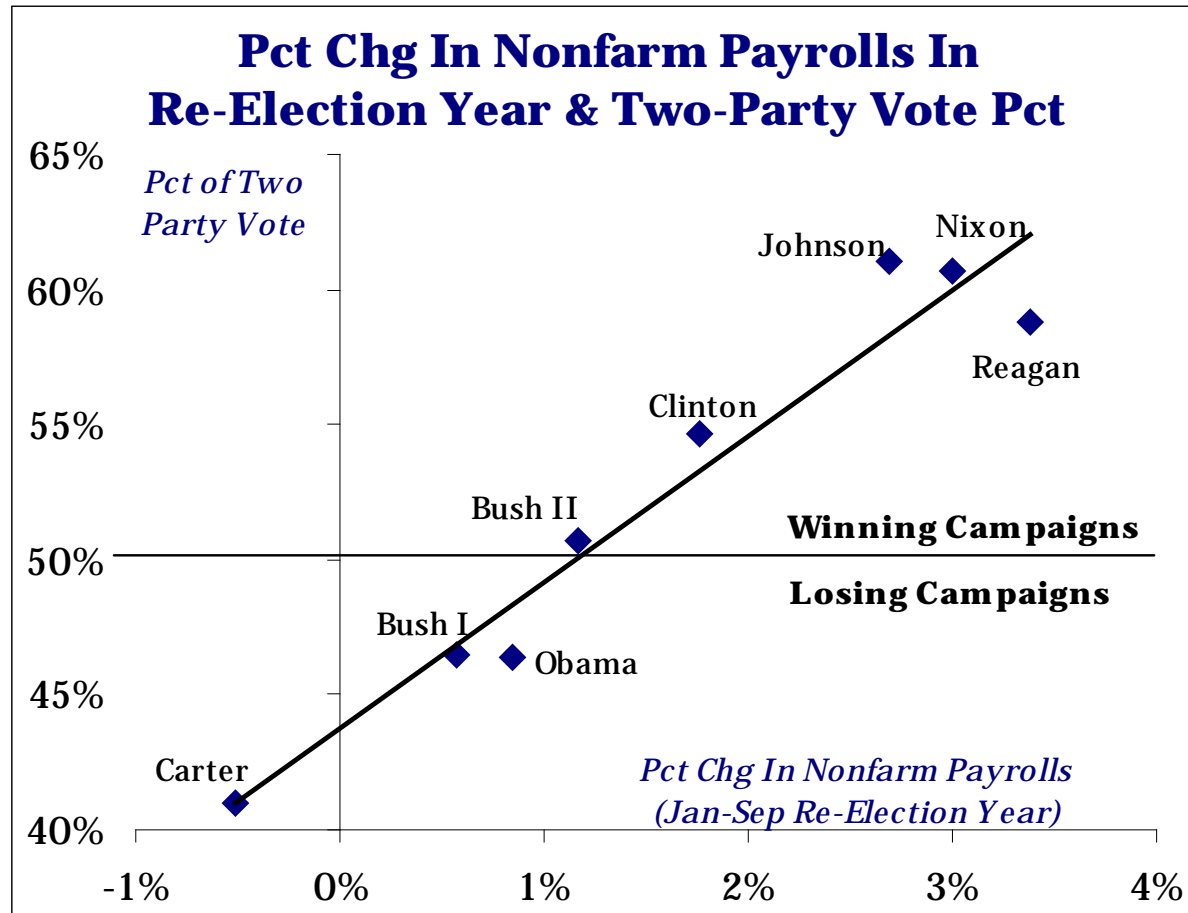
STRATEGAS

Obama Hoping For A Clinton “Glide Path” Effect



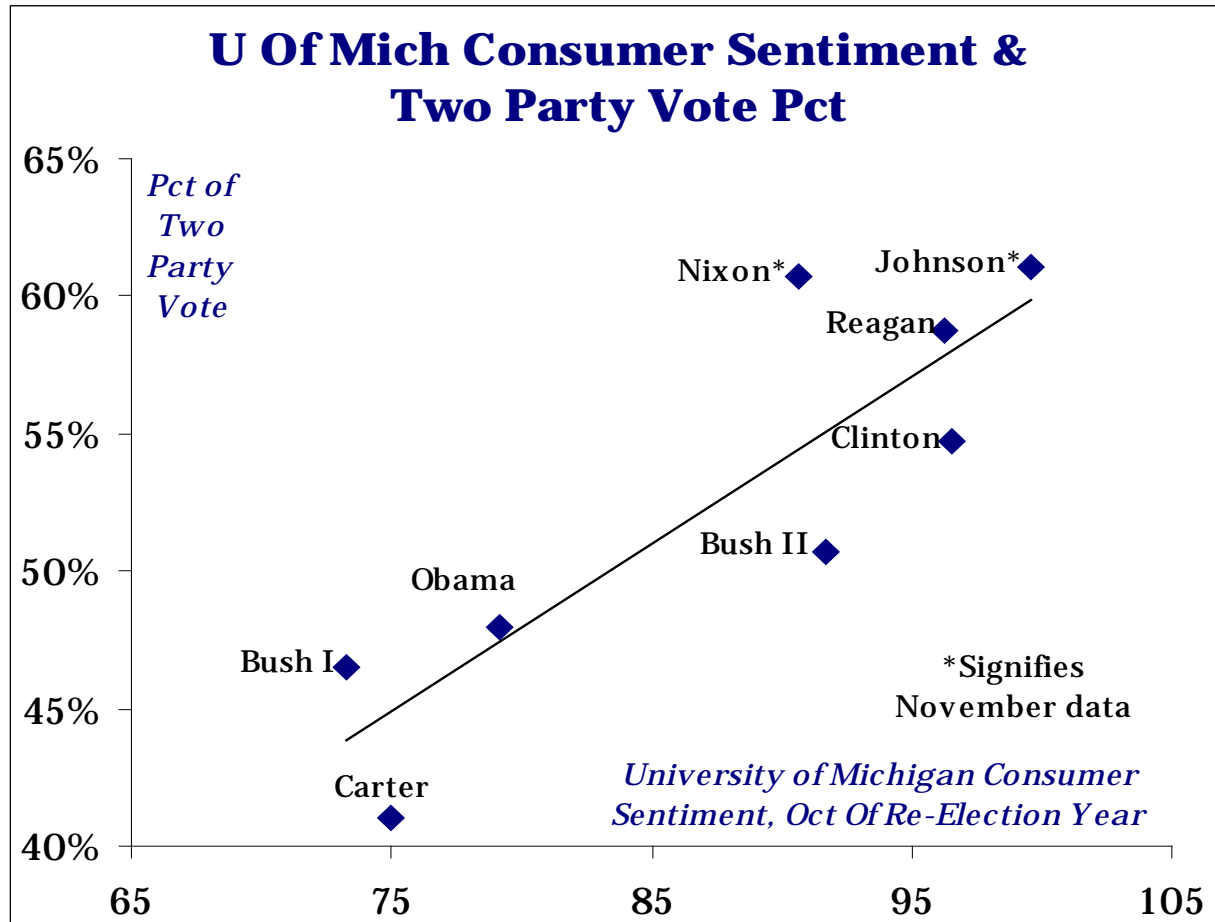
STRATEGAS

President Still Needs Employment Growth Through The Election



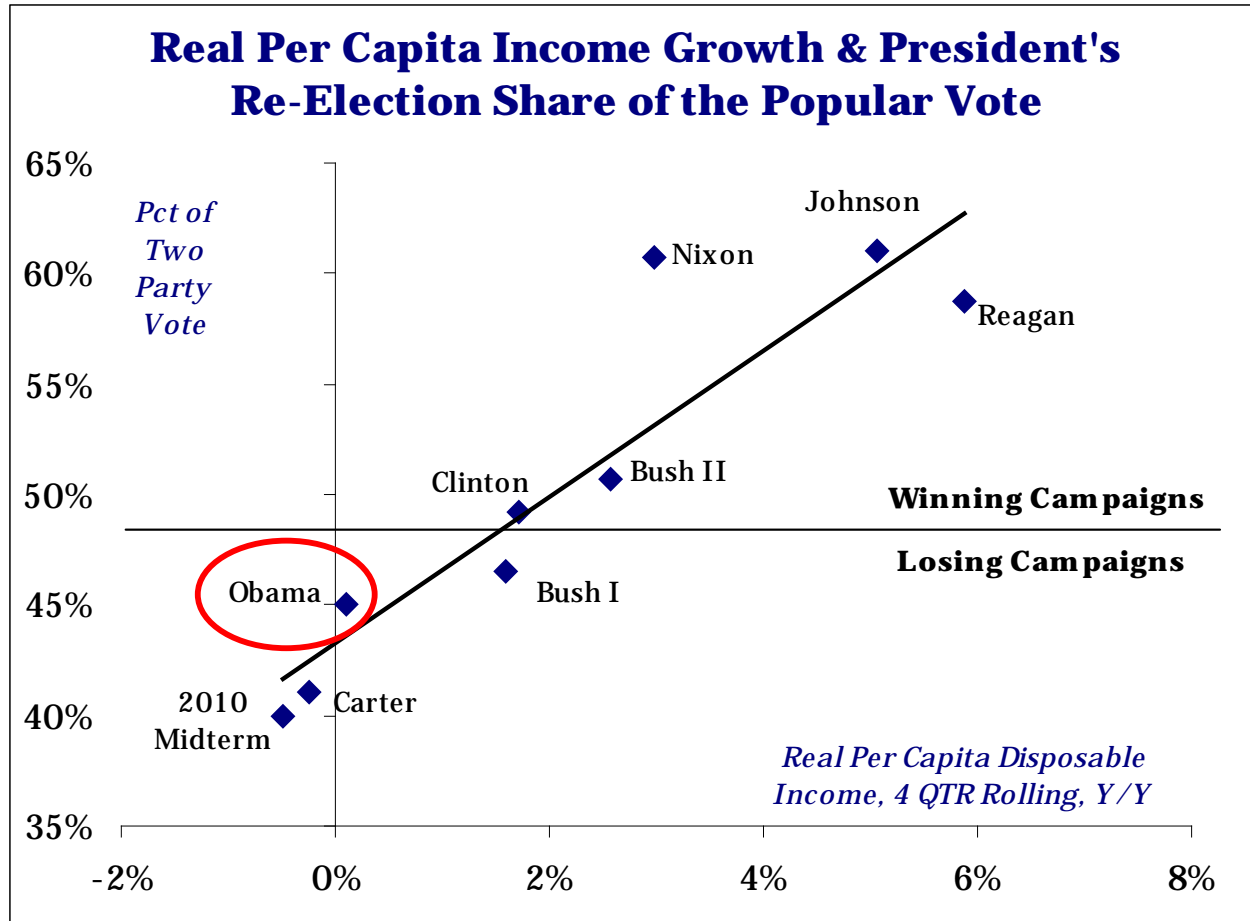
STRATEGAS

Consumer Sentiment Has Been A Good Predictor of Reelection



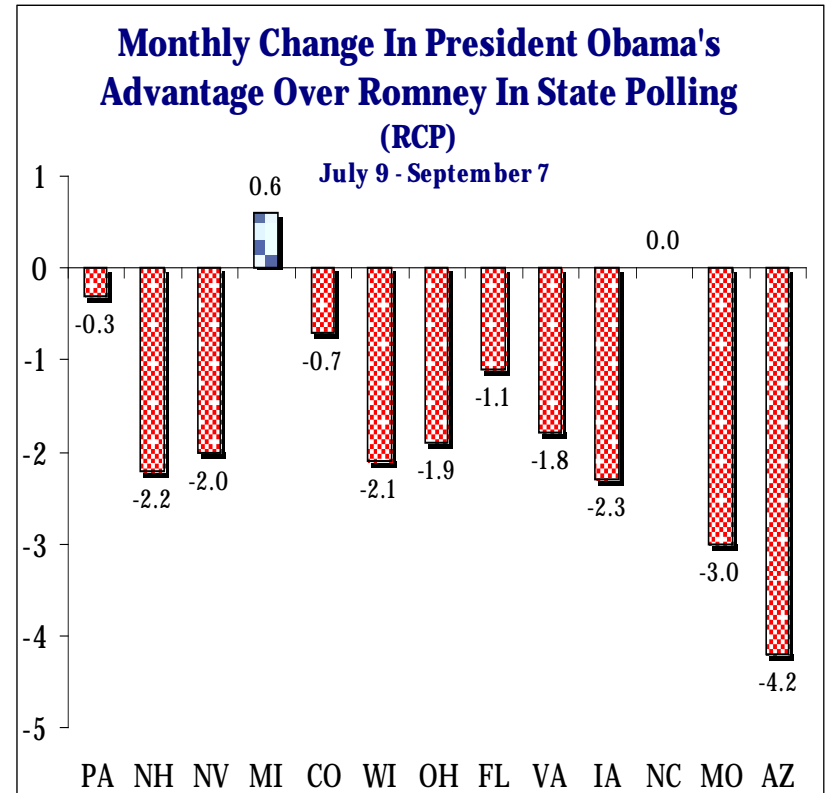
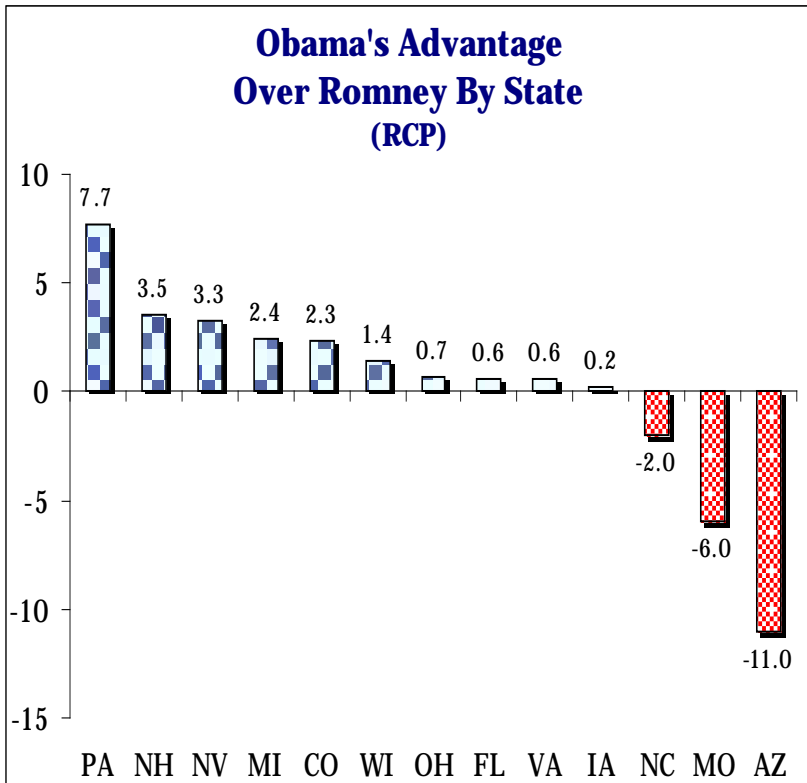
STRATEGAS

After-Tax, After-Inflation Income Is A Good Predictor of Re-Election



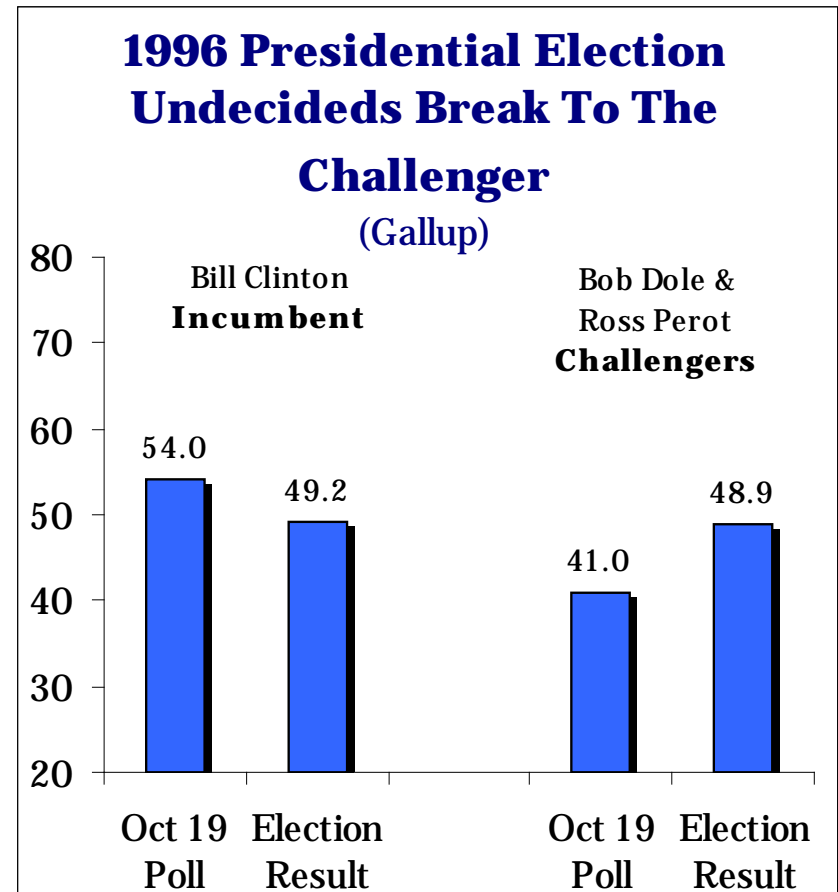
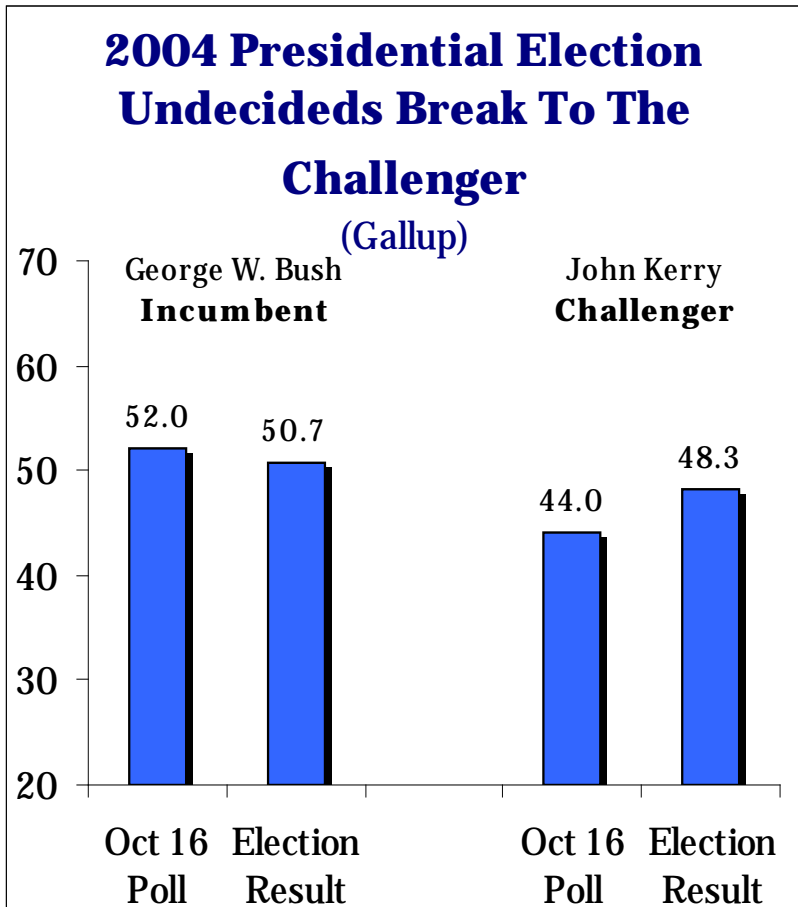
STRATEGAS

Key To States Is Watching Which Candidate Gets Over 50 Pct

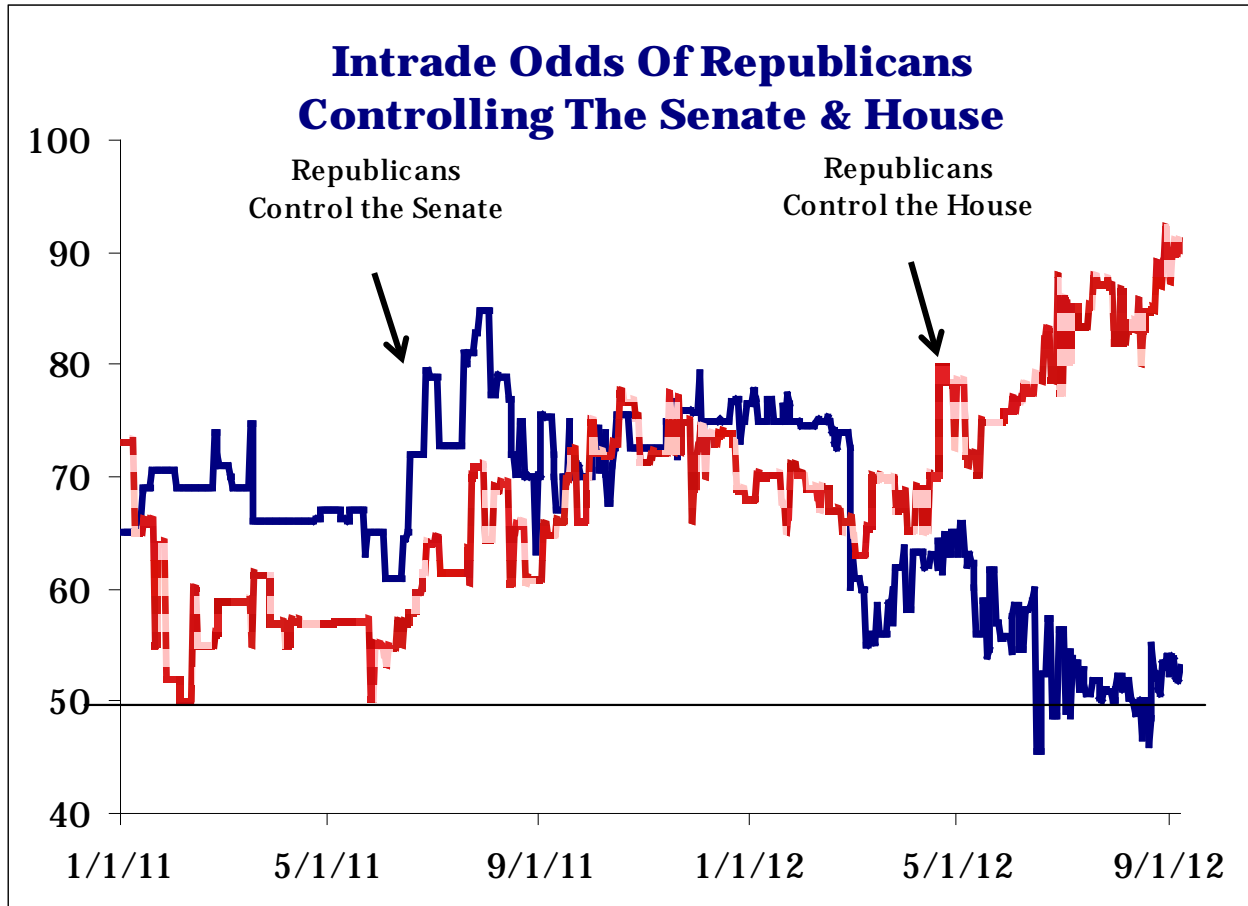


STRATEGAS

Undecided Voters Break To The Challenger In Mid-October

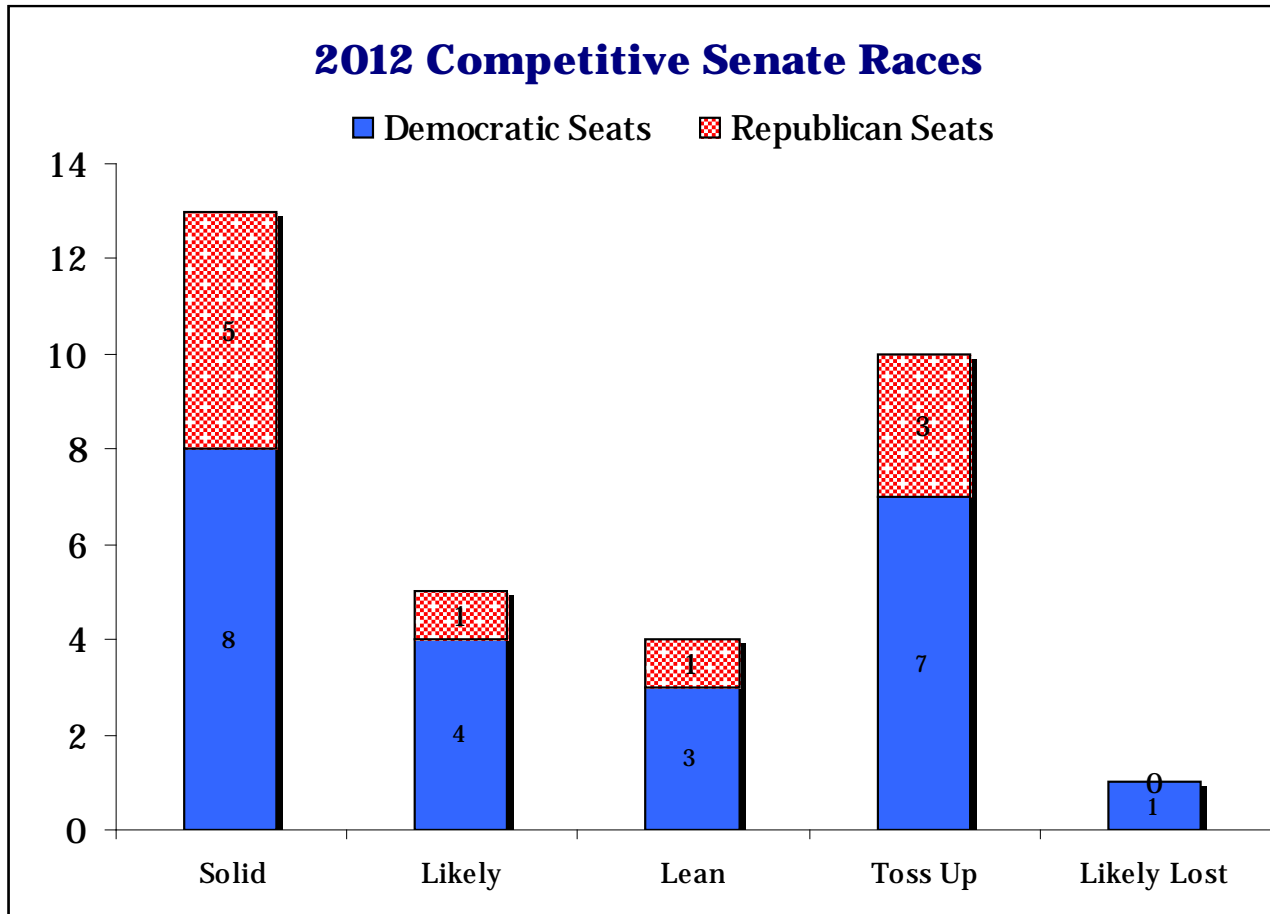


Consensus Pointing To A GOP Sweep In Congress



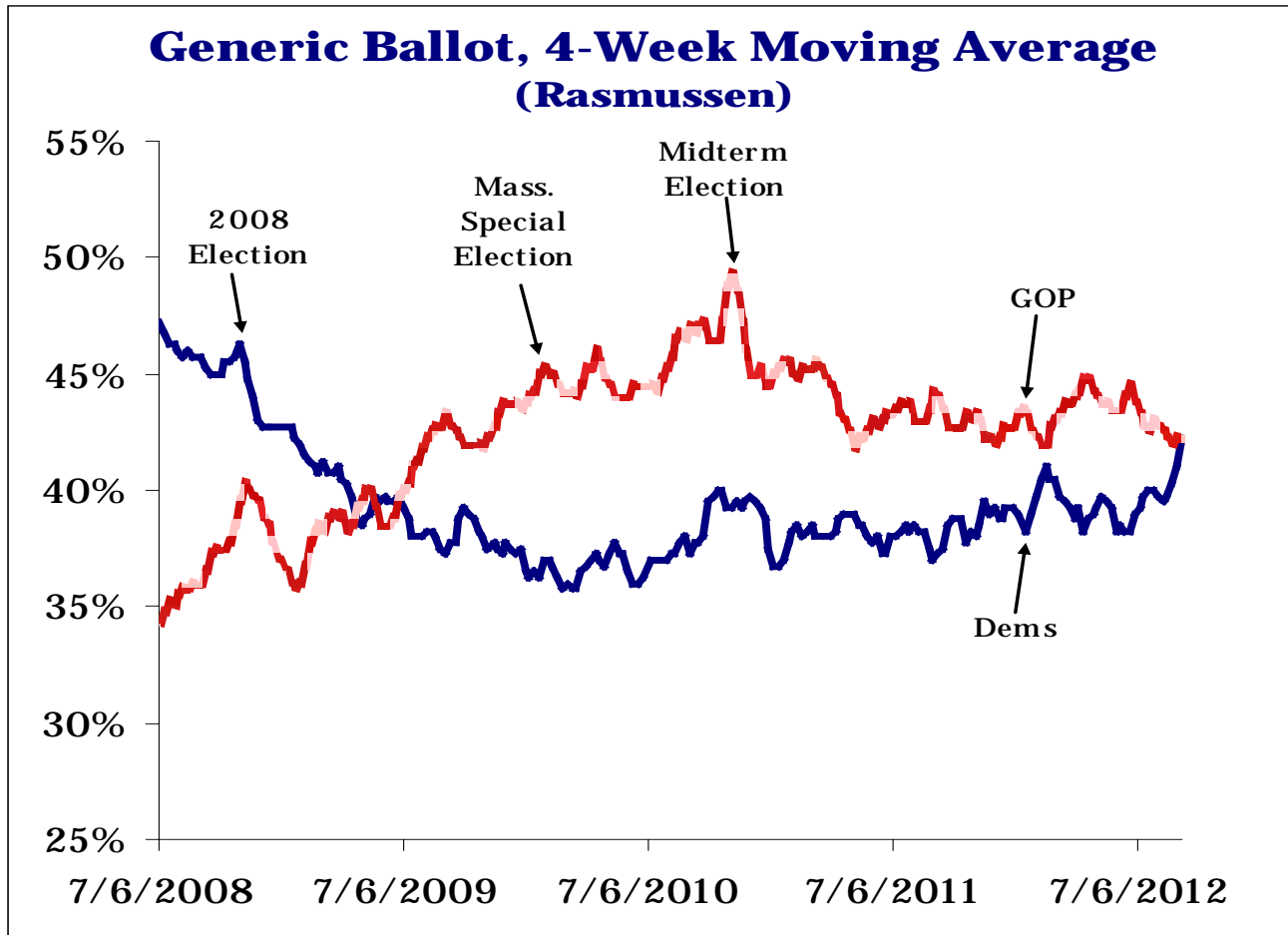
STRATEGAS

Democrats On Defense In The Senate But Holding Strong



STRATEGAS

No Wave Election But Democrats Are Gaining Momentum



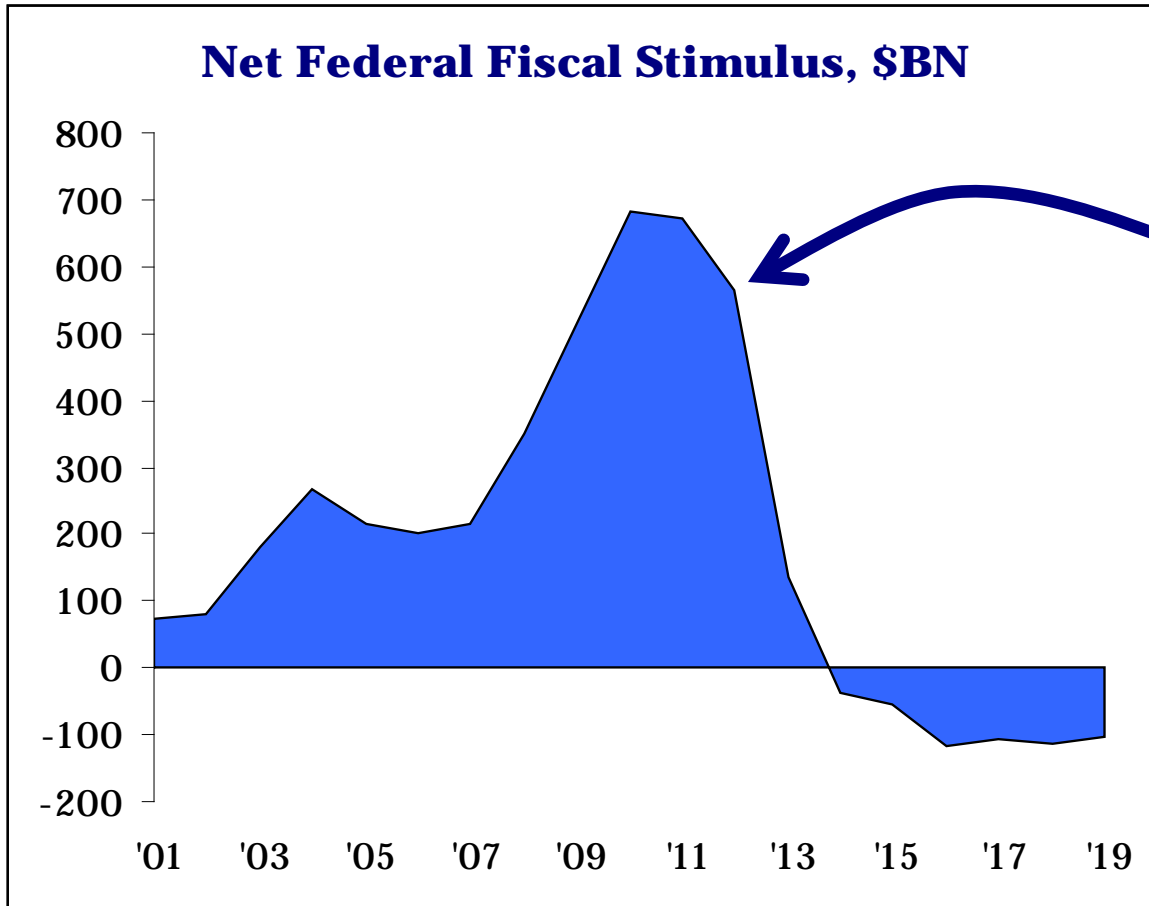
STRATEGAS

Governing In Lame Duck & 2013



STRATEGAS

REMINDER: NEW CONGRESS FACES A MASSIVE FISCAL CLIFF



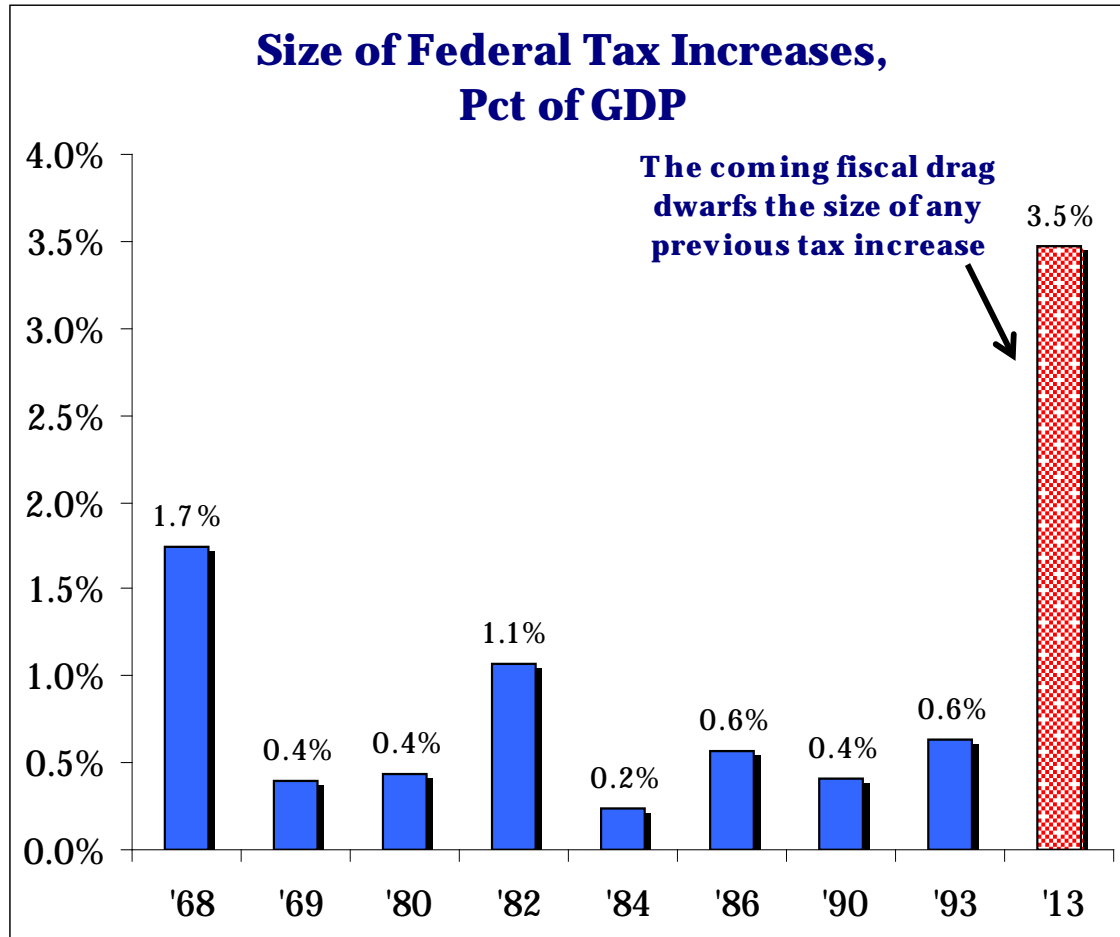
The fiscal cliff approaching is about \$537bn in 2013. The election will have an outsized impact on how the issue is resolved. But we are skeptical the entire drag can be offset in 2013.

Forecast 2012-2021, Joint Committee On Taxation, Congressional Budget Office, Strategas



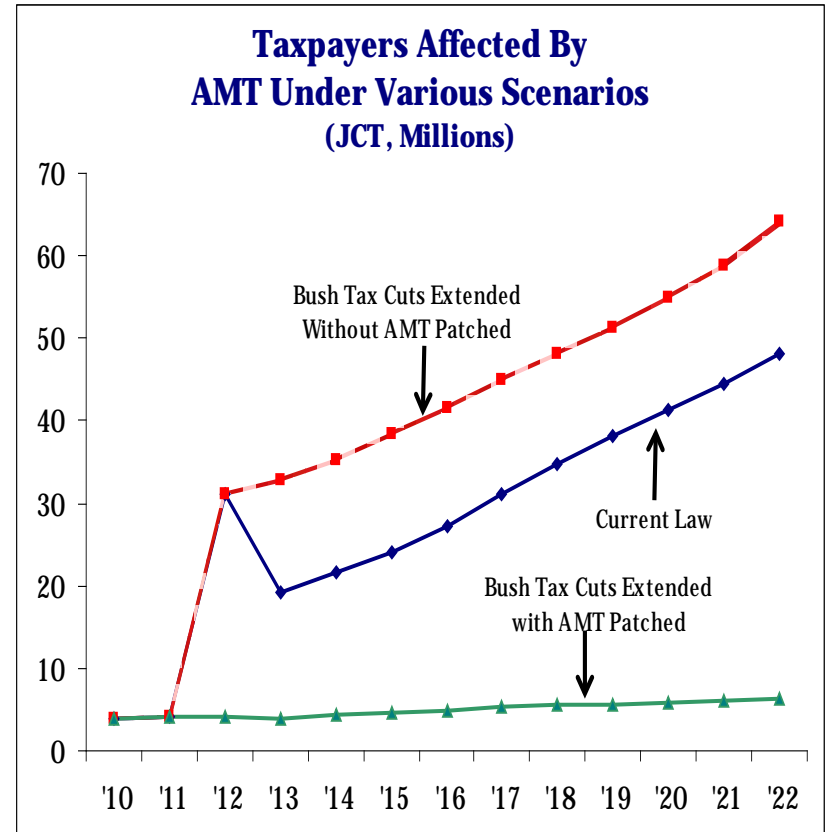
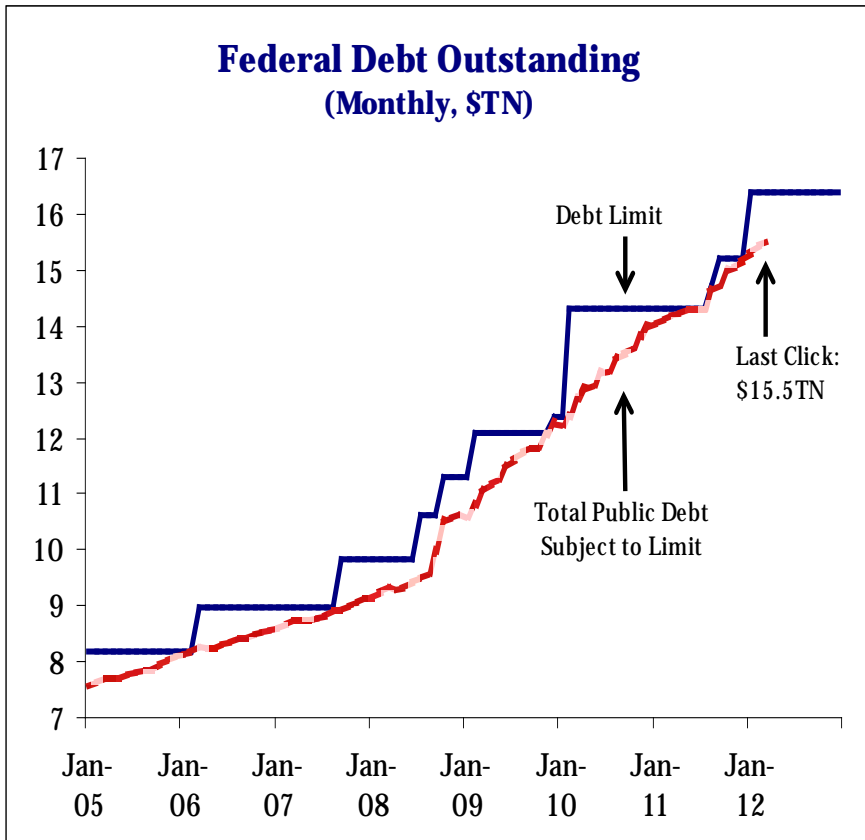
STRATEGAS

Fiscal Drag Is Twice The Size Of The Largest Post WWII Tax Increase



STRATEGAS

Two Catalysts For A Lame Duck Tax Bill: Debt Ceiling & AMT



STRATEGAS

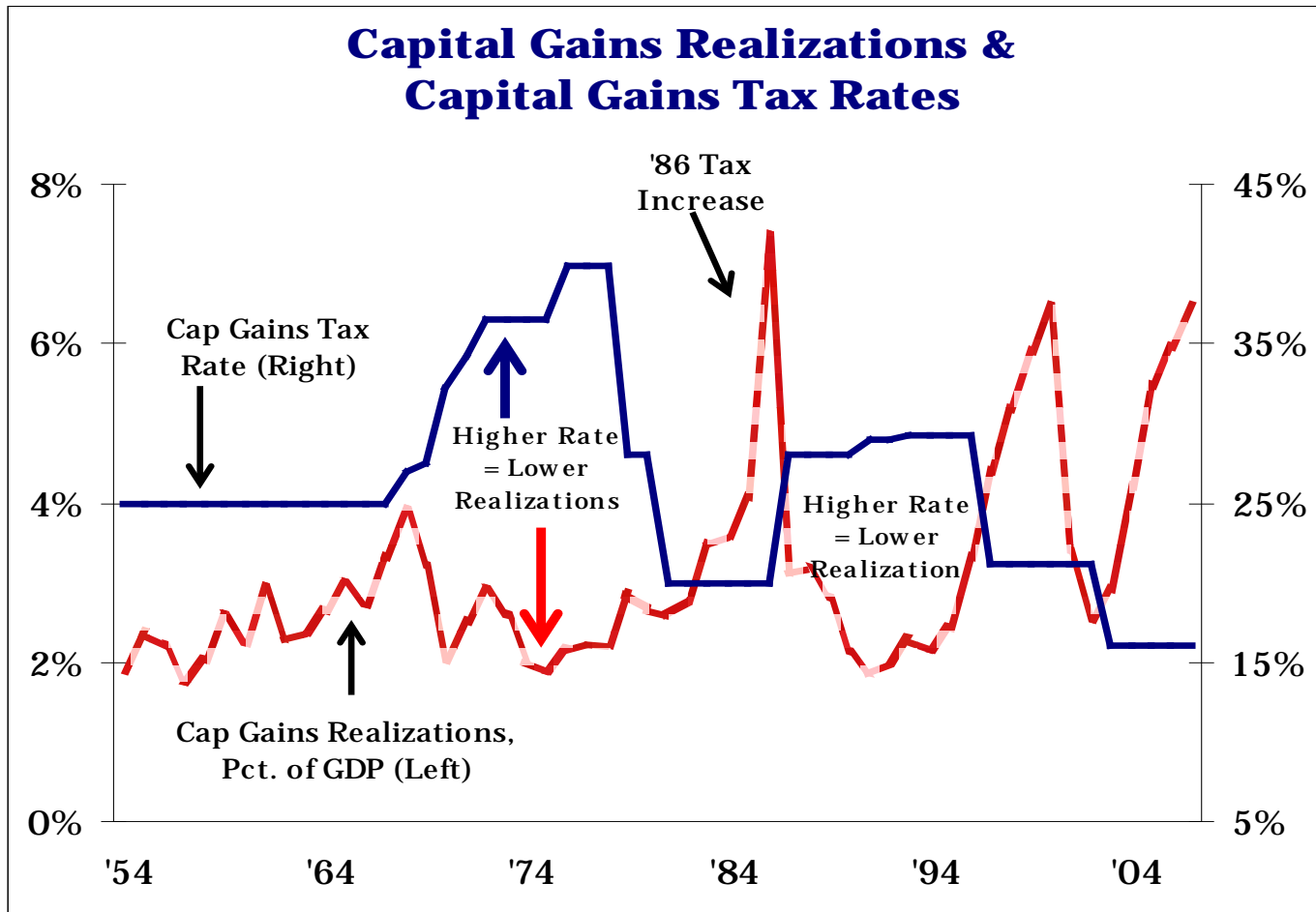
Fiscal Cliff Implications

- Fiscal Cliff Is Not Binary: Most But Not All of the Cliff Gets Resolved By The End of the Year.
- Payroll Tax Cut Seems Unlikely To Get Extended At This Time
- Tax Increase of 3.8% on Investment Income Looks Difficult To Stop Regardless of Who Gets Elected



STRATEGAS

Tax On Investment Income Is A Backdoor Cap Gains & Dividend Tax



STRATEGAS

2013 Fiscal Deal?



STRATEGAS

Growing Number of Catalysts For A Fiscal Deal In 2013

- Elevated Debt & Deficit Levels
- Rising Interest Costs
- Rating Agency Warnings
- Subpar Economic Growth
- Expiring Tax Provisions
- Spending Sequester
- Social Security Unfunded Liabilities
- One Party Controlling Congress?

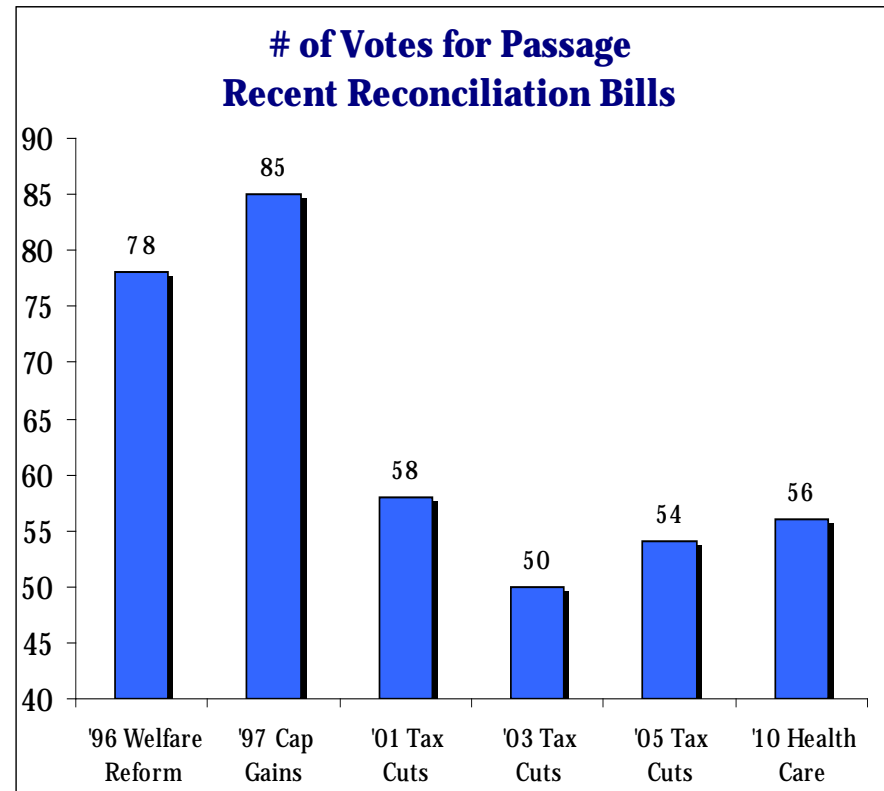


STRATEGAS

One Party Controlling Congress Gives Greater Fiscal Flexibility

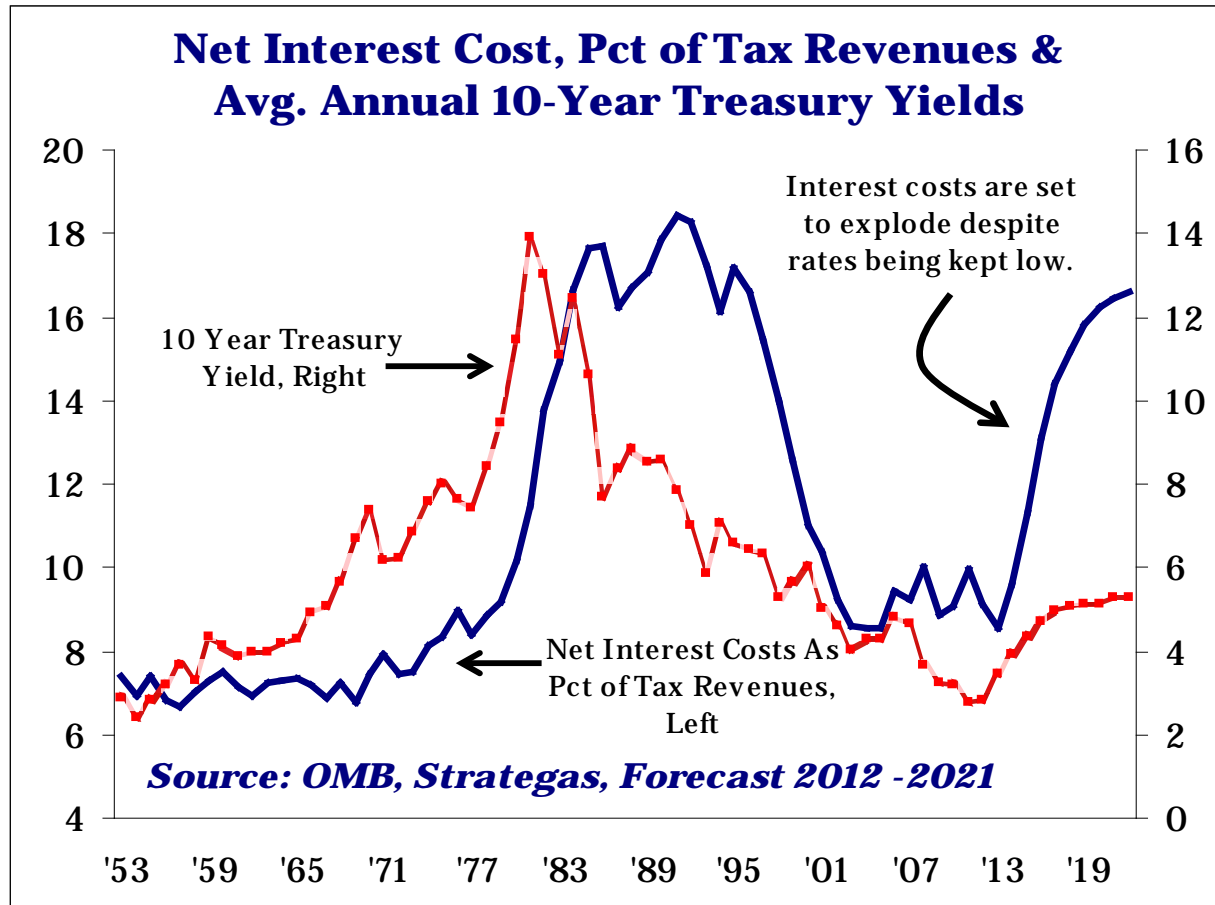
Reconciliation Background

- Legislative process established in Congressional Budget Act of 1974
- Allows Senate to pass reconciliation bill with simple majority, rather than 60 votes
- Eliminates a Senate filibuster
- Debate limited to 20 hours
- Requires House and Senate passed budget resolution in place
- Designed to speed passage of laws impacting spending and taxes
- Takes about six months to pass the legislation into law.
- In recent years, is used to pass fiscal legislation lacking bi-partisan support such as the Bush tax cuts and Obama healthcare.



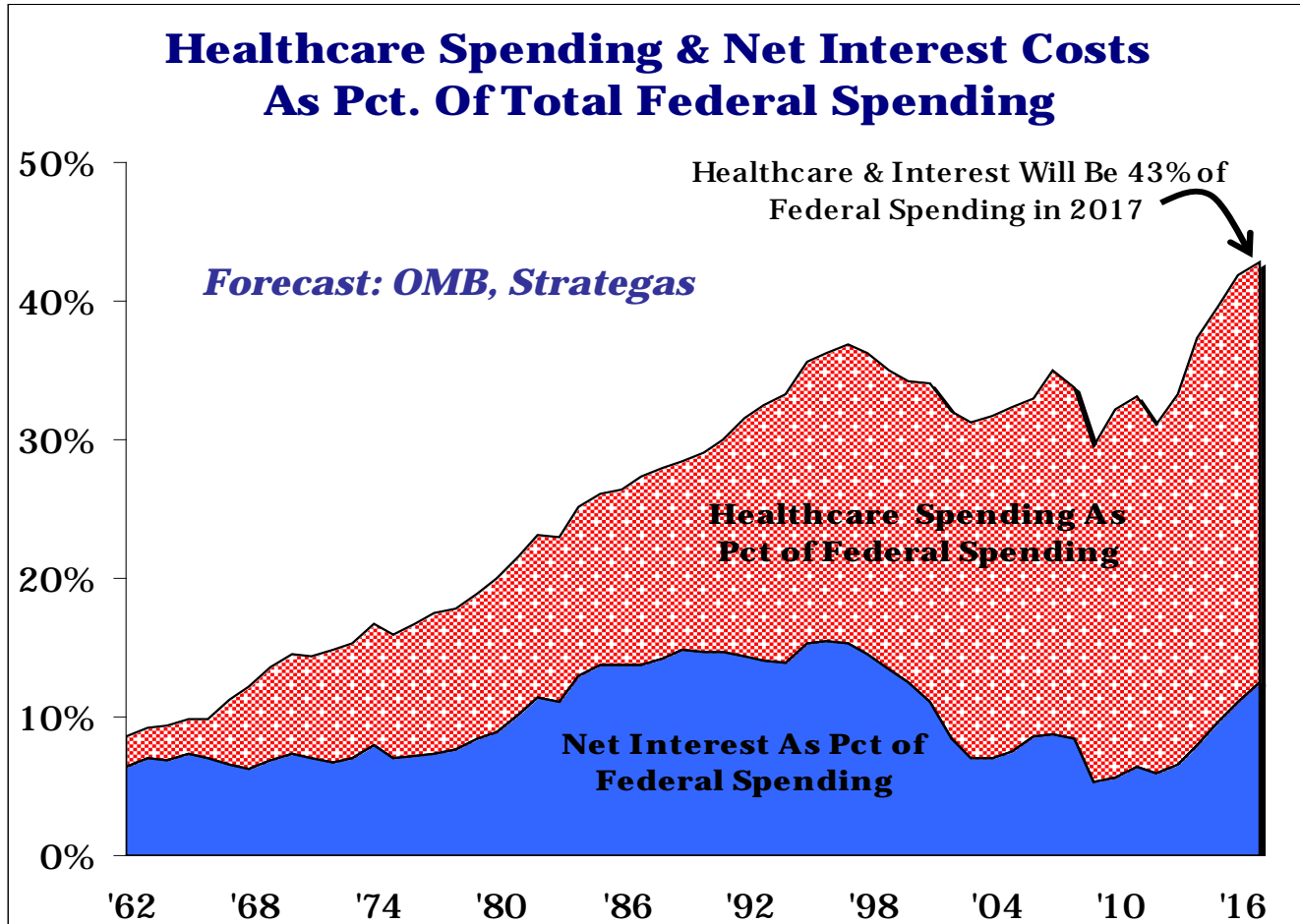
STRATEGAS

Crowding Out Effect Coming



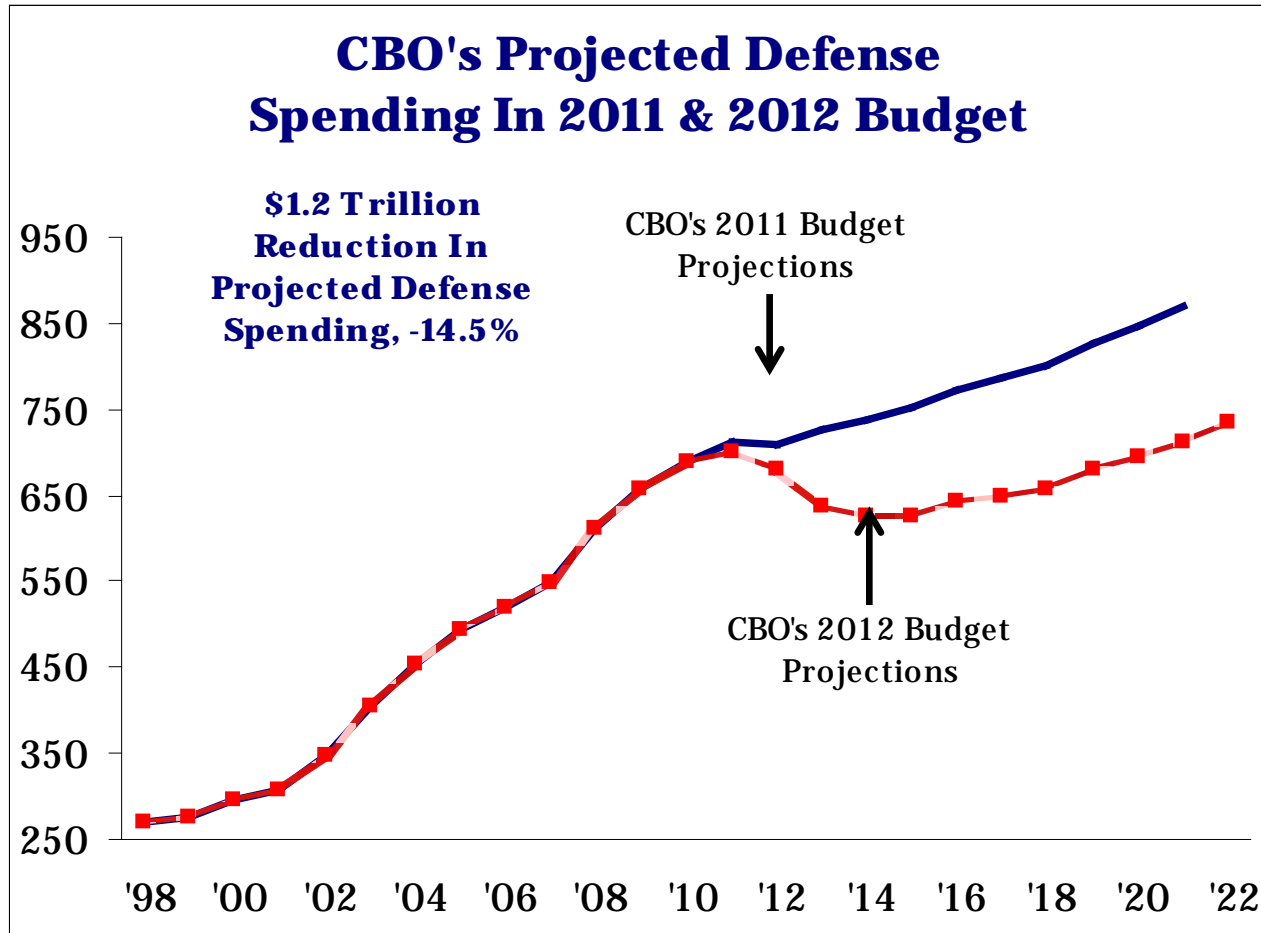
STRATEGAS

Healthcare & Interest Costs: 43% of Total Federal Spending By 2017



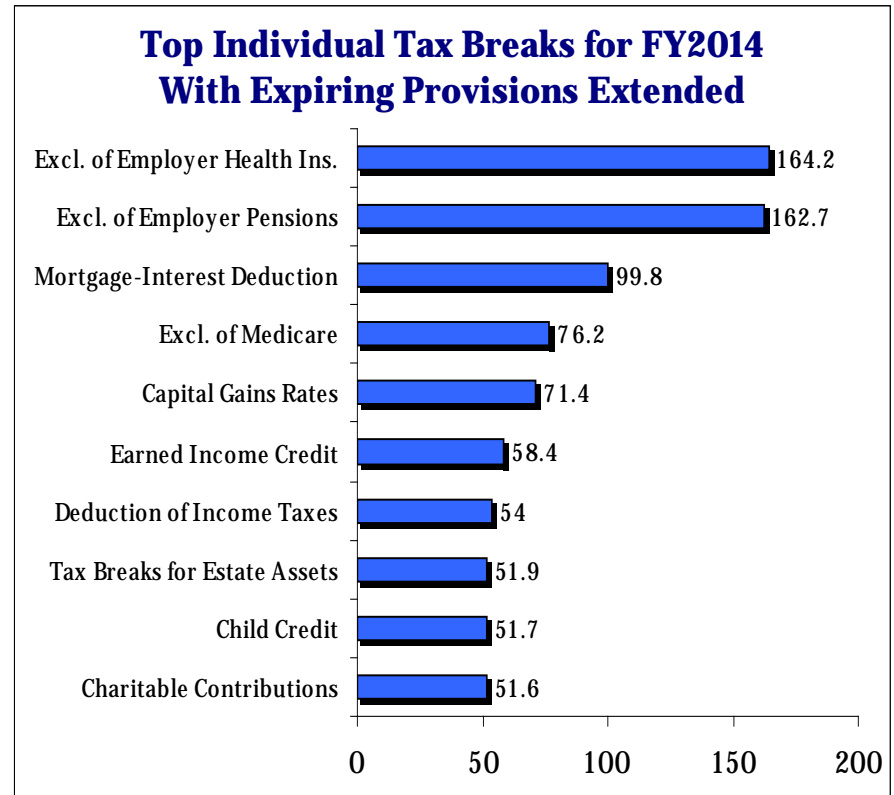
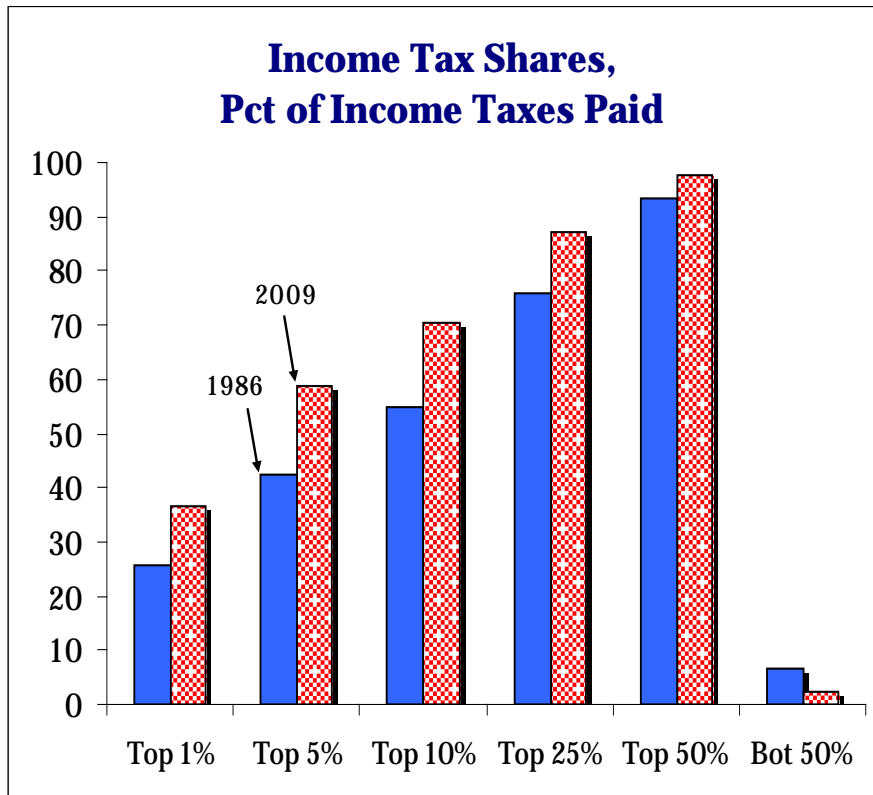
STRATEGAS

Meaningful Defense Cuts Coming



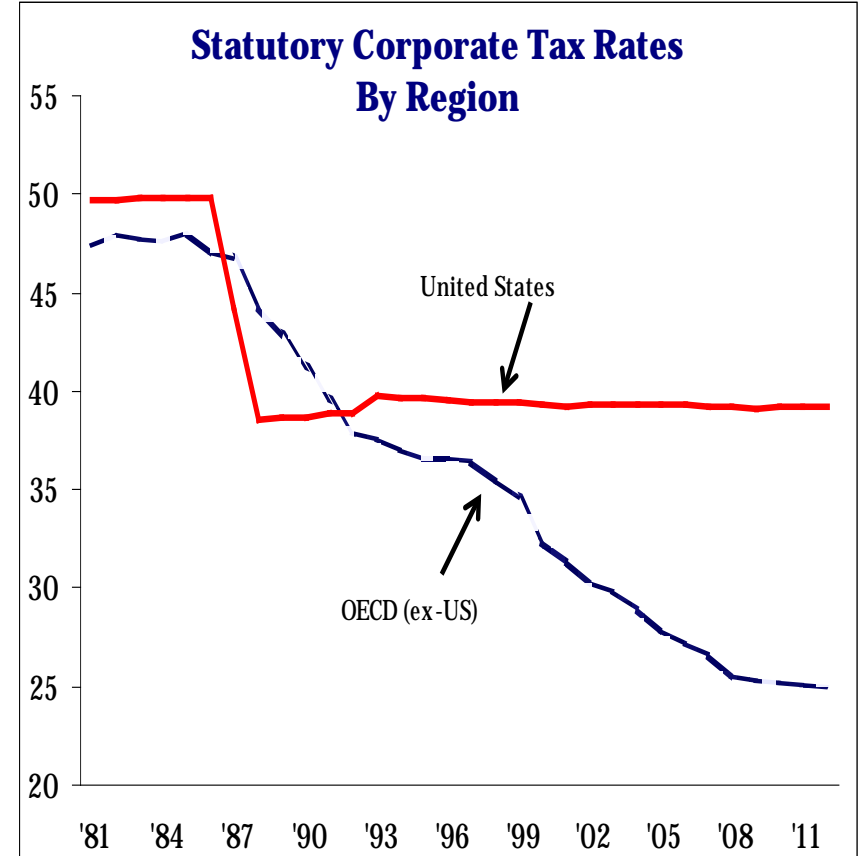
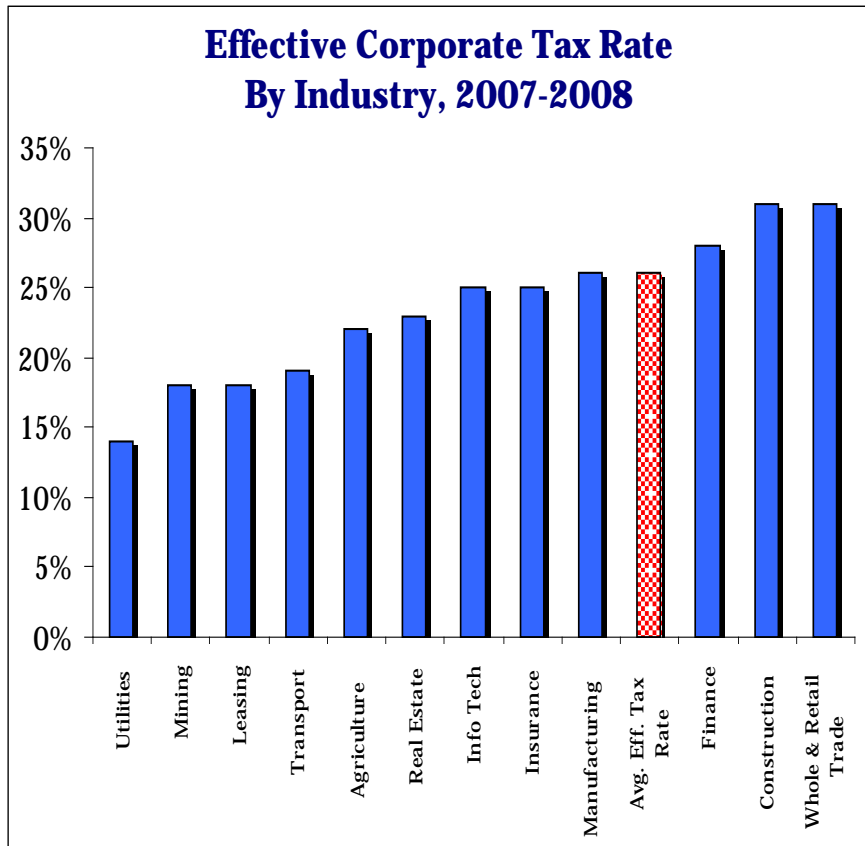
STRATEGAS

Tax Reform Is The Best Way To Deal With The Fiscal Cliff But Challenging



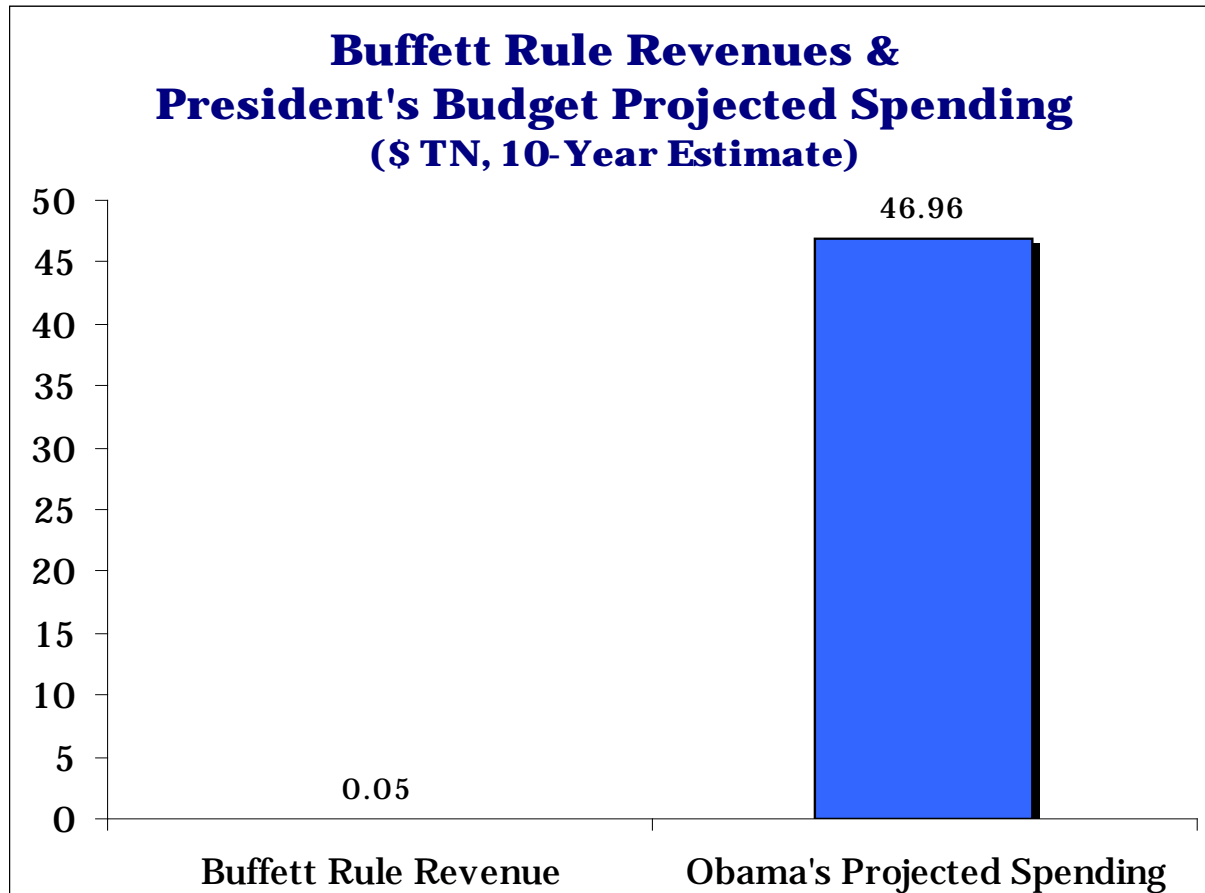
STRATEGAS

Individual & Corporate Tax Reform Need To Move Together



STRATEGAS

Buffett Rule Is About Raising Capital Gains & Dividend Tax Rates



STRATEGAS

Consensus Scenario

- Obama wins presidency
- GOP controls both houses of Congress
- Lame duck bill extends some, but not all tax cuts
- Contentious 2013 fiscal deal could get done
- Obama would need to sacrifice some HC measures to get GOP to increase taxes
- No deal = rolling debt ceiling increases
- Obama uses his regulatory levers



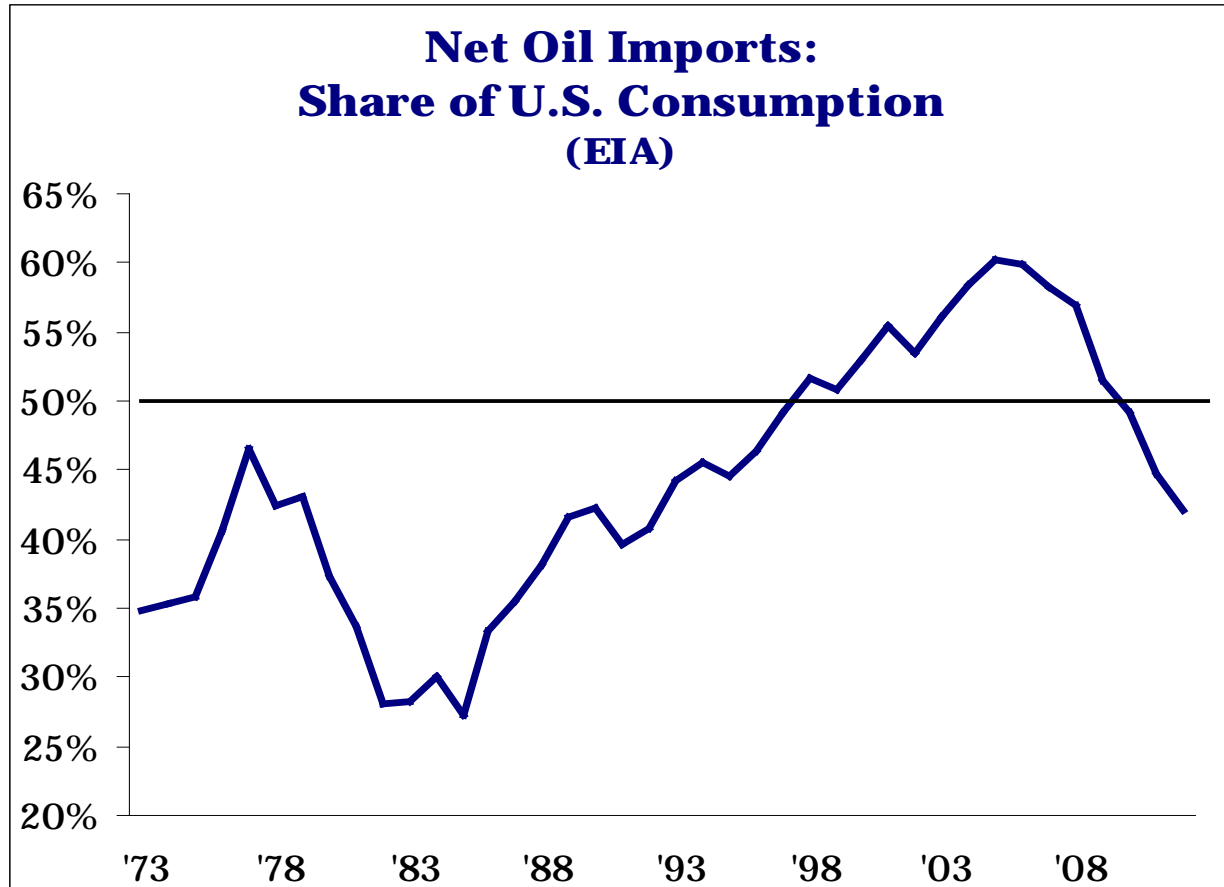
Out of Consensus Scenario

- Romney wins presidency
- GOP controls both houses of Congress
- All tax cuts get temporarily extended
- Republicans complete a fiscal package of tax and entitlement reform
- Green light on energy development
- Healthcare bill changed
- Small changes to Dodd-Frank



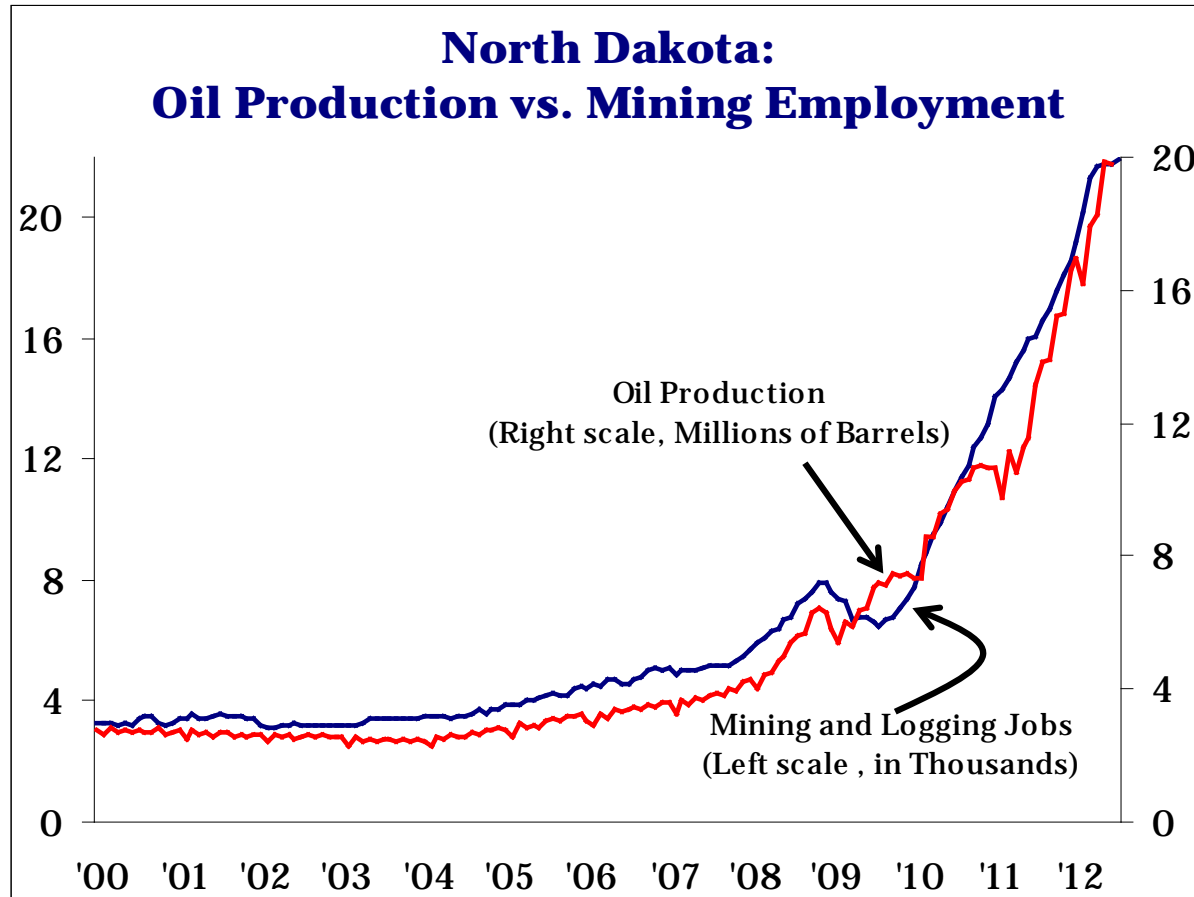
STRATEGAS

Need To Identify Sectors Not Impacted By Austerity: Energy



STRATEGAS

Energy Production Is Creating Jobs



STRATEGAS

What To Watch For In 2012

- President Obama's approval rating
- Unemployment Rate
- Congressional generic ballot test
- Federal Reserve/ECB Policy
- Fiscal cliff negotiations
- Iran negotiations
- Social unrest in the U.S.



STRATEGAS

The Big Questions For 2013 & Beyond

- Next Federal Reserve Chairman
- China Trade Policy
- Tax Reform: REITs, Home Mortgage Deduction, Capital Gains, Dividends, Carried Interest, Municipal Bonds, Estate
- Regulatory Policy



STRATEGAS



STRATEGAS

Questions?