

Libby Cantrill, CFA

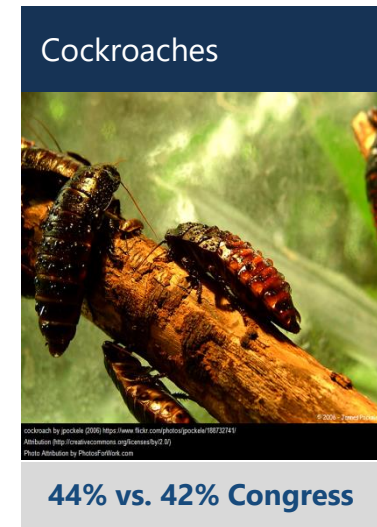
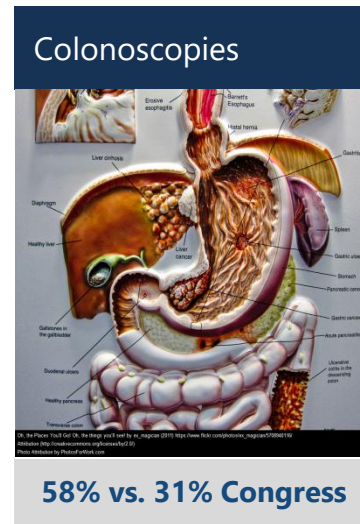
May 2017

The Trump Administration: Fatter Policy Tails and Implications for Markets

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What do all of these have in common?

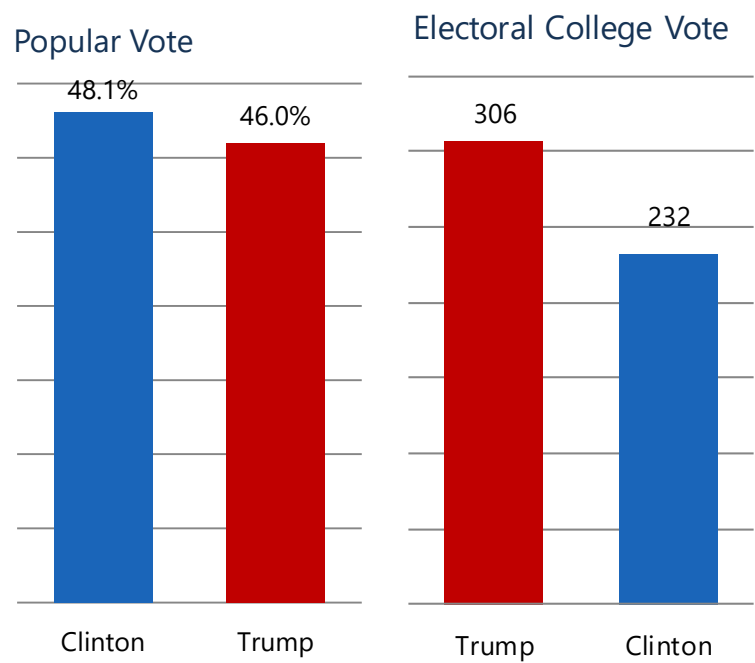


As of 30 June 2016
SOURCE: PhotosForWork.com

Election 2016 recap: President Trump loses popular vote, but wins Electoral College in a change-oriented election

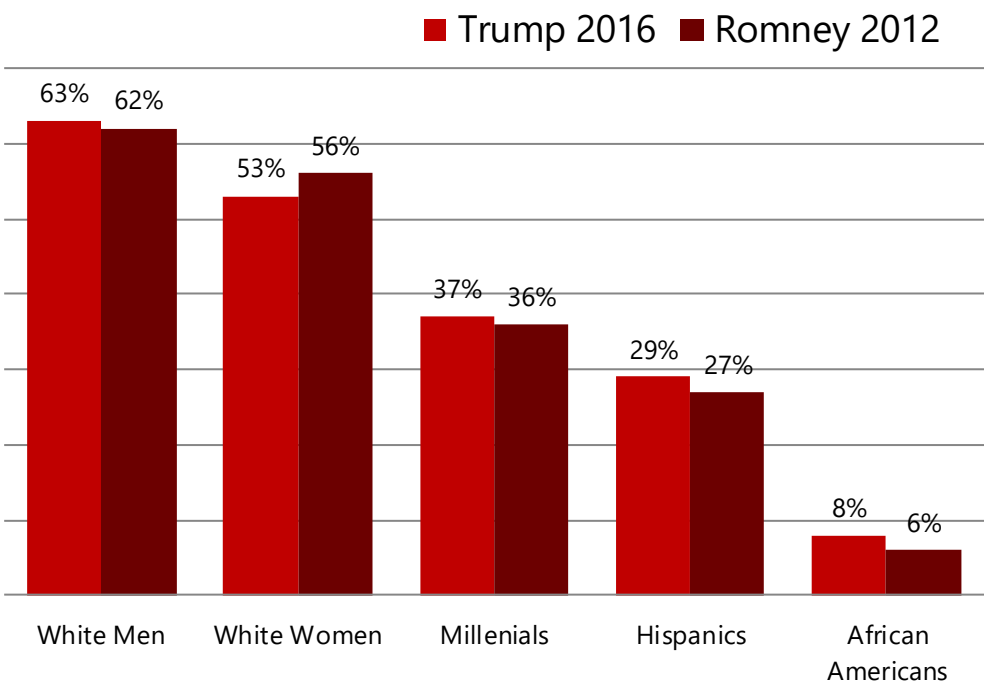
Popular vote vs Electoral College vote:

Trump is only the 5th president to lose the popular vote but win the electoral college vote



Trump picked-up former Democratic supporters:

Trump did better than Romney across most groups, including non-whites and picked up Obama supporters



Source: Pew Research; Cook Political Report

Composition of Congress: Republicans retain both chambers, but have smaller majorities than in 2016

House of Representatives:

Republican



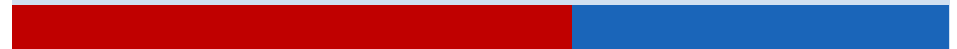
Republicans : 241

Democrats: 194

- **Total seats:** 435
- Republicans lost 6 seats in November, retaining their historically large House majority
- Republicans need 218 votes to pass legislation; **can afford 23 defections**
- 2018 prognosis: All 435 seats up; midterms tend to be bad for the incumbent party, but redistricting should help

Senate:

Republican



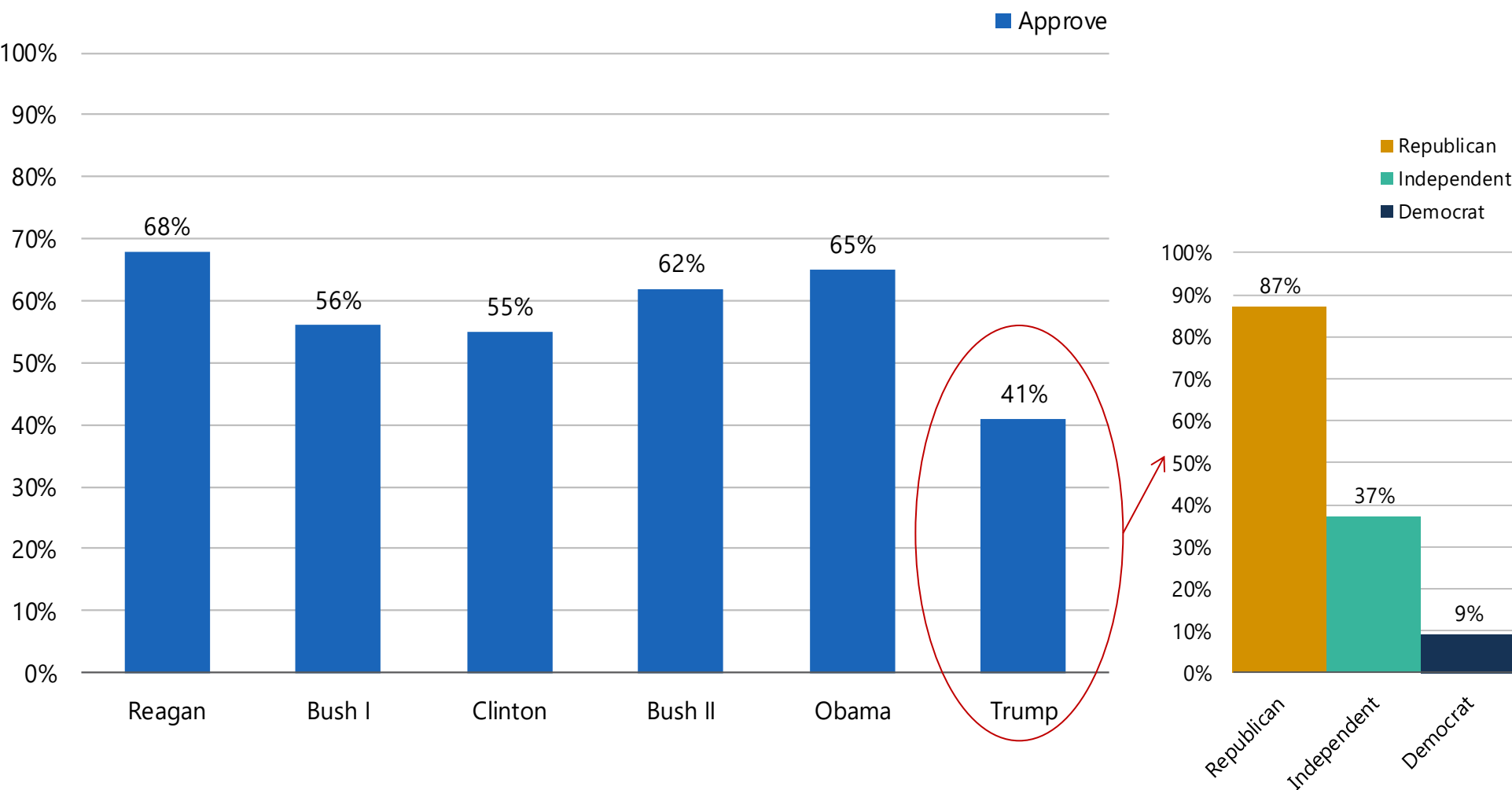
Republicans : 52

Democrats: 48

- **Total seats:** 100
- Republicans lost 2 seats despite a tough election cycle in the Senate
- **Republicans do not have a filibuster-proof majority** (60 votes), but can pass specific legislation through "reconciliation" (50 votes)
- 2018 prognosis: 33 seats up; strong for Republicans but will depend on Trump

Trump has the lowest approval rating of any modern president but continues to do well with his base

Favorability Ratings of First-time Presidents: 100 Days Post Inauguration



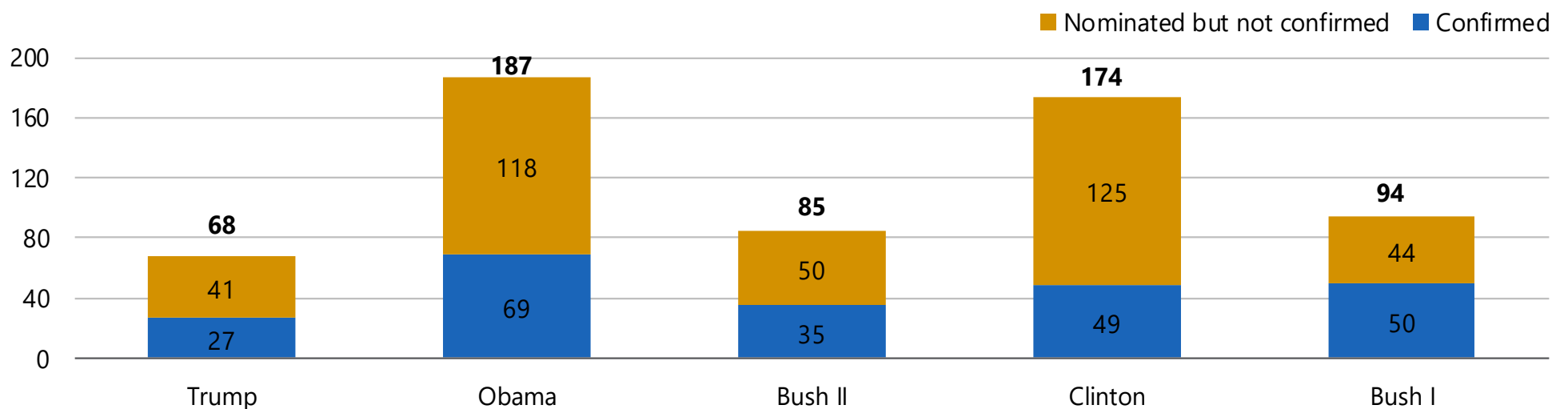
Source: Gallup; as of April 29, 2017

Composition of Trump's Cabinet matters, too: Light on government, heavier on business experience with many vacancies

Background of Trump's Cabinet

President	Government Experience	Military Experience	CEOs	PhDs
Trump	52%	25%	30%	0%
Obama	91%	9%	0%	23%
Bush II	91%	32%	18%	9%
Clinton	81%	48%	14%	24%
Bush I	81%	48%	5%	19%

The Trump Administration continues to have many vacancies (of 550 positions need to be confirmed)



Source: RealClearPolitics; Partnership for Public Service

What to expect? More possibility for “right tail” policies, but also for “left tail” missteps

Increased potential for “left tail” policy outcomes

- Unilateral protectionist trade policies
 - Currency manipulator label
 - Imposition of tariffs
 - Withdrawal from free trade agreements (e.g., NAFTA)
- Geo-political escalation (e.g., Russia, North Korea)
- Missteps from lack of Washington experience

Increased potential for “right tail” policy outcomes

- Increased deregulation
 - Financial sector
 - Energy deregulation
- Fiscal expansion
 - Corporate tax reform
 - Individual tax reform
 - Infrastructure spending

What is President Trump likely to do over the next 12 months?

Proposal	Growth Impact	Inflation Impact	Est. Fiscal Impact*	Possible Timing	Additional Comments	Needs Congress?	Probability	Prob. Change Since Jan.
Repeal and Replace of Obamacare	TBD	TBD	TBD	2017	<ul style="list-style-type: none"> The House has passed a bill, but the Senate will pass its own bill; unclear whether a compromise is possible 	✓	70%	↓
Tax Reform	+	+	\$2T (Ryan)- \$5T (Trump)	2018	<ul style="list-style-type: none"> Tax reform is complex and not clear who is leading Base case is smaller bill that takes longer 	✓	50%	↓
Infrastructure Spending	+	+	\$1T total	2018	<ul style="list-style-type: none"> No proposed plan yet, and little discussion on Capitol Hill 	✓	35%	↓
Dodd-Frank Roll-back	+	+	TBD	2018	<ul style="list-style-type: none"> Legislative roll-back is unlikely, but softening of regulation via executive order will happen 	✓	20%	↓
Trade	-	+	TBD	2017	<ul style="list-style-type: none"> Renegotiation of FTAs /targeted tariffs on sectors (high) More severe measures possible (but now less likely) 	X	90%/40%	↓
Immigration	-	+	TBD	2017	<ul style="list-style-type: none"> Bite has been as loud as bark, although Constitution and Congress will hamper efforts 	X	90%	→

* As proposed; all scores are static over ten year period; source: CBO, Tax Foundation, Tax Policy Center, DonaldJTrump.com; PIMCO probability estimates

What will a tax deal look like? A “skinny” tax bill in early 2018 is the base case, but slippage beyond that is problematic

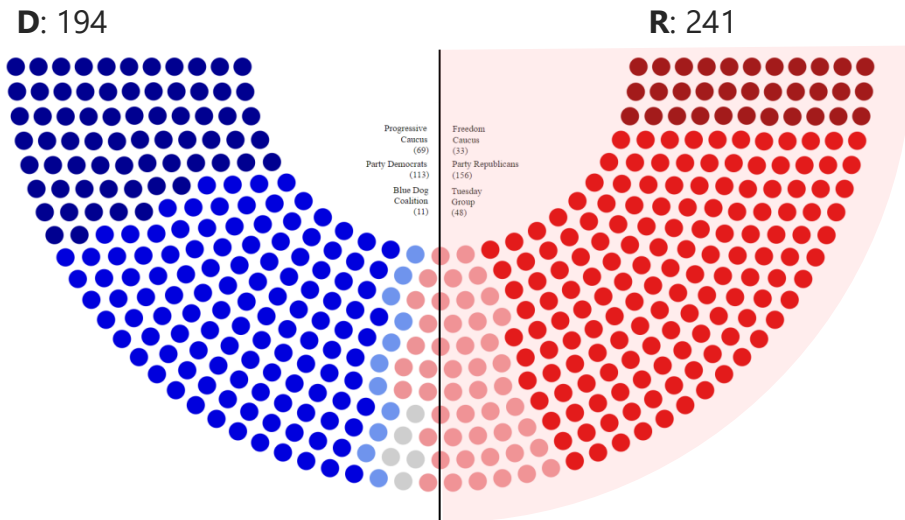
Provisions	Odds of Inclusion	Notes
Corporate Tax		
Reduced Corporate Rate	High	• Rate is likely to be higher than proposed 20% rate (e.g., 25%)
One-Time Deemed Repatriation	High	• Significant support and raises revenue
Eliminate Net Interest Deduction	Moderate	• If included, likely to be significantly modified
Full Expensing of Capital Investment	Moderate	• Expensive, so likely to be scaled-back, especially without BAT
Border Adjustment Tax (BAT)	Low	• Currently on life support; could change if Trump supports on Hill
Individual Tax		
Reduction in Individual Rate	High	• Top rates are likely to be higher than 33% in proposal (e.g., 35%)
Reduction in Capital Gain Rate/ Interest Income Rate	Moderate	• Some reduction possible but not as low as proposed 16%
Elimination of Deductions/Exemptions	Low	• Mortgage interest, muni tax exemption both likely to be preserved

How about financial regulatory relief? Don't expect Congress to act

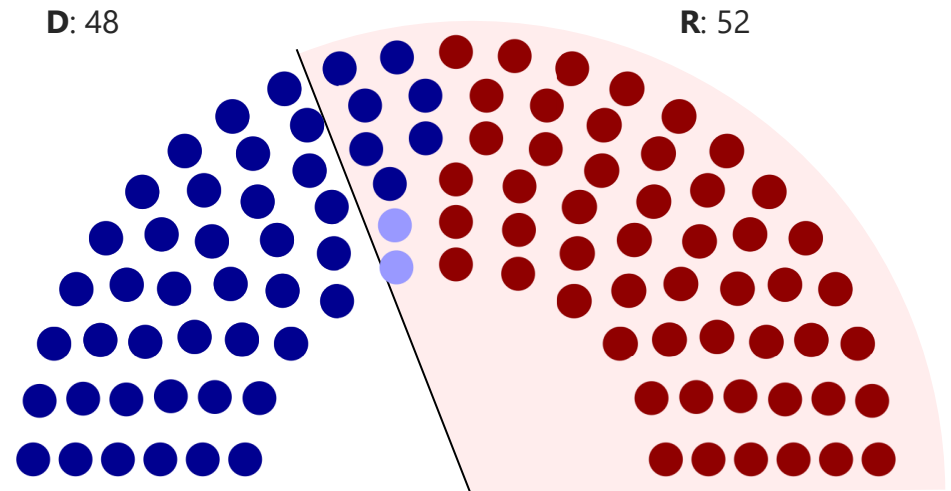
Dodd-Frank reform/roll-back faces significant hurdles in both houses

- Moderate Republicans (Tuesday Group) and Freedom Caucus not aligned on Rep Hensarling's Financial CHOICE Act (maximum of 23 defections to pass the House)
- Senate version of any bill will require support of at least 8 Democrats / Independents
- Limited room for compromise

House of Representatives: 218 votes needed



Senate: 60 votes needed



Expect incremental regulatory relief via executive order, but Obama appointments still dominate

Financial Stability Oversight Council (FSOC)

Name	Role	Appointment	End of Term
Steven Mnuchin	Secretary of the Treasury (Chairperson)	Trump	Jan 2021
Janet Yellen	Chairman, Federal Reserve System	Obama	Jan 2018
Keith Noreika*	Comptroller of the Currency (OCC)	Trump	5 year term**
Richard Cordray	Director, Consumer Financial Protection (CFPB)	Obama	Jul 2018
Jay Clayton	Chairman, Securities and Exchange Commission (SEC)	Trump	May 2021
Martin Gruenberg	Chairman, Federal Deposit Insurance Corporation (FDIC)	Obama	Nov 2017
J. Christopher Giancarlo*	Chairman, Commodity Futures Trading Commission (CFTC)	Trump	5 year term**
Melvin Watt	Director, Federal Housing Finance Agency (FHFA)	Obama	Jan 2019
J. Mark McWatters*	Chairman, National Credit Union Administration (NCUA)	Trump	Aug 2019
S. Roy Woodall, Jr.	Independent member with insurance expertise	Obama	Sep 2017

*Acting chair

**Upon confirmation of permanent chair

As of 3 May 2017

SOURCE: U.S. Treasury

What about the Fed? President Trump will have a significant ability to remake the Fed over time



Janet L. Yellen
Chair Term: Feb 2018
Governor Term: Jan 2024



Stanley Fischer
Vice Chair Term: Jun 2018
Governor Term: Jan 2024

TERM EXPIRES
2018 *



Lael Brainard
Governor Term: Jan 2026

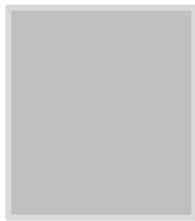


Jerome H. Powell
Governor Term: Jan 2028



Daniel K. Tarullo
Governor Term: Jan 2022

RESIGNED *



Name Surname
Governor Term: Date

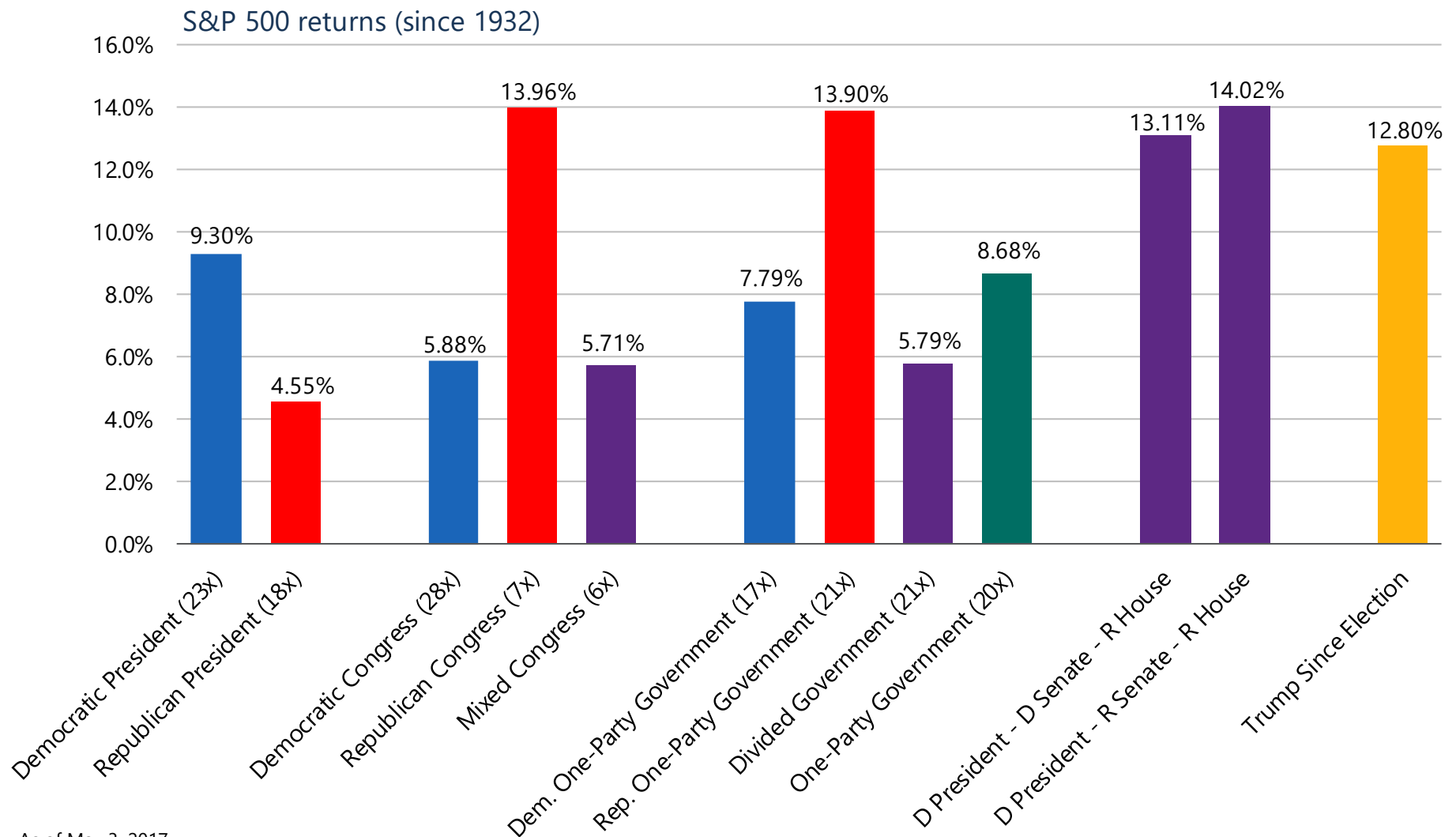


Name Surname
Governor Term: Date

VACANT

As of April 2017
SOURCE: Federal Reserve
* Yellen and Fischer are speculated to step down when their respective chair positions end in 2018; Tarullo's resignation is effective April 2017

Markets have liked one-party Republican control before, but will the “Trump trade” last?



As of May 3, 2017

SOURCE: Bloomberg

Note: Returns are annualized except for Trump data. Past performance is not a reliable indicator of future results.

How is PIMCO positioned given our policy outlook?

- **Neutral US duration:** Fundamentals of U.S. economy are still relatively positive regardless of dysfunction in Washington, and yields have come back to earth as Trump reflation trade has lost steam
- **Harvesting gains in credit** given rich valuations, especially in U.S. investment grade credit; however, there are still attractive pockets of credit market, including financials and housing-related credits
- U.S. trade policy under President Trump is not as draconian as many thought, so **taking advantage of attractive valuations in EM FX**, e.g., Mexican Peso
- **Volatility is likely to continue** in part because of politics in Washington (and elsewhere), creating inefficiencies in the market and opportunities for active managers

What to look out for?

- Comey firing/Russia investigation? Impeachment?
- How long does healthcare take?
- Who is leading on tax reform? (House, Senate, Trump?)
- A detailed infrastructure plan with more specifics on timeframe?
- West Wing shake-up?
- Staffing/nominations of Treasury, other important agencies



The window to pass large, fiscally-expansionary legislation is relatively small and usually occurs after a recession

President	Stimulus Plan	Date	Implemented During Recession?	Months After Inaguration
Roosevelt	New Deal	March 1933	Yes	1
Eisenhower	Tax Cuts	September 1954	Yes	21
Reagan	Recovery Act	September 1981	Yes	8
Bush II	Tax Cuts	July 2001	Yes	6
Obama	American Recovery & Reinvestment Act	March 2009	Yes	2

SOURCE: Morgan Stanley Research

Speaker Ryan vs. President Trump Tax Plans:

Differences exist, including controversial “border adjustment tax;” could delay timing (Reagan tax reform took ~3 years)

	House Republican Proposal	Trump Proposal	Current Law
Corporate Tax			
Corporate tax rate	20.0%	15.0%	35.0%
Top pass-through rate	25.0%	15.0%	39.6%
Business expensing	100% expensed	Silent	Accel. through 2019
Corp. net interest deductibility	Repeal deductibility	Silent	No cap
Corp. foreign income rate	0% (territorial system)	0% (territorial system)	35% (when repatriated)
One-time repatriation tax	8.75%	Silent (10% campaign plan)	35%
Border adjustment tax	Yes	Silent	N/A
Personal Tax			
Top individual rate	33.0%	35.0%	39.6%
Top capital gain rate	16.5%	20.0%	23.8%
Top dividend rate	16.5%	20.0%	23.8%
Top rate on interest income	16.5%	Silent	43.4%
Mortgage deduction	Retain	Retain	Up to \$1MM in principal
State/local tax deduction	Repeal	Repeal	Unlimited
Muni exclusion	Silent	Silent	Unlimited
Standard deduction	\$24k	\$25k	\$12.6k
Total cost	\$2.2 trillion	N/A¹	

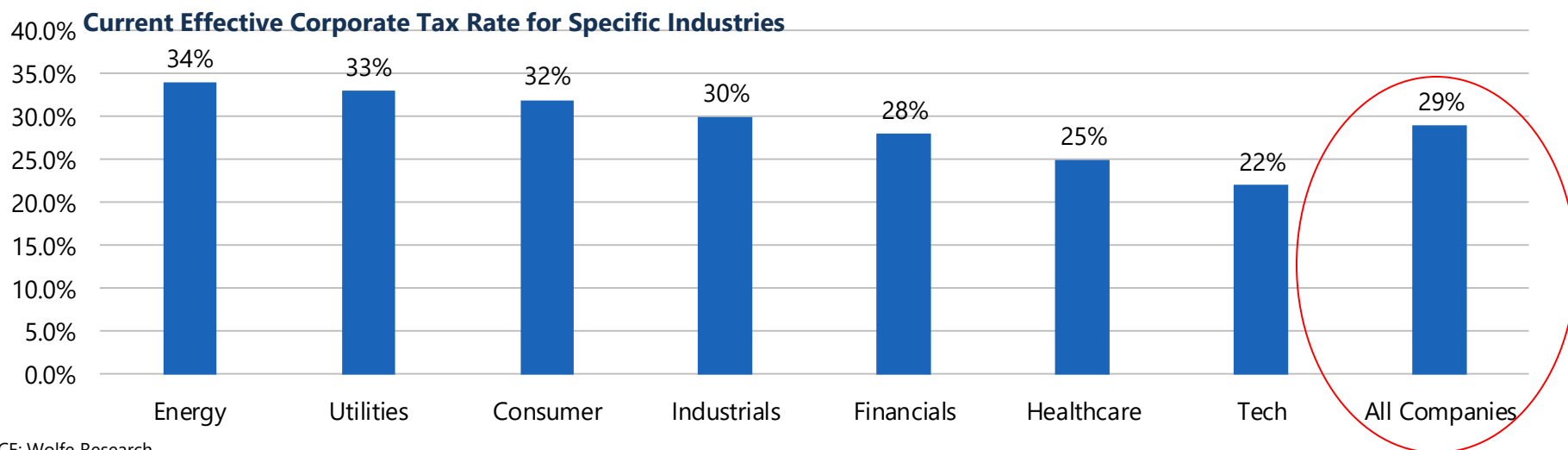
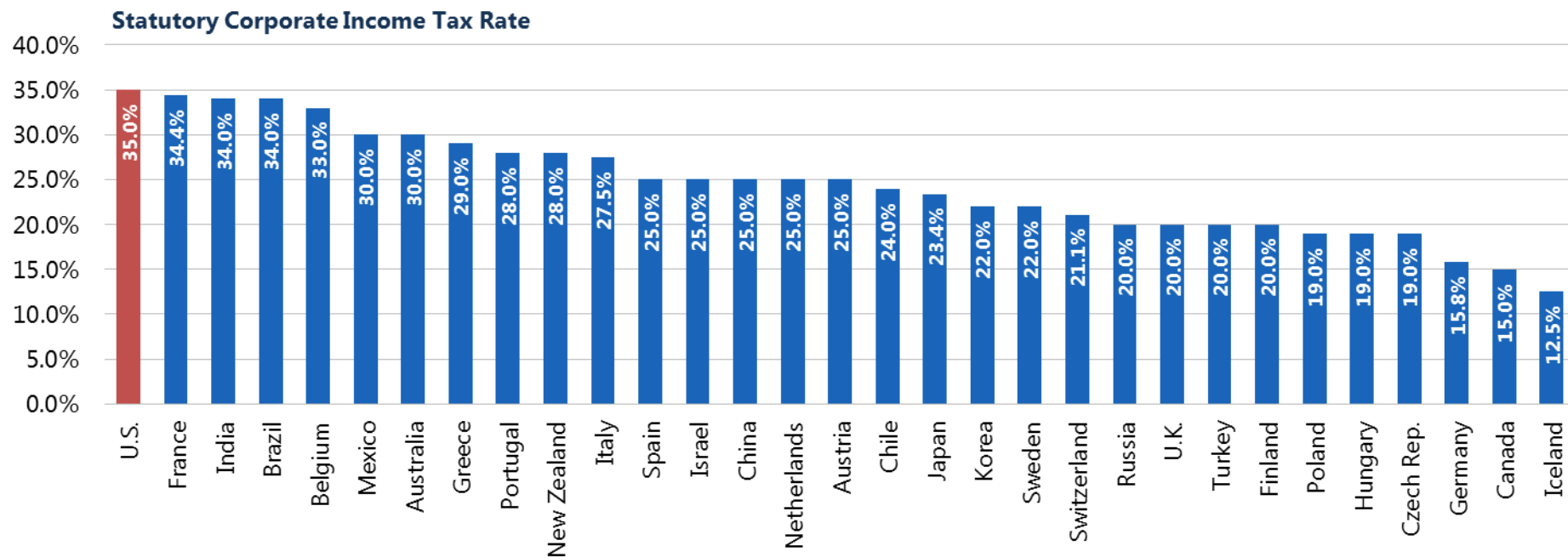
1. Trump campaign plan was estimated to cost \$5 trillion over ten years on static basis
Source: Tax Foundation; The White House

What can President Trump do on trade? Trump has extensive unilateral authority to impose protectionist measures should he choose

Action	Legal Basis	Duration	Details
Withdrawal from NAFTA (six months notice required)	Section 2205 in NAFTA agreement	Indefinite	<ul style="list-style-type: none"> Allows President to “proclaim” a return to “most favored nation” status and reestablish MFN tariff rates on Mexico (~4% but vary by industry); additional duties can apply Most free-trade agreements have similar provisions for unilateral withdrawal Little precedent of U.S. withdrawal from a FTA; 1866 was last time
Labeling country a “currency manipulator”	Trade Facilitation and Trade Enforcement Act of 2015	Revisited annually	<ul style="list-style-type: none"> Certain conditions must be met to qualify as currency manipulator, but can be changed Once labelled, U.S. is to pursue “bilateral engagement” with offender for one year If no resolution after year, Treasury can pursue: 1) denial of OPIC financing; 2) exclusion from U.S. contracting; 3) call for heightened IMF surveillance; and 4) reevaluation of FTA President can waive punitive follow-up measures if deemed too “harmful”
Impose tariffs citing “national security” concerns	Trade Expansion Act of 1962	Indefinite	<ul style="list-style-type: none"> Allows the President to impose “necessary restrictions” in the name of protecting national security; no limit on nature or scope of restrictions Case for national security could take months, but when made, courts defer to executive Nixon used this statute to impose 10% surcharge
Impose tariffs to deal with “large” balance of payments	Trade Act of 1974 (Sec. 122)	Temporary (150 days)	<ul style="list-style-type: none"> Allows the President to impose 15% tariff for up to 150 days; any extension would need Congressional approval Countries would likely contest via the WTO since U.S. has floating currency (WTO complaint can take years for resolution, however)
Impose tariffs as “safeguard” measures”	Trade Act of 1974 (Sec. 201)	8 years	<ul style="list-style-type: none"> Allows President to impose tariffs to “safeguard” industry after it is “seriously injured” WTO requires U.S. to subsidize impacted trading partners Bush II imposed 30% tariffs on steel imports in 2002, but later found in violation of WTO
Impose tariffs in retaliation of unfair trade practices	Trade Act of 1974 (Sec. 301)	Indefinite	<ul style="list-style-type: none"> Allows President to impose tariffs in retaliation for a manipulated or under-valued exchange rate, or anything else that burdens U.S. exports U.S. agreed in 1994 <i>not</i> to invoke this provision unilaterally without adverse determination by WTO but not codified in U.S. law
Ability to regulate “all forms of international commerce” in “time of war” or “emergency”	Trading with the Enemy Act of 1917	For as long as “time of war”	<ul style="list-style-type: none"> Impose tariffs or any other restrictions on enemy nation Courts have not questioned “time of war” or “national emergency” declaration Roosevelt, Johnson and Nixon all used legal basis to impose sanctions, tariffs, etc.

Source: Peterson Institute for International Economics

The U.S. has the highest corporate tax rate, but a lower effective rate: Energy, consumer, industrials set to benefit most from rate cut



SOURCE: Wolfe Research

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