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TACTICAL INSIGHTS

WHAT TRUMP'S TAX PLAN MEANS FOR INCOME INVESTMENTS?

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Despite the Russian scandal hanging over the Trump administration, many investors still believe some type of the tax reform bill may pass this year. In late April, the members of the administration outlined the broad strokes of the proposed plan and called it the "biggest tax cut in history". Table 1 summarizes the main points of the proposal.

Table 1: Summary of the Trump Tax Plan

	Individual	Corporate
Tax Rate	• Simplify the tax brackets from seven to three: 10%, 25% and 35% • Reduce maximum tax rate from 39.6% to 35%.	• From 35% to 15% for both corporations and pass-through identities
Deductions	• Double standard deductions • Allow only mortgage interest and charitable contributions • Repeal the Alternative Minimum Tax (AMT).	• One-time tax on assets held overseas • Eliminate tax break for special interest
Estate Tax	• Remove estate tax.	

It remains unclear how much, if any, of the plan will become law and whether that will be this year or next year or ever. Yet it will be interesting to exam the potential implications of the Trump tax plan on income investments and income-generating asset classes. During last eight years of low interest rate environment, many investors have been searching for higher income by utilizing a multi asset income approach, which invests in alternative income-generating asset classes in addition to traditional high grade bonds and mortgages. Let us take a look at each asset class one by one.

Master Limited Partnership (MLP)

MLP could be the biggest winner under the proposed tax plan. Most of the publicly-traded MLPs invest in the oil and gas infrastructure such as pipelines, storage tanks and refinery facilities. Many investors like MLPs because of its ability to generate high income. Currently, the most popular MLP ETF – AMLP – has a 7.7% yield. The proposed tax cut on corporations and pass-through businesses to 15 percent from the current rate of up to 35 percent would deliver a windfall to investors in MLPs and thus offer a boost to this niche segment.

Dividend Stocks

The stocks with high dividends could be another group of winners. Lower corporate tax rate would enhance corporations' ability to pay higher dividends and improve after-tax earnings and stock valuation.

Real Estate Investment Trust (REIT)

The plan does not address REITs directly. However, lowering corporate tax rates would impact the cost-benefit analysis for the REIT structure. REITs does not pay corporate tax, but those tax savings come at some cost—such as the inability to retain earnings because 90% of the income needs to pay out to shareholders. If the corporate tax rate declines, the benefit of REIT structure becomes less valuable. On the other hand, the lowering personal income tax rate should make the REIT income more attractive. It is not a clear-cut case for REITs.

Corporate Bonds

The Trump tax plan shouldn't have much impact on credit spreads, but may make high grade bonds more attractive. Investment-grade bonds will likely benefit from a limited supply of bond inventory as corporations repatriate dollars from overseas and find fewer needs to issue debts. By contrast, high-yield bonds will probably struggle a bit because the limited interest expenses deductibility proposed by GOP could impact the low-grade companies' earnings. On the other hand, lower corporate tax rate should help the bottom lines of all companies.

Muni Bonds

The impacts on muni bonds could be negative. Many investors own municipal bonds because the interest on those bonds are exempt from federal, state and local income taxes. These investors would benefit from lower personal tax rates, but the value of their muni holdings could drop if the new tax plan remove the deduction for state and local income taxes from federal taxes. Additionally, demand for munis could also decline as a result of lower corporate tax rates since many banks and insurance companies are big buyers of munis.

In general, the lower personal and corporate taxes proposed by the Trump tax plan could be favorable to all the taxable income-generating asset classes. MLPs and dividend stocks may emerge as the biggest winners. However, tax-exempt muni bonds could be negatively impacted.

Note: Julex Capital Management offers a tactical multi asset income strategy aiming to deliver both high income and low volatility. For more information, please visit our website.

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