

Key Questions

What Does Tax Reform Mean For Investors?

by **Ather Bajwa**, CFA, CPA, Senior Investment Analyst, Key Private Bank

Key Takeaways

The 2017 Tax Cuts and Jobs Act is the most comprehensive reform to the tax code in more than 30 years. While broad-ranging, the bill most significantly impacts businesses and transforms the tax treatment of companies in the United States. For individuals, as rates are reduced, many forms of tax deductions have either been reduced or eliminated. The following is a summary of the bill alongside a comparison to the prior tax structure.

Implications for Investors

We expect the Tax Cuts and Jobs Act to have a meaningful positive impact on U.S. economic prospects in the near-term. The benefits of the tax cuts are somewhat front-loaded, such as immediate reduction of individual and corporate tax rates and immediate expensing for corporations. A strong late-cycle stimulus should not only help increase the length of the current economic expansion (currently in its 9th year), but also provide a major boost to global economic prospects.

Overall the changes enacted will likely be quite positive for both equities (vis-a-vis higher profits) and high-quality corporate bonds (especially asset-heavy companies). The combination of reduced corporate taxes, lower tax rate on repatriated foreign earnings (likely leading to significant foreign cash coming onshore) and accelerated depreciation provisions could lead to increases in share buybacks,

dividends and debt repayments, further lifting companies' earnings prospects. However, in the case of high-yield debt, the impact of the interest deductibility cap will likely be more disruptive as it will limit their financial flexibility options.

Longer-term, the legislation looks likely to add to the size of the U.S. federal deficit by as much as a \$1 trillion over the next decade, which could create some upward pressure on inflation and U.S. interest rates. At the same time, changes to the standard deduction, limitations on SALT exemptions and reduced mortgage interest deductibility limits the tax benefit of homeownership, which in turn will reduce the value proposition for owner-occupied housing.

The new tax law significantly impacts the municipal bond market by repealing the tax-exempt interest exclusion for advance refunding bonds (bonds issued to pay-off a higher interest bearing bond). Advance refunding bonds accounted for nearly 30% of 2016's supply and will likely lead to a significantly smaller municipal bond market in the intermediate term – a strong positive for existing municipal bond investors.

Aside from these likely investment implications, investors should continue to consult with their investment, tax and legal advisors to assess how the new tax bill will impact them directly and what portfolio considerations might be warranted to increase their after-tax investment results.

For questions, **please contact your Key Private Bank Portfolio Manager.**

Key Private Bank



Publish date: January 8, 2018

Any opinions, projections or recommendations contained herein are subject to change without notice and are not intended as individual investment advice.

Investment products are:

NOT FDIC INSURED • NOT BANK GUARANTEED • MAY LOSE VALUE • NOT A DEPOSIT • NOT INSURED BY ANY FEDERAL OR STATE GOVERNMENT AGENCY

© 2018 KeyCorp. 180105-338525