

# Presidential Politics

## Background

As the U.S. presidential race heats up, speculations are swirling about the effect the election will have on the economy and the stock market. Commenting on politics is fraught with peril, but leaving aside partisan preferences, we can offer a few observations and historical perspectives.

Below, we address some of the questions most frequently asked by investors.

### Q: How will the economic outlook change with the next administration?

To be sure, John McCain and Barack Obama have distinct visions for the future. But as the last several elections have shown, campaign rhetoric will likely evolve into more moderate policies once the business of running the government is underway. In fact, regardless of who the next president is, he will enter the White House at a challenging time. Slow economic growth, wartime expenses, and a sizable budget deficit are just a few of the factors likely to crimp the next administration's agenda. As a result, we do not anticipate far-reaching legislation that will either open the gates of growth or bring the economy to its knees.

We must also consider each candidate's economic advisers, who will help shape future policies.

- McCain's senior policy adviser is Douglas Holtz-Eakin, who served as director of the Congressional Budget Office from 2003 to 2005 and has had academic appointments at Columbia and Princeton Universities. He is an advocate for balancing the budget. Among McCain's other advisers is former CEO of Hewlett-Packard Carly Fiorina.

- Obama recently named Jason Furman, an economist from the Brookings Institute with a strong pro-trade stance, as his economic policy director. In addition to his other top adviser, Austan Goolsbee, a professor at the University of Chicago, Obama has also consulted with government and business leaders with varied backgrounds and perspectives, including former Treasury secretaries and Federal Reserve officials.

### Q: Will either candidate's policies adversely affect world trade?

It appears highly unlikely that either candidate would seek to reverse the overall trends of globalization. Sen. McCain is an ardent advocate of free trade, and he supports existing as well as several pending trade agreements. Sen. Obama appears more cautious on free trade, expressing an interest in balancing the need for trade agreements with labor and environmental issues. We interpret several recent statements by the Obama camp as an attempt to soften earlier statements on trade matters, and we anticipate his campaign rhetoric will continue to shift toward the center on this key issue. Ultimately, we believe the powerful forces that are increasingly linking the world's local economies are beyond the point where the U.S. can meaningfully withdraw.

### Q: Can we expect changes to the tax code?

Yes. The next president will face the impending December 2010 expiration of the 2001 and 2003 tax cuts, as well as a tax code in need of repair. In the Appendix on page 4, we provide a comparison of the key tax provisions of each candidate's platform.

Some notable commonalities exist. Both candidates advocate tax-advantaged status for capital gains and dividends, permanent AMT relief, a higher estate tax exemption, and a lower estate tax rate than is currently scheduled for 2011. Of course, we cannot know whether these proposals will become law, especially since they may increase the budget deficit.<sup>1</sup>

Nonetheless, there are some important differences in the two candidates' tax proposals, particularly Sen. Obama's plan to increase tax rates for higher-income families.

**Q: How significant are Sen. Obama's proposed tax increases?**

Families earning more than \$250,000 per year, who would be subject to higher tax rates, may indeed view these increases as significant. But history may provide helpful perspective for investors. As shown in Exhibit 1, Sen. Obama's proposed tax rates for ordinary income, capital gains, and dividends would remain significantly below their 40-year averages. Democrats today are putting forth tax rate proposals akin to those of Republicans 25 years ago.

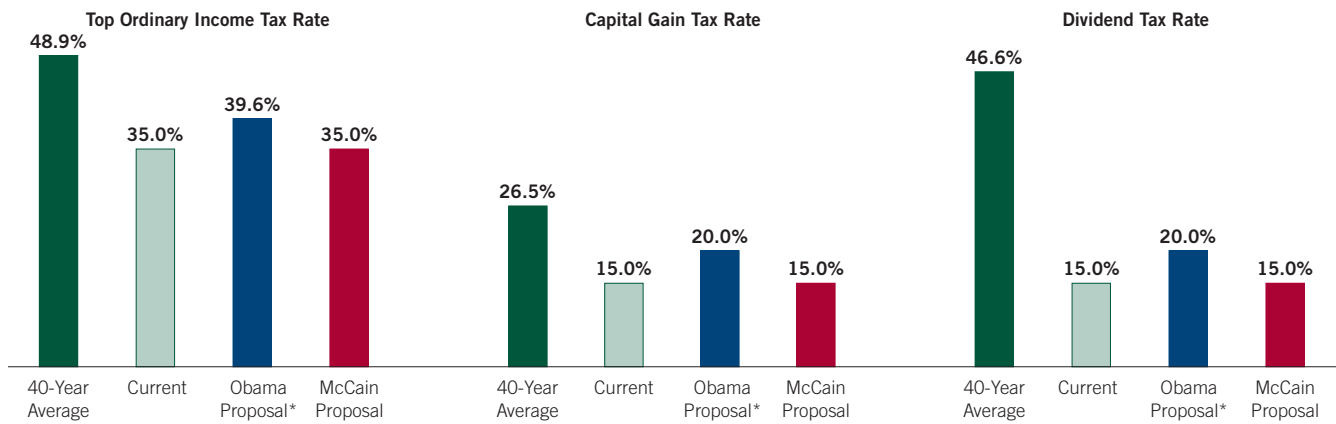
**Q: Could changes in the capital gain tax rate affect investor behavior?**

Yes. History suggests investors will modify their short-term behavior in anticipation of tax changes. When capital gain tax increases are expected, investors tend to accelerate taking gains to lock in lower rates. When they expect rates to decline, investors have historically deferred gain realization. We believe a sharp hike in capital gain tax rates could discourage high-net-worth taxpayers from taking investment risk. Nonetheless, as evidenced by economic results during the Nineties, we would not expect a capital gain tax rate of 20% to significantly affect longer-term investor behavior.

**Q: Would a switch to a Democratic administration harm stock market prospects?**

It is impossible to predict stock market movements, but history suggests no. As we've noted before, over the past 80 years the stock market has averaged higher returns under Democratic administrations than under Republican administrations. Further research takes into account the composition of the White House *and* Congress, as shown in Exhibit 2. The best combination for stock market

**Exhibit 1: Tax Platform Comparison**



\*Represents Obama's proposal for families with income greater than \$250,000. For families with less than \$250,000 in income, he proposes maintaining the current tax rates.  
Source: Tax Policy Center

<sup>1</sup> The nonpartisan Tax Policy Center projects that, over the next decade, Sen. Obama and Sen. McCain's proposals would increase the national debt by \$3.4 trillion and \$5.0 trillion, respectively. It is, however, extremely difficult to make reliable long-term forecasts that fully take into account behavioral responses to changes in tax rates.

returns appears to have been a Democratic president and Republican Congress. Of course, this is an unlikely outcome for the upcoming election. Instead, we appear headed for one of the two middle-range options, which are better than the worst scenario suggested by this research, a Republican president and Congress.

Interesting statistics aside, we believe other factors — such as inflation, economic growth, the banking system, the housing market, and corporate earnings — are far more likely to drive the stock market going forward. While the upcoming election creates near-term uncertainty, we don’t anticipate it will remain a major market event.

**Exhibit 2: Stock Market Returns and Partisan Politics**

	Republican President	Democratic President
Republican Congress	1.62%	9.63%
Democratic Congress	5.68%	6.56%

Stocks are represented by the Dow Jones Industrial Average, 1901 to present, excluding dividends.  
Source: Ned Davis Research

**Q: In light of the upcoming election, is Bessemer making any changes to its recommendations?**

No. It is far too early to tell who will win the election in November or what policy changes the next president and Congress will be able to enact. The last two decades remind us that presidents don’t always follow a partisan script in regard to implementing new trade deals or overseeing significant spending increases.

Members of our Client Tax Services and Financial Planning team and our Investment team are closely following the issues and are prepared to take action if appropriate. In our view, though, only extreme policy shifts, which neither camp appears to embrace, would compel us to make major changes to our recommendations. At this time, we recommend clients maintain their well planned tax strategies and long-term, globally diversified portfolios.

## Appendix: The 2008 Presidential Candidates' Tax Platforms

### Barack Obama, Democratic Nominee

- Maintain the 2001 and 2003 tax cuts for all lower- and middle-class Americans, defined as families with less than \$250,000 in income
- Restore the pre-2001 top two marginal tax brackets of 36.0% and 39.6% on ordinary income for families with income greater than \$250,000
- Restore the phase-outs for personal exemptions and itemized deductions for families with income exceeding \$250,000
- For taxpayers with income greater than \$250,000, increase the tax rate for qualified dividends and long-term capital gain to 20%, compared with the current rate of 15%
- Extend and index the 2007 alternative minimum tax (AMT) patch
- Make the estate tax permanent, raising the exemption amount to \$3.5 million per taxpayer at the maximum tax rate of 45%, which equates to freezing the scheduled rate and exemption amount for 2009
- Simplify the current tax preparation process by providing certain taxpayers with their tax returns already "completed" by the IRS. Those who qualify could simply look over, verify, and sign these IRS-generated tax returns
- Tax carried interest from partnerships as ordinary income, not as capital gain
- Contemplating a possible reduction in corporate income tax rates, but nothing specific at this time

### John McCain, Republican Nominee

- Permanently extend the 2001 and 2003 tax cuts, with the exception of estate tax repeal
- Maintain the current top two marginal tax brackets of 33.0% and 35.0% on ordinary income
- Retain the 15% tax rate on qualified dividends and long-term capital gain
- Permanently repeal the alternative minimum tax (AMT)
- Make the estate tax permanent, raising the exemption amount to \$5 million per taxpayer at a reduced maximum tax rate of 15%
- Simplify taxation by creating two systems that people could file under: the current system, or a new system with two different tax rates and a larger standard deduction and exemption
- Preserve the 15% tax rate on carried interest for hedge funds and private equity funds
- Reduce the current maximum corporate income tax rate from 35% to 25% (phased in)

Source: Tax Policy Center

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