Economic & Investment Perspectives

The window for legislative success is closing fast

Success in passing major legislation is complicated enough; handicapping them is magnitudes more difficult. While we were not enthusiastic about the chances of success for the President's agenda at the beginning of the year, we are even less enthusiastic given the developments of this month.

It's fair to say that healthcare, tax reform, and the passage of a budget were the top three priorities of the White House and Republicans on Capitol Hill as the new administration and congress took office in January. In our 2017 Outlook commentary, we mapped out the complexities and discussed why we were not optimistic about such possibilities. With the passage of nearly five months and little to show for, the window of time is closing fast. In addition, the historical precedents relating to legislative accomplishments subsequent to the initiation of major investigations are not very good. At this point, we believe that any reform of the ACA in 2017 is unlikely, and tax reform almost impossible. Success in passing of the budget—while still a possibility—will be more dependent on bipartisan cooperation in Congress than any effort coming from the White House.

With Memorial Day weekend around the corner, time is running out on the Senate's ability to write its own healthcare legislation before the August recess. Even if the Senate manages to make the deadline (we remain doubtful), and assuming CBO scoring goes their way (which will be difficult), reconciliation between what the House of Representatives passed and what the Senate is likely to pass will probably not begin until well after the August recess and budget discussions. With the Senate bill, likely to be far more expensive and include provisions allowing Medicaid expansion to remain part of the permanent picture, the coming together of the two will be far more difficult than what we have seen to date. At best, we are talking about a 2018 story. Why at best? Because the window of action in 2018 will be far smaller than 2017 due to mid-term congressional primaries and elections later that year. If the debate is still on-going as we enter the Spring, then the chances of anything being placed on the President's desk for signing becomes remote.

Success in tax reform, an equal if not more intricate effort, especially when it's likely to be partially dependent on savings from healthcare legislation, will as a result fall well into 2018 by even our most optimistic assessment. While tax cuts (only a subset of tax reform) are still a possibility for 2017, the fact that such cuts are deficit-additive will limit the extent of any rate reductions. While a strategy of cutting rates first and agreeing to deficit neutralization counter measures later can be accomplished, we question the future motivations for policymakers in agreeing on those counter measures, since they can be perceived as absolute tax hikes at the time. Deficit neutralization counter measures can be included as part of tax reform, but if in aggregate they will be dependent on savings from healthcare legislation first, then mid-term elections are likely to interfere and delay such actions until well into 2019.

We take Treasury Secretary Mnuchin's recent request for an increase in the borrowing limit before the August recess as a sign that the administration is gearing up for and wanting some breathing room on spending before a budget is agreed to in order to avoid a shut-down in September. If the bipartisan passage of the spending bill earlier this month is any signal, Congress is willing to go its own route separate from the President if spending differences remain far apart as we approach the new fiscal year on October 1st. The White House's budget proposal is dead on arrival on Capitol Hill as currently proposed, and time is of the essence if the White House hopes to have a major place at the negotiating table. Failure to pass a budget of course will require a continuing resolution on spending. If deficit-additive tax cuts are part of the picture by the time budget negotiations are underway, the task will be that much more complicated and a budget resolution that much more unlikely in our opinion.

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Of course, many if not all of our assumptions above are incumbent on no major developments occurring on the Congressional and Special Council investigations front for the foreseeable future, admittedly an extremely optimistic assumption. While Congressional and Special Council investigations are not anything new to Washington, the degree of the present investigations is high enough where historical comparisons lead us to conclude that there is a high possibility of legislative paralysis, and it should not be ignored.

The impacts on the financial markets from fiscal policy cannot and should never be ignored, especially when the business cycle is this mature. To what extent the financial markets have discounted the initial optimism from the beginning of the year, as well as the uncertainty ahead, is the topic of much debate these days. When comparing sectors and relative performances, we believe a lot of uncertainty has already been discounted. The relative underperformance of financials, retailers, industrials, and energy to the general market are some examples in point. However, it is on the absolute levels that we are not so sure future uncertainty is appropriately priced in.

As always, stay tuned.

Ardavan Mobasheri
Chief Investment Officer
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