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Joe Biden's plan to punish equity investors

BY MIKE COSGROVE, OPINION CONTRIBUTOR — 07/14/20 06:30 PM EDT

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Equity investors responded positively to Donald Trump's election. Investors expected President Trump to follow through on his economic agenda of reducing regulations and corporate and personal income tax rates.

The S&P 500 price gain, dividends excluded, one year after the election was nearly 20 percent. Trump signed the Tax Cuts & Jobs Act on December 22, 2017, enacting his tax reform. Investors had already discounted most of the short-term benefits of tax reform by the time the bill was signed into law.

A year later, in November 2018, the S&P 500 Index had moved up another 5 percent. That 5 percent, plus the 20 percent gain that occurred before tax reform was signed, provides a proxy for the short-term benefits of tax reform, such as 3.5 million net new jobs added in 2017 and 2018.

The Federal Reserve hiked the funds rate seven times in 2017 and 2018. It also implemented quantitative tightening in 2017 as the Fed attempted to slow the economic benefits of tax reform.

The longer-term benefits of tax reform accrued to all sectors and groups in the economy, as an additional 1.8 million jobs were created in 2019 and unemployment rates hit all-time lows. Equity investors participated in the longer-term benefits and enjoyed a price gain, dividends excluded, of 20 percent from November 2018 to February 2020. Then the coronavirus derailed the U.S. economy.

Equities dropped by one-third after COVID-19 struck but have since recovered. Improvement in the U.S. economy reflects the effect of the pro-growth tax and regulatory policies.

Presumptive Democratic presidential nominee Joe Biden has partially spelled out his economic agenda. He has said he plans to increase the corporate tax rate to 28 percent from 21 percent, a 33 percent tax hike.

Such a hike would encourage offshoring by U.S. companies, and the losers would include U.S. workers who are out of a job and investors such as 401K equity-holders.

His agenda includes a more progressive personal income tax system with the taxation of capital gains and dividends at ordinary tax rates for higher income households and the elimination of the step-up basis for capital gains.

His economic agenda would likely include application of the 12.4 percent payroll tax on incomes earned over $400,000, but with no additional benefits to those paying the new tax. For 2020, the 6.2 percent rate is paid on earned income up to $137,770. The progressive wing of his party may like to have the 6.2 percent applied to unearned income, but that feature may not be part of Biden's initial economic agenda.

For higher-income workers in states with a state income tax, there may be a top tax rate of 60 percent or higher, which would include a combination of the state income tax rate, the top marginal personal income tax rate plus the new 6.2 percent payroll tax rate.

Planks in Biden's economic agenda representing the above tax changes, if implemented, would likely mean an initial 25 percent reduction in equity prices. Biden's proposed tax changes would likely reverse the equity gains of 2017 and 2018, which were the short-term gains in response to Trump's tax reform.

Trump's economic platform focused on full employment and opportunity to increase incomes for all. Biden's economic platform, meanwhile, focuses on reducing the incomes of those at the top and redistributing that income to those deemed to be in need.

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