PRIVATE ASSET MANAGEMENT, INC.
WEALTH STRATEGY ADVISORS
PARADIGM

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***This is the fourth and final part of our series on long-term trends that we believe investors should incorporate into their financial game plans. This Paradigm addresses taxes and provides a summary of the series.***

Our view is that investors need to be prepared for higher taxes in the future. Given the current tax reform debate, some will question our thinking. Therefore, we are going to review our thinking about higher taxes in the future, and then overlay the current situation onto that thinking.

## Original Thesis

In the first part of this series we stated, "We believe higher taxes are a long-term trend that investors will have to navigate. The Congressional Budget Office (CBO) projects a growing deficit due to entitlement spending and increased interest expense. This spending deficit is at a reasonable level right now, however the CBO predicts the current deficit will almost double by 2023 and continue to grow in future years. This is unsustainable. One obvious solution is to raise taxes. Of course higher taxes reduce how much one has to spend."

Three threads in the CBO's thinking are worth noting. First, it stated that the main drivers for the increased deficit were healthcare (Medicare and Medicaid), Social Security, and interest payments on the debt. Second, it stated that healthcare reform (a center-stage topic earlier this year) could cause the rate of deficit increases to slow down. Third, the 2023 projections assumed a continuation of current policies, which is not likely to be what will occur.

What reasonable assumptions can we draw from the above? First, current versions of entitlement programs (Social Security, Medicare, and Medicaid) and interest payments on the Federal debt will have a material and adverse effect on future deficits. Second, higher deficits are likely to lead to higher taxes.

## Current Tax Reform Debate

There is no way of knowing how the current tax reform debate will play out. However, let's assume tax reform occurs, that a major component is the reduction of the corporate tax rate, and that most individuals benefit slightly. Again, nobody knows.

The impact of the reforms on future deficits depends on the string of logic you employ. One string says that corporations will invest more, and pass some of the tax savings on to employees in the form of higher wages. These actions could lead to higher growth, higher incomes, and higher tax revenues. Whether the tax cuts pay for themselves is debatable. It currently appears they will not pay for themselves over a 10 to 20 year period, though they will likely provide a near-term boost to growth and incomes. Another string says corporations will buy other companies, buy stock, reduce prices, or do something else that will not increase growth or incomes.

Neither string of logic leads to an outcome that directly addresses entitlement spending and interest payments on the Federal debt. For now, it appears reasonable that our initial premise still applies: taxes are likely to be higher in the future. The timing and amount may be less certain, but the ultimate outcome appears no less certain. Please prepare.

## Summary of Series

In the first part of this series we wrote, "We have identified three long-term trends we believe investors would be well advised to account for in their planning." These trends were (1) returns are likely to be lower, (2) inflation is likely to be higher, and (3) taxes are likely to be higher. Hopefully, we demonstrated that each trend is a trend worth paying attention to, that each trend will not play out in some "clean" fashion, and that there is some planning each investor can do revolving around each trend.

We encourage you to review this series, ask questions about each Paradigm, and to ask questions about how this may or may not affect your situation. Engagement usually leads to better outcomes.

You can still be optimistic about the future. However, successfully navigating these and other trends requires conscious choices. Be sure to plan, monitor, and review.

***Your money horizon is likely several decades. Conscious choices are required for successful outcomes. As always, we are here to help you assess and navigate your unique situation.***



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