With Congress back in session and just a few days remaining in the lame-duck period, some key issues need to be addressed:

- **Continuing resolution.** After the Republican Party’s (GOP) big gains in the midterm election, party leadership announced plans to avert short-term budget battles and restore order to the budget reconciliation process next year. President Obama’s willingness to move forward on immigration during the lame-duck session has changed the tone of the discussion regarding the extension of the continuing resolution (CR)—that is, short-term legislation funding the federal government. Some Republicans are suggesting that, as part of the CR extension, they should defund the Homeland Security division that issues visas, which would set up a budget battle as we approach the December 11 deadline. We don’t think either party wants to shut down the government two weeks before year-end holidays, so a short-term extension into early 2015 is likely.

In the immediate aftermath of the election, there was hope that a best-case outcome would emerge in the form of either a broad omnibus spending bill or a CR extension through October 2015. The rhetoric from both parties after the president’s executive order on immigration leads us to believe that this best-case scenario is now unlikely.

- **Extension of tax breaks.** On December 31, 2013, a series of tax breaks dealing with both individuals and corporations expired. Congress has been negotiating a renewal of this package of tax breaks retroactively for 2014 and prospectively for 2015, and some of these tax breaks could be made permanent.

As defined in the Senate bill known as the EXPIRE Act, these “tax extenders” consist of roughly 55 provisions in three broad categories: (1) Individual – these include mortgage debt relief, deductions for state and local taxes, IRA charitable giving exclusions, and more; (2) Business – the largest provisions include the research and development credit, bonus depreciation, and small business expensing; and (3) Energy – which covers incentives for biodiesel, renewable and wind energy credits, and more. All total, these provisions amount to $85 billion, of which 20% applies to individuals, 60% is business related, and the remaining 20% is tailored specifically to the energy industry.

The 10-year permanent cost of this package is an estimated $240 billion, which would add to the deficit if enacted. Both parties are now working together closely to find common ground on these important provisions. Although some reports suggest that the ultimate package could exceed $400 billion, the president has pushed back against such a substantial package. According to
independent research firm Strategas, renewal of these tax expirations in the aggregate could add 0.5% to GDP in 2015, with upside if the package ends up larger than the EXPIRE package.

**Other.** There are several other items on the lame-duck agenda—namely, the confirmation of Loretta Lynch as attorney general, the renewal of government-backed terrorism insurance (likely a temporary extension), and additional funding to combat both Ebola and ISIS.

Looking out to 2015, we think there are several legislative items that are on the agenda:

**Energy.** On November 19, the Keystone Pipeline vote, which would have funded a project seeking to transport oil from Canada to U.S. refineries, failed in the Senate by a margin of 59-41 (60 votes are needed to achieve a filibuster-proof majority). In its aftermath, Republican leaders indicated that revisiting energy policy would be a priority under the new GOP-led Congress. With their new Senate majority in the 114th Congress, Republicans will have the more than 60 votes needed for the passage of Keystone; then it would go to the president for his approval or veto. President Obama has indicated that he wants final resolution of a lawsuit in Nebraska before approving the pipeline, so that could impact the timing. The other issue to be revisited is the U.S. ban on crude oil exports, a policy that goes back to the days of the OPEC oil embargo in the 1970s. We would expect Republicans to push for broader energy reform, including loosening the export ban, facilitating the approval of liquid natural gas exports, and accelerating the pipeline approval process.

**Corporate tax policy.** One area with some bipartisan support is corporate tax reform. Democrats want to see policy change to blunt the proliferation of corporate inversions, and Republicans would like to see rates lowered to make U.S. corporations more competitive with the rest of the developed world. Other catalysts for tax reform include the election outcome (the GOP has historically been a big proponent of tax reform) and reduced pressure on Congress to raise revenue as deficits have declined (from 10% of GDP to 3% since the financial crisis). We think the likelihood of meaningful corporate tax reform in 2015 is low, given the significant time needed to negotiate, draft, and approve such legislation. That being said, progress is likely to be made next year. One possibility is a one-time tax repatriation holiday—a temporary lower tax rate on profits. It is estimated that U.S. multinationals have accumulated $2.5 trillion in untaxed profits in overseas subsidiaries since the last repatriation holiday in 2004. Such a holiday would encourage companies to bring the cash back to their U.S. parent. The taxed portion could be used to fund infrastructure projects, while the remaining cash could be used to fund capital investments, dividend increases, stock buybacks, and more.

**Trade policy.** The administration is currently negotiating two major free-trade agreements, one in Asia known as the Trans-Pacific Partnership (TPP), and another in Europe known as the Transatlantic Trade and Investment Partnership (TTIP). These trade deals, which have undergone several rounds of negotiations, would aim to reduce tariffs and regulatory barriers in an effort to create jobs and forge stronger trading ties. Typically, the president is granted authority by Congress to allow his representative to negotiate a deal and then solicit an up-or-down vote from Congress. Senate Democrats have been reluctant to provide such authority, given their close ties with labor unions. A GOP-led Congress increases the likelihood of such authority being granted.

**Immigration.** On November 20, President Obama announced his plan to reform U.S. policy on immigration through executive order, the details of which were covered in our November 21 Market Update. Republican reaction was swift and harsh, but to this point GOP leaders
have not agreed upon an immigration strategy when the party takes over control of Congress. The range of possibilities includes using the budget process to defund the president’s order, bringing forth a lawsuit to stop the order, and crafting new legislation to supersede the order.

- **Other.** There are many other issues that will need to be addressed by the new Congress in 2015, such as the budget, funding the Export-Import Bank, the Highway Trust Fund, the debt ceiling, and revisiting the Affordable Care Act, among others.

Given the breadth and importance of the issues mentioned above, we are closely watching developments on each to determine the potential for market, sector-specific, and stock impacts. We see some sectors being potentially more influenced than others. For example, the outcome on energy policy would meaningfully impact companies in that sector, as would any progress in finalizing the TPP trade deal, especially as it relates to potential energy exports to Japan. Meanwhile, immigration reform could impact the construction sector. A tax repatriation holiday would disproportionately benefit those sectors with meaningful cash in overseas subsidiaries, such as technology and healthcare. It could also, at least tactically, provide an additional support to the U.S. dollar, creating its own implications for other asset classes and securities. The package of tax extenders includes breaks for renewable companies and industrials. Extending the export-import charter would benefit companies that receive funding from that policy, most notably Boeing.

Bottom line: Many of the aforementioned legislative items could have a beneficial impact on various sectors, or for equities overall. Indeed, history has shown that equity markets often generate positive returns the year following a midterm election, as lawmakers seek to pass tax cuts and spending legislation before the presidential election.

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