The Tax Bill May Not Be Good News

As the day of decision on the future of U.S. taxes draws near, it seems appropriate to give further thought to its potential impact on business and individual taxpayers. Behind all the hoopla surrounding this legislation, the probability is that whatever benefits may be forthcoming will be more like a sugar high that ultimately gives way to a less encouraging milieu.

Let me explain.

From this vantage point, it appears that the major goal of what's afoot in the Beltway is a substantial reduction in the statutory tax rate for corporations. Why? Because without looking more deeply it appears that the U.S. business community is paying far higher rates than those of other countries. The reality, however, is that there's a considerable difference between the statutory rate and the actual rates being paid.

Given that understanding, what's working its way through Congress turns out to be more of a nod to major donors to the current administration than an effort to level the playing field. The same appears to be the case with individual tax rates.

There, too, although there's a small tax hors d'oeuvre for lower income folks, the bulk of the tax relief is aimed at people at the upper end of the rate spectrum. Not exactly a surprise, but from the perspective of the team calling the shots these days it's essentially a campaign to prove that it can actually get something done before the end of the year.

The initial reaction from investors has been decidedly positive. In recent months, U.S. stocks have moved steadily higher, with nary a burp. Indeed, the current year has been one of those rare periods in which there's been no pullback of any significance. That's in sharp contrast to the past, when a correction of 10% or so has been an almost annual occurrence. And since we're now in the traditionally strongest season for stocks, one might well feel confident that 2017 will sidestep any potential slippage and end up as a well above average year.

What follows may be another story. A long-term truism is that whenever there have been unusually broad gains it's likely that the offset to those gains will be more moderate progress in the years that follow. A prime example of this was the extraordinary gains of the dot.com era, which were followed by a decade of limited progress, despite considerable volatility along the way.

With U.S. stocks currently priced toward the upper end of what would be considered reasonable valuation, even with accelerated growth in underlying profits, there can be little doubt that by taking a bigger piece of the pie now there will be less left of it to slice going forward.

More likely than not, the coming progress in the major indexes will downshift significantly. What's going on now is not sustainable. But, there are more interesting opportunities available in international markets, especially in the emerging countries, where valuations are well below those prevailing in the U.S.

It's time to take a hard look of where things thing and adjust accordingly.