The Diversification Vote

HOW PARTY PLATFORMS MAY SHED LIGHT ON HOW THE 2016 PRESIDENTIAL ELECTION COULD IMPACT AMERICA’S RETIREMENT FUTURE

As financial professionals and investors consider the implications of another presidential election on their retirement portfolios, the financial press has been steadily reminding readers that new presidents and economic outcomes are not always a simple cause and effect relationship.

As part of its election year coverage, FORTUNE published a graphic that showed the Gross Domestic Product (GDP) generally faring better during democratic administrations. In contrast, the New York Times pointed out this pro-Republican fact: The greatest stock market surge since 1900 occurred during the Republican Coolidge Administration.¹

WHO’S RIGHT?

When U.S. News set out to answer the question “Which Presidents Have Been Best for the Economy?” they arrived at this even-handed conclusion: “(While) Democrats would no doubt like to attribute the growth gap (with Republicans) to macroeconomic policy choices, the data does not support such a claim. If anything… both fiscal and monetary policy actions seem to be a bit more stabilizing when a Republican is president.”²

The picture during an election year can grow even more complicated as investors and voters weigh the implications of tax policy and regulations on their election year choices.

TANGLED THREADS

As financial professionals and investors vote for their best hope for a better future, the core implications of tax policy and regulation on retirement security is likely to occupy the thinking of one group in particular: the 10,000 baby boomers a day entering retirement. This demographic shift will impact the securities markets as well. According to the Charles Schwab publication, How to Transition Your Portfolio for Retirement, the shift in portfolio allocations from growth-oriented investments to retirement income will likely be lasting, profound and influenced by post-election fiscal policies.³

- **Tax Policies Can Affect Retirement Portfolios** Tax payments can impact retirement security by limiting the resources required to grow a sustainable retirement nest egg. The Wall Street Journal has reported
on the high level of disagreement between the two major parties concerning tax policy. “Under President Barack Obama, Congress permanently extended George W. Bush-era tax cuts for all but the highest earners, imposed new taxes on investment income and expanded tax credits for low-income families and college tuition. Yet the bipartisan goal of ‘tax reform’ remains elusive because Republicans and Democrats disagree on how much money the government should collect and who should pay.”

**The Department of Labor Wants Advisors to Put the Best Interests of Retirement-Minded Clients First**

Certain to impact the way they conduct their business, advisors, broker-dealers and asset managers are rushing to accommodate the provisions of the vaunted DOL Fiduciary Rule, which begins its implementation phase in April, 2017 and has a completion date of January 1, 2018.

**“Retirement Security” Left Out of Policy Discussions**

Aside from commenting on Social Security, Forbes’ Richard Eisenberg has reported how both presidential campaigns “are surprisingly mute” on the topic of retirement security.

**RETIREMENT PLANKS AND PARTY PLATFORMS**

“The next administration will need to tackle two key issues when it comes to retirement;” said attorney Michael Kreps, a principal with Groom Law Group in Washington and a former Senate pension aide. “First, they need to do the hard work of implementing policies that expand access to the private retirement system,” Mr. Kreps said. Doing more to ensure lifetime income will be the other challenge, he added.

Here are the key party positions likely to impact tax policy and retirement security. Sources include *The Wall Street Journal*, 2016 Republican Party Platform and 2016 Democratic Party Platform.

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<th>Policy</th>
<th>The Democratic Platform Advocates for…</th>
<th>The Republican Platform Advocates for…</th>
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| Economic 8, 9, 10      | • Increased spending on job training and community college education, broadband networks, infrastructure, and clean energy  
                         • Increase in the federal minimum wage, an overhaul of immigration laws, and a boost to women's workforce participation through paid leave and access to child care  
                         • Cover spending increases with higher taxes on businesses, entrepreneurs, and the upper and middle income classes  
                         • Maintain and improve upon Patient Protection and Affordable Care Act (PPACA), commonly called the Affordable Care Act (ACA) or Obamacare | • Increased spending on defense, infrastructure, paid maternity leave benefits, veterans' health care and border security  
                         • Ridding government of wasteful spending and renegotiating trade deals to boost tax revenue and overall GDP to help support government spending  
                         • Preserve benefit programs such as Social Security and Medicare to keep them available to all who have paid into them throughout their lifetimes  
                         • Due to rising premium costs, replace Obamacare with a more privatized option that requires insurance providers to compete for participants' dollars |
### Policy

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<th>Taxation</th>
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<td>• Tax increases on middle to high-income households and some incentives for businesses that share profits with their workers</td>
<td>• Lower taxes in most categories</td>
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<td>• In an effort to encourage long-term investing, boost capital gains tax rates on assets held between one and six years</td>
<td>• Implementing a 15% business tax rate and a repeal of the estate tax, both of which are meant to encourage offshore American businesses to bring their wealth (in the form of business taxable income and jobs) back home</td>
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<td>• Tougher restrictions on companies seeking to relocate outside of the U.S. to cut their tax bills</td>
<td>• A deduction for child care costs and a proposed increase in the standard deduction</td>
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<td>• Using overall “business tax reform” to pay for $275 billion in infrastructure spending</td>
<td>• Capping itemized deductions at $100,000 per individual and reducing the top individual tax rate from 39.6% to 33%</td>
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<td>Regulatory Issues</td>
<td>• Resist “any attempt to roll back the [DOL] Conflict of Interest Rule,” which requires that retirement advisors put the best interests of their clients above their own financial gain”</td>
<td>• Maintain opposition to the DOL Fiduciary rule; up to and including the proper usage of the term ‘Fiduciary’</td>
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<td>• Keep the Dodd-Frank regulatory provisions in place and, in some cases, expanding regulatory oversight for Wall Street, such as taxing high-frequency trading activity</td>
<td>• Resist: “the continuously increasing burden of governmental regulation and red tape”</td>
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<td>Social Security</td>
<td>• Oppose every effort “to cut, privatize, or weaken Social Security,” including attempts to raise the retirement age or diminish benefits by cutting cost-of-living adjustments, or reducing earned benefits</td>
<td>• Keep all options to preserve Social Security, while opposing “tax increases and letting the power of markets to create wealth and to help secure the future of our Social Security system”</td>
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<td>• Expansion of Social Security so that every American “can retire with dignity and respect”</td>
<td>• “Saving Social Security,” terming it more than a challenge, but a moral obligation to those who trusted in the government’s word”</td>
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<td>Retirement Security</td>
<td>• Protections for workers looking to collect their defined benefits from pension plans in distress</td>
<td>• Re-set the eligibility age for retirement in light of today’s longer life span “without disadvantaging present retirees or those nearing retirement”</td>
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<td>• Costs of litigating to ensure pension benefits to be borne by closing tax loopholes that benefit “millionaires and billionaires”</td>
<td>• Preserving and modernizing a system of retirement security “forged in an old industrial era beyond the memory of most Americans”</td>
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### CALCULATING THE POST-ELECTION IMPACT ON ALTERNATIVE ASSETS

For the retirement-minded investor who is particularly risk-averse, the election outcome may prove critical for one favorite risk management mainstay: Diversification.

Low-cost, passive index-based products may seem like the logical default option for anxious broker-dealers looking to keep their investment recommendations under the regulatory radar. The trade-off between investment cost and investment diversification, however, may be considerable. A look back to 2008 and the near catastrophic downdrafts in both the global equity and bond markets are near-term reminders about what can happen when investments track too closely with the broader indexes.

Don Phillips, a managing director at Morningstar Research, pointed out recently that the cheapest solution – low-cost ETFs – may not always be best. More diversified portfolio construction, he said, can allow investors a way to avoid putting all of their eggs in one basket. Accordingly, diversification strategies that include...
alternative investments may help optimize a portfolio. “Alts continue to play an important role in outcome-oriented investing,” he said, expressing concerns that the predominance of ETFs might provide too much correlation with the broader market, perhaps leading to greater risk exposure in the event of another major sell-off.11

**Portfolio Diversification Takes Specialists**

With alternative investments like real estate, precious metals, private equity, private debt and investment crowdfunding opportunities on the increase, broker-dealers are also becoming aware of the importance of utilizing the services of more specialized custodians. According to Jeffrey Kelley, Senior Vice President for Equity Institutional, “Managing payments, documentation and reporting can become more complicated in the world of alternatives. Qualified custodians in this area require an understanding of complex transactions and tracking capabilities for both contributions and distributions.”

How the DOL Fiduciary Rule impacts investments may not be the only regulation to ponder post-election. A range of policy proposals from the hedge fund carried interest loophole to new approaches to stimulating energy production might restrict or expand the appeal of alternative investments for diversification-minded advisors and investors – depending on who is elected the next President of the United States.

**CONCLUSION: BOTH PARTIES LACKING IN RETIREMENT SPECIFICS**

While both the Democratic and Republican platforms mention retirement planning, neither have yet adequately addressed how IRAs or qualified retirement plans can offer a supplement to most Americans’ Social Security payments. None have offered fresh ways to build individual savings for retirement beyond discussions concerning the impact of tax policies on discretionary income.

In order to develop a coherent retirement savings policy for America’s overworked under-savers, according to Forbes’ Richard Eisenberg,12 both campaigns should push retirement security further up on their agendas and present some policy ideas before the clock runs out for many of America’s under-resourced retirees.

James A. Klein, president of the American Benefits Council in Washington, said he hopes the next administration will look at all the pieces involved in retirement security to see how they work together. “Personal financial security involves not only robust pensions and retirement savings plans, but also health, disability and long-term care coverage” he said. Plan fiduciaries and participants will need help managing complexity “in a way that helps them save for retirement but not overwhelm them,” he said, and policymakers will also have to address increased longevity.13
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EXPERIENCE EQUITY INSTITUTIONAL


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