

Deutsche Bank

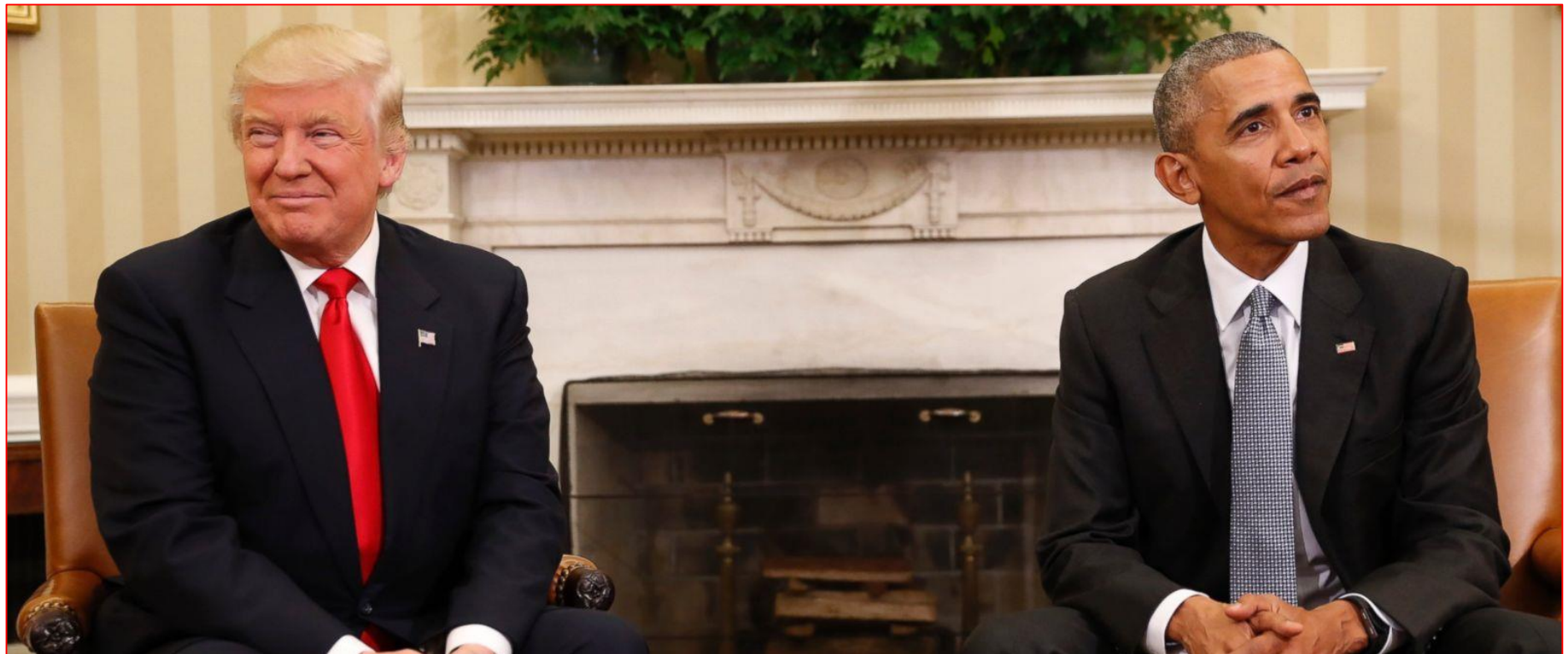
Geopolitical Risk and Global Markets: What to watch for in 2017

**AEGON Annual Conference
New York, New York
January 12, 2017**

**Francis Kelly
Managing Director & Head
Government & Public Affairs Americas**



I. The United States: Looking in a new direction



They said it...



“Elections belong to the people. It’s their decision. If they decide to turn their back on the fire and burn their behinds, then they will just have to sit on their blisters.”

- Abraham Lincoln

“Hell, I never vote for anybody. I always vote against”

- W.C. Fields

**“America will no longer settle for anything but the best...
dream big and bold and daring.”**

- President-Elect Donald J. Trump

Critical Questions for “The First 100 Days”



Critical Questions for “The First 100 Days”

- ✓ **Trump:** How much will Trump “the President” resemble Trump “the candidate”? Will the power base in Trump’s White House be driven by anti-establishment loyalists, or the more traditionally conservative Republican establishment?
- ✓ **First 100 days:** Which 2-3 major Trump policy proposals will be prioritized in the first year of his Presidency? Will FY 2017 and 2018 budgets be passed in the first 100 days to facilitate ObamaCare repeal and comprehensive tax reform?
- ✓ **Confirmation Hearings:** Will the more controversial Trump cabinet appointments (Sessions, Price, Tillerson, Mnuchin) result in bruising confirmation hearings that require political capital better used for an ambitious policy agenda?
- ✓ **Tax Reform:** Given its sheer magnitude and complexity, will Republicans be able to execute the largest reform of the US tax code (individual, corporate, international) in a generation? Will Trump get behind the House plan’s concept of “border adjusted taxes” in order to push it through the Senate?
- ✓ **Infrastructure:** Will conservative fiscal Republicans (McConnell, Ryan, Pence, Mulvaney, Priebus) support anything close to Trump’s \$1 trillion infrastructure program, and how will it be funded?
- ✓ **China & Trade:** Will Trump’s renegotiation efforts be more bark than bite, or is he willing to risk a damaging trade war to reset the US-China economic relationship?
- ✓ **ObamaCare:** Will Republicans use budget reconciliation in Jan-Feb to unwind trillions of ObamaCare spending and taxes immediately? Will they be able to co-opt the 10 vulnerable Democratic Senators in Red States to “replace” with a more defined contribution-based system? Will there be resistance to “repeal” without a clear “replace” strategy?
- ✓ **Dodd-Frank:** What will be the focus areas of Trump’s unwind of selected Dodd-Frank provisions, and will he pivot to center from his campaign rhetoric regarding the big banks (Glass Steagall, Volcker, TBTF, FSOC)?
- ✓ **Treasury:** Will new US Treasury Secretary Mnuchin pursue a strong US Dollar policy, and how quickly will he pivot if there is contagion to global markets (EM, China peg, oil, US exports, S&P 500 earnings)?
- ✓ **The Fed:** Will Trump pursue campaign promises to curtail Fed policy independence, and will he replace Yellen as Chair in 2018?

Key Risks to Watch in 2017



10 Elections to Watch

- 1) **Mar 15:** Netherlands General
- 2) **Mar 26:** Hong Kong Chief Executive
- 3) **Apr 23:** French Presidential (1st Round)
- 4) **May 7:** French Presidential (2nd Round)
- 5) **May 19:** Iran Presidential
- 6) **Aug:** Rwanda General
- 7) **Oct:** China's Politburo
- 8) **Oct 22:** Germany General
- 9) **Dec 20:** South Korea Presidential
- 10) **Late 2017:** Thailand General

10 Risks to Watch

- 1) **Dovish Fed falling behind rate curve**
- 2) **Stagflation if US growth slow to materialize**
- 3) **Fed or USD induced tightening of financial conditions**
- 4) **Escalating US-China trade disputes / retaliatory measures**
- 5) **US Dollar contagion** (EM, China, oil, exports, earnings)
- 6) **European politics** (Brexit, elections, migrant crisis)
- 7) **Republican failure to pass "comprehensive" tax reform**
- 8) **Oil supply glut** (US production upside; OPEC production cut enforcement)
- 9) **Recovery delays for commodity exporters**
- 10) **Geo-political escalation** (cyber security, failed states, terrorism)

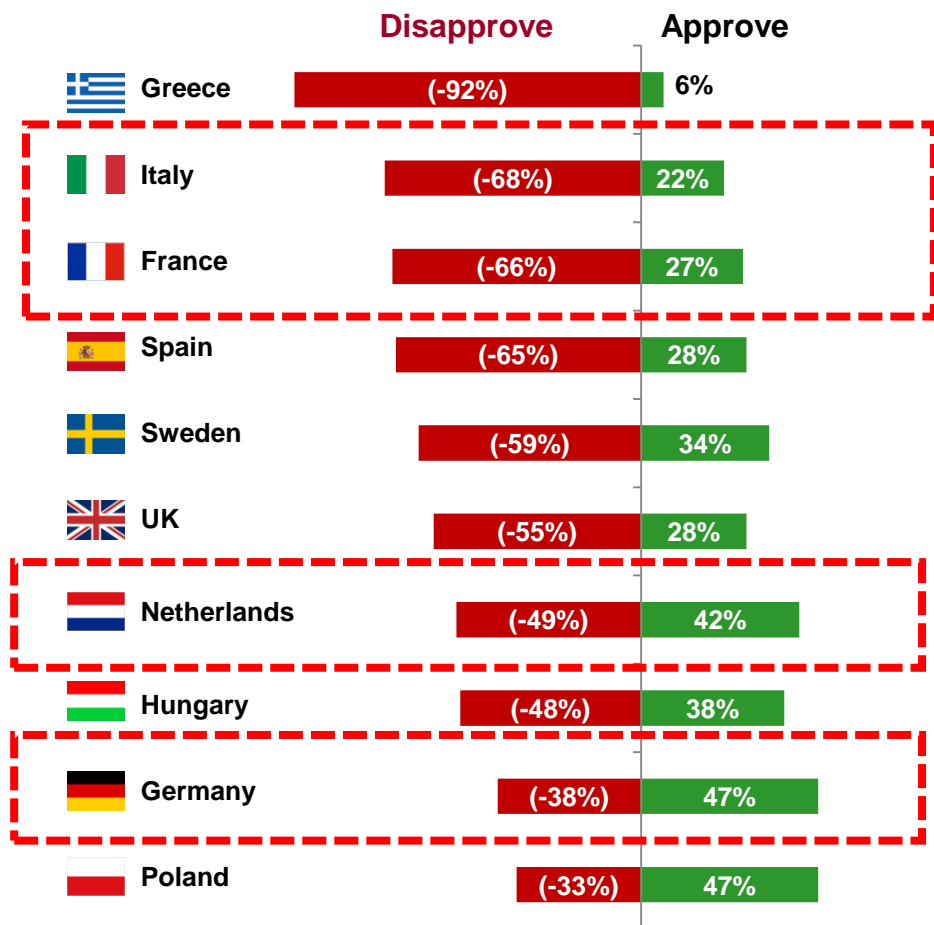
Note: Though not currently scheduled, both Italy and the UK have a high probability of early elections in 2017.

Vox Populi Risk: Anger and Change around the world



Disapproval Rating

Ratings for EU Economic Policy



European Populism

| | Support level | Anti-austerity | Anti-globalization | Anti-eurozone | Anti-establishment | Anti-European Union | Anti-immigration |
|---------------------------|---------------|----------------|--------------------|---------------|--------------------|---------------------|------------------|
| Podemos Spain | 23% | ✓ | ✓ | | ✓ | | |
| Syriza Greece | 14% | ✓ | ✓ | | ✓ | | |
| Five Star Italy | 30% | ✓ | | ✓ | ✓ | | |
| UKIP Britain | 11% | | ✓ | ✓ | ✓ | ✓ | ✓ |
| National Front France | 23% | | ✓ | ✓ | ✓ | ✓ | ✓ |
| Freedom Party Netherlands | 17% | | | ✓ | ✓ | ✓ | ✓ |
| AFD Germany | 13% | | | ✓ | ✓ | | ✓ |
| Freedom Party Austria | 35% | | ✓ | ✓ | ✓ | ✓ | ✓ |

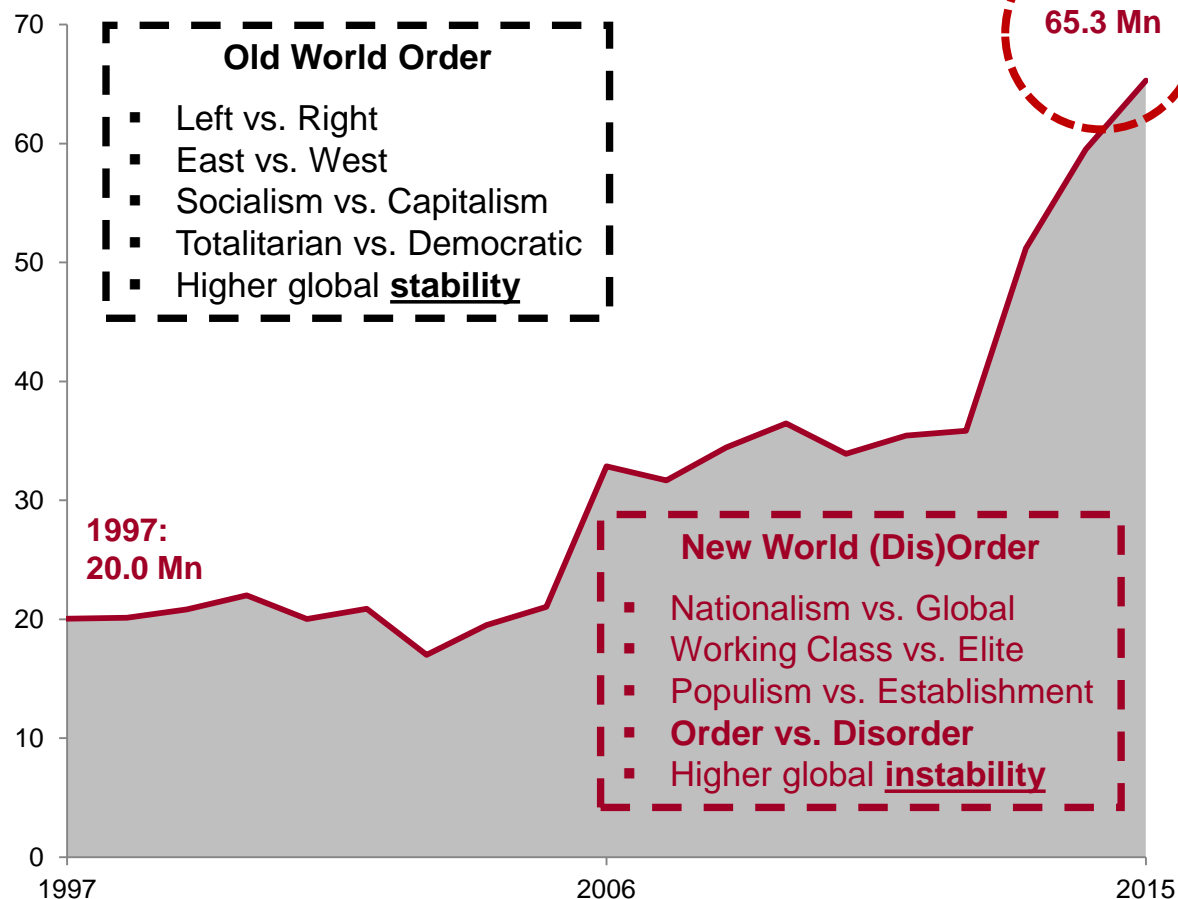
You May Not Know: According to the IMF's World Economic Outlook, political risk in advanced economies has become the largest risk to global growth. Italy, for example, has had 64 governments in 70 years. If 2016 was the year of the referenda in Europe, 2017 will be a year of pivotal elections: Netherlands (Q1), France (Q2), Germany (Q3), and possible early elections in both Italy and the UK. Sluggish growth, the migrant challenge and a busy election schedule will all pose significant challenges for the European project in 2017.

New World (Dis)Order



of Displaced People Globally

Global Refugees, Asylum-Seekers, and Internally Displaced Peoples (Millions)



2016 Fragile States Index

| Very High Alert | | High Alert | |
|-----------------|----------------------|------------|-------------|
| 1. | Somalia | 9. | Afghanistan |
| 2. | South Sudan | 10. | Haiti |
| 3. | Central African Rep. | 11. | Iraq |
| 4. | Sudan | 12. | Guinea |
| 5. | Yemen | 13. | Nigeria |
| 6. | Syria | 14. | Pakistan |
| 7. | Chad | 15. | Burundi |
| 8. | Congo (D.R.) | 16. | Zimbabwe |

You May Not Know: According to the UN, the world today has over 65 million displaced people, nearly double the number from a decade ago. Globally, 1 in 122 humans today is a refugee, internally displaced or seeking asylum. If this population were a country, it would be the 24th largest in the world.

Say Hello to Team Trump: The Domestic Policy Squad



Nominees and Appointees for Key White House Positions

| Position | Nominee / Prior Experience | Congressional Approval? | Pick Type | |
|---|--|-------------------------|----------------|-----------------------|
| | | | Trump Loyalist | Establishment / Other |
| Cabinet: | | | | |
| Attorney General | Jeff Sessions, Senator (R – AL) | ✓ | ✓ | |
| Secretary of the Interior | Ryan Zinke, Representative (R – MT) | ✓ | ✓ | |
| Secretary of Health and Human Services | Tom Price, House of Rep (R – GA) | ✓ | | ✓ |
| Secretary of Housing and Urban Development | Ben Carson, Neurosurgeon | ✓ | | ✓ |
| Secretary of Transportation | Elaine Chao, Bush Secretary of Labor | ✓ | | ✓ |
| Secretary of Education | Betsy DeVos, School voucher advocate | ✓ | ✓ | |
| Secretary of Agriculture | To Be Announced | ✓ | | |
| Secretary of Veterans Affairs | To Be Announced | ✓ | | |
| Non-Cabinet: | | | | |
| Chief Strategist | Steve Bannon, Campaign manager | ✗ | ✓ | |
| Chief of Staff | Reince Priebus, RNC Chairman | ✗ | ✓ | |
| Adviser | Jared Kushner, Real Estate developer | ✗ | ✓ | |
| White House Counsel | Donald McGahn, Campaign finance lawyer | ✗ | ✓ | |
| White House Press Secretary | Sean Spicer, RNC communications director | ✗ | ✓ | |
| Chairman of the EPA | Scott Pruitt, Oklahoma Attorney General | ✓ | | ✓ |
| CMS Administrator (Centers for Medicare and Medicaid Services) | Seema Varma, President of SVC Inc | ✗ | | ✓ |
| Counselor to the President | Kellyanne Conway, Campaign manager | ✗ | ✓ | |

Say Hello to the Trump Team: Foreign Policy Squad



Nominees and Appointees for Key White House Positions

| Position | Nominee / Prior Experience | Congressional Approval? | Pick Type | |
|--------------------------------------|---|-------------------------|----------------|-----------------------|
| | | | Trump Loyalist | Establishment / Other |
| Cabinet: | | | | |
| Secretary of State | Rex Tillerson, CEO of Exxonmobil | ✓ | | ✓ |
| Secretary of Defense | James Mattis, Marine General | ✓ | | ✓ |
| Secretary of Homeland Security | John Kelly, Retired Army General | ✓ | | ✓ |
| Non-Cabinet: | | | | |
| National Security Adviser | Michael Flynn, Army Lieutenant General | ✗ | ✓ | |
| Deputy National Security Adviser | Kathleen McFarland, National Security analyst | ✗ | | ✓ |
| US Ambassador to the United Nations | Nikki Haley, Governor of South Carolina | ✓ | | ✓ |
| Central Intelligence Agency Director | Mike Pompeo, Representative (R – KS) | ✓ | | ✓ |
| Ambassador to China | Terry Branstad, Gov. of Iowa | ✓ | ✓ | |
| Homeland Security Advisor | Thomas Bossert, Bush Deputy Homeland Security advisor | ✗ | | ✓ |
| Deputy Secretary of State | To Be Announced | ✓ | | |
| Director of National Intelligence | Dan Coats, ex-US Senator (R-IN) | ✓ | | |

Say Hello to Team Trump: The Economic Policy Squad



Nominees and Appointees for Key White House Positions

| Position | Nominee / Prior Experience | Congressional Approval? | Pick Type | |
|---|--|-------------------------|----------------|-----------------------|
| | | | Trump Loyalist | Establishment / Other |
| Cabinet-level: | | | | |
| Secretary of State | Rex Tillerson, CEO of ExxonMobil | ✓ | | ✓ |
| Secretary of the Treasury | Steven Mnuchin, Goldman Sachs partner, Hollywood financier | ✓ | ✓ | |
| Secretary of Commerce | Wilbur Ross, Investment banker | ✓ | ✓ | |
| Secretary of Labor | Andrew F. Puzder, CEO of CKE Restaurants | ✓ | | ✓ |
| Secretary of Energy | Rick Perry, Governor of Texas | ✓ | | ✓ |
| Head of OMB | Mick Mulvaney, Representative (R – SC) | ✓ | | ✓ |
| US Trade Representative | Robert Lighthizer, Lawyer; frmr. trade representative | ✓ | | ✓ |
| Non-Cabinet: | | | | |
| Deputy Commerce Secretary | Todd Ricketts, Chicago Cubs Co-Owner | ✓ | ✓ | |
| Director of the National Economic Council | Gary Cohn, frmr. COO of Goldman Sachs | ✗ | | ✓ |
| Head of the National Trade Council | Peter Navarro, Professor, author | ✗ | ✓ | |
| Head of the Small Business Administration | Linda McMahon, Business executive | ✓ | ✓ | |
| Advisor on Regulatory Overhaul | Carl Icahn, Investor | ✗ | ✓ | |
| Chairman of the Council of Economic Advisers | To Be Announced | ✓ | | |
| → Assistant Treasury Secretary for Tax Policy | To Be Announced | ✓ | | |
| → Federal Reserve Vice Chair for Supervision | To Be Announced | ✓ | | |

Source: Public Media. Trump Transition Team.

Though technically not part of the Cabinet, Head of OMB and the USTR are treated as Cabinet-level positions.

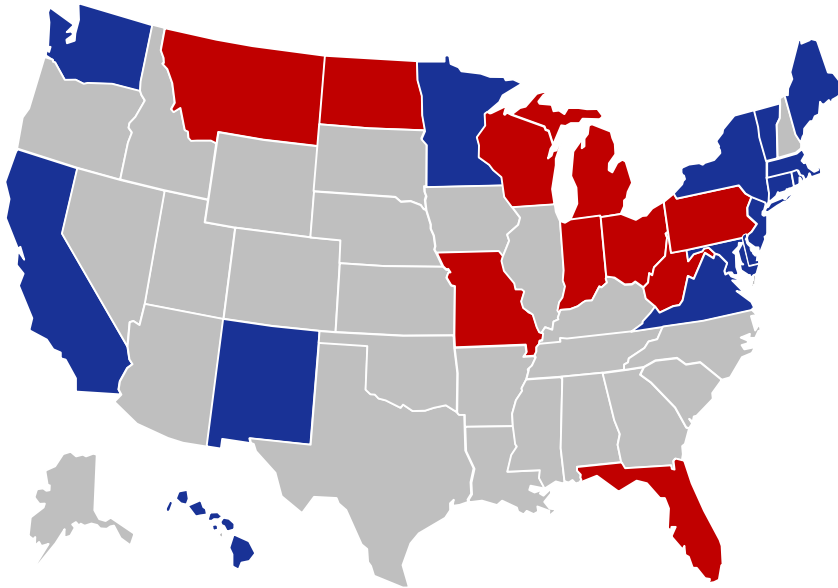
Democrats' Diminishing Footprint Nationally



2018 US Senate Elections

Total Democrats' Senate Seats Up in 2018: 25*

- Red states: 10
- Blue states: 15



Seats Held by Democrats

| | 2009 | 2017 |
|---|------|-------|
| President | 1 | 0 |
| Senate | 58 | 48 |
| House of Representatives | 257 | 194** |
| <i>**1/3 of Dem Seats from 3 states: CA, NY, MA</i> | | |
| State Governorships | 29 | 15 |
| State Legislative Chambers | 57 | 31 |
| Unified Government at State Level | 17 | 6 |

You May Not Know: Republican control of the White House, Senate and House in 2016 has fit a pattern of larger gains across State Governorships and legislative chambers nationally. In 2018, 25 of the 33 Senate seats up for re-election are held by Democrats. Of the 25, 10 are from red states, 5 of which Trump won decisively, and 5 of which Trump won narrowly. While it is unlikely that vulnerable Dems will cross party lines to dismantle Dodd-Frank, they may prove pivotal to Trump's efforts on ObamaCare and economic issues.

Source: New York Times.

* Includes 23 Democrat seats and 2 independents.



II. Policy Priorities

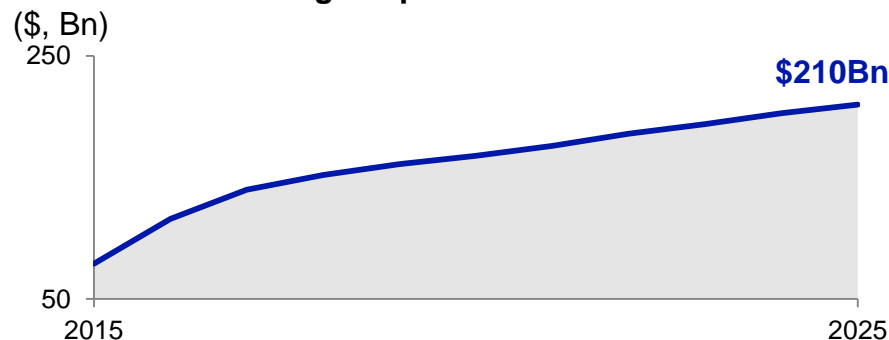


Congress' Legislative Priorities: Here we go!



Priority #1: ObamaCare

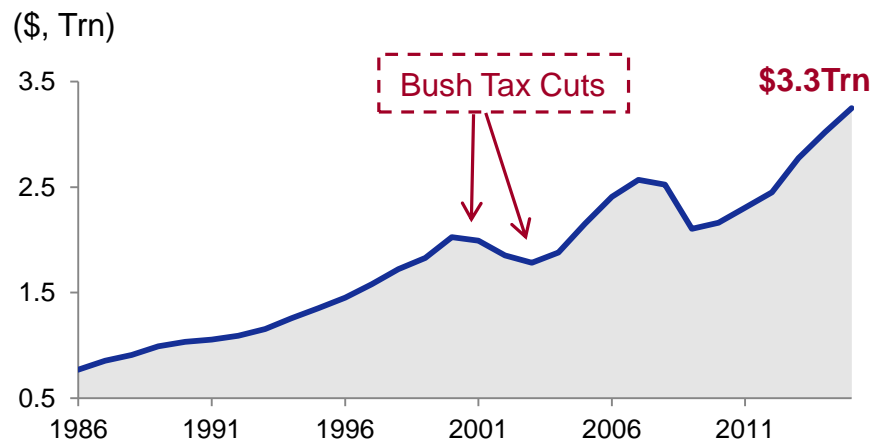
Annual ACA Coverage Expenses



Priority #2:

Comprehensive Tax Reform

US Federal Revenues



Expected Trump Agenda

Via Budget Reconciliation (January and April 2017)

- **FY 2017 Budget Reconciliation (January):** “Repeal” ObamaCare taxes and spending with a “bridge to replace” at later date
- **FY 2018 Budget Reconciliation (April):** Comprehensive US Tax Reform to then follow later in 2017

Via Executive Order (First 100 Days)

- **Immigration** (border security, not comprehensive reform)
- **Deregulation** (environment, energy, financial sector, business)
- **International trade**
- **Lobbying ban for former officials** (5 years)

Other Priorities

- **Senate Confirmations & Supreme Court nominee** (January – March)
- **Dodd-Frank revisions** (repeal highly unlikely)
- **Infrastructure** (GOP opposition likely)
- **Rebuilding defense** (raise spending caps)
- **Extend March 16, 2017 debt ceiling**

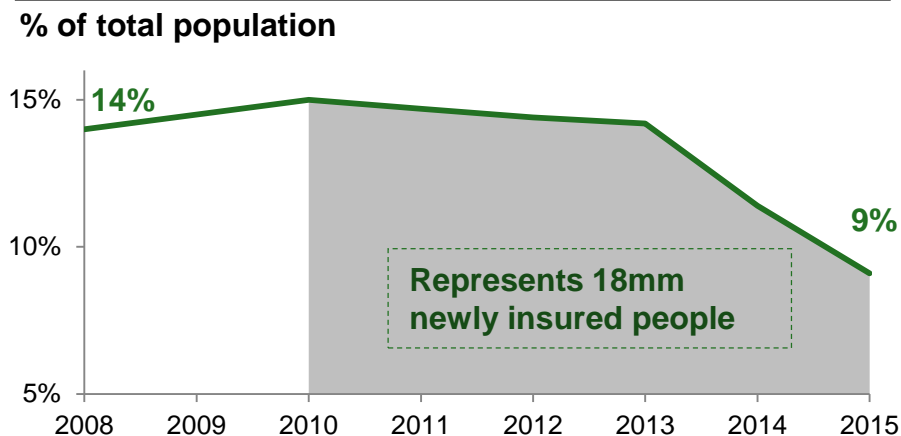
You May Not Know: By our count (see Appendix C), President Barack Obama executed 261 executive orders between 2009 and 2016. The new 115th US Congress will convene on January 3rd with a stated goal of “reclaiming” Congressional authority under Article 1 of the Constitution, which they believe President Obama “whittled away” over the last 8 years.

ObamaCare Repeal & (Delayed) Replace

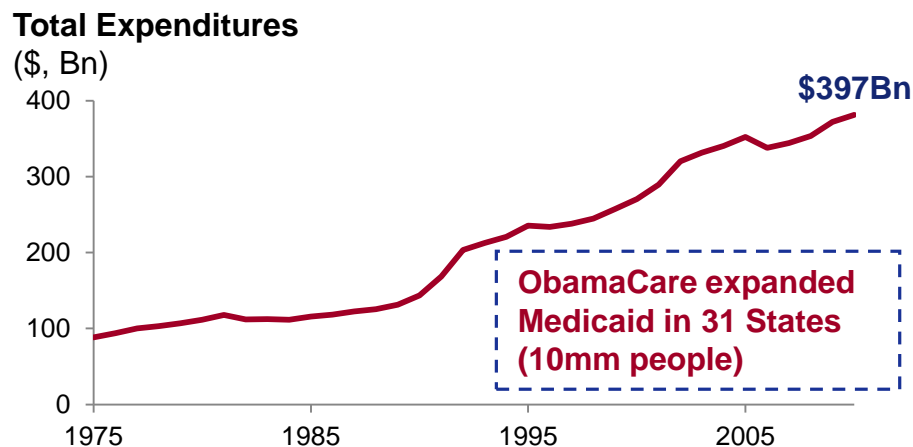
Expectations



Uninsured Americans



US Medicaid Spending



Under President Trump

Step #1: "Repeal" ObamaCare Tax & Spending Provisions

Timing: Jan – Feb 2017

Possible Guidepost: HR 3762, passed by Congress in Dec 2015 ("Restoring Americans Healthcare Freedom Reconciliation Act")

- Repeal \$1.3 trillion of ACA spending (over 10 years)
- Repeal \$1.1 trillion of ACA taxes (over 10 years)

Step #2: "Replace" ObamaCare

Timing: Unclear (could be 1-3 years)

Possible Guidepost: GOP's "Better Way" (only a 37 page blueprint)

- Promotes HSAs
- Caps employer-based health insurance exclusion
- Permits sale of insurance across state lines
- High risk pools and other insurance market reforms
- Medicaid and Medicare reforms

You May Not Know: Repealing ObamaCare tax and spending provisions is the #1 priority of the GOP in 2017. The path to replace is less clear, could be 1-3 years, and remains a concern for many GOP leaders. While Republicans will seek to shift from an open-ended defined benefit structure, to a more cost-mitigating defined contribution scheme, the bridge to replace poses enormous political risks. In 2016 alone, subsidies to consumers and health plans totaled \$43 bn as nearly 20mm Americans have added insurance since 2010.

Moving Hard and Fast on Deregulation



Selected Areas Trump Can Act without Congress Approval

- Certain immigration controls

- Certain foreign trade abuses

- Leaving the TPP

- ▪ Labeling China an FX manipulator

- Limiting Federal regulations

- ▪ Roll back environmental regulations

- Cancel UN payments on climate change

- Rescind certain gun restrictions

- Approve Keystone Pipeline / Dakota Access

- Tighten lobbying restrictions

The CRA: 10 High Cost Rules that Could be Repealed

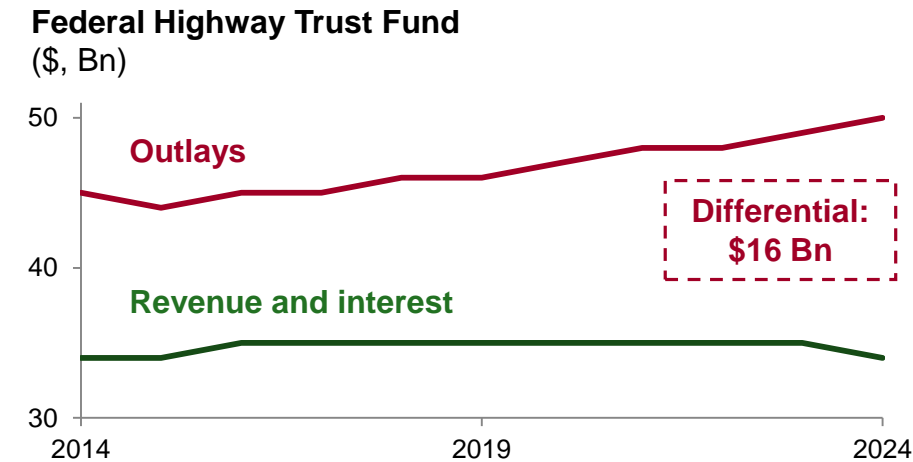
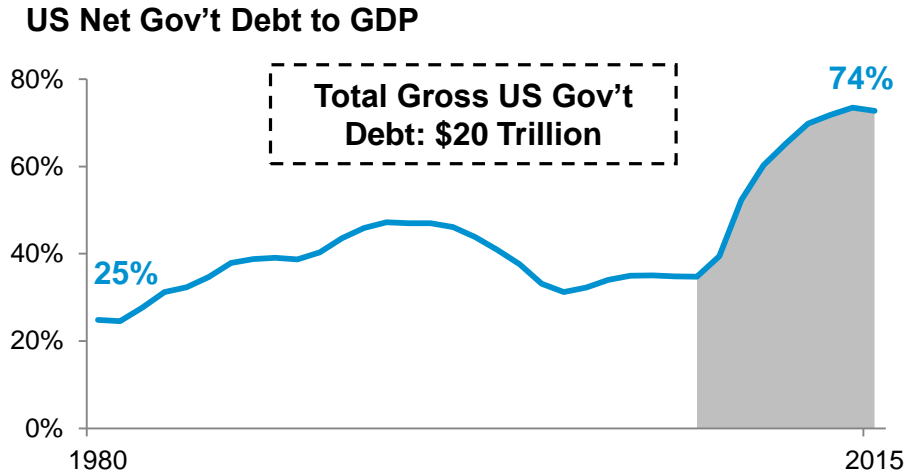
| Rule | Cost (\$, Bn) |
|---|------------------|
| 1. Head Start Performance Standards | \$5.6 |
| 2. Food Labeling Requirements | \$4.3 |
| 3. Food Labeling Revisions | \$4.3 |
| 4. Selected Medicare and Medicaid Programs | \$3.1 |
| 5. Child Care and Development Fund (CCDF) | \$3.0 |
| 6. Overtime Rule | \$2.9 |
| 7. Operation and Certification of Small Unmanned Aircraft Systems | \$2.6 |
| 8. Customer Due Diligence Requirements for Financial Institutions | \$2.5 |
| 9. Exploratory Drilling on the Arctic Outer Continental Shelf | \$2.1 |
| 10. Disclosure of Payments by Resource Extraction Issuers | \$1.3 |
| Total | \$31.6 Bn |

You May Not Know: The 1996 Congressional Review Act (CRA) allows Congress with a simple majority to pass disapproval resolutions to unwind regulations passed over the prior 60 legislative days. House Republicans also plan to pass the “REINS Act”, which requires Congressional approval for regulations > \$100 mm. Lastly, Trump himself can also issue or repeal dozens of executive orders without Congressional approval.

Infrastructure Spending: Really?



US Infrastructure Considerations



The Ross-Navarro Public-Private Investment Proposal

- **Target Size:** \$1 Trillion (over 10 years)
- **Required Equity:** \$167 Billion
- **Avg. Project Leverage:** 5x
- **Avg. Financing Rates:** 4.5 – 5%
- **Target Financing Term:** 20 – 30 years
- **Assumed Equity Returns:** 9 – 10%
- **Government Tax Credits:** Equal to 82% of equity
- **Implied Reduction to Debt Cost:** 18 – 20%

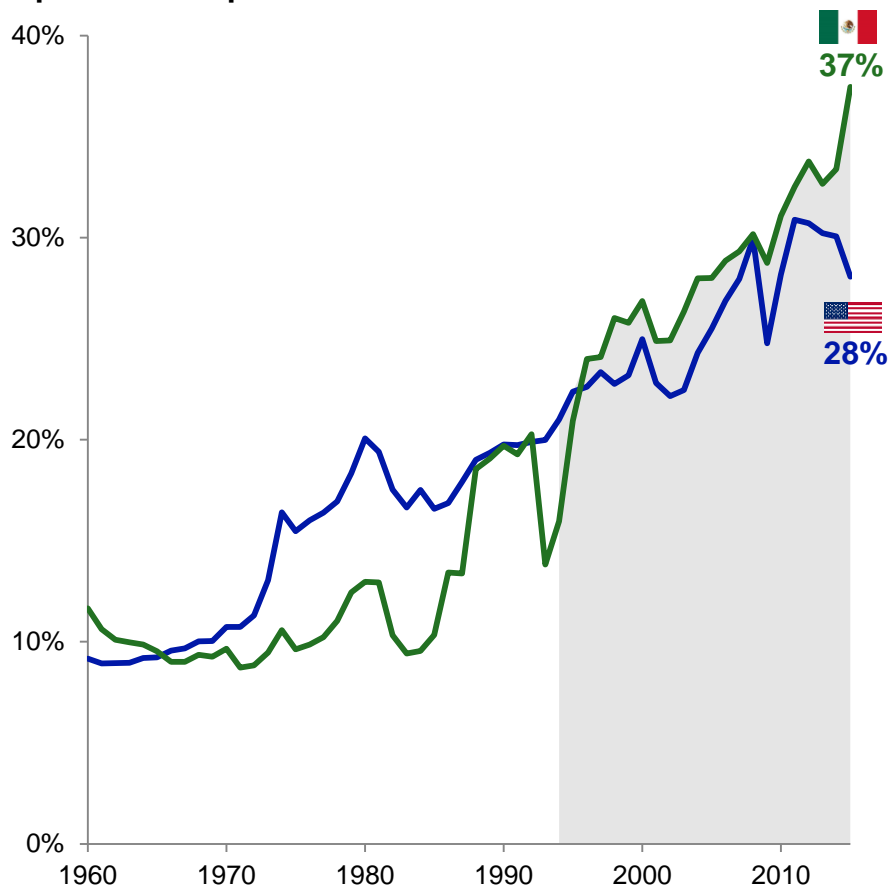
You May Not Know: President-elect Trump is likely to fall short of anything close to his \$1 trillion of proposed infrastructure spending. While fiscally conservative Republicans are highly unlikely to fund it with deficit build, privately funded models such as the Ross-Navarro plan are likely to fall far short of its ambitious target size. Sector interest would also vary widely with the largely publicly held transport industries likely to attract much less investment than energy and utility projects.

Trump going to be Tough on Trade?



Trade Since NAFTA

Exports and Imports as % of GDP



Expectations Under President Trump

More Likely:

- Withdraw from the Trans-Pacific Partnership (TPP)
- Renegotiate NAFTA (NAFTA Article 2202)
- TTIP with Europe on permanent hold
- More unilateral deals (Post-Brexit US-UK deal)
- Commerce Secretary to identify all overseas trade violations
- USTR to initiate WTO cases (anti-dumping, IP, subsidies)
- Pressure US corporates on offshoring
- Push for “border-adjusted taxes” within tax reform

Less Likely:

- WTO withdrawal (requires 6 months notice)
- NAFTA withdrawal (requires 6 months notice)
- Raise tariffs outside WTO procedures (1974 Trade Act, Sec 301)

You May Not Know: Trump’s rejection of the TPP deal is a watershed moment in US trade policy, as the US has never previously failed to ratify a major negotiated trade agreement. It is also worth noting that while Congress is required to ratify new trade deals, a US President may terminate such deals unilaterally without Congressional approval. Getting behind “border-adjusted taxes” in the US tax reform agenda may offer a more attractive path to Trump than the WTO and temporary tariffs.

Dodd-Frank Revisions: How much and how fast?



Dodd-Frank Rulemaking Process

Status of Dodd-Frank Rules as of November 29, 2016:



Total Rule-Making Requirements: 391

Expectations Under President Trump

More Likely:

- More accommodative DF enforcement
- Significant leadership changes at Agencies
- Possible governance changes at CFPB
- More flexibility on Volcker
- Slowdown in SIFI designations
- Regulatory relief for smaller banks
- Fed preserves independence from Congress

Less Likely:

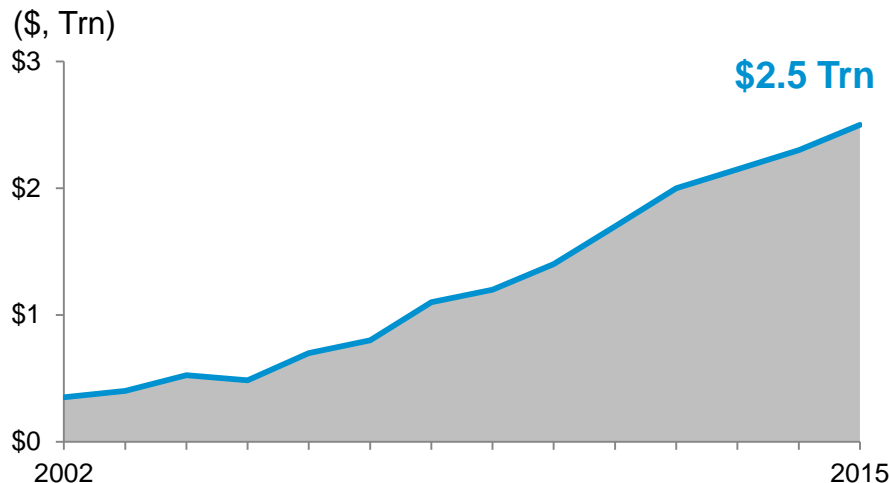
- Repeal of Dodd-Frank
- Replace Dodd-Frank with Financial CHOICE Act 2.0
- Unwind Dodd-Frank derivatives title
- Repeal Volcker Rule
- Elimination of CFPB
- “Modernizing” of Glass Steagall
- Taylor rule prescriptions for Fed rate policy

You May Not Know: Substantive changes to Dodd-Frank are likely to be limited. Most financial regs are statutes, not executive orders, and so not easily repealed. While the House may pass some version of the Financial Choice Act 2.0, DF repeal in the Senate is unlikely (given 60 vote filibuster proof threshold required). Where DF rules have been finalized, unwind also becomes difficult. Look for most change to occur through more accommodative enforcement and high turnover among senior regulatory staff (as happening now at SEC).

Tax Reform: Dysfunction Junction

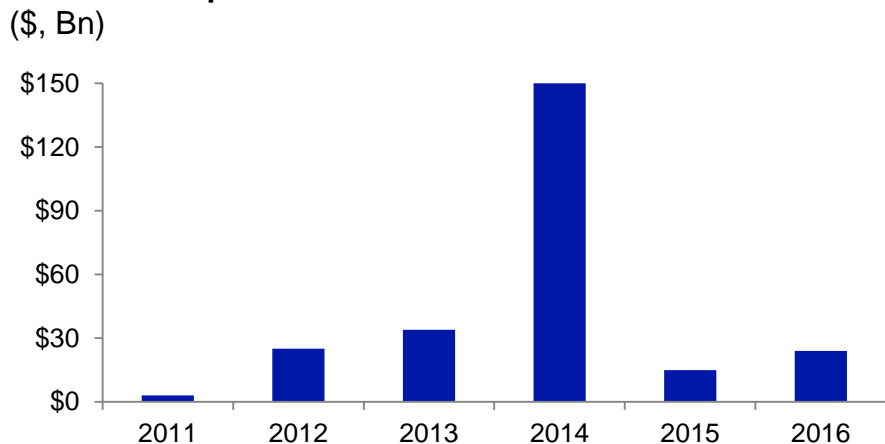


Unrepatriated US Foreign Earnings



US Inversion Tally

Value of completed US tax inversion deals



Key Features of Comprehensive Tax Reform

| | Current | House GOP Plan |
|---------------------------|--|---|
| System | Worldwide | Territorial |
| Tax Rate | 35% | 20% |
| CapEx Depreciation | Over time | Immediately |
| Interest Expense | Deductible | Not deductible |
| Basis for Taxation | Profits | Sales |
| Overseas Earnings | Pay if repatriate (less foreign tax credits) | Not taxed (one time transition tax on current overseas earnings at 8.75%) |
| Border Adjustments | None | On imports only (exports exempt) |

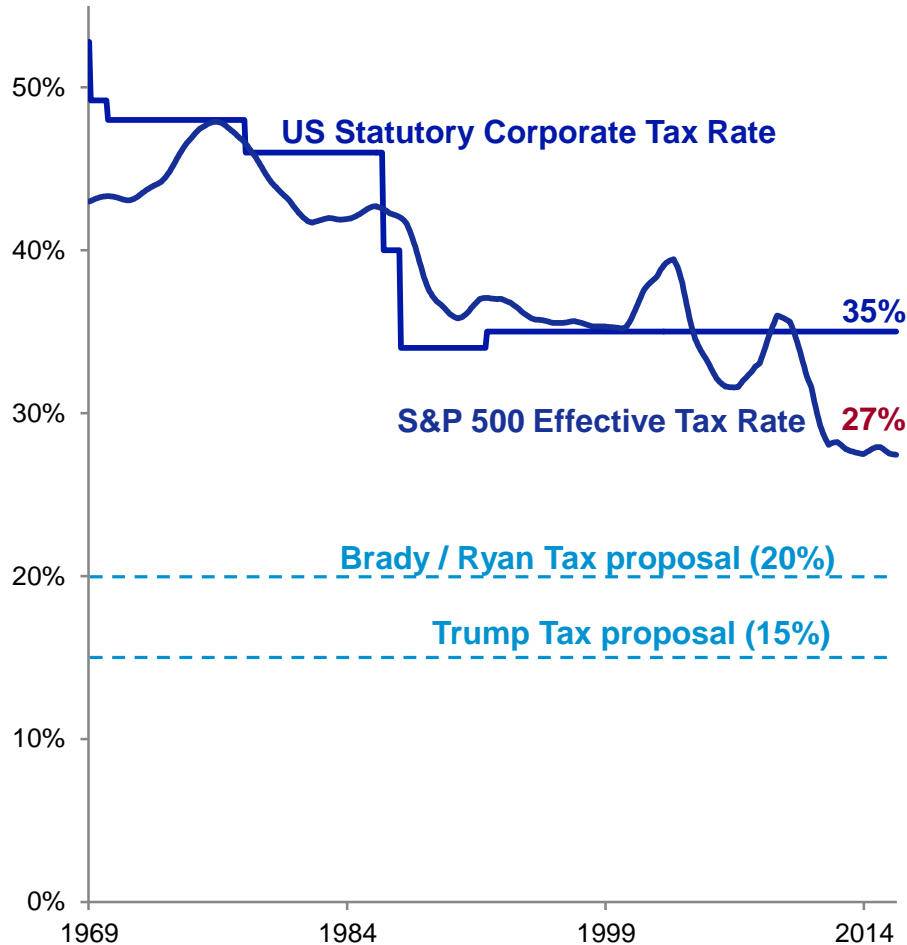
You May Not Know: In its totality, US Federal tax laws today fill approximately 70,000 pages (3x 1986 levels). Recent estimates suggest Americans spend over \$400 Bn annually (and 8.9 Bn hours) complying with the tax code. The outdated US corporate tax system effectively encourages debt, re-domiciling, overseas investment and innovation, job outsourcing and tax avoidance.

Pillars of Corporate Tax Reform



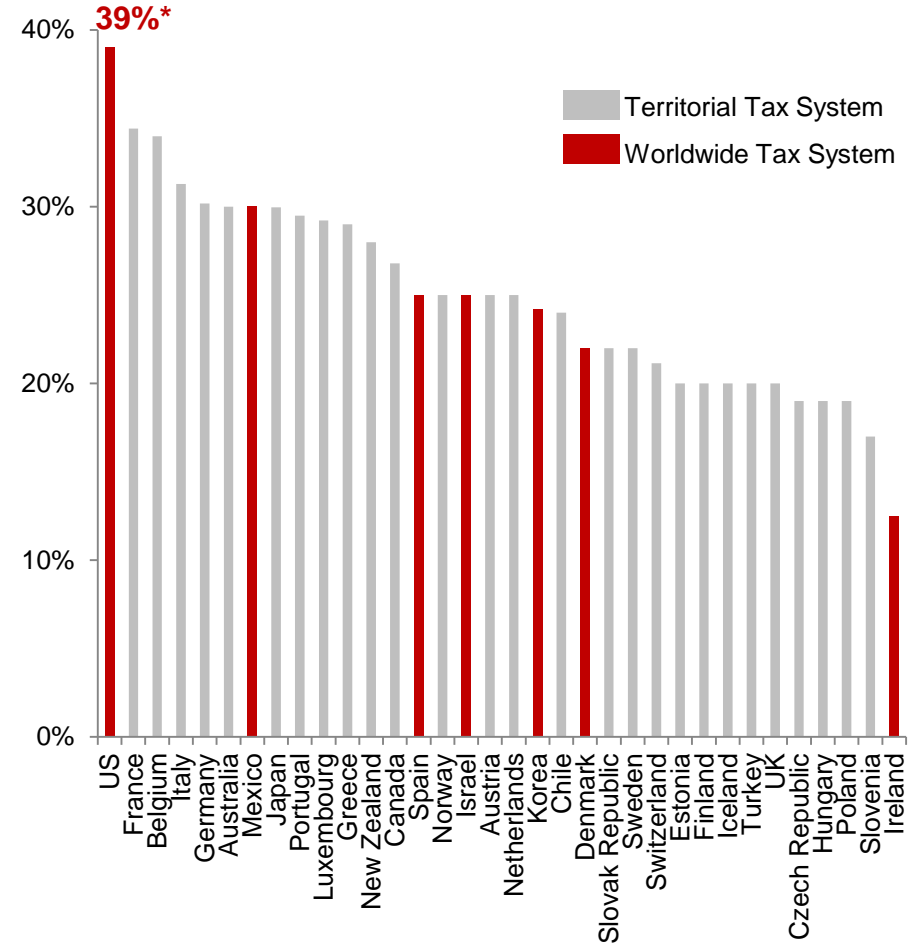
#1: Lower the Rates

US Corporate Statutory and Effective Tax Rates



#2: Move to Territorial

OECD Tax Systems



You May Not Know: Globally, only 2 of 173 countries have a higher corporate tax rate than the US (Chad & UAE). Countries have moved away from worldwide tax systems, with 33 countries using it a century ago, 24 in the 1980s, and only 7 today (including the US). The transition to a territorial system would entail a one-time deemed repatriation (i.e., “mandatory” taxation at 8.75%) of currently deferred foreign profits, and a 100% exemption for dividends from foreign jurisdictions going forward (i.e., 0% tax).

Source: DB Global Markets Research (Bianco). OECD. Tax Foundation. Tax Policy Center. Deloitte. GOB Tax Plan (“A Better Way”).

* Includes central government income tax rate and sub-central rates for combined 2016 tax rate.

The Path to Tax Reform

2 Budget Reconciliations

Reconciliation #1

Timing: Jan – Feb 2017 (launch)

Budget: FY 2017

Purpose: **ObamaCare Repeal**

- Unwind ObamaCare taxes and spending
- “Replace” to happen at later date

Reconciliation #2

Timing: Likely April 2017 (launch)

- Passage into law in Q3 or Q4 (if successful)
- Effective date could vary (i.e., retroactive)

Budget: FY 2018

Purpose: **Comprehensive US Tax Reform**

Precedents for Legislation Through Budget Reconciliation



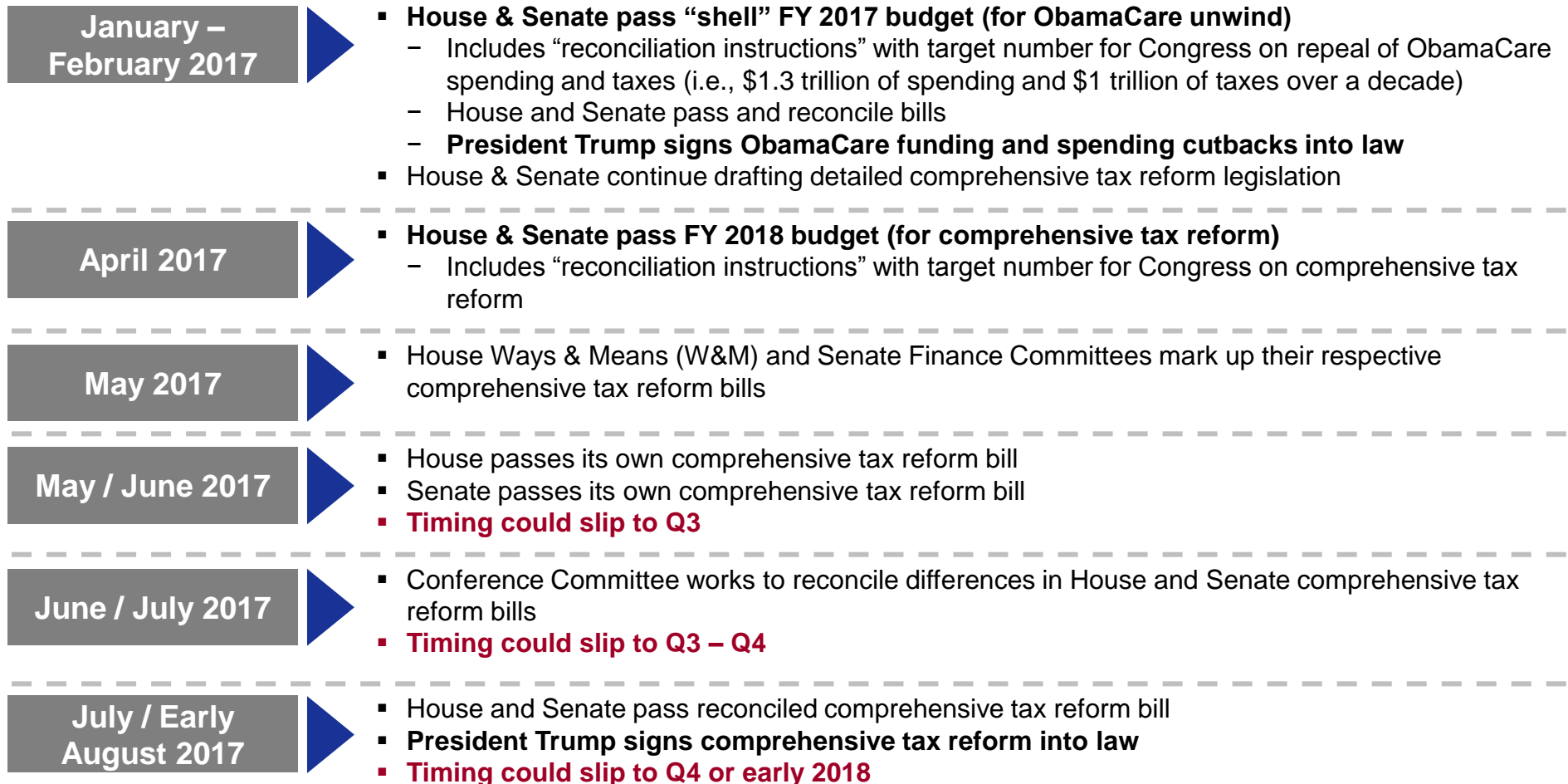
| Year | President | Policy |
|------|---|---|
| 1981 |  Reagan | Tax Cuts |
| 1990 |  Bush | Tax Increases |
| 1993 |  Clinton | Fiscal Stimulus (tax & spend) |
| 1997 |  Clinton | Tax Cuts |
| 2001 |  Bush | Tax Cuts |
| 2003 |  Bush | Tax Cuts |
| 2005 |  Bush | Reduced Government Spending (Medicare, Medicaid, Student loans) |
| 2005 |  Bush | Tax Cut Extension |
| 2010 |  Obama | ObamaCare Tax & Spend |

You May Not Know: Article 1, Section 7 of the US Constitution states that all bills for raising revenue (i.e., taxation) shall originate in the House of Representatives. The Congressional Budget Act of 1974 created the reconciliation process whereby bills on budgetary matters only (i.e., tax) can be passed with a simple majority (not subject to 60 person Senate filibuster) on a more rapid timeline (debate limited to 24 hours). The weakness of this tool is that many of the tax code changes would not be “permanent,” but rather would sunset, creating a “fiscal cliff” in 10 years (2027).

Expected Timeline: Look to the fall 2017



Target Timetable for US Tax Reform (Via Two Budget Reconciliations: FY 2017 and FY 2018)



You May Not Know: Republicans will only get two bites at the apple with the budget reconciliation tool in calendar year 2017. Look for them to pass a “shell” FY 2017 budget in January to facilitate “reconciliation instructions” to repeal ObamaCare spending and taxes. Then in April, look for Republicans to commence work on the FY 2018 budget, paving the way for passage of more comprehensive US tax reform (corporate, international and individual) as early as July 2017 (more likely Q4 2017, if at all).

The Math: Does it add up?



Non-Gov't Scoring of "Selected" Brady / Ryan Tax Provisions

Revenue Reductions

| (\$, Bn) | Static Basis | Dynamic Basis |
|--------------------------------|-------------------|-------------------|
| Individual Tax: | | |
| Lower Individual tax rates | (-\$1,954) | (-\$1,641) |
| ----- | | |
| Lower cap gains and div taxes | (-\$609) | (-\$531) |
| ----- | | |
| Corporate Tax: | | |
| Lower corporate tax rates | (-\$1,807) | (-\$1,325) |
| ----- | | |
| Full & immediate capex expense | (-\$2,236) | (-\$883) |
| ----- | | |
| Move to territorial system | (-\$160) | (-\$160) |

Revenue Additions

| (\$, Bn) | Static Basis | Dynamic Basis |
|---|----------------|----------------|
| Individual Tax: | | |
| Eliminate most deductions (except mortgage interest & charitable) | \$2,331 | \$2,218 |
| ----- | | |
| Corporate Tax: | | |
| Border Adjusted Taxes | \$1,069 | \$936 |
| ----- | | |
| Eliminate debt interest deductions | \$1,194 | \$1,176 |
| ----- | | |
| Eliminate most deductions, limit NOLs | \$701 | \$677 |
| ----- | | |
| Deemed repatriation of foreign earnings | \$185 | \$185 |

You May Not Know: Importantly, the CBO/JCT is the only score that matters for budget reconciliation, and they have not yet scored the Brady/Ryan tax plan due to its limited detail. As a general rule of thumb, every 1% reduction in the US corporate tax rate costs \$100 billion in revenue over 10 years. Other sources of revenue are therefore critical to lowering the statutory rate. On a static basis, the comprehensive Brady / Ryan plan would reduce total US Government revenue by \$2.4 trillion over a decade.

The ObamaCare Taxes: Will it trip up tax reform?



10 Yr Impact of ObamaCare Repeal

| Description | CBO / JCT Score |
|---|-----------------|
| Reduced ObamaCare Spending | \$1.4 Trillion |
| <hr/> | |
| Reduced ObamaCare Tax Revenue | \$1.05 Trillion |
| Reduced Fiscal Deficit (without macro-economic benefits) | \$282 Billion |
| Reduced Fiscal Deficit (with macro-economic benefits) | \$474 Billion |

Largest ObamaCare Taxes

| Largest Taxes | CBO / JCT Score |
|---|-------------------|
| Medicare taxes (3.8%) (payroll, cap gains and dividends) | \$318 Bn |
| Cadillac Tax on Premium Plans (40%) | \$111 Bn |
| Employer Mandate Penalty | \$106 Bn |
| Tax on Health Insurers | \$102 Bn |
| Individual Mandate Penalty | \$55 Bn |
| Tax on Drug Manufacturers | \$34 Bn |
| Tax on Medical Device Manufacturers | \$29 Bn |
| Flexible Spending Account Cap | \$24 Bn |
| Codify IRS Economic Substance Doctrine | \$5.3 Bn |
| Tax on HSAs | \$4.5 Bn |
| Tax on OTC Medications | \$4.0 Bn |
| Subtotal | \$793 Bn |
| Other Taxes & Revenue Effects | \$260 Bn |
| Total Gross Tax Revenues | \$1,053 Bn |

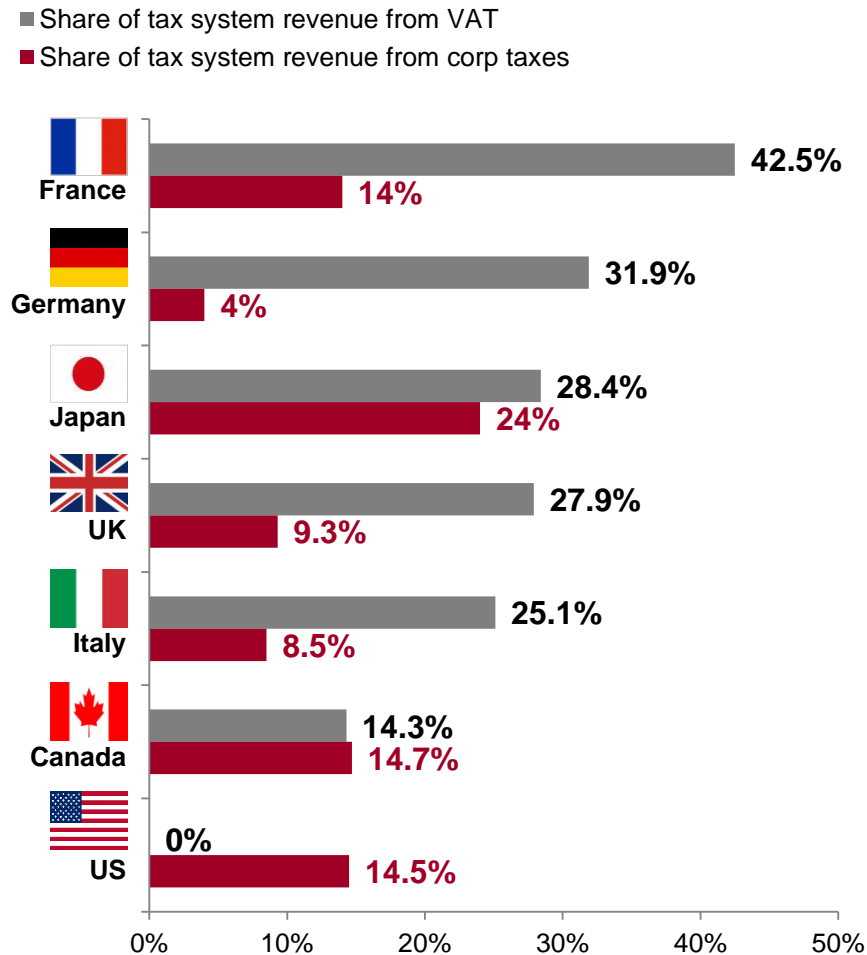
Most Market Relevant

You May Not Know: In December 2015, the Republican Congress passed a bill (H.R. 3762) to repeal much of the ACA, but it was subsequently vetoed by President Obama. Nonetheless, the bill is likely a good roadmap for Republicans action on ObamaCare in Jan-Feb 2017. Though the plan for “replace” remains unclear, look for Republicans to quickly repeal nearly \$1.4 trillion of ObamaCare spending, and \$1.1 trillion of new ObamaCare taxes over the next 10 years.

Border-Adjusted Taxes: An idea too big to pass?



G7 Tax Systems



10 Considerations on Border-Adjusted Taxes

10 Considerations

- 1. Radical Departure:** Destination-based principle (with exports exempt)
- 2. Revenue:** Generate \$1.1 trillion over 10 years
- 3. Tax Rate Impact:** Critical to reducing corp rate below 25 - 27%
- 4. Industry Impact:** Refiners and retail hit hard
- 5. House Plan:** Included in Brady – Ryan Plan
- 6. Senate Plan:** Not clear; more skepticism given radical shift
- 7. Trump Plan:** Not included, but could be attractive alternative to tariffs
- 8. VAT:** Conceptually similar (but GOP applies to corp taxes only)
- 9. US Trade Advantage:** Minimal, because USD would adjust
- 10. WTO Compliance:** VATs (yes); border adjusted taxes (unclear)

You May Not Know: Border adjusted taxes would generate \$1.1 trillion of revenue over 10 years and have thus become an important piece of US tax reform. Without border adjusted taxes, it will be difficult to lower the US statutory corporate tax rate below 25-27%. While many countries apply VAT taxes at each stage of production but then remove them at the border (similar concept), the US would be the first major country to adopt such a border-adjusted corporate tax system.

The Corporate Tax Reform Plans So Far



Comprehensive US Tax Reform

| | Current | Trump | Brady / Ryan |
|---------------------------------------|--|--|---|
| Top Corporate Rate | 35% | 15% | 20% |
| Top Pass-Through Rate | 39.6% | <ul style="list-style-type: none"> • 15% • May elect 15% corp rate or individual rate • 2nd level tax on large distributions to owners | 25% top rate to active business income of sole proprietorships and pass-through entities |
| Capital Investment | Depreciation schedule | <u>Optional</u> immediate and full write-off for US manufacturing | Immediate and full write-off except for land purchase |
| Amortization of Intangibles | 15yr amortization schedule | N/A | <ul style="list-style-type: none"> • Full expensing in year one |
| Interest Expense Deductibility | Yes | Non-deductible if elect to expense capital investment | <ul style="list-style-type: none"> • Effectively eliminated • Only to offset interest income (unlimited carry forward of expense) • Special rules for financial services companies to come |
| Carried Interest | Long-term capital gains rate | Ordinary income | N/A |
| Research Credit | Up to 20% credit for expenses over base amount | Retain | Retain |
| Domestic Production Deduction | Up to 9% of qualified production activities income | Eliminate most credits except for R&D | Repeal |

Corporate Tax Reform (Cont'd)



Comprehensive US Tax Reform

| | Current | Trump | Brady / Ryan |
|--|--|-------------------------------------|--|
| NOLs | Carry back (2 yrs) & Forward (20 yrs) | N/A | <ul style="list-style-type: none"> • No carry back • Indefinite carry forward, adjusted for inflation • Only applicable to offset 90% of taxable income |
| Corporate AMT | Yes | Repeal | Repeal |
| Energy Tax Credits | For fossil fuels, alternative energy, and energy efficiency | Repeal most except R&D | N/A |
| Healthcare Benefits | Employer-provided health benefits excluded from income and payroll tax | N/A | <ul style="list-style-type: none"> • Limit exclusion for employer-provided health benefits • New refundable credit for individuals without workplace coverage |
| ObamaCare | Over a dozen new taxes (\$1 trillion over 10 years) | Repeal | Repeal |
| Employer provided Child Care Benefits | <ul style="list-style-type: none"> • 25% credit on expenses for on-site child care • 10% credit on expenses for resources / referral Max credit \$150,000 / yr | General call to increase credit cap | N/A |

International Tax Reform



Comprehensive US Tax Reform

| | Current | Trump | Brady / Ryan |
|-----------------------------------|---|---|---|
| System | Worldwide (with deferral) | No change | Territorial (with 100% participation exemption for foreign dividends) |
| Deferred Overseas Earnings | Taxed at full corporate rate with allowance for foreign tax credits upon repatriation | <ul style="list-style-type: none"> • One-time mandatory deemed repatriation • 10% | <ul style="list-style-type: none"> • One-time mandatory deemed repatriation • Cash: 8.75% • Non-cash: 3.5% • Payable over 8 years |
| Future Foreign Income | Taxed at applicable corporate rate when repatriated | Tax profits as earned (ends deferral, maintains foreign tax credits) | 100% dividend exemption on foreign earnings (0% tax) |
| Border Adjustability | No | No | Destination-based cash flow tax on jurisdiction of consumption, not production (exports exempt) |
| Inversions | 20% foreign ownership threshold | Discouraged via more competitive tax code | Discouraged via more competitive tax code |

Individual Tax Reform



Comprehensive US Tax Reform

| | Current | Trump | Brady / Ryan |
|--------------------------------------|---|--|--|
| Rates | <ul style="list-style-type: none"> • 7 brackets • Top rate: 39.6% • Additional 0.9% Medicare tax | <ul style="list-style-type: none"> • 3 brackets • Top rate: 33.0% • Repeal 0.9% Medicare tax | <ul style="list-style-type: none"> • 3 brackets • Top rate: 33.0% • Repeal 0.9% Medicare tax |
| Individual AMT | Yes | Repeal | Repeal |
| Capital Gains & Dividends | <ul style="list-style-type: none"> • Short term: income rate • Long term: 20% • Additional 3.8% net investment income tax for high earners • Dividends taxed as ordinary income | <ul style="list-style-type: none"> • Retain current-law rates and brackets • Repeal 3.8% additional Medicare tax | <ul style="list-style-type: none"> • Tax at ordinary income rates with 50% exclusion (effective top rate is 16.5%) • Repeal 3.8% additional Medicare tax |
| Interest Income | Taxed as ordinary income | N/A | Tax at ordinary income rates with 50% exclusion (effective top rate is 16.5%) |
| Standard Deduction | \$6,300 / \$12,600 (single / joint filing) | <ul style="list-style-type: none"> • \$15,000 / \$30,000 • Personal exemptions eliminated | <ul style="list-style-type: none"> • \$12,000 / \$24,000 • \$18,000 single filers with child • Personal exemptions eliminated |

Individual Tax Reform (Cont'd)



Comprehensive US Tax Reform

| | Current | Trump | Brady / Ryan |
|---------------------------------|---|---|--|
| Mortgage Interest | Itemized deduction of interest up to \$1mm in acquisition indebtedness and \$100,000 in home equity indebtedness | Itemized deductions capped at \$100,000 and \$200,000 for single and joint filers, respectively | Retain current system |
| Charitable Giving | Fully deductible | Itemized deductions capped at \$100,000 and \$200,000 for single and joint filers, respectively | Retain current system |
| State / Local Deduction | Itemized deduction of state / local taxes or general sales tax | Itemized deductions capped at \$100,000 and \$200,000 for single and joint filers, respectively | Repeal |
| Estate Tax | <ul style="list-style-type: none"> • Top rate 40% • Exemption of \$5.45 mm per spouse for 2016 • Additional tax may apply to generation-skipping transfers | <ul style="list-style-type: none"> • Repeal but certain appreciated assets subject to capital gains tax if > \$10 mm • Disallows contributions to private charities established by descendants | Repeal |
| ObamaCare | <ul style="list-style-type: none"> • 0.9% Medicare Hospital Insurance • 3.8% Net Investment Income Tax | Repeal | Repeal |
| Retirement Savings Plans | Permitted with contribution limits (Roth, 401Ks) | Retained | <ul style="list-style-type: none"> • Minor changes possible • Additional new vehicles possible |

Source: CIB Capital Markets Strategy. Shearman & Sterling. Davis Polk. Deloitte. A Better Way. WSJ. Tax Policy Center. Tax Foundation. CBO.

III. Geopolitical Update: A world in turmoil



Even today, after the second failure of a another world war perhaps one can speak of a third war, one fought piecemeal, with crimes, massacres, destruction.”

- Pope Francis
Redipuglia War Memorial, Italy September 12, 2014



North Korea: The next US President's biggest global risk and headache



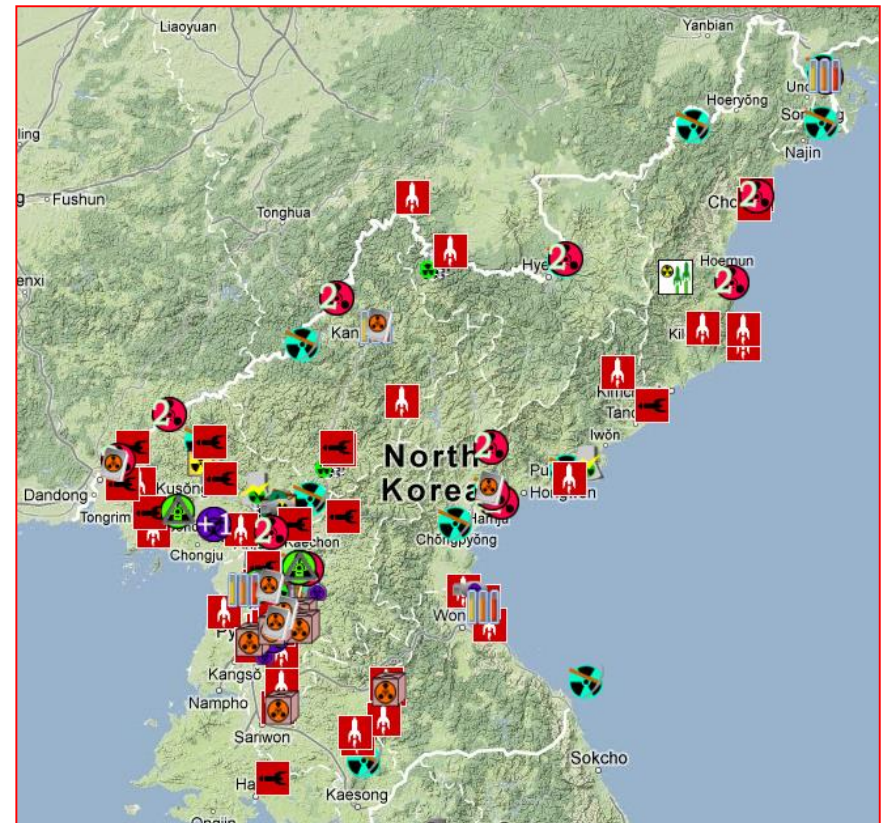
-North Korea has one of the largest stockpile of chemical and biological weapons in the world. It is estimated to be in possession of an estimated 5,000 metric tons of chemical weapons and capable of quickly assembling 12,000 metric tons more.

- They also possess dozens of nuclear weapons and may have thermonuclear weapons.

- In recent years, they have made considerable advancements in both short-range and Intercontinental Ballistic Missile (ICBM) capability – potentially capable of hitting the US.

- What they do not have (yet) is the capacity to put their chemical/biological or nuclear weapons on these missiles.

North Korea's Weapons of Mass Destruction



| | |
|--|-----------------|
| | MISSILE |
| | Base (15) |
| | Production (10) |
| | R&D (1) |

| | |
|--|-----------------------------|
| | BIOLOGICAL |
| | Dual-use infrastructure (1) |
| | Research & Development (10) |
| | Production (1) |
| | Weaponization (1) |

Source: US Dept. of Defense; CSIS

Watching the world: Election headwinds continue

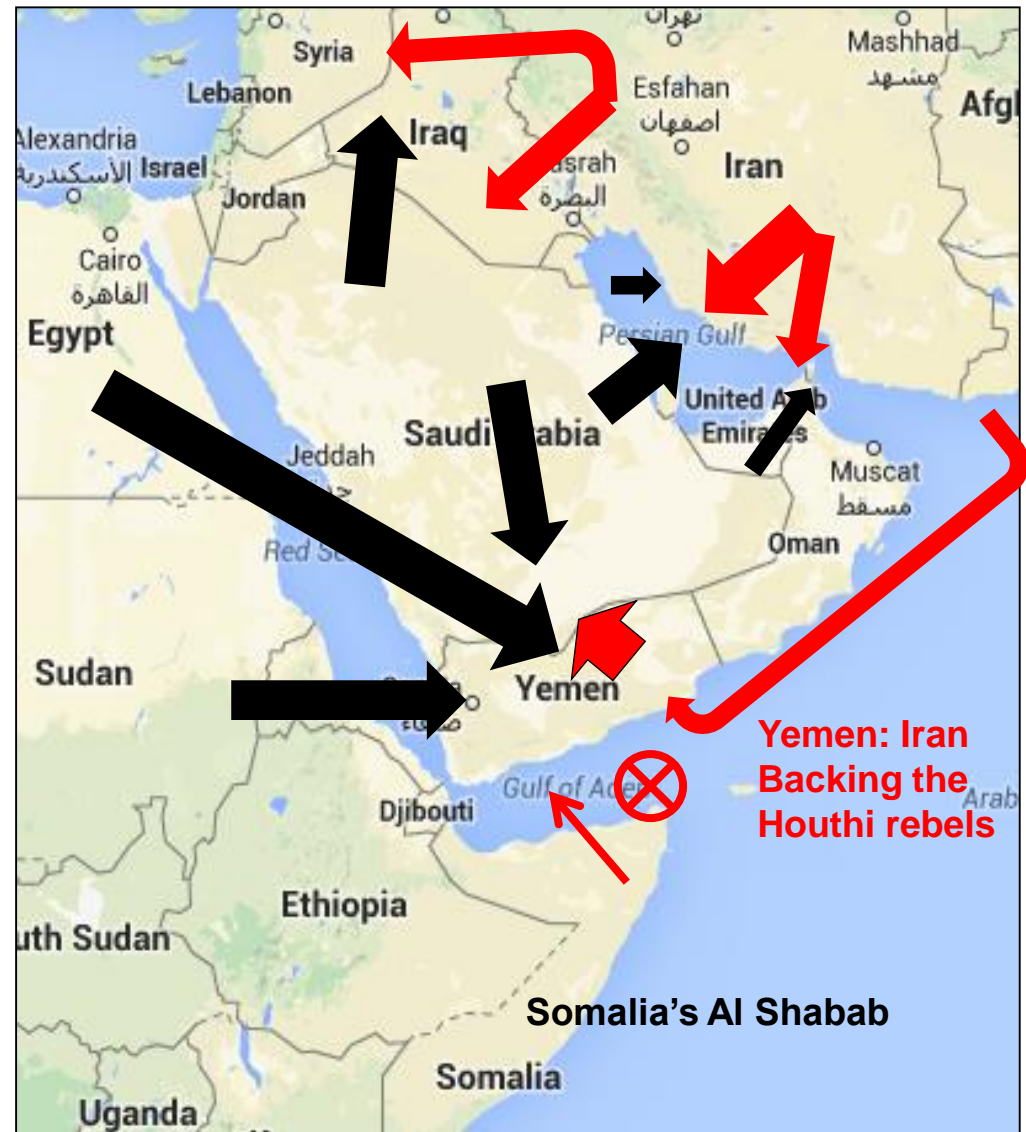


| Country | Date | Event | What to watch |
|--|---------------------|-----------------------------------|--|
|  Netherlands | March 15 2017 | Dutch Parliamentary elections | Will various eurosceptic parties emerge stronger than ever? |
|  France | April & May 2017 | Presidential Elections | Will Marine Le Pen and anti-EU elements score big gains? |
|  Iran | May 19 | Iranian Presidential Elections | Will hard-liners stage a comeback? How will nuclear deal play out? |
|  Germany | September 2017 | German Federal Elections | Can Merkel win again? Will Schulz run? What about the AfD? |

The Middle East in Crisis: Evolution of the Sunni-Shia war for control of the region



- Iran is seen to be trying to build a “Shia Crescent” while Iran sees/fears being encircled by “Sunni Crescent.”
- Proxy wars between Iran and Saudi Arabia now being fought in Syria and Yemen – and to some degree, in eastern provinces of Saudi Arabia itself.
- What will Trump do with the nuclear deal? Has the nuclear deal with Iran empowered them regionally? Or will it further spur the collective Sunni nations to up their defense efforts?
- The answer is “yes” to both – which means conflict will become heightened.



■ = Sunni forces ■ = Shia (Iran-backed) forces

Saudi Arabia: Risky reforms and succession risk



-Saudi Arabia has launched Vision 2030: an ambitious plan to transform the country from an oil producing state into the world's leading tech and investment state.

- Biggest challenges lie in demographic trends, workforce transition (70 percent of population is under the age of 30) and ongoing competition in global oil market.

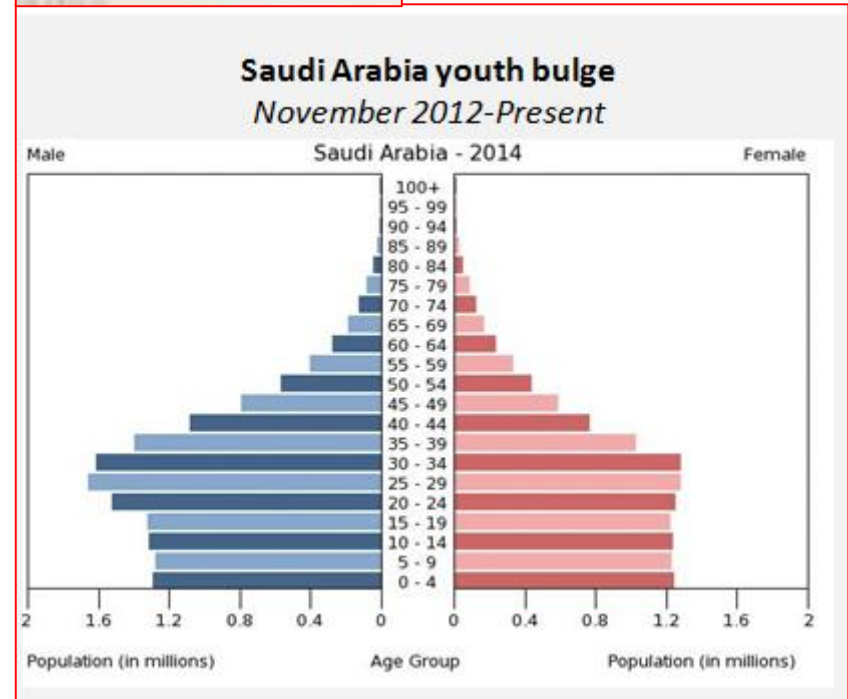
- Critical to the success of the plan is also privatizing critical sectors ranging from oil to healthcare.

- Will Crown Prince Mohammed bin Salman (who has been tasked with managing the effort) succeed and will this accelerate the succession timetable?

- Will this plan actually work?



Deputy Crown Prince
Mohammed bin Salman

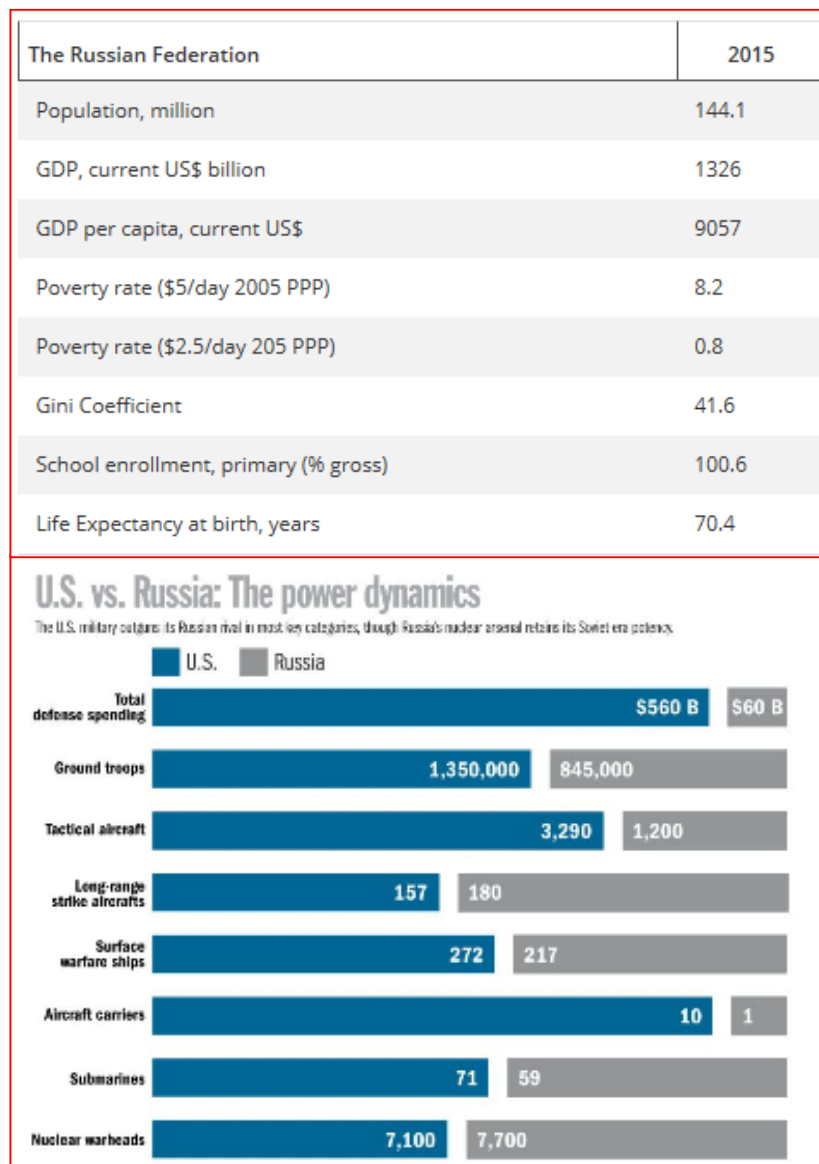


Source: CIA Factbook; Scowcroft Group

Russia: What sort of threat does he pose to west now?



- Western sanctions are taking a sizeable and painful bite out of Russia's economy; growth is negative (-0.8%) as deficit spending has increased (now 2% of GDP up from 1.1% in 2015).
- Low oil prices and pressure to maintain and improve the military in wake of Ukraine and Syria is a growing pressure point on Kremlin.
- Consolidation of intelligence services (FSB & SVR) are worrisome to west.
- But recent Duma elections solidified his power as well as crackdown on several oligarchs.
- Biggest worry for West: reigniting conflict in Ukraine or active destabilization/intervention in Baltic's or even Balkans.

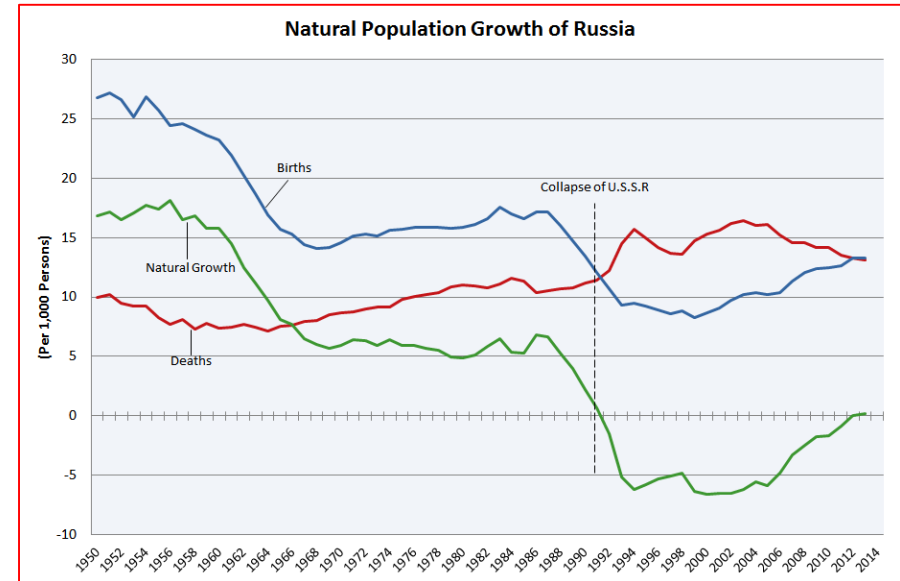


Sources: World Bank; Washington Post; IISS

Russia: Return of the empire or death of a nation?



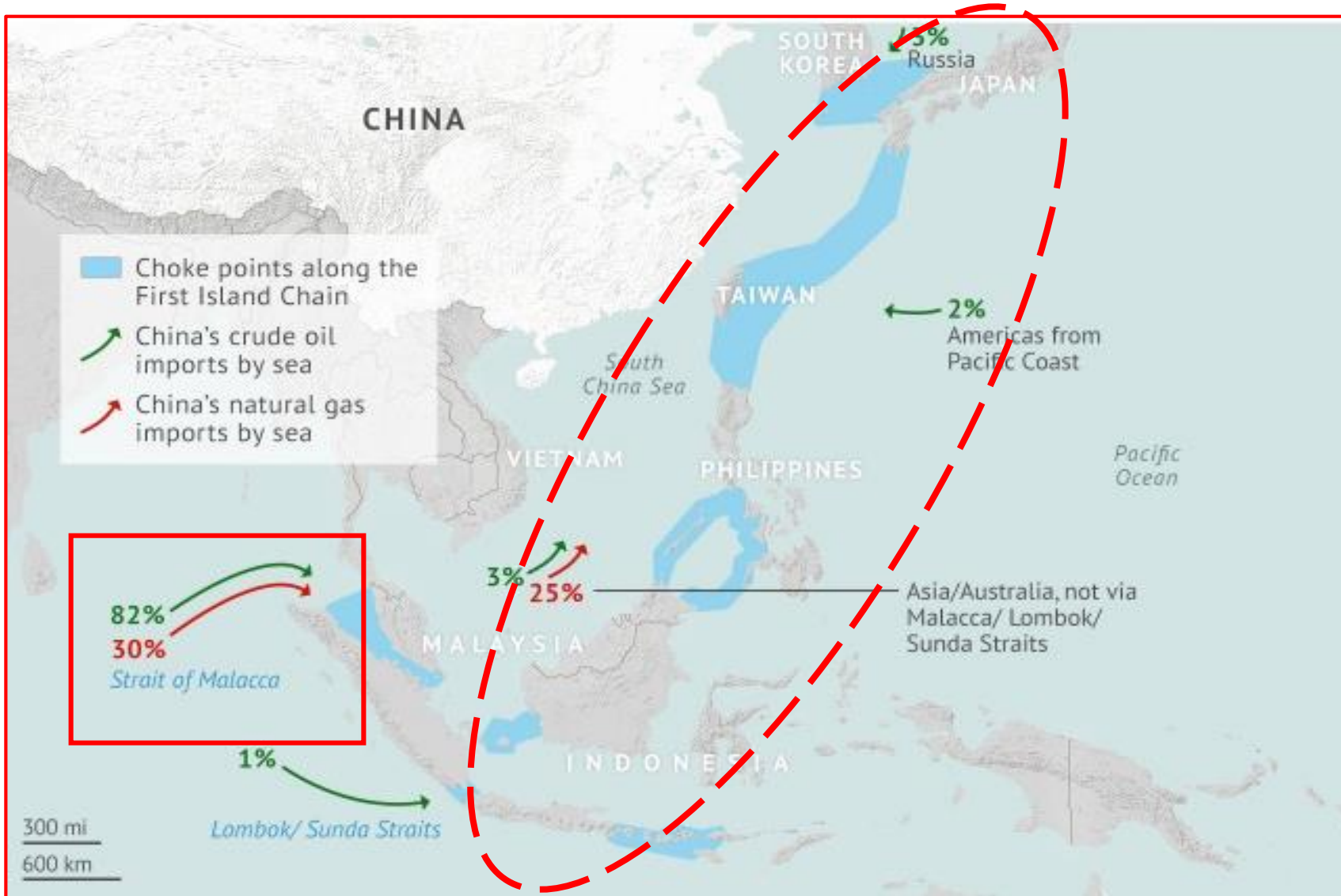
- Putin has his work cut out for him now and in advance of 2018 elections.
- Russia covers nine time zones and almost 7,000 miles end to end.
- The current Russian population: 143 million. With the annexation of Crimea: 146 million.
- By 2030, the Russian population will have shrunk to 136 million.
- By 2050, it will likely have shrunk to below 120 million and perhaps as low as 115 million (roughly the size of Mexico or Philippines today).
- Putin has also overseen the building or reconstruction of 23,000 Russian Orthodox Churches. And urged Russians to have lots of children (offering financial incentives).



Natural population growth of Russia since 1950
— Birth rate — Death rate — Natural growth

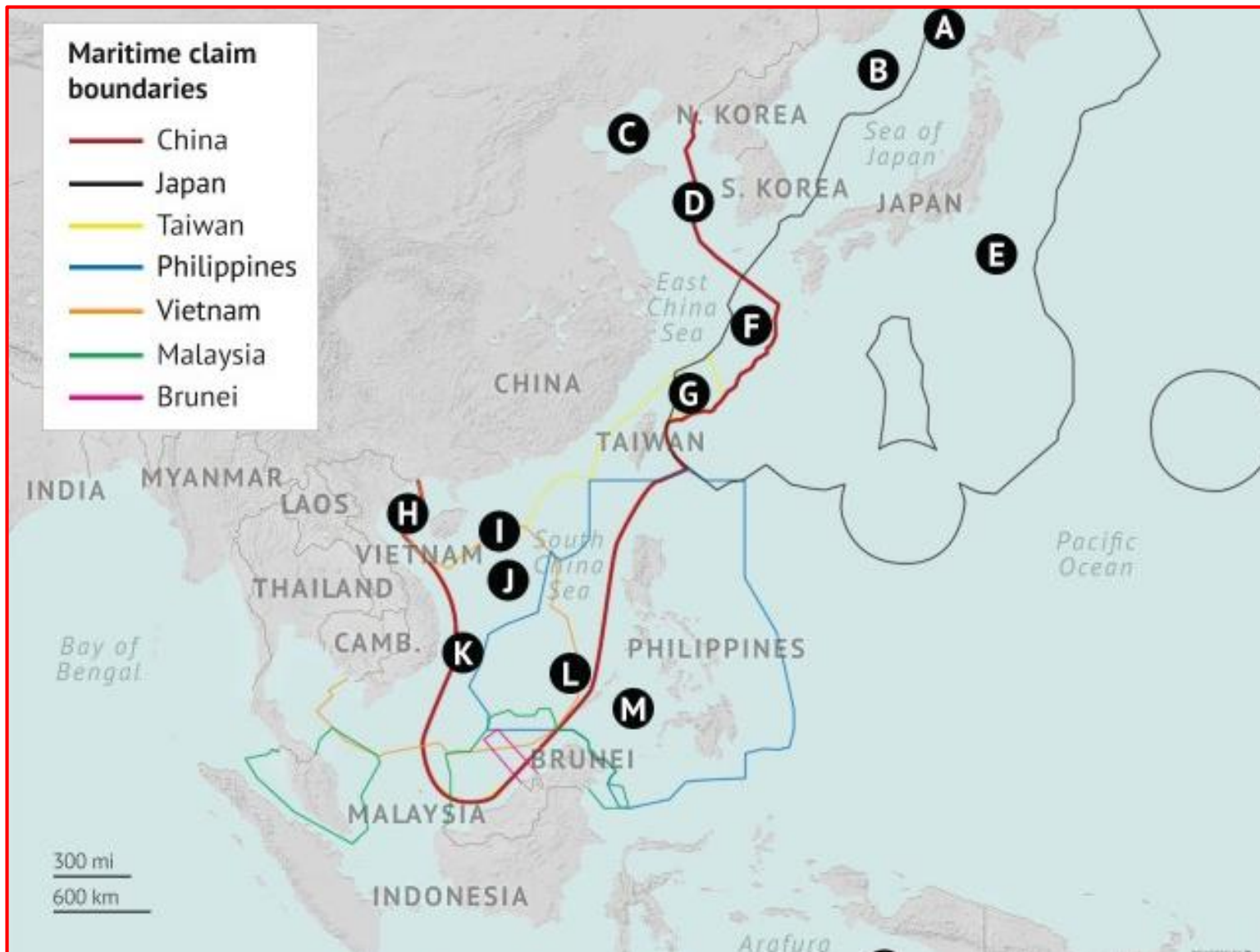


Understanding the Tensions in the South China Sea: It is all about China's shipping lanes



Sources: Stratfor; Rand Corp; US Dept. of Defense

Who owns what? Good luck figuring these nautical boundaries out anytime soon



Source: Rand; Stratfor

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