Topics: The 1970's, war and oil; Europe, Pillar II, NATO, Russia and Poland; Trump/Biden and the senescence risk for the 2024 Presidential election; China and Taiwan; the spending and taxation policies required to fix the US Federal Debt; the American experiment and Thanksgiving

Not That 70's Show. I don't write about geopolitics often, mostly since it hasn't been a primary driver of equity market returns. Of ~20 post-WWII geopolitical events, only the Arab-Israeli War of 1973 ended up being a primary driver of equity markets 6-9 months later due to an oil embargo, three years of US wage and price controls and stagflation (see page 11). And in 2018 when we examined different market indicators to see which were most useful for investors, a Geopolitical Risk Index came in last since equity market returns weren't that different whether geopolitical risk levels were high or low, or rising or falling.

One possible reason: the impact of the world's conflict zones on global output, equity market capitalization, bank lending, portfolio investment, trade, oil/gas/mineral production and capital formation are usually small, as shown below. Russia's invasion of Ukraine changed that and led to a surge in global energy/food prices that is now subsiding, and some de-industrialization in Germany. That said, the Russian invasion has not been a primary developed equity market catalyst. A dramatic expansion of the war in the Middle East, a direct Russia-NATO conflict or a China-Taiwan conflict would obviously change these dynamics substantially.

Conflict zone countries as a % of total world....

		ex Russia	Incl. Russia
1	Oil production	7.3%	19.2%
2	Natural gas production	2.3%	17.5%
3	Population	8.9%	10.7%
4	Mineral production	2.8%	8.8%
5	Food production	1.9%	4.3%
6	Foreign direct investment - outflows	0.5%	3.8%
7	GDP	1.3%	3.6%
8	Trade	1.5%	3.2%

		ex Russia	Incl. Russia
9	Gross national income	1.3%	3.2%
10	Gross capital formation	1.0%	2.8%
11	Imports	1.5%	2.6%
12	Interbank claims	0.2%	0.5%
13	Portfolio investment inflows	0.2%	0.3%
14	Corporate profits	0.3%	0.3%
15	Equity market capitalization	0.1%	0.3%
16	Foreign direct investment - inflows	2.1%	-0.2%

Conflict zone countries (civil war, shooting war, anarchy and special cases): Afghanistan, Burkina Faso, Central African Republic, Chad, Democratic Republic of the Congo, Ethiopia, Haiti, Iraq, Israel, Libya, Mali, Myanmar, Niger, North Korea, Palestine, Russia, Somalia, South Sudan, Sudan, Syria, Ukraine, Venezuela, Yemen. Negative FDI inflows = disinvestment from Russia/Iraq in 2022

Source: BIS, Bloomberg, Energy Institute, IMF, RMG Consulting, UN, World Bank, World Trade Organization, JPMAM, 2023

In any case, here are questions I receive on the intersection between geopolitics, US politics and markets

Michael Cembalest, JP Morgan Asset Management

December EoTM: an update on alternatives (private equity, venture, private credit, hedge funds, etc).

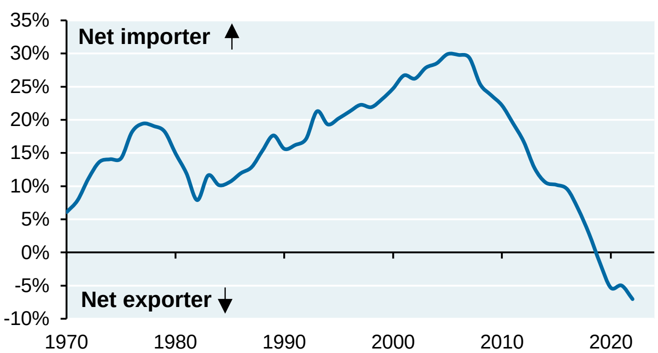
[1] Will the Middle East War cause oil and inflation to surge and equities to collapse, as in the 1970s?

Given what is now taking place, are market risks similar to those in the 1970's? Oil markets are priced globally, so any sustained rise in oil prices would affect US energy prices and core inflation a few months later. However, energy risks to the US are generally much lower than in the 1970's, with some caveats (in red):

- The US is a net energy exporter vs its net import position in the 1970's; US net crude imports are down 75% from their 2005 peak, and net refined product *imports* of 4 mm bpd flipped to net *exports* of 4 mm bpd
- The oil intensity of US GDP growth is 65% lower than it was in the 1970's
- Annual global oil consumption growth has declined from 8%-10% in the early 1970's to 0%-2% today
- Geopolitical benefits to OPEC of an oil embargo would be less clear now: 75% of Saudi oil exports go to Asia, China gets half its oil from the Middle East and the US gets most of its imported oil from Canada, Mexico and other non-OPEC sources [Source: Gavekal Research]
- Saudi Arabia also has spare capacity to bring online if needed
- US oil production is at new highs but is more a function of drilled/uncompleted wells coming online than new projects. As shown below, global capital spending on new projects by public energy companies has declined before a downshift in oil/gas consumption, setting the stage for well-supported energy prices outside of recessions. Similarly, the global oil & gas rig count is at the low end of its non-recessionary range
- The Biden Administration, in an act of geopolitical malpractice, opted not to refill the Strategic Petroleum Reserve before the conflict erupted; the SPR is down ~50% from its peak and at its lowest level since 1983

US energy dependence and independence

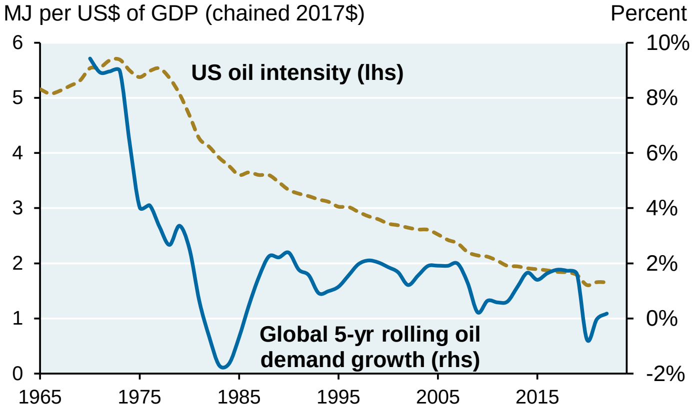
Net imports of oil, natural gas and coal as a share of total primary energy consumption



Source: EI Statistical Review of World Energy, JPMAM, 2023

Oil intensity and consumption

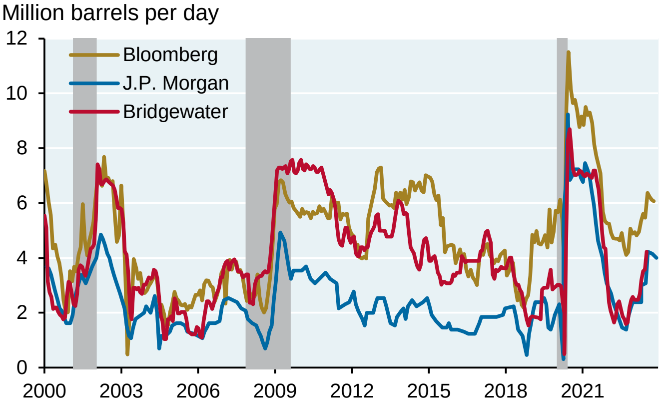
MJ per US$ of GDP (chained 2017$) Percent



Source: Bloomberg, Energy Institute, JPMAM, 2023

Estimated OPEC spare capacity

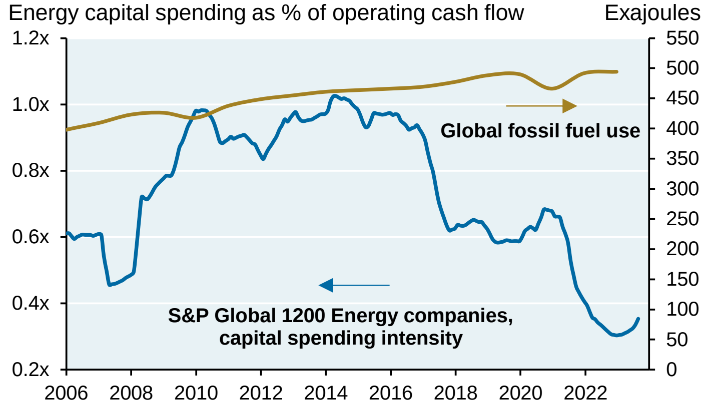
Million barrels per day



Source: Bridgewater, Bloomberg, J.P. Morgan. October 2023.

Fossil fuel consumption vs energy capital spending

Energy capital spending as % of operating cash flow Exajoules



Source: Bloomberg, Energy Institute, JPMAM, September 2023

[2] What is the connection between Europe's new international tax system and NATO, Russia and Poland?

Europe is spearheading a global initiative for over 100 countries to adopt new multinational tax laws. The first two components of Pillar II are not controversial: a minimum tax applied by a country to subsidiaries operating there, and the ability for a country to tax its parent companies if its subsidiaries operate in low tax jurisdictions. But the third part of Pillar II is controversial, and best way to understand why is with an example. Suppose that:

- a US parent company is 100% compliant with US tax law
- its India subsidiary is 100% compliant with Indian tax law
- its German subsidiary is 100% compliant with German tax law

Even so, if the German gov't determines that the US parent or its Indian subsidiary paid too little tax in the US or India as per Pillar II rules[1], the German gov't can collect taxes from the US company's German subsidiary to make up for it. This provision is essentially a **bounty-hunting rule** that allows a third-party country to intervene in the tax policy of other countries and collect tax revenue that it has no legal nexus with.

By allowing non-US countries to collect taxes from US companies on income earned in the US, Pillar II arguably undermines US tax policy and hamstrings Congress' ability to design policy based on US needs. The Biden Administration likes Pillar II and has proposed changes to bring US corporate tax law closer to it[2], but tax policy can only be set via Treaty by the Senate or via Congressional legislation. So far, Pillar II rules have not been adopted by the US, and neither have Pillar I rules on Digital Service Taxes[3].

Pillar II component	Principle	Example	Comment
Qualifying Domestic Minimum Top-Up Tax (QDMTT)	Countries participating in Pillar II have the ability to ensure via a QDMTT tax that subsidiaries operating in that jurisdiction pay at least 15%, computed using a standardized international tax accounting approach ("Global Anti-Base Erosion" or GloBE Rules)	Turkey enacts a QDMTT tax on a Turkish subsidiary of a UK parented group since the subsidiary has an effective GloBE tax rate in Turkey below 15%	Consistent w/existing tax policy
Income Inclusion Rule (IIR)	If a host country lightly taxes multinational subsidiaries operating there, the country in which the parent company is located can collect the Pillar II top-up tax via the Income Inclusion Rule (IIR)	Turkey does not adopt a QDMTT and lightly taxes the UK subsidiary, so the UK enforces its IIR and collects the Pillar II top-up tax for itself rather than sharing it with Turkey	Consistent w/existing tax policy
Undertaxed Profits Rule (UTPR)	If both the country of the subsidiary and the country of the parent company do not collect the GloBE top-up tax, an unrelated country within an undertaxed profits rule can collect the underpaid taxes of the subsidiary from a a subsidiary of the parent company that is located in the unrelated country	Turkey does not adopt a QDMTT and lightly taxes the UK subsidiary; the UK does not have a qualifying IIR; the UK parent company also has a subsidiary in Italy; so the Italian govt collects underpaid taxes of the Turkish subsidiary from the Italian subsidiary	Bounty hunting with no nexus
Undertaxed Profits Rule (UTPR)	The UTPR does not only apply when subsidiaries are undertaxed, it also applies if the parent company itself is undertaxed	A US parented multinational group has a GloBE effective tax rate in the US that is less than 15% due to its R&D credits and due to FDII rules on the export of US-owned intellectual property. The US parent company also has a subsidiary in France; France can tax the French subsidiary of the US parent company for the underpaid taxes in the US (sharing with other claiming countries)	Bounty hunting with no nexus

[1] GloBE rules use GAAP/IFRS as a starting point while US tax law ignores GAAP/IFRS except in specified cases. Another point of contention: treatment of R&D credits. **The tortured logic of Pillar II**: non-refundable US R&D credits count as tax reductions whereas refundable European R&D credits are included as income (!!)

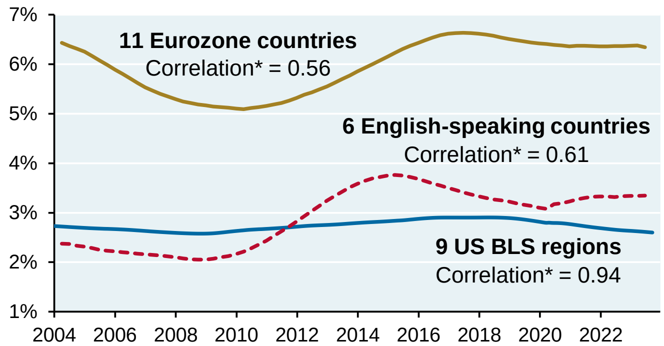
[2] Biden has proposed an Undertaxed Profits Rule, higher corporate tax rates, a profit tax on pharma, a bank tax, a stock buyback excise tax, a 15% corporate Alternative Minimum Tax and higher taxes on intangible income

[3] **Pillar I** would reallocate profits from corporate residence jurisdictions to market jurisdictions (i.e., the location of end users). In other words, France would collect Digital Service Taxes from French users of Google based on the ad revenues that French advertisers pay Google. We have explained before (2021 EoTM Outlook) that DSTs are effectively service sector tariffs that may violate existing tax treaties since they ignore arm's length transfer pricing and taxable nexus standards, longstanding pillars of the international tax system. As currently drafted, the Pillar I treaty cannot be adopted unless the US ratifies it. As a result, some countries are moving ahead with extraterritorial VAT taxes which increasingly resemble Pillar I rules

Something's Rotten near Denmark: Europe suffers from one-size-fits-all monetary policy, so why should the US adopt one-size-fits-all tax policy?

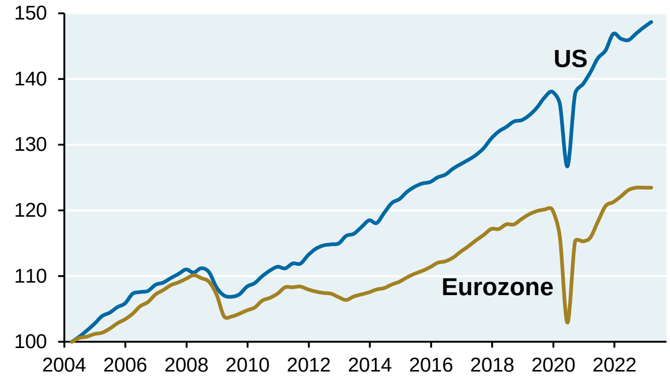
The Eurozone has struggled with its one-size-fits-all monetary policy, as illustrated below. The ECB sets policy for countries with much more disparate business cycles than the Fed does for US regions. The Eurozone is even more dissimilar than a *theoretical* union of English-speaking UK-offshoot countries all over the world (UK, USA, CAN, AUS, NZ, IRE). **The result of one-size-fits-all monetary policy: subpar Eurozone growth and total factor productivity, less innovation[4] and an unprecedented production gap between Germany and Italy**. If one-size-fits-all monetary policy isn't working out that well, why adopt one-size-fits-all tax policy?

One-size-fits-all policy not well suited for Eurozone
Standard deviation of business cycle proxy (employment to population ratio) across countries/regions



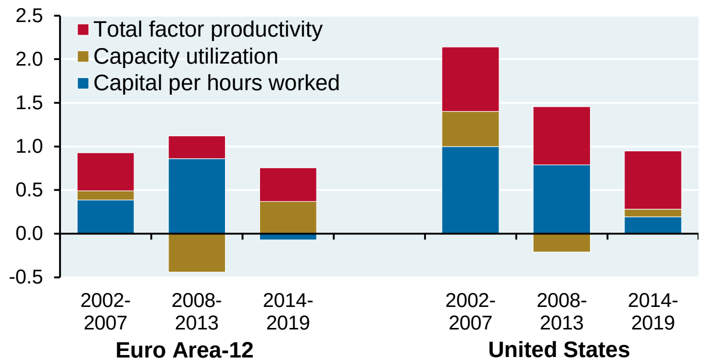
Source: OECD, BLS, JPMAM, Q2 2023. *Avg pairwise correlation.

US vs Eurozone: real GDP growth
Index (100 = Q1 2004)



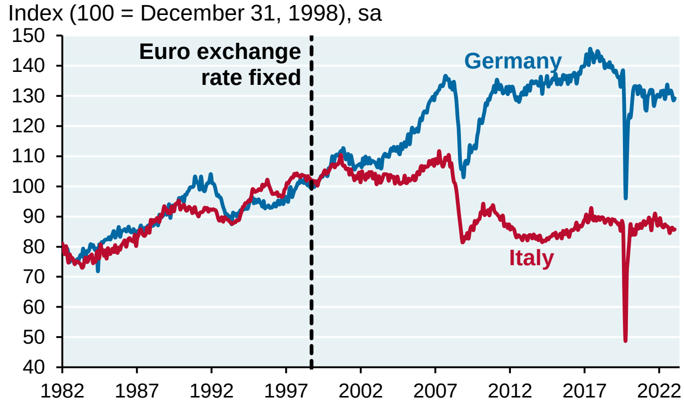
Source: Bloomberg, JPMAM, Q2 2023

Where does US and Eurozone growth come from?
Ratio



Source: *"Comparing Economic Growth between EU and US States"*, European Center for International Political Economy (ECIPE), Erixon et al. July 2023

Industrial production and the launch of the Euro
Index (100 = December 31, 1998), sa



Source: OECD, JPMAM, August 2023

[4] While the US ranks #1 or #2 out of 140 countries in business dynamism and innovation (World Economic Forum), the average Western European country ranks #17-#23

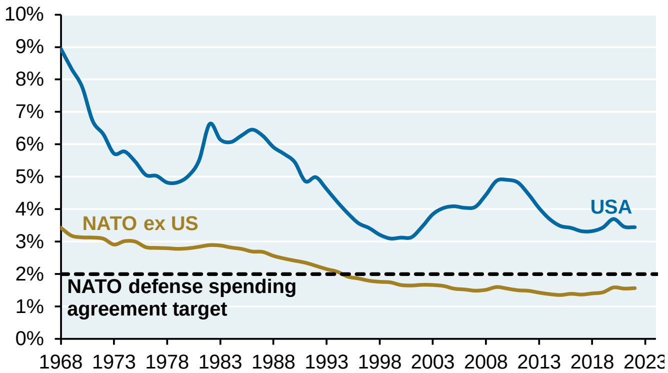
Let's broaden the sovereignty discussion to include Europe's unpaid debt for its national defense

By taxing US subsidiaries based on their parent's US income, Europe's new tax policy collides with US fiscal and economic sovereignty. So, let's broaden the discussion to include *political* sovereignty. This is a pertinent issue given Russia's invasion of Ukraine and Russian threats against Europe. Recent statements by Former Russian President Medvedev on risks to Poland's statehood are striking examples of the latter[5].

As shown on the left, the European defense spending gap vs the US was so wide that NATO had to implement an agreement in 2006 requiring each country to spend at least 2% of GDP on defense. Only a few countries do despite the agreement. So, I computed the cumulative amount of money in today's dollars that Europe arguably owes either towards its own defense or to the US which protects it[6]. **The cumulative unpaid amount since the 2006 NATO 2% agreement: $1.4 trillion.** If we go back to 1999 when Putin took power in Russia, the bill goes up to $1.8 trillion[7]. And if we go back to Reagan's Evil Empire speech in 1983, the bill rises to $2.0 trillion.

In my view, US Presidents should not advocate for Pillar II unless all aspects of national sovereignty are on the table, and should consider retaliation against Europe if it moves forward with Pillar II without US participation, particularly with GloBE rules that treat R&D credits differently to the disadvantage of US multinationals.

US vs European defense spending
Percent of GDP



Source: World Bank, SIPRI, Federal Reserve, JPMAM, 2022

Shortfall in NATO defense spending by country vs 2% of GDP defense spending target, billions of 2022 US$, since:

	Joined NATO	Reagan evil empire speech (1983)	Putin comes to power (1999)	Defense spending agreement (2006)
United Kingdom	1949	$ 5	$ 5	$ 5
France	1949	$ 53	$ 53	$ 53
Italy	1949	$ 365	$ 287	$ 236
Netherlands	1949	$ 171	$ 160	$ 128
Denmark	1949	$ 69	$ 62	$ 50
Portugal	1949	$ 44	$ 37	$ 28
Belgium	1949	$ 141	$ 127	$ 103
Norway	1949	$ 46	$ 46	$ 42
Germany	1955	$ 896	$ 770	$ 590
Spain	1982	$ 252	$ 238	$ 196
Total		**$ 2,041**	**$ 1,785**	**$ 1,430**

Source: World Bank, SIPRI, Federal Reserve, JPMAM, 2022

[5] Former Russian President Dmitry Medvedev, now deputy chairman of Russia's Security Council, warned Poland that it is now considered a "dangerous enemy" by Russia and **could end up losing its statehood if it continued on its current course**. "We will treat Poland precisely as a historical enemy. If there is no hope for reconciliation with the enemy, Russia should have only one and a very tough attitude regarding its fate. History has more than once delivered a merciless verdict to the presumptuous Poles: **no matter how ambitious their revanchist plans may be, their collapse could lead to the death of Polish statehood in its entirety**." Reuters, November 2, 2023

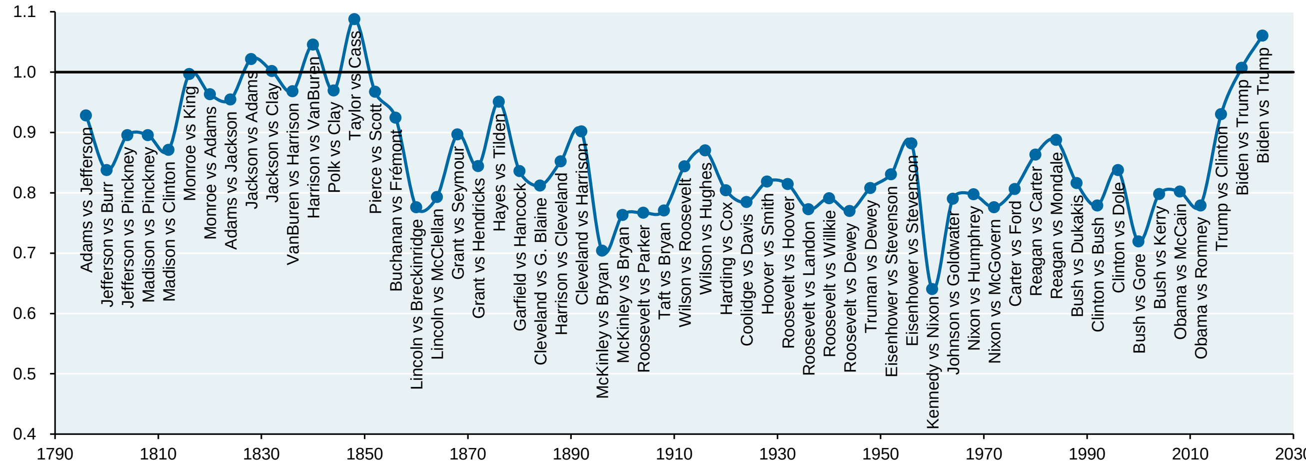
[6] **On Europe's military reliance on the US**: "*America's European burden: How the Continent leans on the US for security*", Politico, M. Kartnitschnig, June 14, 2023; "*Only the US Can End the Ukraine War and Protect Europe: American efforts have a better chance if the EU paid their fair share*", M. Hastings (BBC/Evening Standard), Nov 13, 2022; "*The War in Ukraine is about Europe's Future*", Carnegie Europe, J. Dempsey, August 2023

[7] European defense spending fell sharply after the collapse of the USSR in 1991. A lot has been written on how Europe misread events in Russia, including the "Putinverstehers" led by former Chancellor Gerhard Schroder

[3] How unprecedented would it be for two senior citizens like Trump and Biden to run against each other, and what would happen if one or both had to drop out during the primary process or the general election?

If Trump and Biden are the respective party nominees for President in 2024, they would represent the second oldest pair of candidates in US history, even after adjusting for the shorter lifespan of adult males in prior centuries. As shown below, Trump vs Biden would entail an average age that's above male life expectancy.

2024 election, assuming Biden vs Trump
Average age of both candidates as a % of prevailing non-infant male life expectancy



Source: Social Security Administration, CDC, "*Decennial Life Tables for the White Population of the United States, 1790-1900*" JD Hacker, JPMAM, 2023

As a result, I wanted to figure out what would happen if either candidate dropped out due to health reasons. I structured this discussion as a Q&A using Biden as the Democratic nominee and Gavin Newsom as the candidate named by the Party to replace Biden in certain scenarios[8]. The rules below are generally the same for the GOP. Thanks again to Michael Morley for his detailed guidance and research on these topics[9].

What if Biden dropped out well before the ballot eligibility deadline for a given Presidential primary?

Newsom would simply have to provide the required list of signatures to get on the ballot, typically a % of registered voters. In several states there's also limited judicial discretion to extend the ballot eligibility deadline

What if Biden dropped out just before the ballot eligibility deadline for a given Presidential primary?

If no one else were on the ballot, there would be no primary and the state's delegates would be unbound for purposes of the Democratic convention. The Democratic Party could also unbind the state's delegates even if Marianne Williamson received a plurality of votes, if the Party were willing to deal with the public backlash

What if Biden dropped out after the last primary in June but before the party convention in August?

All delegates would likely become unbound. Party officials would either rely on the Convention's existing rules for placing Newsom's name into nomination, or amend the Convention's rules through the Rules Committee and a floor vote. [The Republican Party might have to amend rules to allow a candidate to be placed into nomination by submitting signatures from a specified number of delegates from a certain number of states]

What if Biden dropped out after the Party convention in August, but before the November general election?

In late September, election officials begin to distribute absentee ballots to military and overseas voters and in some states to domestic voters who request them. If Biden dropped out, the Democratic National Committee could name Newsom as replacement. Some states would allow ballots to reflect Newsom as the new nominee, but in others Biden might continue to appear on the ballot. The Democratic Party would make clear that a vote

[8] We have no view on who the replacement candidate would be; we chose Newsom for the examples since he is the second place candidate according to Vegas Insider and ElectionBettingOdds.Com

[9] Michael Morley is the Sheila M. McDevitt Professor of Law at FSU College of Law. Michael is a specialist on election law, constitutional law and the federal courts, and author of "Election Emergencies" in the forthcoming Oxford Handbook of American Election Law

for Biden is really a vote for Newsom: when voting for a presidential candidate, you're casting a vote for the *slate* of presidential electors nominated by that candidate's party in that state. So, a vote for Biden or Newsom would both count as a vote for the same slate of Democratic nominees for presidential elector from that state. Even so, there's a chance voters could become confused or lose enthusiasm, depressing turnout on Election Day

What if lackluster voter support for Newsom as Biden's replacement results in neither Newsom nor Trump reaching the 270 electoral vote threshold due to the success of third-party candidates?

If RFK Jr and "No Labels" candidates won enough electoral votes to prevent both Trump and Newsom from surpassing 270[10], a contingent election would be held in the House (see below). Between November 2 and December 17, if a sufficient number of third-party electors switched their votes, they could push Newsom or Trump over the 270 level. However, elector vote switching could only take place if it survived an incredibly complex maze of elector binding laws and enforcement mechanisms that exist at the state level, since some states prevent electors from voting for a candidate that didn't win the popular vote in that state. Elector vote switching would also have to survive constitutional challenges that could result from voters claiming their rights were infringed (particularly if elector vote switching occurred simply to avoid triggering a contingent election)

What if Biden wins the general election in November, becomes incapacitated and the Party replaces him with Newsom before December 17 when electors gather to vote in state capitols?

Now it gets complicated since there could be a collision between the Party's right to name Newsom as a replacement and state elector binding laws. Some states require presidential electors to cast their electoral votes for specific individuals without clarifying language on death, incapacity or withdrawal. So in theory, in some states the electors might still be forced to vote for Biden despite his incapacity, while in others electors could vote for Newsom. As a result, it's remotely possible that neither Newsom nor Biden receive at least 270 electoral votes which would result in a contingent election in the House

What if Biden wins and is incapacitated after December 17 but before the Jan 6th Joint Session of Congress?

A Constitutional Black Hole. A substantial argument exists that electoral votes cast for Biden in mid-December are now ineligible since a deceased or incapacitated person does not satisfy the Constitution's requirements for President. The one time that Congress was confronted with this issue, it declined to count votes cast for a deceased presidential candidate (Horace Greeley in 1872), though that did not impact the outcome. If Congress declined to count electoral votes for Biden, no candidate would amass 270 electoral votes. This would trigger a contingent election in the House. But since the House is limited to choosing from among the three candidates who received the highest numbers of electoral votes that Congress accepted, it would be forced to choose from among the losing candidates. So…Trump might be the only eligible candidate Congress could vote for

What if Biden becomes incapacitated after the January 6th Joint Session but before the inauguration?

The Democratic VP would be sworn in as President. The VP vacancy would be filled through Presidential appointment and confirmation by both chambers of Congress pursuant to Section 2 of the 25th Amendment

How does a contingent election work according to the 12th amendment?

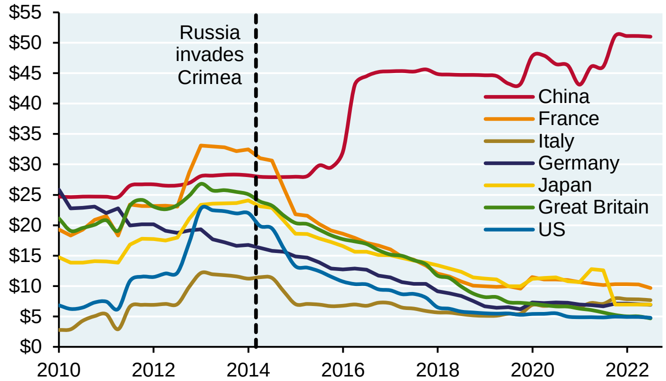
Each state's Congressional House delegation receives one vote for President. A candidate must receive votes from a majority of 50 state delegations to be declared President. The House is permitted to choose only from candidates who received the three highest numbers of electoral votes in the Electoral College. There currently are 26-27 state delegations with more Republicans than Democrats, but a contingent election would be decided by Representatives elected in November 2024 and take office in 2025, and the composition of those delegations is unknown at this point

[10] **Don't be too quick to dismiss the possibility of third-party candidates winning one or more states**. George Wallace won 46 electors in 1968, Strom Thurmond won 39 electors in 1948, Robert La Follette won 13 electors in 1924 and Theodore Roosevelt won 88 electors in 1912

[4] Would Taiwan stand a chance against a Chinese military invasion?

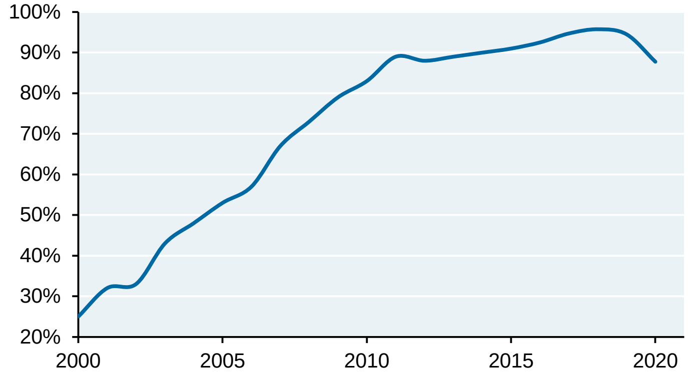
China has signaled through its economic policies that it defines its geopolitical self-interests very differently than the West. Here are two notable examples: Chinese economic support for both Russia and North Korea.

China providing critical loan lifeline to Russia
Cross border syndicated loans, US$, billions



Source: BIS, Q3 2022

China is practically North Korea's sole trade counterparty
China as a % of total North Korean trade



Source: US Korea Institute at Johns Hopkins SAIS, KOTRA, UN, 2020

Recent polling of Taiwanese citizens reported by the Taipei Times shows 11% for reunification, 27% for status quo and 49% for independence. Given China's adamant statements on the latter, Taiwan is an obvious potential flashpoint of geopolitical risk. CSIS, a pre-eminent US think tank on defense issues, assessed potential outcomes of a 2026 military invasion by China[11]. Among the reasons CSIS cited for preparing its analysis now: growing concerns expressed by current and former military admirals on rising risks. Also: the Pentagon released videos of Chinese fighter jets confronting unarmed US reconnaissance planes on routine patrols over the East and South China seas. As per the Washington Post, China's military conducted more than 180 risky intercepts in the past two years, more than the entirety of the previous decade[12].

In any case, even when CSIS assumed the following three conditions…

- Taiwanese forces vigorously defend the mainland against Chinese ground forces
- The US immediately gets involved militarily by striking the Chinese fleet from outside the conflict zone
- The US is permitted by Japan to use its bases for aircraft operations

CSIS found that the US could sustain Taiwan's political autonomy but at an enormous cost…

- Opening Chinese bombardment destroys most of Taiwan's navy and air force in the first hours of hostilities
- Chinese navy encircles Taiwan and prevents any attempts to get ships and aircraft on or off the island
- Tens of thousands of Chinese soldiers cross the strait in a mix of military amphibious craft and civilian roll-on, roll-off ships while air assault and airborne troops land behind the beachheads
- Still, the Chinese invasion founders. Despite massive Chinese bombardment, Taiwanese ground forces stream to the beachhead and successfully defend it at great cost. US submarines, bombers, and fighter/attack aircraft reinforced by Japan Self-Defense Forces cripple the Chinese amphibious fleet
- The US and Japan lose dozens of ships, hundreds of aircraft and thousands of servicemembers. Such losses would damage the US global position for years. In three weeks, the US would suffer about half as many casualties as it did in 20 years of war in Iraq and Afghanistan. Some specifics: the US loses 200-300 aircraft, 10-20 destroyers/cruisers and 2 aircraft carriers, by far the biggest losses since WWII
- Taiwan's military is degraded and left to defend a damaged economy without electricity and basic services
- China also suffers heavily. Its navy is in shambles, the core of its amphibious forces is broken and tens of thousands of soldiers are prisoners of war

[11] "*The First Battle of the Next War*", CSIS International Security Program, Cancian and Heginbotham, 2023

[12] Washington Post: "*Chinese fighter jets buzz US planes in dramatic new videos*" 10/17/2023, and "*China's naval provocations are getting too blatant to ignore*" 10/29/23

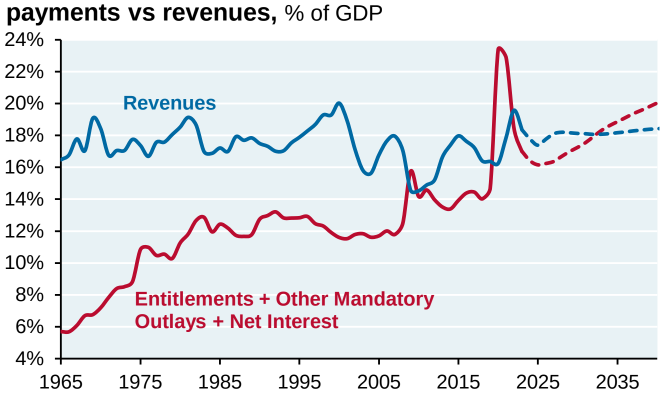
As a reminder, the US does not have a defense treaty with Taiwan so the presumption by the authors that the US would get involved militarily is conjecture. Classified assessments reportedly undertaken by the Dep't of Defense are even less sanguine on the ability of the US to sustain Taiwan's political autonomy when assuming the conditions above. Without US/Japanese participation, CSIS believes that the only uncertainty would be the number of weeks required for China's victory given military force imbalances.

To be clear, CSIS also cites several analysts who argue that there's no evidence that China has abandoned its long-term peaceful reunification strategy. In addition, Gavekal Research argues that Taiwan in its current form is highly useful to China given China's ability to poach Taiwanese semiconductor engineers[13], and given the damage that an invasion could inflict on Taiwanese semiconductor facilities that China heavily relies on for 60% of its semiconductor consumption.

[5] What taxation and spending policies are required for the US to stabilize the Federal debt?

By the early 2030's, the CBO projects that all Federal government revenues will be consumed by entitlement payments and interest on the Federal debt. Sometime before this happens, I expect a combination of market pressure and rating agency downgrades (which have already begun) to force the US to make substantial changes to taxes and entitlements. The most likely policies in my view appear in the accompanying text box. A wealth tax is also a possibility; there's an active Supreme Court case that might impact its Constitutional feasibility (*Moore vs United States*, which is related to the Constitutionality of the Mandatory Repatriation Tax in the 2017 tax bill). What's not in the text box? Further cuts to discretionary spending, since the US has run out of road on that one. In the CBO's recent publication on deficit reduction options[14], the benefit from "reduce non-defense discretionary spending" was the smallest on the CBO list since it has been cut so much already.

Entitlement spending, mandatory outlays and net interest payments vs revenues, % of GDP



Source: Congressional Budget Office, JPMAM, June 2023

The latest news on the Federal debt

- US debt to GDP ratio converging with Italy
- Moody's cuts US outlook citing higher deficits, higher interest rates and polarization
- Poorly received 30-year Treasury auction
- 5-year credit default protection on the US has risen to one of the highest levels on record
- Gross and net interest expense as % of GDP rising sharply, still below 1980's peak but not by much

Policies to raise revenue

- Eliminate or raise the cap on income used to compute Social Security contributions, or raise payroll tax rate
- Lifetime/means-tested cap on 401k contributions
- Further limits on itemized deductions (i.e., mortgages)
- Federal tax on municipal bonds for AGI > $250k
- Unify capital gains and income tax rates at higher level for AGI > $250k
- Value added taxes, carbon taxes

Source: CBO, JPMAM, 2023

Policies to reduce entitlement spending

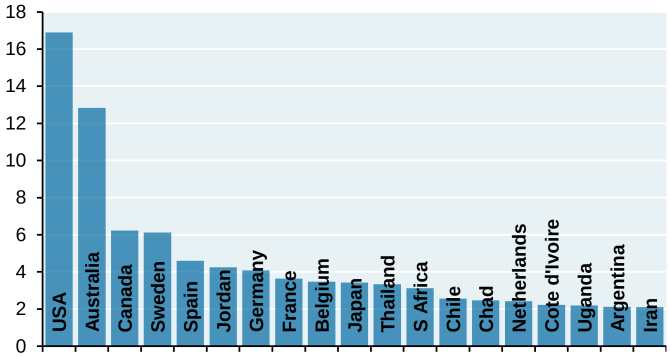
- More gov't price-setting on drugs/treatments within Medicare/Medicaid
- Higher Medicare co-pay and deductibles for everyone
- Means-test Medicare outlays based on lifetime income
- Caps on Medicaid spending
- Higher Medicare eligibility age and/or Social Security retirement age
- Chained CPI for Social Security benefit payments

13 "*The technological golden goose*", Louis Gave, Gavekal Research, November 10, 2023
14 "*Options for Reducing the Deficit, 2023 to 2032*", Congressional Budget Office, Volume 1

[6] Anything else to add on the US at Thanksgiving?

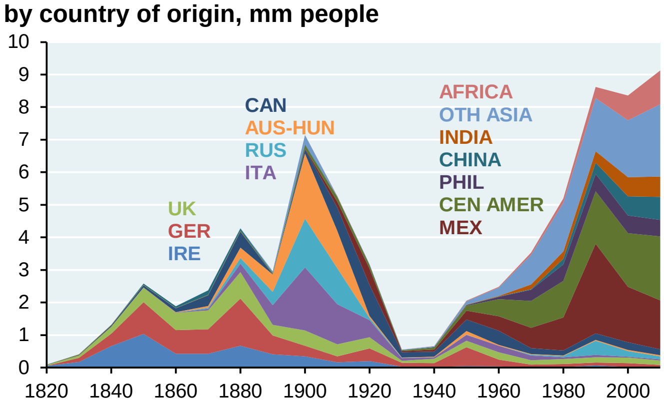
Despite its political, financial, racial, judicial and social problems, a lot of people appear very thankful to live in the United States. As shown in the first chart, the US has the world's highest ratio of people who arrive (migrants) relative to people that leave (emigrants), and by a wide margin. Over the long history of migration to the US, if migrants *choose* to, they can create a completely new American identity, supporting American self-interests, American soldiers and American communities, leaving behind their historical antagonisms and their foreign allegiances, and confining their political litmus tests to issues solely related to the success of the uniquely American experiment.

US remains a beacon that few people leave
Ratio of migrants to emigrants



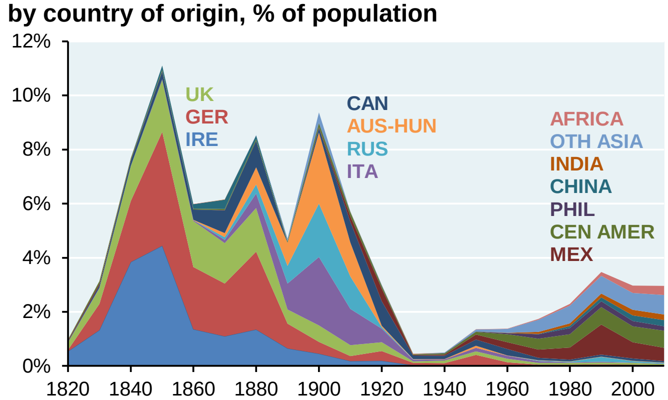
Source: UN International Migration Stock Database, 2022

People obtaining lawful personal resident status in the US by country of origin, mm people



Source: 2021 DHS Yearbook of Immigration Statistics

People obtaining lawful personal resident status in the US by country of origin, % of population

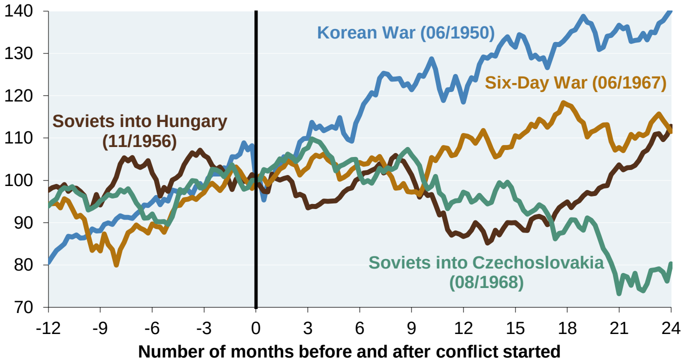


Source: 2021 DHS Yearbook of Immigration Statistics

Michael Cembalest
JP Morgan Asset Management

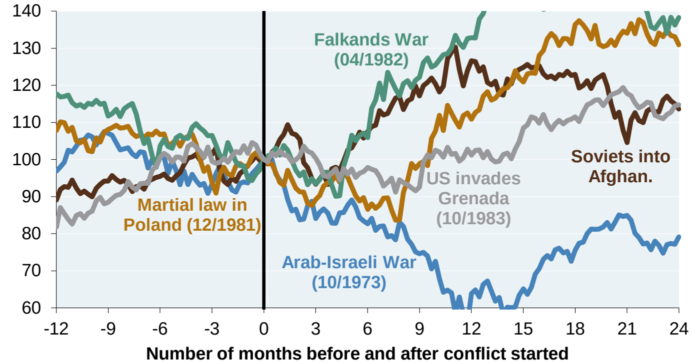
Appendix: geopolitical events and equity markets 6-9 months later. 1973 is the exception. 2001 and 2022 selloffs were mostly related to tech bust and inception of Fed hikes after a decade of negative real rates.

S&P 500 Index around military invasions and conflicts (1950 - 1968)
Index, month conflict started = 100



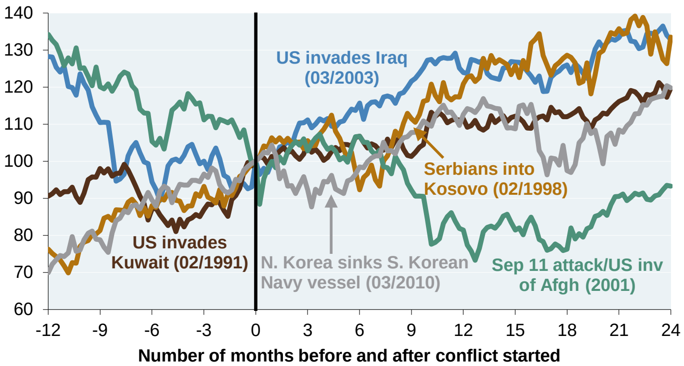
Source: Bloomberg, JPMAM, October 18, 2023. Equity index represents price returns.

S&P 500 Index around military invasions and conflicts (1973 - 1983)
Index, month conflict started = 100



Source: Bloomberg, JPMAM, October 18, 2023. Equity index represents price returns.

S&P 500 Index around military invasions and conflicts (1991 - 2010)
Index, month conflict started = 100



Source: Bloomberg, JPMAM, October 18, 2023. Equity index represents price returns.

S&P 500 Index around military invasions and conflicts (2014 - today)
Index, month conflict started = 100

Source: Bloomberg, JPMAM, October 18, 2023. Equity index represents price returns.

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