First Trust Portfolios Canada®

Weekly Outlook

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Odds Brightening for Tax Cut Extension

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Washington DC became intensely angry at British Petroleum during the Gulf oil spill, partly because BP was stingy with information. Washington should remember its anger, because that's what many American investors and businesses leaders feel right now about the lack of information about what tax rates will be in 2011.

This isn't a surprise. For almost a decade, everyone has known this day was coming. On January 1, 2011, the top income tax rate on ordinary income and dividends will go back to 39.6%, the top tax rate on capital gains will revert to 20%, and the top tax rate on estates will go back to 55%. Some in Congress want to extend the tax cuts for everyone, some want to extend them but not for the "rich," and others want to hold the dividend tax rate to 20%. These decisions make a huge difference to American business. But rather than putting it up for a vote, Congress is playing political games.

Our best guess is that, ultimately, all the current tax rateson regular income, dividends, and capital gains get extended for another year. <u>When</u> this happens remains a major mystery, and no matter what we say or think, uncertainty about all of this remains extremely high.

Ideally, it would happen before the election this year. But this would require President Obama and the Democrats to turn dramatically, just when the public is paying more attention to politics. It would look opportunistic, it would demoralize some liberal voters and it would undermine the Democratic position that tax rates on the rich don't matter that much to the economy.

How about in a lame duck session? If the consensus is right and Republicans take the House and make large gains in the Senate, it would give Democrats a chance to say they are listening to the voters. But in a lame duck session, Speaker Pelosi would still rule the House with little to no incentive to do the heavy-lifting needed to pass a bill.

That leaves us with one more scenario for extending the tax cuts, the one loaded with the most taxpayer uncertainty, but which may be the most likely outcome. In this scenario, Congress fails to extend <u>any</u> of the tax cuts before the end of the year. All of the tax rates from 2000 – on everyone, from the "rich" on down – come back on January 1. Then, sometime in 2011, President Obama – his political advisers telling him to maximize growth going into his re-election battle – agrees to an extension but only through 2012, with all the lower tax rates made retroactive to January 1.

Then, after all the uncertainty this time around, we will repeat all of this in 2012, waiting until Election Day to see who will have the political advantage in 2013 and beyond.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-30 / 7:30 am	Personal Income - Jul	+0.3%	**+0.2%**	+0.2%	0.0%
7:30 am	Personal Spending - Jul	+0.3%	**+0.5%**	+0.4%	0.0%
8-31 / 9:00 am	Chicago PMI - Aug	57.0	**57.7**		62.3
9:00 am	Consumer Confidence - Aug	50.9	**52.3**		50.4
9-1 / 9:00 am	ISM Index - Aug	52.8	**54.5**		55.5
9:00 am	Construction Spending - Jul	-0.5%	**-0.6%**		+0.1%
afternoon	Domestic Vehicle Sales - Aug	8.9 Mil	**9.0 Mil**		8.8 Mil
9-2 / 7:30 am	Q2 Non-Farm Productivity	-1.9%	**-2.0%**		-0.9%
7:30 am	Q2 Unit Labor Costs	1.2%	**+1.2%**		+0.2%
7:30 am	Initial Claims - Aug 28	475K	**469K**		473K
9:00 am	Factory Orders - Jul	+0.4%	**+0.3%**		-0.7%
9-3 / 7:30 am	Non-Farm Payrolls - Aug	-100K	**-20K**		-131K
7:30 am	Private Payrolls - Aug	46K	**+110K**		+71K
7:30 am	Manufacturing Payrolls - Aug	+10K	**+15K**		+36K
7:30 am	Unemployment Rate - Aug	9.6%	**9.5%**		9.5%
7:30 am	Average Hourly Earnings - Aug	+0.1%	**+0.2%**		+0.2%
7:30 am	Average Weekly Hours - Aug	34.2	**34.2**		34.2
9:00 am	ISM Non-Man. - Aug	53.2	**54.0**		54.3

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