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Potential opportunities as fiscal policy takes shape

Key takeaways

- Clarity around fiscal policy has arrived. We believe the single, most important change for individual taxpayers extends the 2017 tax cuts, but we outline other notable individual deductions and exemptions, as well as some important changes in corporate taxation.
- The U.S. economy has been gradually slowing, but we expect that the tax changes, accumulating deregulation, modest oil prices, and lower short-term interest rates will help the economy avoid a recession.

What it may mean for investors

- Against this backdrop of tax changes and a slowing economy, we continue to favor a disciplined, selective investment approach and identify how the new law works with our investment guidance.

Clarity around fiscal policy has finally come into view with the July 4 signing into law of the reconciliation budget bill. The One Big Beautiful Bill Act made many of the tax provisions of the 2017 Tax Cuts and Jobs Act permanent, enacted additional individual and business tax cuts, and increased spending on defense and border security over the next decade. These changes were partially offset by planned tariff revenue and by spending cuts to Medicaid, the Affordable Care Act, and food stamps, and the phasing out of renewable-energy tax credits. The final legislation also raises the debt ceiling by \$5 trillion.

The tables on the following pages compare the prior law against what we believe are the most prominent individual and corporate provisions in the new law. For individuals, we believe the single, most important feature is the extension of the 2017 tax cuts, but other notable provisions include a larger deduction for older adults, an increase in the state and local tax (SALT) deduction, and higher tax exemptions for estates and gifts.

While the individual tax changes are significant, even a cursory glance through the tables will show that the most significant economic implications in the new law are on the corporate side. Specifically, firms may take bonus depreciation of 100% (up from 40% previously) and fully expense the cost of manufacturing structures. Both provisions apply retroactively to January 19, 2025. The new law also provides for the full expensing of research and development (R&D), which is a more favorable treatment than the five-year amortization under the prior law. The following tables summarize key features of the final bill.

Investment and Insurance Products: ➤ NOT FDIC Insured ➤ NO Bank Guarantee ➤ MAY Lose Value

Individual tax provision details

(Note: Some provisions are unavailable above certain income thresholds; consult a tax specialist for details)

Provision	Prior law	New law
Individual tax rates	2017 tax rates (highest at 37%) were set to expire at the end of 2025	Made permanent
Standard deduction	\$15,000 (single); \$30,000 (joint) for 2025	\$15,750 (single); \$31,500 (joint) for 2025
Senior deduction	\$1,600 for age 65 and older; \$2,000 unmarried/not surviving spouse for 2025	Additional \$6,000 deduction through 2028 (on top of current \$1,600 deduction or current \$2,000 deduction for unmarried/not surviving spouse); 2025 through 2028.
Estate and gift tax exemption	\$13.99 million (single); \$27.98 million (joint) for 2025	\$15 million (single); \$30 million (joint) for 2026; made permanent; indexed for inflation
State and Local Tax (SALT) deduction	\$10,000 limit through 2025	\$40,000 limit for 2025; increases by 1% annually through 2029; reverts to \$10,000 in 2030
Child tax credit	Max credit of \$2,000 per child through 2025; refundable portion \$1,700 for 2025	Max credit of \$2,200 per child; refundable portion \$1,700 for 2025
Trump accounts for child savings	N/A	One-time \$1,000 credit to account per child born between 2025 and 2028
Tips	N/A	Deduction up to \$25,000 per year; 2025 through 2028
Overtime pay	N/A	Deduction up to \$12,500 per taxpayer; 2025 through 2028
Auto loan interest	N/A	Deduction up to \$10,000 of annual interest on new loans for U.S.-made cars; 2025 through 2028

Sources: Wells Fargo Investment Institute, Bloomberg, CNBC. As of July 8, 2025.

Corporate and other business tax provisions

	Current law	New law
Pass-through (199A) deduction	Deduction of up to 20% of Qualified Business Income (QBI)	Made permanent at 20%
Bonus depreciation	40% bonus depreciation	100% bonus depreciation from January 19, 2025, made permanent
Research & development (R&D)	Five-year amortization for domestic R&D	Full expensing restored, made permanent
Expensing for structures	N/A	100% for manufacturing structures, starting January 19, 2025

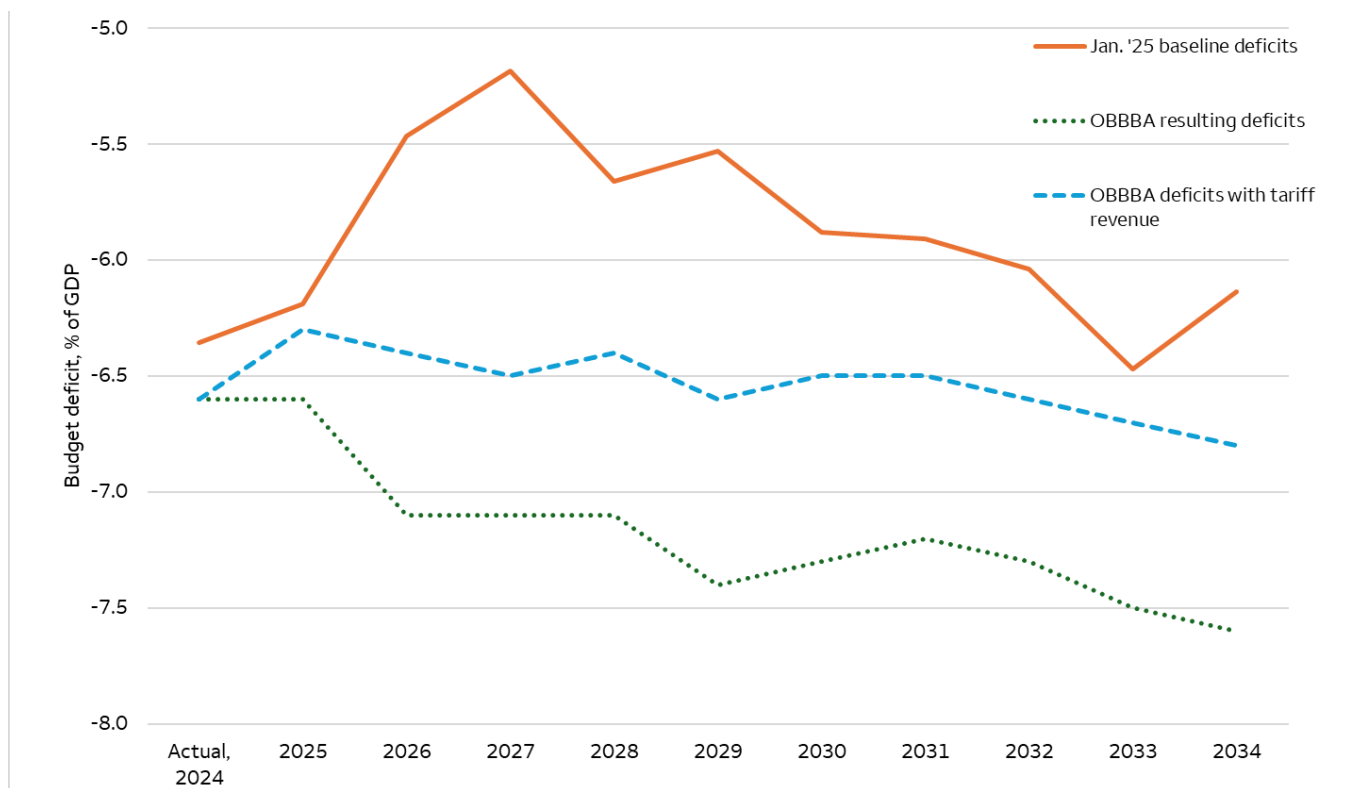
Sources: Wells Fargo Investment Institute and Bloomberg. As of July 8, 2025.

Debt ceiling increase, rising deficits likely keeps upward pressure on longer-term yields

Imbedded in the budget bill is a \$5 trillion debt-ceiling increase to accommodate expanded government borrowing for the next three years, according to estimates by the Congressional Budget Office (CBO). Pushing the next debt ceiling debate out by three years should bolster financial market sentiment, in our view.

The bill also increases cumulative, 10-year deficits by \$3.3 trillion, according to the CBO, largely financed by an estimated increase in tariff revenue. However, even accounting for the estimated tariff revenues over the next decade, U.S. deficits are historically elevated, on track to remain above 6% as a percentage of gross domestic product (GDP) in the coming years (Chart 1), well above the roughly 3.5% average during the two decades before the coronavirus pandemic.

Chart 1. U.S. budget deficits still on elevated path, even with tariff revenue as an offset



Sources: Wells Fargo Investment Institute, Congressional Budget Office, and Committee for a Responsible Federal Budget (CRFB). Data as of July 8, 2025. GDP = gross domestic product. OBBA = One Big Beautiful Bill Act.

We see fixed-income markets paying closer attention to the interest expense portion of the deficit. The growth in the federal debt over the past two decades and the more recent rebound in interest rates have raised the U.S. Treasury's interest expense to now rival the defense budget in size. In turn, we believe growing debt service is becoming a more important driver of volatility in U.S. Treasury bonds. That volatility may increase in the coming weeks, while the Treasury uses its borrowing authority under the new debt ceiling to increase issuance and rebuild its cash balances. This volatility is a main reason why our investment preference since March has shifted away from longer- to more intermediate-term maturities (from 3 to 7 years).

Investment implications

The U.S. economy has been gradually slowing, but we expect the tax changes, accumulating deregulation, modest oil prices, and lower short-term interest rates to help avoid a recession. We also expect softer inflation from energy

prices, services disinflation, and a more drawn-out imposition of tariffs. Still, investors may encounter heightened market volatility during coming months, as uncertainties about the timing and ultimate size of the tariffs create tariff impact questions for households and businesses.

Against this backdrop, we continue to favor a disciplined approach to portfolio adjustments, tilted toward quality large- and mid-cap equities and, as mentioned above, selectivity in fixed-income allocations. We offer additional thoughts on equity sectors and sub-sectors below:

- **Consumer Discretionary** (we hold an unfavorable rating): The sector should benefit somewhat from the individual tax changes, but potentially larger, negative factors come from recent automobile tariff increases and from the new law's phase-out of most Biden-era tax breaks for clean energy. The new law also eliminates a \$7,500 consumer tax credit for electric vehicle purchases after September 30. These factors and the sector's rich valuations leave us unfavorable on the sector. However, we do see room for some selectivity at the sub-sector level. We remain favorable on Broadline Retail (e-commerce), Specialty Retail (automotive aftermarket, home improvement, off-price), and Hotels, Restaurants & Leisure, and maintain our unfavorable rating on Leisure Products.
- **Utilities** (we hold a favorable rating): Utilities may come under near-term pressure from the new law's phase-out of several Inflation Reduction Act investment and production incentives. However, safe harbor provisions for renewables deployment and other final details are still being reviewed by the Trump administration. Our recent upgrade of the sector to favorable sees the headwinds outweighed by attractive fundamentals that include strong artificial intelligence-related power demand and the sector's relative stability historically during times of macroeconomic stress.
- **Industrials** (we hold a neutral rating): The new law's expensing, R&D, and depreciation features are potential positives for this sector, but it's not clear yet how widely industrial firms can solve other problems related to expansion, such as limited skilled labor supply and rising prices of raw materials (many of which are subject to new tariffs). We see another counterweight to these potential positives in the economy's current slowdown and likely tariff headwinds. Once again, however, there may be an opportunity in a sub-sector. The new law boosts defense spending by \$150 billion, with much of the funding going to new weapons systems made by major contractors. We believe this provision reinforces our favorable rating on Defense and Aerospace.
- **Information Technology** (we hold a favorable rating): As a research- and capital-intensive sector, Information Technology should benefit from full expensing of R&D, capital equipment, and factory structures.
- **Energy** (we hold a favorable rating): We view the new law's incentives for expanding oil and gas leasing on federal lands, along with tax breaks for the fossil fuel industry, as positives that reinforce our favorable outlook for the sector. At the sub-sector level, we continue to favor Integrated Oil and Midstream Energy.

Risks Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. The prices of **small and mid-cap** company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

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