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Markets on Hold as Trump Era Begins

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What will the Trump Era Bring? Will it be endless tweets, corporate callouts, currency wars, and tariffs? If that is the case, forget about equities. But if it is a pro-business and growth platform, with less regulation and substantial corporate tax reform, stocks will greatly benefit. And if the inducement to keep manufacturing firms in the US is to provide carrots instead of sticks, then this equity rally is just beginning. Starting today, we will see the true Trump agenda unfold.

The year-over year CPI went over two percent for the first time in two and one-half years. Of course the PCE deflator, the Fed's preferred measure of inflation, is still below the central bank's 2% target. But there is little doubt that, at least over the near term, the deflation dragon has been vanquished. Inflationary expectations measured by the difference between the nominal and inflation-adjusted (TIPS) treasuries continue to creep upward and now exceed two percent for the ten-year maturities. This is why even the doves at the Fed are voicing support for moderate increases this year. A hike will not come at the next meeting, February 1st, but it could come at the quarterly meeting on March 15. By that time we will have 8 more weeks of data and, more importantly, some economic direction from the new administration. As I have stressed before, the Fed is not committed to any particular path for the funds rate. The FOMC looks at the economy and particularly the financial markets when making its rate decisions. The direction of the ten-year Treasury bond is a key variable. If that rate stays below 2 ¾%, the Fed may wait beyond March, but other variables, such as the dollar and commodity prices, will figure in the Fed's decision.

Early corporate earnings have been good with more positive guidance than we received last quarter. Of course, the real flood comes in the next two weeks – over 100 S&P 500 firms are expected to announce next week alone. But all these data are "pre-Trump." The markets will be assessing the post-Trump environment starting from his inauguration today. Repealing the taxes and regulation surrounding ObamaCare and reforming the corporate tax code are task number one. How the Republicans do that while keeping the GOP deficit hawks in line will be the biggest challenge. I noted last week that the probability of substantial "border adjustments" was very low. This week Trump essentially shot them down. Keep it simple: lower tax rates, less deductions, and reasonable repatriation rates is what the market wants and I am quite sure the GOP can deliver.
