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Nobody knows quite what to make of President Trump's tumultuous first days in office, or what the implications may be. U.S. markets moved past their initial post-election optimism and took on a more wait-and-see attitude in January, even as Fourth Quarter GDP data gave us our first real insight into what the Trump Economy may look like.

Because Barack Obama was still president, commentators have paid little attention to Q4's mildly disappointing +1.9% GDP growth, assuming it tells us more about the past than the future. In fact, the defining trends in Q4 were driven by expectations of reflationary policies under the incoming Trump. And what those expectations gave with one hand, they took back with the other. Renewed business confidence pushed non-residential investment up by +2.4%, its strongest pace in over a year, while inventory restocking added a full point to GDP growth. But the sharp post-election surge in the dollar, to a 13-year high, caused exports to fall (−4.3%) and imports to rise (+8.3%), shaving −1.7 points from GDP.

Rising inventories can only be supported with rising sales, but so far the solid upswing in consumer confidence that followed Trump's victory hasn't translated into stronger spending growth, which slowed to a modest +2.5% in Q4. With consumers contributing +1.7 points to GDP growth, and the wider trade deficit subtracting the same, it's fair to say that the stronger dollar channeled the quarter's entire increase in consumer spending to fuel foreign, not domestic, output. The fact that, without the stronger dollar and widening trade gap, GDP growth would have been +3.6%, shows the extent of the pushback on growth.

With the coming of the new year, confidence in how smoothly and quickly Trump's pro-growth agenda—tax cuts, deregulation, and new public spending—could be implemented began to cool, while concerns over the emphasis he seemed to place on potentially more disruptive policies—on trade, immigration, and health care—began to mount. While the Dow Jones Industrial Average eventually wobbled, to great fanfare, past the symbolic benchmark of 20,000, it ended January below that mark, up just +0.5%. The rally that boosted the S&P 500 +8.6% from Election Day to year's end delivered a more modest +1.8% gain in January, while market volatility (VIX) settled down to a two-year low. Excited optimism has been replaced with watchful waiting.

Other markets, in January, also showed signs of cooling expectations. The 10-year U.S. Treasury rate stabilized at 2.45%, and the dollar fell back −1.8% on a broad trade-weighted basis. Just as reflationary expectations generated their own pushback against growth, in the form of higher interest rates and a stronger dollar, reduced expectations should relieve some of that negative pressure, keeping the U.S. economy on a steady, if unexciting, growth path. Meanwhile, emerging markets, which saw a post-election downturn on worries of a dollar shortage, rebounded +5.5% in January as those concerns receded.

The U.S. economy itself is showing solid growth momentum going forward. The ISM Manufacturing Index for January registered its strongest expansion in over two years, while the Non-Manufacturing survey showed continued steady growth. New orders, in both cases, indicated a positive future. Q4's +10.2% rebound in housing investment, after two negative quarters, is an encouraging sign. So are the 227,000 jobs added to the U.S. economy in January, the strongest gains in four months, which should support continued consumption growth. At the same time, wage pressure remains muted, and inflation has yet to pick up to a degree that would force the Fed to respond.

Of course, this assumes no major misstep from President Trump. The U.S. market appears willing to grant him the benefit of the doubt, for now, even if those doubts loom larger than before. Gold rose +5.8% in January, which suggests some are hedging against worst-case scenarios. Asian and European markets have held steady, but the CAC 40 index in France, where a far-right victory in two-round presidential elections in April and May is no longer inconceivable, fell −2.3%, and the sovereign bond spread over German Bunds has widened noticeably. Along with Trump's own actions, the French election outcome—and its impact on the continued viability of the European Union—could prove critical in determining which way the wind of investor sentiment will blow.

We remain focused, however, on the economic and earnings data, and the prospective impact of specific policies on both, in shaping our market outlook. With 57% of the S&P 500 index reporting for Q4, operating earnings per share are expected to be up about +30% from their low point a year ago. That puts the P/E ratio at 21x, a full multiple lower than it stood at the end of Q3. The equity risk premium, versus risk-free bonds, continues to narrow, but at 5.6% remains well above the long-term historical average (4.1%), which implies meaningful rewards for taking equity risk. Earnings performance is somewhat uneven: while all but 3 out of 11 sectors—industrials, telecom, and utilities—have seen earnings gains from a year ago, only three—energy, health care, and IT—saw quarterly earnings rise, rather than fall, in Q4. We're constructive about the U.S. economy, but under no delusion there is smooth sailing ahead.

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