Investors, hedge funds, and systematic strategies in particular, have de-risked over the past month on inflation, Fed rate cuts, and Trump 2.0 policy concerns. (UBS)

Will Trump 2.0 policies ultimately favor DOGE over MAGA?

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Perhaps the safest prediction that one could make about Trump 2.0 is that Donald Trump would wear a blue suit, white shirt, and red tie at his inauguration to become the 47th President. He instead wore a blue and red tie. Is this the first sign of the unpredictability of Trump 2.0?

The public could have weighed in on this sartorial choice had he posted a fit check video on TikTok before the inauguration. Maybe the uncertain TikTok ban, which Trump will ultimately decide, was why he abstained. But in the spirit of those TikToks by stylish content creators, the following is a fit check on the US economy and financial markets at the start of Trump 2.0. An apropos caption for such a fit check: "dressed to impress."

Economy: With most of the relevant data for December already released it's hard not to conclude that the economy looks good, but it's not Goldilocks. It is consistent with our base case of benign growth for 2025, and the fundamentals, absent policy shocks, should keep it on that path. Yet the market narrative on the economy is likely to oscillate this year as it did in 2024, when it went from benign growth to stagflation fears to slowing growth concerns and then back to benign growth. Inflation and rates are high enough for investors to be simultaneously optimistic and cautious, and that duality is why the market narrative can flip with unexpected data or policy news.

- **Growth:** December data on the labor market, ISM manufacturing and services indices, control group retail sales, and industrial production all exceeded expectations. Consequently, the Atlanta Fed GDPNow 4Q tracking estimate is up to 3%. The labor market soft patch last summer is over, while the manufacturing recession that has lingered for two years is also on the cusp of ending. This momentum to start the year is why growth in the mid-2% range still looks very plausible, and consistent with the **"Roaring '20s" regime** continuing another year.

- **Inflation:** December CPI coming in below expectations—core was 0.23% m/m versus 0.3% expected—is even better news because of the risk that inflation is sticky, or re-accelerates. Owners' equivalent rent at 0.31% m/m after the deceleration in November (0.23%) suggests that the shelter component is finally stepping down sustainably, making it easier for inflation to continue its gradual descent to 2%.

- **Fed:** After a hawkish 25bps rate cut in December, the data is welcome news for the Fed. Officials can credibly argue that policy is in a good place and a pause will give them time to assess disinflation progress and the impact of Trump 2.0 policies. Our base case for two cuts in 2025 (June and September) do require further cooling of inflation and the labor market. Market pricing has shifted in this direction, with nearly one cut priced in by June and 1.6 cuts for the entire year.

Markets: US risk assets were already pricing in benign growth before the recent data, but arguably not much downside risk from higher tariffs and reduced immigration. Yet it was the prospect of higher-for-longer inflation and rates that was the primary driver of US equities being choppy and range-bound for the past month. This pattern is likely to persist until there is more clarity on the impact of Trump 2.0 economic policies. But the path to year-end still points upward, supported by the good economic conditions. Market pricing and investor positioning suggests the same thing.

- **What's in the price:** Good growth and confidence that inflation will keep falling, allowing the Fed to resume rate cuts. This is evident in the equity bounce after the inflation data being led by cyclical stocks, boosted by strong 4Q earnings reports from the big banks. In fact, value stocks have outperformed growth over the past month: 3.2% vs. -0.06%. Moreover, the rapid rate rise—the 10-year Treasury yield is up 95bps since 16 September as of this writing—is due primarily to higher real rates (up 62bps), a reflection of growth expectations being reset higher more so than inflation.

- **Positioning & sentiment:** Investors, hedge funds, and systematic strategies in particular, have de-risked over the past month on inflation, Fed rate cuts, and Trump 2.0 policy concerns. Metrics suggest positioning is around average levels of recent years, and if rate and policy risks recede, such investors will be biased towards re-risking. Consistent with the positioning data, investor caution is evident in the AAII bulls/bears index at its lowest level since November 2023.

The bottom line: President Trump inherits an economy that, in fit check parlance, is "dressed to impress" and "dressed for ongoing success." While Trump didn't post a video on TikTok, he may have implicitly followed the advice of Coco Chanel, who recommended that before you leave the house, look in the mirror and take one thing off. Applying that thinking to policy not fashion, he took off the Day One announcement of new tariffs and instead issued a memorandum of understanding directing federal agencies to study trade policies. It's only the first day, but that decision supports our view that Trump 2.0 policies will ultimately favor **DOGE over MAGA** economic ideologies, which means that the net effect of the policies should be positive for the supply side of the economy. If that assumption proves correct, a year-end fit check will likely look as good.

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