Dynamic Wealth Advisors

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Market Update: Holiday Gifts for the Stock Market

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Recent Activity

As we had predicted, despite continued volatility, the fourth quarter of 2022 has been relatively favorable for the stock market as various uncertainties were abated and a healthy consumer market was introduced to the holiday season.

More recently, Christmas came early for investors with the presentation of a few gifts to unwrap. They have been mostly "nice"…

1. **Gift #1: Reduced Inflation** – The Consumer Price Index (CPI), a key measure of inflation, rose by only 0.1% in November, and the annual rate dropped to 7.1%. This was below expectations and the lowest level since the end of last year. This was a healthy sign that inflation could be tempering, which could result in lower interest rate hikes from the Federal Reserve (Fed) and a benefit for the markets.
2. **Gift #2: Smaller Rate Hike** – The Federal Reserve (Fed) hiked the federal funds rate by another 0.50% to a range of 4.25% to 4.50%. This broke the string of 0.75% increases we have had at the last four meetings—one of the most aggressive policies on record. The decrease in hike magnitude indicates that while the fight against inflation isn't over, there is promise of better days ahead.
3. **Lump of Coal: More Rate Hikes in 2023** – Fed officials indicated expectations to keep rates higher through next year, with no reductions until potentially 2024. The projected rate of where hikes would end was placed at 5.10%, according to individual Fed member expectations.

Future Outlook

What are the implications of high inflation, rate hikes and an inverted yield curve (short term rates are higher than long term rates)? Often this combination results in an economic recession. The Fed does its best to not overtighten the economy to prevent a recession, but sometimes it's unavoidable. But more importantly for investors, what is the impact to the stock market?

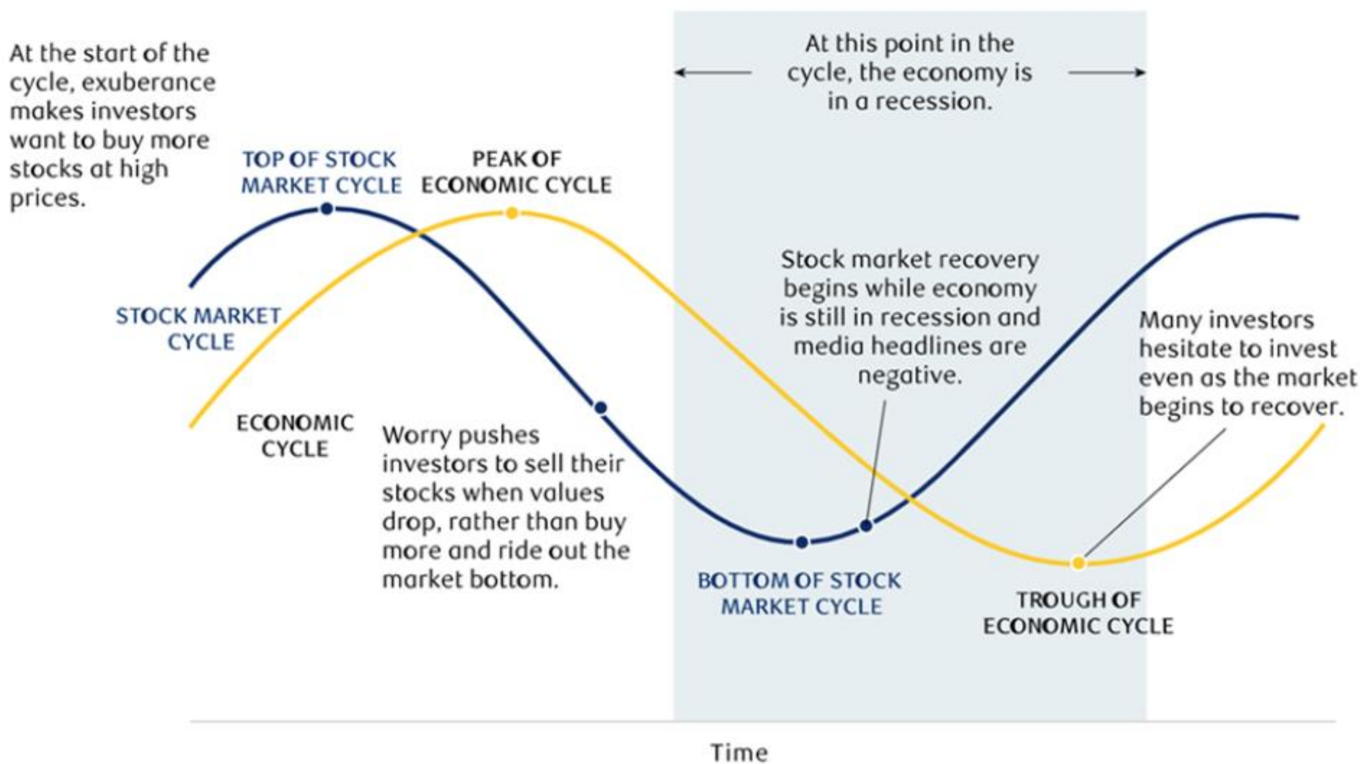
The graph on pg. 2, "The Stock Market and The Economy: How the Two Cycles are Related," helps to identify the typical relationship between the economy and stock market. Key ideas include:

1. **The Economy is Backward Looking.** Did you know that we only find out we've been in recession *after* the fact? The National Bureau of Economic Research (NBER) officially declares a recession based on a decline in economic activity, often measured by a variety of data including the Gross Domestic Product (GDP). GDP and other such metrics measure activity over a previous period (i.e., last quarter or year). Thus, by the time the NBER officially announces a recession, it's typically over. We could be in one right now and not know it.

2. **The Stock Market is Forward Looking.** The stock market is based on expectations for the future and is known as a leading indicator. Investors evaluate expectations about corporate earnings, economic activity, inflation, interest rates and just about everything else to decide where prices should be. Thus, a recession if often "priced" into the stock market before it actually happens.

3. **How the Two Cycles are Related.** To recap, while economic data is backward looking, the stock market is always looking to the future. The market often starts falling well before a recession begins and bottoms out before the economic trough. This means that a market recovery could happen, and often does, during periods of economic weakness. *It is possible that in 2022 this "future recession" has already been priced in and we may have seen the market bottom.*

The Stock Market and The Economy
How the Two Cycles are Related



Source: RBC Global Asset Management. For illustrative purposes only.

As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it's more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

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