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Market Update
Key to Life: Manage Expectations

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Results vs. Expectations

As you may know by now, I'm a movie buff and get excited about new movie releases. In fact, my favorite Super Bowl commercials were the new movie trailers for some of the most highly anticipated movies of the year. However, one serious problem I have is that I get very high expectations in my head about how great a movie will be, and even if the movie is good, I end up disappointed after watching it. So, I've determined that the key to happiness is to moderate your expectations and learn to enjoy all the good things that life has to offer.

How does any of this relate to the markets? Well in many ways, most market and economic data is evaluated relative to expectations or estimates, as opposed to actual results. For example, the biggest headline of the week was the U.S. Labor Department's inflation report on Feb. 14, as measured by the Consumer Price Index (CPI). The headline read, "Inflation rose more than expected" with a year-over-year increase of 6.4%, while 6.2% was expected by a survey of economists by Dow Jones.

Markets reacted negatively, expecting the Federal Reserve (Fed) to maintain their restrictive stance and higher rates for longer, based on this data. Most interesting to note: The article didn't mention that 6.4% was lower than the previous month's reading of 6.5%. From that respect, inflation did drop, but that detail seemed to be overlooked. The bottom line is that inflation is continuing its downward trend and should continue to do so, favoring the economy and the markets overall.

Trend is On Track

While expectations may not have been met, we can see from the "U.S. Inflation Rate" chart below, the downward trend of inflation is maintained. From the peak level of 9.1% in June 2022, there have been seven consecutive months of inflation drops to the latest reading of 6.4%.

Let's review the primary drivers of inflation and how they've contributed to this downward trend:

1. **Supply Chains:** After the U.S. economy reopened post-COVID, there was a lot of pent-up demand as consumers demanded more goods and services. Unfortunately, other countries that produce products were affected by COVID at different times and in general, didn't have enough supply to meet that extra demand, pushing prices higher. Global supply chain problems have been improving over the past half-year and disruptions are becoming less frequent, representing that supply is starting to catch up with demand.

1. **Commodity Prices:** The conflict between Ukraine and Russia, among other factors such as increased demand, raised the prices of food-based commodities such as wheat as well as energy commodities such as oil. As 2022 progressed, many of these commodities have come back down to more stable levels that we saw before the conflict started. As an example, oil trading prices spiked to close to $130 in early March of 2022; they've traded around $70 to $80 since late November of 2022.

2. **Interest Rates:** The Fed has hiked interest rates to the highest levels in more than 15 years. With higher interest rates, people are more reluctant to take out loans on homes and cars, while businesses are less likely to build new offices and buy machinery. Overall, the impact is lower spending, which puts downward pressure on prices. This is perhaps the strongest component which is bringing down inflation and should continue to do so as 2023 progresses.

U.S. Inflation Rate
Consumer Price Index (CPI) Over the Past Year

Source: Tradingeconomics.com, U.S. Bureau of Labor Statistics, as of 2/15/23. Past performance does not guarantee or indicate future results.

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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