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Market Update: Dear Bond Investors, Please Calm Down

By Kostya Etus, CFA®
Chief Investment Officer, Dynamic Investment Management

After a rough month, the markets finally had a great week last week, ending January 17, posting the strongest weekly performance since November. The main reason for the weakness is that interest rate expectations for higher-for-longer may have been overblown as the 10-year Treasury yield hit a 14-month high of nearly 5%. Some of this was driven by expectations for a stronger economy and higher inflation. When inflation came in below expectations last week, rates shot down and the market shot up.

Inflation and economic growth don't change overnight; investors need to remain calm and moderate their expectations for the future. This will help stabilize bond prices. Also, let's not forget that stock prices are more importantly driven by earnings. Here are a few things to keep in mind:

1. **Inflation Steady.** While the headline CPI inflation for December has increased for the third consecutive month to 2.9%, it was largely driven by the more volatile energy and food price components (as reported by the U.S. Bureau of Labor Statistics). The more important Core CPI figure (which excludes food and gas) went down to 3.2% for the first time since September, beating expectations. This bodes well for expectations of stability in inflation and potential for lower rates ahead.
2. **Unemployment Steady.** The Labor Bureau also reported a lower-than-expected unemployment rate at 4.1% for December. This points to continued economic strength and may be viewed as inflationary, or a detractor from lowering interest rates. But I think the market, and all of us, would appreciate a scenario of lower inflation and a strong economy.
3. **Earnings Strong.** Interest rates aside, a primary and more stable component of market growth is corporate earnings. And earnings for the fourth quarter have come out of the gate with a boom. Particularly, several big banks have blown away already lofty expectations for earnings and provided positive guidance for future quarters.

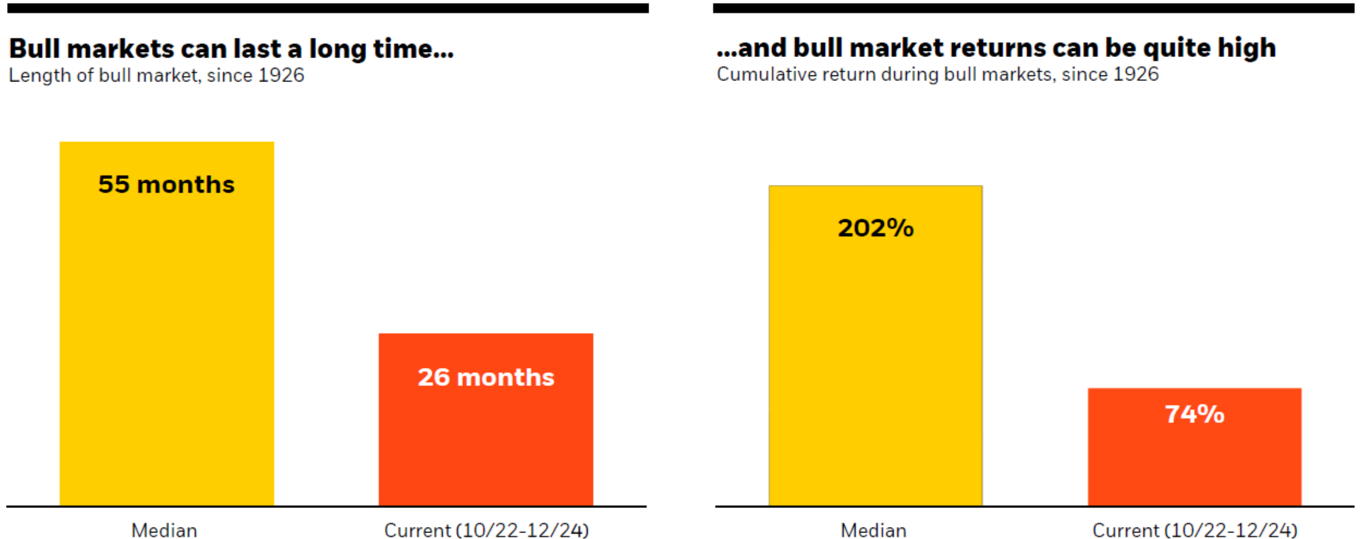
As small fluctuations in inflation and unemployment may happen, they don't need to disrupt financial markets. With bond yields at elevated levels, it presents an attractive opportunity for bond prices going forward. Similarly, if earnings continue to exceed expectations, it could spell more market strength to come.

Can the Market Keep Going Strong?
As we have discussed in the past, the stock market has had historically high back-to-back annual returns. This may be giving some investors pause in terms of what to expect for the future. To help answer the question whether the market can keep going strong, the chart below compares the current length and strength of the bull market to history and can be used to draw some conclusions:

1. **Bull Markets Can Be Long**. Going back to 1926, the median bull market lasts 55 months. With only 26 months in the current bull market, we are only about halfway there. There could certainly be more gains ahead.
2. **Bull Markets Can Be Strong.** The median bull market returns over 200%. This is an astounding number but makes sense if you consider the median length. That said, the current bull market is only 74% strong. On a per-month basis, we are behind historic averages (less than halfway there). There could certainly be more gains ahead.
3. **Bulls Beat Bears**. Finally, did you know that bear markets are typically shorter and less severe? The median bear over this period has only been about 15 months with a median loss of about 30%. This is quite a difference from bull markets and points to the benefits of staying invested for the long-term.

Stay diversified, my friends.

Bull Market Length and Strength
Historical Median of U.S. Stock Market Returns 1926-2024



Source: BlackRock January 2025 Student of the Market. Morningstar and BlackRock as of 12/23/24. Stock market represented by the S&P 500 Index from 3/4/57 to 12/31/24 and IA SBBI U.S. Large Cap TR Index from 1/1/26 to 3/4/57. This illustration assumes reinvestment of dividends and capital gains. Assumes investor stays fully invested over the full period. Index performance is for illustrative purposes only. Past performance does not guarantee future results. It is not possible to invest in an index.

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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2415 E. Camelback Rd., Ste. 700, Phoenix, AZ 85016 | 877.257.3840 | dynamicwealthadvisors.com

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