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Investment Market Review
July 2023

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The recovery from the 2022 stock market selloff gained momentum during the second quarter, with many of the trends observed in the first quarter persisting. Growth stocks continued to outperform value stocks, and the technology sector played a significant role in driving the market higher. Furthermore, the S&P 500 and NASDAQ widened their lead over the Dow Jones Industrial Average. Despite concerns about a slowing economy and rising interest rates, the economy demonstrated resilience, and the stock market performance remained robust.

During the second quarter, the technology, consumer discretionary, and communications services sectors once again emerged as the top-performing sectors within the S&P 500. These sectors have outpaced the overall market over the past six months. Conversely, the energy, utilities, healthcare, and financial sectors experienced lackluster performance, with negative returns for the year through June 30.

The surge in the share prices of technology stocks can be partly attributed to the excitement surrounding new artificial intelligence (AI) applications. Chip-maker NVIDIA, in particular, stood out as the best-performing stock in the S&P 500 during the first half of the year, benefiting from the investor rush into AI-related companies. NVIDIA's strong performance propelled it into the exclusive club of companies with a market capitalization exceeding $1 trillion, joining Apple, Google parent company Alphabet, and Amazon. Apple, the largest company in the S&P 500 index, surpassed a market cap of $3 trillion. Notably, the stock prices of all these trillion-dollar companies increased by at least 35% during the first half of the year, surpassing the performance of the overall index.

A small group of stocks exerts significant influence over the market's direction, with the top 10 companies in the S&P 500 comprising approximately one-third of the index, representing a historically high concentration. Through May, removing the eight best-performing stocks from the index would have resulted in negative performance for the index as a whole. However, by the end of June, over forty stocks would have needed to be removed to turn the index performance negative, indicating an increase in market breadth. This broader participation is considered healthy for the sustainability of a stock market rally.

Inflation, which peaked at 9.1% in June 2022, has been trending lower. The Consumer Price Index (CPI) registered a 3% increase in June, marking the smallest increase since 2021. While it is premature to declare victory in the battle against inflation, the direction of inflation is encouraging, particularly in view of the fact that low inflation typically leads to higher stock valuations.

After implementing ten consecutive rate increases, the Federal Reserve opted to keep interest rates unchanged at its June meeting. This pause allows Fed officials to evaluate the economic impact of the rate hikes implemented thus far. Although inflation has moderated, it still remains above the Fed's target of 2%. Given the persistent inflation and a tight labor market, it is likely that at least one additional rate increase will occur. As of this writing, the market anticipates a quarter-point rate hike in July, followed by no further changes through the end of the year.

In a last-minute move, Congress passed legislation suspending the debt ceiling through January 2025, averting a potentially catastrophic default that would have had adverse effects on the markets. The legislation also imposed constraints on short-term spending. However, the challenge remains to pass appropriations bills that fund the various functions of the federal government. The early bills reflect partisan battles that could intensify and potentially lead to a government shutdown in the fall.

At the beginning of the year, there was a strong consensus that a recession would occur. However, the probability of the Federal Reserve orchestrating a "soft landing", wherein they are able to bring inflation down without causing a severe recession, has increased. While many economists still predict a recession later in the year, the timing and certainty have become less definitive. If a "soft landing" is achieved, it can be argued that future earnings growth will support the current market level. Conversely, if a more prolonged cycle of rate hikes is necessary to contain inflation, and the economy experiences a more substantial contraction as a result, increased market volatility can be expected.

Regardless of the scenario that unfolds, our approach to managing client assets remains unchanged. A broadly diversified portfolio of high-quality companies capable of weathering various economic cycles has served our clients well over the past three decades, and it is an approach to which we remain committed.

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