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Check these numbers out: The S&P 500 gained 6.5% in June.[1] That's the best month the index has seen since October of 2022. The Dow climbed 4.6% — its best showing since November.[1]

This is good news! Even better news is that June was merely the cherry on top of a terrific second quarter sundae. The S&P 500 jumped 8.3% in Q2, marking three straight quarters of growth.[1] And through the first six months of the year, the S&P rose 15.9%.[1] That's the best first half since 2019.

So, what's behind these numbers? Well, the market's performance has been largely driven by good economic news. Inflation, while remaining higher than anyone wants, has gradually cooled off, but the Fed continues to raise rates. (Higher interest rates make it more costly for companies to borrow money, which means they spend less on investment, expansion, and ultimately, growth.)

Finally, we have the overall economy. You probably remember how, when the year started, many economists predicted that rising interest rates would lead to a recession. Despite that, the labor market has proven to be extremely resilient, and consumer spending has remained largely steady.

Put all these factors together and you have the aforementioned sundae. Consumer spending is the bowl. Cooling inflation is the ice cream. A strong labor market is the hot fudge topping. And the stock market is the cherry. A delicious combination, isn't it?

But before we all start digging in, a few words of caution. (After all, everyone knows you should never eat ice cream too fast unless you want a brain freeze.)

While it's perfectly reasonable to cheer how the markets have been performing lately, that doesn't mean it's all sprinkles and whipped cream on the horizon. You see, there are two things to really keep in mind when contemplating the markets.

First: When specific storylines are driving performance – interest rates and jobs for instance – we have to be prepared for a twist in the plot. Because if those storylines change directions, the markets could change directions in a hurry, too. That's especially true with *these* storylines. For example, inflation has cooled – but it's *nowhere near* where the Federal Reserve wants it to be. (Historically, the Fed has targeted an inflation rate of 2%, and we're a long way away from that.) Furthermore, many officials at the Fed don't believe low inflation is even possible with a labor market running this hot. They reason that, as long as the economy keeps adding jobs, people will keep spending money – and businesses will have no incentive to lower their prices.

For this reason, a strong economy is sort of a double-edged sword. It may delay a recession, which is undoubtedly a good thing. But from the Fed's perspective, it's also keeping inflation stubbornly high. That means new interest rate hikes could be on the horizon, which the Fed has alluded to.[2]

And if those higher rates *do* lead to a recession later in the year? That would be a double-whammy for the stock market.

The second thing to keep in mind: Raw numbers don't always tell the whole story.

I mentioned before that the S&P 500 rose 15.9% through the first half of the year. That's impressive no matter which way you scoop it, but it also obscures an important fact: Not every company or industry contributed to this rally. In fact, only a narrow segment of the market did. Much of the S&P's performance was driven by technology companies, with investors excited by the promise of AI. Hundreds of other stocks went up, but nowhere near as much. Meanwhile, many stocks finished the quarter flat or down. This is important to keep in mind, because when performance is being driven by such a specific subset of the market, it's worth pondering how long that trend will continue…and what will happen if it stops. (By comparison, the S&P 500 fell 19.4% in 2022, and much of that decline was driven by – you guessed it – technology companies.)[3]

All this is to say, that we need to continue being cautious about the markets and hold to our long-term strategy rather than get caught up in hype or expectation.

Speaking of our long-term strategy, the narrow breadth of the market's performance is exactly why our strategy is based around the concept of diversification. As you know, we work to ensure your portfolio is based around a wide variety of companies, industries, and other factors. The way the markets have performed over the past year – from up to down to back up again, and often driven by the same stocks – illustrates exactly why. Nobody knows just *which* segments of the markets will outperform or underperform the others. Trying to guess would be like playing whack-a-mole with your money. Instead, we seek to diversify investments across market segments and security types. When investments are diversified, if a particular market segment or security type is underperforming, like tech stocks for instance, exposure to other market segments or security types may outperform or at least maintain current levels, thereby minimizing volatility of the overall portfolio.

So, that's where things stand at the moment. It's been an interesting quarter, and the next one promises to be fascinating too. What should we do in the meantime? Well, my team and I will keep our eye on every aspect of this "market sundae." If we ever feel the need to change our internal recipe, we'll let you know. My advice to you? Forget the markets for a while and enjoy the summer sun. In fact, go treat yourself to some *real* ice cream. That, after all, is what summer is really for.

I hope you have a great one!

Sincerely,

Robert G. Elliott, CFP
Vice President

Sarah L. Elliott, CFP

[1]"S&P 500 rises on Friday to close out big first half," *CNBC*, https://www.cnbc.com/2023/06/29/stock-market-today-live-updates.html

[2] Federal Reserve Press Conference, June 2023 https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20230614.pdf

[3]"Stocks fall to end worst year since 2008," *CNBC*, https://www.cnbc.com/2022/12/29/stock-market-futures-open-to-close-news.html