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The second quarter began with markets still in the throes of the regional bank crisis caused by the March failures of Silicon Valley Bank and Signature Bank. Yet stocks drifted steadily higher and regional banks were stable throughout most of April. However--following an underwhelming earnings report--concerns about the solvency of First Republic Bank weighed on markets as the S&P 500 declined, posting only a modest gain to close out April. Fears of a First Republic Bank failure were realized on May 1st as the bank was seized by regulators and the FDIC was appointed its receiver. Later that same day, JPMorgan announced it was acquiring the bank from the FDIC, which helped calm investor anxiety.

On May 2nd, the Federal Open Market Committee (FOMC)[1] of the Federal Reserve helped to distract investors from the First Republic Bank failure by hiking interest rates and implying it would pause rate hikes at its next meeting. Because that change was expected by investors, it failed to ignite a meaningful rally in stocks. Instead, the tech sector helped push the S&P 500 higher in mid-May, thanks to an explosion of investor and financial media enthusiasm around Artificial Intelligence (AI), which was highlighted by a massive rally in Nvidia (NVDA)[2] following a strong earnings report. Thanks to the lack of progress on a U.S. debt ceiling extension and rising fears of a debt ceiling breach and possible U.S. debt default, market volatility increased toward the end of May. On May 28th, a two-year debt ceiling extension was agreed to by Speaker

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[1] The Federal Open Market Committee (FOMC) consists of twelve members--the seven members of the Board of Governors of the Federal Reserve System; the president of the Federal Reserve Bank of New York; and four of the eleven Reserve Bank presidents who serve one-year terms on a rotating basis. The FOMC reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth. Changes in the federal funds rate trigger a chain of events that affect interest rates, foreign exchange rates, and, ultimately, a range of economic variables, including employment, output, and prices of goods and services.

[2] NVIDIA Corp. (NVDA) designs, develops, and markets graphics processors as well as related software and hardware products. The company has played a pioneering role in the development of the graphics processing unit (GPU), a type of chip or electronic circuit capable of complex computational calculations. NVIDIA's architecture has become a crucial technology for artificial intelligence (AI), machine learning, autonomous vehicles, robotics, augmented reality (AR), and virtual reality (VR), as well as cryptocurrency mining.

McCarthy and President Biden, and was signed into law a few days later, avoiding a financial calamity. The S&P 500 finished May with a slight gain.

With the debt ceiling resolved, a pause in rate hikes, and continued stability in regional banks, the rally in stocks resumed in early June and was aided by several potentially positive developments. First, inflation declined as the Consumer Price Index (CPI) hit the lowest level in two years. Second, economic data remained impressively resilient, reducing fears of a near-term recession. Finally, in mid-June, the Federal Reserve confirmed market expectations by pausing rate hikes which helped fuel a broad rally in stocks that saw the S&P 500 move through 4,400 and hit the highest levels since April 2022. The last two weeks of the month saw some consolidation of that rally thanks to mixed economic data, political turmoil in Russia and hawkish rhetoric from global central bankers, but the S&P 500 still finished June with strong gains.

In sum, markets were impressively resilient in the second quarter and throughout the first half of 2023. Most major stock indices logged solid gains, corporate earnings were stronger than expected, and there was more evidence of a "soft" economic landing and relative stability in the regional banks. These factors pushed the S&P 500 to a 14-month high at the end of the first half of 2023.

Second Quarter Performance Review

The second quarter of 2023 saw an acceleration of the tech sector outperformance witnessed in the first quarter, as "AI" enthusiasm drove several mega-cap tech stocks sharply higher. Those strong gains resulted in large rallies in the tech-focused Nasdaq and, to a lesser extent, the S&P 500 as the tech sector is the largest weighted sector in that index. Also, like in the first quarter, the less-tech-focused Russell 2000 and Dow Industrials logged more modest, but still solidly positive, quarterly returns.

By market capitalization, large caps outperformed small caps, as they did in the first quarter of 2023. Regional bank concerns and higher interest rates still weighed on small caps as smaller companies are historically more dependent on financing to maintain operations and fuel growth.

From an investment style standpoint, growth handily outperformed value again in the second quarter, continuing the sharp reversal from 2022. Tech-heavy growth funds benefited from "AI" enthusiasm. Value funds, which have larger weightings towards financials and industrials, underperformed growth funds, as the performance of non-tech sectors reflected the broad economic reality of mostly stable, but unspectacular, economic growth.

On a sector level, eight of the 11 S&P 500 sectors finished the second quarter with positive returns. As was the case in the first quarter, the Consumer Discretionary, Technology, and Communication Services sectors were the best performers for the quarter. The surge in many mega-cap tech stocks such as Amazon (AMZN), Apple (AAPL), Alphabet (GOOGL), Meta Platforms (META), and Nvidia (NVDA) drove the gains in those three sectors, and they handily outperformed the remaining eight S&P 500 sectors. Industrials, Financials, and Materials saw moderate gains over the past three months, thanks to rising optimism regarding a "soft" economic landing.

Turning to the laggards, traditional defensive sectors such as Consumer Staples and Utilities declined slightly over the past three months, as resilient economic data caused investors to rotate to sectors that would benefit from stronger than expected economic growth. Energy also posted a slightly negative return for the second quarter, thanks to weakness in oil prices.

Internationally, foreign markets lagged the S&P 500 thanks mostly to the relative lack of large-cap "AI" exposed stocks in major foreign indices, combined with some late-quarter worries about the EU economy and pace of Bank of England rate hikes, although foreign markets did finish the second quarter with a modestly positive return. Foreign developed markets outperformed emerging markets thanks to a lack of significant economic stimulus in China, which weighed on emerging markets late in the quarter.

Commodities saw modest losses in the second quarter as most major commodities declined over the prior three months. Oil prices witnessed a moderate drop despite a surprise production cut from Saudi Arabia and an increase in geopolitical tensions in Russia, as concerns about future economic growth and oversupply weighed on oil. Gold, meanwhile, posted a modestly negative return as inflation declined while the dollar failed to meaningfully drop.

Switching to fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) realized a slightly negative return for the second quarter of 2023, as the resilient economy and hope of a near-term end to Fed rate hikes led investors to embrace riskier assets.

Looking deeper into the fixed income markets, shorter-duration bonds outperformed those with longer durations in the second quarter, as bond investors priced in a near-term end to the Fed's rate hike campaign, while optimism regarding economic growth caused investors to rotate out of the safety of longer-dated fixed income.

Turning to the corporate bond market, lower-quality, but higher-yielding "junk" bonds rose modestly in the second quarter while higher-rated, investment-grade debt logged only a slight gain. That performance gap reflected investor optimism on the economy, which led to taking more risk in exchange for a higher return.

Third Quarter Market Outlook

As we begin the third quarter of 2023, the outlook for stocks and bonds is arguably the most positive it's been since late 2021, as inflation hit a two-year low, economic growth and the labor market remain impressively resilient. The Fed has temporarily paused its historic rate hiking campaign, the debt ceiling extension is resolved, and we've seen no significant contagion from the regional bank failures from earlier this year. That improvement in the fundamental outlook has been reflected in both stock and bond prices so far this year, as the S&P 500 hit the best levels since last April and more cyclically focused sectors led markets higher late in the quarter on rising hopes for a broad economic expansion.

While the past quarter brought positive developments in the economy and the markets, leading the financial media to proclaim a "new bull market" has started, it's important to remember that potentially significant risks remain to the economy and markets. Put more bluntly, the market has taken a decidedly positive view on the ultimate resolution of multiple macroeconomic unknowns, but their outcomes remain very uncertain and thanks to the strong year to date rally in stocks, there is now little room for disappointment.

First, the economy has not yet felt the full impact of the Fed's historically aggressive hike campaign, and while the economy has proved surprisingly resilient so far, we know from history that the impacts of rate hikes can take far longer than most expect to impact economic growth. Put in plain language, it's premature to think the economy is "in the clear" from recession risks, and we should all expect the economy to slow more as we move into the second half of 2023. The key for markets will be the intensity of that slowing, as these valuation levels stocks are not pricing in a significant economic slowdown.

On inflation, clearly there's been progress in bringing inflation down, as year-over-year Consumer Price Index (CPI) has fallen from over 9% in 2022 to 4% in less than a year's time. However, even at 4%, CPI remains far above the Fed's 2% target. If inflation bounces back, or fails to continue to decline, then the Fed could easily hike rates further, like the Bank of Canada and Reserve Bank of Australia did in the second quarter, following pauses of their own. Those higher rates would weigh further on economic growth.

Turning to banks, markets have taken the regional bank failures in stride, as the collapse of First Republic Bank caused minimal volatility in the second quarter. However, it's likely premature to consider the crisis "over" and at a minimum, reduced lending by regional banks poses an additional threat to the commercial real estate market and small businesses more broadly. Bottom line, measures taken by the Fed in March have "ringfenced" the regional bank stress for now, but this remains a risk to the economy.

In a note of caution, it was the best first six months of a year for the NASDAQ in four decades. However, the rally has been confined in large part to mega-cap stocks. Markets are trading at their highest valuation in over a year, and investor sentiment has turned suddenly--and intensely--optimistic. The CNN Fear/Greed Index ended the second quarter at "Extreme Greed" levels, while the American Association for Individual Investors (AAII) Bullish/Bearish Sentiment Index hit the most bullish level since November 2021, right before the market collapse started in early 2022. Positive sentiment does not automatically mean markets will decline, but the sudden burst of enthusiasm needs to be considered in the context of what is a still uncertain macroeconomic environment and markets no longer have the protection of low expectations and valuations to cushion declines.

In sum, clearly there have been positive macro developments so far in 2023 that have helped the stock market rebound. However, it's important to remember that multiple and varied risks remain for the economy and markets.

As such, while we are happy with the market's performance, we remain vigilant towards economic and market risks and are focused on managing both risk and return potential. We understand that a well-planned, long-term-focused, and diversified financial plan can withstand any market surprise and related bout of volatility, including bank failures, multi-decade highs in inflation, high interest rates, geopolitical tensions, and rising recession risks.

At Centurion, we understand the risks facing both the markets and the economy and are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even intense volatility is unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it's critical for you to stay invested, remain patient, and stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

We remain focused on both opportunities and risks in the markets, and we thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

The S&P 500 ended the first quarter of 2023 with a solid gain as hopes for an economic "soft landing" and the Fed signaling that their historic rate hike campaign is coming to an end helped offset two rate increases and the biggest bank failures since the financial crisis.

Markets started 2023 with strong gains in January, primarily driven by a continued decline in widely followed inflation indicators. That decline in price pressures was coupled with surprisingly resilient economic data, especially in the labor market. Those forces combined to increase investors' hopes that the Fed could deliver an economic soft landing, whereby the economy slows but avoids a painful recession while inflation moves close to the Fed's target. Additionally, corporate earnings for the fourth quarter of 2022, which were reported in January, were "better than feared" and the resilient nature of corporate America contributed to the growing hope that both an economic and earnings recession could be avoided. The S&P 500 posted strong gains in the month of January, rising more than 6%.

In February, growing optimism for an economic soft landing was delivered a setback, however, as economic data implied a still very tight labor market while the decline in inflation stalled. The January jobs report, released in early February, showed a massive gain in jobs, implying that the labor market will remain extremely tight (something the Fed believes is contributing to inflation). Later in the month, widely followed inflation metrics such as CPI and the Core PCE Price Index showed minimal price declines, implying that the drop in inflation that had powered the gains in stocks was ending. The strong economic data and a leveling off of inflation metrics led investors to price in substantially higher interest rates in the coming months, and that weighed on both stocks and bonds in February. The S&P 500 finished with a modest loss on the month, falling just over 2%.

The final month of the first quarter began with investors still focused on inflation and potential interest rate hikes, but the sudden failure of Silicon Valley Bank, the 16th largest bank in the United States, shifted investor focus to a potentially growing banking crisis. Signature Bank of New York failed just days later, and concerns about a regional banking crisis surged. In response, the Federal Reserve and the Treasury Department created new lending programs aimed at shoring up regional banks and preventing bank runs but concerns about the health of the financial system persisted and those fears weighed on markets through the middle of March. However, while the Federal Reserve hiked interest rates again at the March meeting, policy makers signaled that they are very close to ending the current rate hike campaign. That admission, combined with no additional large bank failures, eased concerns about a growing banking crisis, and the S&P 500 was able to rally during the final two weeks of March to finish the month with a small gain.

In sum, markets were impressively resilient in the first quarter as a looming end to rate hikes, further declines in inflation and quick and effective actions by government officials in response to regional bank failures helped shore up confidence in the banking system. Stocks and bonds both logged modest gains in Q1, despite the threat of a regional banking crisis and still-elevated market volatility.