The Weekly Market Update – 6/26/23: Equities Take a Breather After Multi-Week Gains

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,348.33	-1.39%	5.82%	13.25%	5.23%	4,796.56	10.3%
Dow Jones Industrial Average	33,727.43	-1.67%	1.36%	1.75%	2.23%	36,799.65	9.1%
NASDAQ Composite	13,492.52	-1.44%	10.40%	28.91%	11.68%	16,057.44	19.0%
Russell 2000	1,821.64	-2.87%	1.06%	3.43%	-2.28%	2,442.74	34.1%
MSCI EAFE (USD)	2,097.67	-3.37%	0.24%	7.91%	2.93%	2,398.71	14.4%
MSCI Emerging Markets (USD)	991.91	-3.70%	0.16%	3.72%	-7.96%	1,444.93	45.7%
Bloomberg Commodity Index	102.35	-2.66%	-3.00%	-9.27%	-22.08%	237.95	132.5%
Barclays U.S. Aggregate Bond	90.08	0.14%	-1.11%	1.35%	-4.46%	112.07	24.4%

Source: FactSet

The S&P 500 equity index has posted strong returns in 2023, but decreased 1.4% last week, its first weekly decline since mid-May. With one week remaining in the year's second quarter (2Q23), the widely followed, large-company S&P 500 was solidly positive through 6/23/23, gaining 4.0% in June, 5.8% in the second quarter-to-date, and 13.3% for the year-to-date (YTD). We attribute YTD index gains to improved investor sentiment (compared to December 2022) as U.S. consumer spending (as measured by personal consumption expenditures data reported by the Bureau of Economic Analysis, BEA) has exceeded expectations, buoyed by a healthy labor market and spending on travel and related services. With a resilient U.S. economy, the Federal Reserve Bank (Fed) continues to monitor consumer inflation and, despite holding its overnight bank lending fed funds interest rate target range unchanged at its June monetary policy meeting, is ready to increase the rate target if necessary. In interviews and Congressional testimony, Fed Chair Jerome Powell, along with other Fed officials, said that inflation remains too high and additional fed funds rate hikes remain possible. The consumer price index, or CPI, a closely watched measure of consumer inflation from the Bureau of Labor Statistics, increased 4.0% Y/Y in May 2023, down from a 6.5% rise in December 2022. But core CPI, which excludes volatile food and energy prices, increased 5.3% Y/Y in May, down only modestly from 5.7% in December. Both CPI and core CPI remain well above the Fed's 2.0% target over time, creating challenges as the central bank addresses its dual mandate to foster stable prices and maximum employment. We believe that the potential for higher interest rates "for longer" creates near-term headwinds for equity market valuations and likely contributed to the pull-back last week. An additional factor in near-term caution, in our view, reflects uncertainty in the banking sector as the Fed is expected to unveil a new set of increased capital requirements on large banks, which could be enacted in 2024.

Sector leadership has shifted modestly in June, with Consumer Discretionary and Industrials leading the way. While the S&P 500's strong 2Q23 (April, May, and June) performance has been paced by Technology (+13.6% in 2Q13 through 6/23) and Communication Services (+12.4%), gains for June alone are more broad-based. Ten of the eleven global industry classification standards (GICS) sectors are positive for the month (only Real Estate, down 0.2% through 6/23, is lower), an indication that investor sentiment has improved. In our view, much of the 2Q23 equity rally, especially in technology-centric, large companies, can be attributed to the emergence of advanced artificial intelligence (AI) software. This has led to new investment from cloud service providers and others and could spur a sustained increase in technology capital spending. Investor optimism has now spread to other "cyclical" sectors (groups that can outperform in a growing economy). While near-term market gains could continue, we see limited upside through year-end as earnings growth expectations remain muted and valuations appear extended (using a historical price-to-earnings ratio).

The week ahead includes the end of 2023's second quarter, the Fed's annual stress test evaluation of large banks, and key data on consumer finances and inflation. On Wednesday, the Fed will issue reports on 23 large banks, stress testing capital levels in the event of a severe economic downturn. Despite turmoil in the banking system earlier this year, the results are expected to be largely positive. On Friday, the Fed's preferred measure of consumer inflation, the PCE deflator (from the BEA), is expected to show May inflation of 3.8% Y/Y (vs. 4.4%Y/Y in April).

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