

FLAGSTONE

FINANCIAL ADVISORS, INC.

MARKET REVIEW SECOND QUARTER 2023

What Happened:

After three consecutive quarters of advances, the stock market recovery is well underway. In fact, the S&P 500 index officially attained bull market status in June as it climbed over 20% from the October 2022 low. Upon closer examination, however, there is a great divergence in stock performance. Approximately 75% of the market gains to date in 2023 are attributable to a small number of mega cap stocks, cleverly nicknamed the Magnificent Seven—Amazon, Alphabet, Apple, Meta, Microsoft, Nvidia and Tesla. The rest of the market saw only modest gains.

We have seen this type of behavior many times before. Investors become enamored with certain stocks or sectors and disregard interesting stories elsewhere. Without question, the Magnificent Seven represent great companies with terrific business models. Some are leaders in artificial intelligence (AI) which is all the rage right now. While this technology has immense potential for business and society, investor enthusiasm has pushed prices to lofty levels that may prove unsustainable. Right now, there may be better and safer opportunities in the many great stocks that have been largely overlooked.

Many of our clients may recall that earlier in the year, we made some rebalancing adjustments to increase exposure to some of these overlooked stocks. Many are trading at significant discounts to their intrinsic value. Among our favorites are small and midcap stocks which look very attractive. International stocks also offer great upside potential considering their cheap valuations, growing profits and a weaker dollar. While we still have some exposure to the Magnificent Seven, we also know it is important to keep our portfolios well-diversified. Going into the second half of 2023, we like how our clients' portfolios are positioned.

A note on inflation: Perhaps no federal agency gets more criticism than the Federal Reserve. However, they should be commended for their fight against inflation. A year ago, we were dealing with 9% inflation, today it is down to 4%. Still a bit high but trending in the right direction.

YTD Performance Through June 30, 2023:

S&P 500 Index (large stocks)	16.9%
Russell 2000 Index (small stocks)	8.1%
MSCI EAFE Index (international stocks)	11.7%
Bloomberg U.S. Aggregate Bond Index (bonds)	2.1%

Prognosis:

Our friends at CFRA recently issued a report on historical trends and precedents that gives us optimism for the months ahead. This report analyzed stock performance going back to WWII. They found that following down years, such as 2022, the average market return for the subsequent year is 25.3% when two conditions are met: 1) January is positive and 2) the first quarter's performance does not fall below the previous year's low. We satisfied both conditions in 2023. CFRA always reminds us that history does not guarantee future events, but we get comfort from it nonetheless.

Wishing you all the best this summer season.

SCK