"Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria."

–Sir John Templeton

Through the first half of the year, the stock market has proven nearly impervious to bad news and investor worries. If the market was due for a correction, as some continue to warn, it did not get the memo.

In the second quarter alone, unrest increased around the globe—from Crimea to Iraq. Meanwhile, U.S. economic data were mixed, including a nasty drop in economic growth in the first quarter. And pundits warned that the bull market was running out of gas. The result? Despite a brief pullback in early April, stocks advanced uniformly.

At the same time, bonds defied expectations of rising interest rates, as we will discuss below. If the second quarter demonstrated anything, it is that the market remains full of surprises, and a steady, prudent investment approach continues to be the best approach.

Market/ Index	End of 2Q	End of 1Q	Change	End of 2013	YTD Change
DJIA	*16,826.60*	*16,457.66*	*2.24%*	*16,576.66*	*1.5%*
NASDAQ	*4,408.18*	*4,198.99*	*4.98%*	*4,176.59*	*5.54%*
S&P 500	*1,960.23*	*1,872.34*	*4.69%*	*1,848.36*	*6.05%*
Russell 2000	*1,192.96*	*1,173.04*	*1.7%*	*1,163.64*	*2.51%*
Global Dow	*2,607.22*	*2,502.37*	*4.19%*	*2,485.81*	*4.88%*
10-yr Treas.	*2.520%*	*2.726%*	*-23 bps*	*3.03%*	*-51 bps*

Among U.S. stocks, large- and mid-cap issues stood out in the second quarter. The S&P 500 index of large company stocks returned 5.23%, and the S&P MidCap 400 rose 4.33%. Small-cap stocks lagged, with the Russell 2000 index returning 2.05%.

The advances came amid the surprising news that economic growth plunged at a 2.9% annualized rate in the first quarter, the worst performance in five years. But economists chalked up the decline, in part, to unusual events such as the harsh winter and falling health care spending. Business activity is improving, and labor markets continue to heal: The jobless rate now stands at 6.1%, compared with 6.7% in March. As a result, the economy is widely expected to growth by about 3% in the third quarter.

Spotlight: Dynamic Alpha Value

Steel Peak's Dynamic Alpha Value strategy turned in standout performance in the second quarter. After fees, the portfolio returned 4.71%, more than double the benchmark Dow Jones Industrial Average's 2.24% return. Year to date, Dynamic Alpha Value is up 6.01%, net of fees, compared with just 1.5% for the Dow.

Dynamic Alpha Value is a core component within many of our clients' portfolios. It is designed to provide U.S. equity market returns that are enhanced by an active covered-call writing strategy. This covered-call strategy has generated additional, critical cash flow this year, which helped drive returns even in the first quarter's flat market. In the second quarter, Dynamic Alpha Value's use of a quantitative method to focus on higher-momentum stocks helped to set the strategy apart. Part of the strength of our quantitative formula is that it enables the portfolio to avoid companies that are likely to underperform the Dow, and that has been a clear contributor to its performance so far this year.

To learn more about our Dynamic Alpha Value strategy, click here.

This anticipated growth is one reason that the stock market may have room to climb further. Last year's run-up was largely fueled by expanding price/earnings multiples, as investors expressed their confidence in the market. For stocks to run much higher, companies will have to demonstrate earnings growth, and the improving economy may serve as a tailwind for that growth. It is also noteworthy that the market's recovery since 2009 has proceeded at a moderate pace compared with other recoveries. That may bode well: In the past, sharp recoveries have tended to be short recoveries, and there is evidence that the inverse may prove true now.

Meanwhile, the second quarter saw an unexpected, sharp rally in bonds. With the Federal Reserve continuing to taper the bond buying that has buoyed the fixed-income markets, interest rates were expected to rise. Instead, they fell markedly, triggering a rally in intermediate- and long-term Treasury bonds. The yield on 10-year Treasuries fell one fifth of a percentage point, to 2.53%. That in turn helped to lift other fixed-income sectors, particularly investment-grade corporates. The Barclays U.S. Aggregate Bond Index rose 2.04% in the quarter, for a first-half return of 3.93%.

Investor Education: Rebalancing

Rebalancing your portfolio is a simple requirement for successful investing: Because certain assets in your portfolio will grow and others will contract based on market conditions, it is necessary to periodically sell some of the "winners" and buy more of the "losers" to return to your target allocation.

Keeping your investments in balance is critical to managing risk and enjoying the best cumulative return over time. Jacques Lussier, former chief investment strategist at Desjardins Asset Management, provided an illustration in his book, "Successful Investing is a Process." In 1973, an investor creates a portfolio that is 50% stocks and 50% bonds. By the end of 2010, stocks outperformed bonds, returning 9.8% versus 7.7% per year. If the portfolio were never rebalanced, its ending allocation would have been 68% stocks, and the compound return would have been 8.9%.

But letting it ride–by failing to rebalance–would have been a mistake, Lussier shows. A rebalanced portfolio would have returned 9.5% percent. And it would have done so with less volatility, meaning the portfolio would have been less subject to big swings over time.

It can be hard for individual investors to sell appreciating assets and buy out-of-favor assets. But that is exactly what prudent investing dictates, and it is one of the more important services that we at Steel Peak provide to our investment clients.