MARKET INSIGHT MONTHLY

April Update

MONTHLY COMMENTARY

UNITED BANK Wealth Management

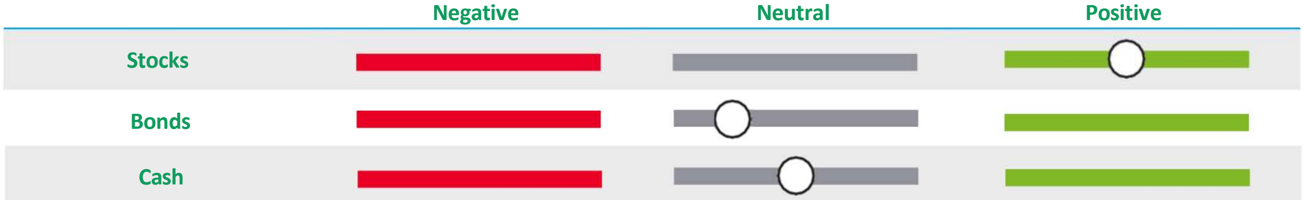
In the short-term, financial markets are at a crossroads. In the rear-view mirror, we see higher inflation and interest rates, higher costs of capital, higher consumer debt and uncertainty about how severely the Federal Reserve would implement policies to constrain the economy to fight higher prices. Investors have endured agonizing months and numerous one-dimensional speeches by Fed officials stating their only concern was to bring inflation under control forcing the populous to pay or suffer almost any consequence no matter the hardship or impact. With the most recent inflation report having been released, annual inflation, as measured by the CPI has fallen from over 9.0% last summer to 5.0% in March. Though clear progress has been made, the Fed has not reached its goal of only 2% inflation growth and will likely raise rates another 25 basis points in the coming months. The path forward, however, seems significantly more advantageous for investors. Instead of increasing inflation and interest rate expectations, investors are committing assets assuming the reverse. Typically, lower rates are very friendly to both equity and fixed income investors. After showing quality performance in Q4 of ‘22, domestic and international equity prices continued their upward bias in Q1 ‘23. Fixed income portfolios have shown progress as well as interest rates have fallen well below their peaks. Using history as a lesson, we expect interest rates to be lower in 2024, therefore favoring traditional asset classes moving forward.

INVESTMENT TAKEAWAYS

- Investors may be feeling a bit more comfortable as the Fed appears to be ending its restrictive monetary policies. By raising the federal funds rate on nine separate occasions since March of 2022, inflation is no longer the dominant threat it once was. Annualized CPI has decreased by almost 35% since last summer’s high. Though the Fed maintains an inflation target of 2% which will take time to achieve, the path to lower inflation and rates is well in place. While one more 25 basis point Fed Funds increase is possible, investors’ actions are indicating that will be the last in this current cycle. The current target range stands between 4.75%-5.00%.
- United Wealth has stated over the past several months we believe rates were closer to their apex. Short term rates have now declined nearly 100 basis points while long rates are down three quarters of a point. The terminal rate, or the likely rate the Fed will take short rates before ending their current policy stance, has decreased by 25 basis points and now stands between 5.00%-5.25%. United maintains a larger exposure to mid/short-term duration fixed income instruments. This action has led to increased income and reduced portfolio risk.
- We maintain our modest value bias within large-, mid- and small-cap companies which better protects portfolios during volatile periods, as was experienced in 2022. Companies with strong, less-leveraged balance sheets often are preferred during uncertain environments. Lack of interest rate stability denies growth companies the opportunity to gain momentum. With rates stabilizing and falling the growth segment has shown improvement. Mid- and small-cap companies are showing very attractive valuations though this segment has recently been negatively impacted by unfavorable media attention regarding domestic banking strength. We feel this topic is overdone as banks remain healthy. Investors should move past this short-term, isolated story.
- International developed nations' equity markets have outperformed those of emerging markets (EM), as both segments considerably lagged the U.S. until Q4 2022. As a response to falling domestic rates, the U.S. dollar began to decline in Q4 and into 2023. This has prompted additional investor interest in international equities. As stated last month, we believe this is a temporary condition due to inflation and rates falling faster in the U.S. than in the rest of the world. As global central banks face the same conditions as in the U.S. (i.e., better inflation reports), we expect the dollar to strengthen once again. We remain comfortable with our international exposure and prefer to wait for more compelling economic evidence before any allocation change. We do note that international valuations are attractive.
- We continue to underweight our allocation to fixed income and favor short to intermediate maturities. Short rates have moved well off their highs as investors anticipate the Fed will end their aggressive policies shortly. However, an inverted yield curve will continue until there is a clear indication of a Fed pivot.

BROAD ASSET CLASS VIEWS

Views on Stocks, Bonds and Cash



EQUITY ASSET CLASSES

2023 has begun with promise as the S&P 500 gained 7.5% in the first quarter. Inflationary pressures are reduced as interest rates have steadily declined since Q4 of last year. While obstacles still exist, investors are able to look forward with greater optimism as Fed induced rate increases should be limited and likely halted within months. Despite last year's uncertainty, corporate operating earnings still set new records. Much of the equity correction was caused by fear of what could happen versus what did actually happen. Equity prices didn't fall due to a recession or collective earnings reductions, but due to fear of the potential consequences if that did happen. Now that both inflation and interest rates have reversed course and are on the decline, investors feel that a major burden has been lifted. What must be considered now is whether earnings may yet be impacted due to previous rate increases and will consumers continue to be as motivated as they have in the past? We acknowledge earnings growth will not be linear in 2023, and we may see some residual impact from the higher rates. Our view is that both domestic and international equities provide exceptional growth opportunities as we look forward into this year and next. While markets may endure occasional bouts of volatility, well-chosen companies and risk managed portfolios provide excellent returns when held over several economic cycles. 2023 earnings are expected to grow in the mid-single digits for next year. While we prefer U.S. large-cap companies for stability and consistency, mid- and small-cap companies continue to present a very compelling case as valuation levels remain compelling.

	Sector	Overall View	Relative Trend	Rationale
Market Capitalization	Large Caps			U.S. large caps were among the leading global equity segments in Q1 with the S&P 500 rising 7.5%. Despite dollar weakness over the past several months, the large cap segment has once again proven to be a magnet for investors during both uncertain and prosperous times. As interest rates stabilize, growth companies have demonstrated resiliency and investor interest. Continued rate stability should allow growth companies to make further progress.
	Mid Caps			Mid-cap companies had a solid Q1 showing rising almost 4%. Equity price momentum was curtained in March with reports of potential turmoil in the banking sector. We do not think this issue will remain a viable reason why investors avoid mid-cap stocks. Valuations are attractive. This segment should do well with rate stability and healthy employment data.
	Small Caps			The small-cap sector was negatively impacted by the banking reports much the same as mid-caps. This segment had performed quite well through February. Valuations are very attractive. We expect further growth as investors re-establish faith in U.S. banking strength. We remain overweight small-caps.
Style	Growth			Large-cap growth stocks staged an impressive Q1 recovery as previously predicted. As growth stock performance is heavily tied to interest rate direction, the lower rate environment propelled growth companies to outperform. The more stable the interest rate curve and the lower it may travel, the better the outcomes for this segment.
	Value			United maintains an active value stock overweight to protect portfolios from risks both known and unknown. The companies held in our value-based Large Cap Dividend Strategy maintain very healthy balance sheets and are clearly preferred by experienced and disciplined investors. We continue to believe select value companies will exceed expectations and will lower portfolio risk.
Region	United States			We believe better relative performance will be generated from the U.S. stock market over the foreseeable future. The U.S. remains both a place of opportunity and refuge. Outcomes are more consistent, predictable and reliable. Valuations remain attractive in both mid- and small-cap companies. The overall strength of the U.S. employment picture and overall consumer health provides the relative preference for U.S. markets. Inflation remains an obstacle but there is no question the U.S. has made more rapid progress in reducing inflationary impacts. We see the U.S. continuing to take the lead in this regard and in establishing a new economic growth trajectory.
	Developed International			Most global central banks followed the direction of the U.S. Federal Reserve. As such, international monetary policy lagged that of the United States. Success in the fight on inflation will be gradual and is taking foreign countries longer to contain. U.S. inflation figures are falling more swiftly. That is a double edged sword. Lower rates lead to a weaker dollar. This leads to brief periods of time of international outperformance. We expect a stronger dollar will return in 2023 and U.S. equities to generate returns in excess of the most other markets.
	Emerging Markets			Though we believe in EM over the long term, current global uncertainty stemming from conflicts are creating obstacles to growth. Lack of stability has created a lack of predictability thus creating even more hurdles. Investor sentiment has the ability to quickly change in this segment. We would prefer not to speculate on the factors that may alter negatives into positives at the moment. We maintain our baseline weight.

FIXED INCOME

Limit Rate Sensitivity with Intermediate Focus

The Fed has now increased the overnight Fed Funds rate by 475 basis points with the latest 25 basis point increase on March 22. Chairman Powell has acknowledged some degree of success in driving down inflation from its peak of last summer but has clearly stated the Fed will continue its aggressive actions until the battle is won. Annualized inflation as measured by the CPI is down over 35% from last summer's high point. Though still well above the Fed target of 2%, inflation is not as formidable an obstacle as it once was. In response to falling inflation, the ten-year Treasury rate is currently yielding a little over 3.50%, having fallen about 50 basis points from early March. Even shorter-term maturities have shown significant rate declines. The two-year Treasury is now yielding just over 4% which is nearly 100 basis points less than its recent peak. Only the shortest maturities, those between three and six months, hover close to the 5% level approximating the overnight rate offered by the Fed. We continue to suggest a blend of high-quality short-to-intermediate bonds in all fixed income portfolios. Quality companies and municipalities continue to perform well across the quality and size spectrum. High yield bonds issued by stable but growing entities continue to be a productive use of fixed income capital. We remain committed to a modest high yield position in both corporate and municipal bonds. United has re-allocated funds previously allocated to inflation protection to shorter-term, investment grade securities to take advantage of considerably higher yields, with both lower duration and risk. In tax-sensitive accounts, we favor municipal bonds as infrastructure spending, strong state revenues and the potential for higher personal tax rates provide support to municipal markets.

		Low / Medium / High	Rationale
Positioning	Credit Quality		The increase in rates has widened credit spreads over the past year. Spreads have been impacted by active Fed policy.
		Short / Int. / Long	
	Duration		Concerns over rising rates have lessened with consistently better inflation reports. Yield curve inversion favors shorter bonds paying higher income.

COMMODITIES

Our precious metals view remains neutral. We are very conscious of the clear influence being exerted on specific commodities, particularly gold, by U.S. monetary policy. Fed policy to fight inflation originally led to higher rates and a strong dollar. This led to depressed gold prices. As inflation declines, so does the general domestic yield curve leading to a weaker dollar and stronger precious metal prices. We feel the dollar will strengthen in time as international rates fall as global inflation forecasts are reduced. Broad baskets of commodities have seen price reductions and have been stable for several months. Commodity indexes remain 10-15% below their highs from 2022.

Over the past year, the world has had to adjust supply and demand expectations due to the Russian invasion. Many countries are now sourcing commonly traded commodities from a variety of locations. WTI is currently trading near $80 a barrel, down about 30-40% from one year ago. We expect future price movement will be directly tied to developments stemming from the war, supply constraints and changes in global economic growth.

CONCLUSION

After months of volatility and uncertainty, some degree of stability has emerged and created a degree of clarity as we move further into 2023. The Fed is determined to bring down inflation and seems to be having relative success. Though short-term rates remain quite high directly tied to Fed activity, the rest of the yield curve has responded favorably to lessening inflation expectations. We expect volatility will remain in effect but will lessen. The second half of 2023 should experience better growth and the financial markets should be decidedly more stable.

Disclosures

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