MARKET INSIGHT MONTHLY

April Update

MONTHLY COMMENTARY

UNITED BANK Wealth Management

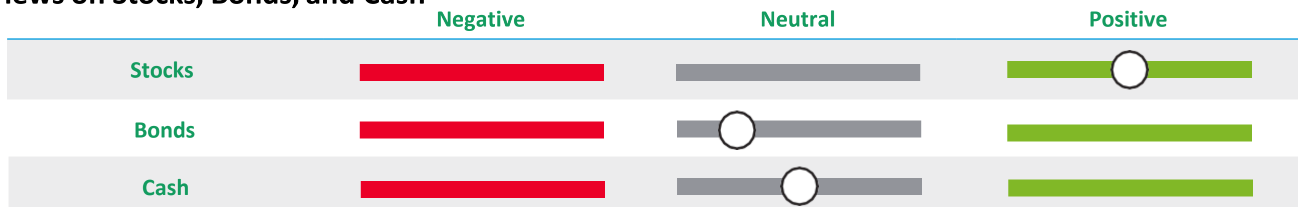
After completing their bond-buying "taper" program last month, the Federal Reserve increased rates by a quarter point for the first time in four years. Some investors are now expecting the Fed to initiate half-point increases (50 bps rather than 25 bps) at the next two Fed meetings. This would be the first 50 bps hike in 22 years. We have stated in the past that the Fed typically prefers to socialize their intent well before taking action so that investors are rarely surprised when actual changes are implemented. In recent weeks we have seen numerous Fed officials state that 50 bps hikes may be needed to help slow inflation. This gives a higher level of credibility to what may be in store. The lingering impact of Covid-19 supply chain disruptions and the completely unexpected Russian invasion of Ukraine combined to generate the worst inflation in 40 years. The Fed has to act so that stagflation, the combination of rising inflation and slow economic growth, does not materialize. In our view, the open market is appropriately reacting to the Fed's interest rate comments. Further, we believe much of the upward movement in rates is behind us rather than ahead of us. U.S. economic fundamentals remain positive with a strong labor market creating strong consumer spending. After record setting earnings for the S&P 500 were reported in 2021, 2022 earnings could be nearly 10% higher. Despite unexpected events and uncertainty, the U.S. markets have been remarkably resilient.

INVESTMENT TAKEAWAYS

- Despite early year volatility and markedly higher interest rates, we continue to overweight equities within our total asset allocation. We favor stocks relative to bonds based on our expectation that strong economic fundamentals remain in place. We do not believe that either short or long rates will move high enough to lure substantial funds from the equity to the fixed income markets. Though the chances of a recession have increased, there is currently insufficient evidence to alter our positive outlook. Corporate earnings for 2022 should be nearly 10% higher than in 2021.
- We favor a combination of large cap value and growth stocks. Our value bias better protects portfolios during volatile periods as is currently being experienced. Companies with strong balance sheets often pay higher dividends and are preferred during less certain environments. Growth stocks typically generate strong earnings and revenues. While subject to somewhat higher volatility, they can perform extremely well during an economic expansion.
- Our positive view of mid and small cap stocks is supported by historical evidence from prior recoveries. Our analysis shows that the current mid-cycle economic position should prompt investors to remain favorably allocated to both segments. Though valuations are in line with historical averages, mid and small companies are generally subject to higher volatility than large-cap stocks.
- Cyclical stocks relative to defensive stocks established leadership across the globe during much of the recovery. Much like the U.S., rising global interest rates and inflation will, from time to time, negatively impact investor sentiment. Though developed nations' equity markets have generally outperformed those of emerging markets (EM), both segments have considerably lagged the U.S. We remain comfortable with our modest international exposure and prefer to wait for more evidence suggesting a higher allocation is warranted.
- We continue to underweight our allocation to fixed income. Rates have recently moved appreciably higher over the last several months, which has negatively affected fixed income. We expect rates will move modestly higher from here. We believe much of the anticipated rate increase has already been seen.
- We favor a blend of short to intermediate bonds with an emphasis on high credit quality.

BROAD ASSET CLASS VIEWS

Views on Stocks, Bonds, and Cash



EQUITY ASSET CLASSES

The factors that influence our decision to overweight equities remain in effect. We continue to favor stocks relative to bonds. There is a general perception that all interest rate increases result in poor equity performance. But this is not the case. Evidence suggests that early-stage interest rate increases (from low real and nominal levels) has little effect on equity prices. In fact, an upward bias in the cost of money reveals generally strong demand which propels economic growth. This leads to earnings growth. The record setting domestic earnings of 2021 will carry forward into 2022. We see little evidence suggesting earnings growth will be curtailed, although the rate of earnings growth will be well less than last year. Our U.S. equity preference has proven to be both prudent and profitable. We continue to favor the U.S. We continue to monitor political/economic activities in both Russia and China as authorities in both countries engage in activities contrary to worldwide economic stability.

	Sector	Overall View	Relative Trend	Rationale
Market Capitalization	Large Caps			U.S. large cap stocks have been the most predictable and reliable equity segment for the last several years. The record setting earnings generated in 2021 influenced investors to continue holding and buying large-cap cyclical value and earnings-driven growth stocks. We remain well positioned in this segment and believe investors will be rewarded by holding quality names.
	Mid Caps			Mid-cap companies have grown dramatically with economic expansion. Despite some recent short-term volatility due to interest rate increases, mid-cap valuations remain attractive as strong earnings continue to be reported.
	Small Caps			The U.S. small cap sector was among the strongest performers of 2021. Continued economic expansion and strong earnings generated increased investor demand despite recent short-term volatility. Valuations remain attractive based on strong earnings growth prospects through 2022. We remain overweight small caps.
Style	Growth			We believe selected large cap growth stocks will continue to garner investor support from strong current and future earnings and revenue expectations. We are mindful that growth equities may be somewhat restricted by inflation and higher interest rates. We do not feel rates will move high enough to be a long-term obstacle.
	Value			We expect most domestic cyclical value stocks to outperform defensive value stocks as the economy expands. Value stocks have lagged their growth counterparts for over a decade. We believe a reversion to the mean began in late 2020 with both mid and small cap companies experiencing this transition more rapidly.
Region	United States			We see the potential for more gains in the U.S. stock market during 2022. Though modestly higher interest rates have already occurred, strong earnings are likely to be reported as the economy moves forward with momentum. There is no doubt that the Russian military action has created anxiety and volatility. The world has become less certain. U.S. assets are a refuge in times of distress. We expect this to remain in place until a clear position is known. U.S. stocks are our dominant position in equity portfolios.
	Developed International			Developed countries around the world have faced economic concerns since the start of the COVID pandemic. Though most of the world is now in a sustainable recovery, investors have been recently challenged by geographic proximity to conflict. Therefore, an encouraging economic path has become more compromised. We maintain our baseline weight to developed country equities.
	Emerging Markets			Chinese government intervention and continued EM pandemic health concerns cast a shadow over EM in 2021. Early in 2022, Russian aggression has resulted in de-listing Russia from EM benchmarks. Though we believe in EM over the long term, self-inflicted obstacles have weighed on investor sentiment to this segment. We have reduced our slight tactical overweight and are now neutral.

FIXED INCOME

Limit Rate Sensitivity with Intermediate Focus

The 10-year Treasury yield now stands at approximately 2.8%. The rapid rate escalation over the past month is primarily due to several speeches made by Fed officials which were clearly deemed to be hawkish. While the Fed only increased the Fed Funds rate by 25 basis points in March, they intend to aggressively fight inflation and have indicated that both the magnitude and frequency of the rate increases will be adjusted upward. Had the Russian invasion not occurred, the yield path would have been modestly higher rather than the sharply higher path we are experiencing. The pressure on global energy prices and to some degree agricultural prices are prolonging inflation growth and forcing the Fed to take remedial action when they otherwise would have allowed inflation to eventually fall under its own cycle. Should the situation in Ukraine continue with little resolution in sight, the same segments will continue to feel inflationary stress which may prolong relatively high inflation and delay rate stability. Should the opposite occur, we would expect some relief. In our view, compensation for longer-maturity bonds remains unattractive, as rates will likely move modestly, but not substantially higher from current levels. We continue to suggest a blend of high-quality short-to-intermediate bonds in all fixed income portfolios.

The continued economic expansion allows for high yield bonds issued by stable but growing companies to be a productive use of fixed income capital. We remain committed to a modest high yield position in both corporate and municipal bonds. As previously stated, inflation primarily rose in 2021 due to an expanding global economy, but one in which access to goods were compromised due to many COVID related supply chain shortages. Though this dilemma has not been completely solved, several factors suggest the worst may be behind us. Unfortunately, as long as the Russian conflict exists, inflationary fears will still be a factor. Thus, we continue to promote inflation protection in fixed income portfolios via a position in Treasury Inflation Protected Securities (TIPS).

We favor municipal bonds for tax-sensitive accounts. 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		Credit spreads have recently widened and are more aligned with historical averages.
		Short / Int. / Long	
	Duration		Concerns over rising interest rates/inflation remain viable with the prospect of a return to normalized economic growth with reduced government stimulus.

COMMODITIES

Although our precious metals view remains neutral, we cannot deny that gold prices saw a pronounced increase in the early stages of the Russian conflict. Now trading at close to $1,900 per ounce, gold is down over $150 per ounce from its recent high. Some investors hold the perception that some metals serve as an inflation hedge. Broad baskets of commodities, including those associated with the agricultural trade have also increased in price, but are stabilizing for the moment.

The global demand for goods and services has clearly improved over the last 18 months. Energy prices started to rise in late 2020 and continued moving higher for much of 2021 due to relatively low supply. West Texas Intermediate Oil has recently spiked to nearly $130 a barrel as a direct consequence of the Russian conflict. Currently trading at just over $100 a barrel, oil will likely rise and fall as a direct consequence of the military conflict. Should the threat abate, prices are unlikely to remain this elevated.

CONCLUSION

The Russian military conflict has clearly heightened anxiety and is exacerbating already high inflationary conditions. While clearly presenting a threat, the U.S. government, consumer and corporate world have been steadfast in their resolve to move forward as each responds to both risks and opportunities.

As we examine market and economic risks, we understand that even well-constructed portfolios are not immune from short-term fluctuation. But over time, diverse portfolios created to withstand occasional uncertainty ultimately benefit from global economic expansion.

Disclosures

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual security. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing.

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Economic forecasts set forth may not develop as predicted.

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