MARKET INSIGHT MONTHLY

August Update

MONTHLY COMMENTARY

UNITED BANK
Wealth Management

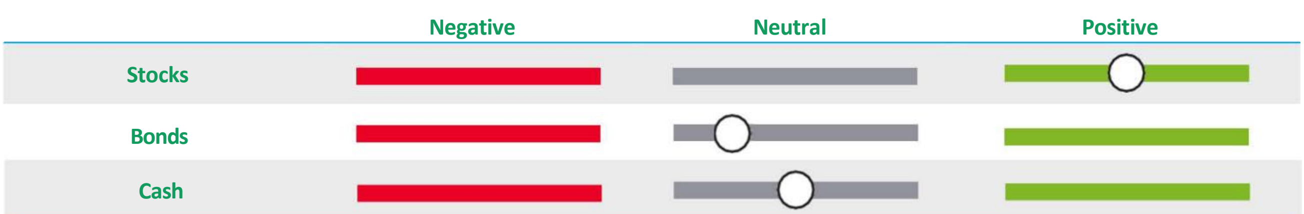
With Congress in recess and many of Wall Street's prognosticators and pundits soaking up the last rays of summer, August is traditionally a time to reflect and, if necessary, reposition. The major themes impacting investor behavior remain the same, but current perspectives are decidedly different. The Fed's battle against inflation remains their primary priority and more work is required to reach their 2% goal, though remarkable progress has been made. Headline inflation is hovering just over 3%, which is far below the 6.5% reading of last December and the 9.1% reading of last summer. To achieve this inflation progress, the Fed has attempted to slow the economy by raising interest rates. While the Federal Funds rate has increased 100 basis points since the start of the year, both the 2- and 10-year Treasury rates have increased only about 60 basis points. This relatively nominal increase has not impacted economic conditions as employment remains strong and the consumer continues healthy buying. Third Quarter Gross Domestic Product (GDP) could be the strongest since 2021. Despite dire forecasts made by many economists and analysts over the last 24 months in reaction to increasing interest rates, the economy continues to produce quality jobs, goods, and services. Average GDP for the past four quarters exceeds 2.5% and overall corporate earnings remain stable. At this time, we are encouraged by these factors and do not see any major impediments to continued growth into 2024.

INVESTMENT TAKEAWAYS

- The period between late summer and early autumn has been known for experiencing added volatility and occasional market corrections. Over the past 50 years, August, September, and October have ranked in the bottom half of all months in terms of frequency of gains and market performance. Of course, nothing happens in a vacuum. Equity prices have increased in eight of the past ten months and six of the seven months in 2023. A pull-back or round of profit-taking would not be unexpected or unwarranted. Our analyses show that a slight correction is possible but would likely be modest and consistent with prior adjustments. It does not cause us alarm or change our positive growth outlook for the remainder of the year and into 2024.
- The short end of the yield curve (1 month to 2 years) continues to rise in concert with Fed policy. While nearly every other segment of the yield curve has shown reasonable stability and yield consistency, surprisingly strong economic data of late has lifted rates to multi-year highs. The Fed Funds Futures market is now predicting these recently higher rates will be maintained through year-end and into Q1 2024. We then expect gradual decreases through the remainder of 2024. United Wealth maintains a larger exposure to short- and mid-term fixed-income instruments. This calculated 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. Companies with strong, less-leveraged balance sheets are often preferred during uncertain environments. After months of moderate economic reports and positive relative performance, recent stronger economic reports have propelled interest rates to multi-year highs. This negatively impacts mid- and small-cap companies more than large-caps. Recent credit quality downgrades in the banking sector disproportionally impact smaller-sized financial institutions and have sent mid- and small-cap indices lower, as financials are more heavily represented in the mid and small segments. Still, we do not believe rates will be unmanageable or have a lasting impact.
- International developed nations' equity markets have outperformed those of emerging markets thus far in 2023. Much like the large-cap segment in the U.S., predictability prevailed over uncertainty. This is not to say that international economies are outperforming that of the U.S., as they are not. Valuations and poor relative performance in 2022 led some investors to speculate that international conditions likely would not deteriorate further. In addition, the U.S. Dollar has shown periods of strength and weakness depending on domestic inflation fighting. When stronger, the U.S. markets have done well; when weaker, the opposite. The dollar has been range-bound, nullifying any pronounced trend. We expect developed markets will continue to be preferred over emerging markets, and changes in the dollar will be heavily tied to inflation reports and economic output.
- We continue to underweight our allocation to fixed income. However, the rate curve is becoming appealing, which may lead to re-positioning to our full baseline fixed income allocation. We continue to favor short to intermediate maturities.

BROAD ASSET CLASS VIEWS

Views on Stocks, Bonds, and Cash



EQUITY ASSET CLASSES

The first seven months of 2023 can be characterized as healthy, favorable, and reassuring for the equity markets. Investors are embracing the fact that no economic slow-down or major recession occurred. Large-cap corporate earnings have been stable and, in many cases, earnings have surprised to the upside. Nearly 80% of all S&P 500 companies reported positive earnings surprises in Q2. Equity prices have generally risen across size, style, sector, and region. International developed markets benefitted from a recovery while emerging markets rose, albeit in a limited manner. Equity performance has been reassuring, in that inflationary pressures have been reduced, and interest rates are more stable—although quality, demand-led economic growth is pushing them upwards. Markets have rebounded strongly from their 2022 lows, so some pause or retracement would be reasonable. August, September, and October traditionally provide investors an opportunity to pause, reflect, and re-position as needed. U.S. large-cap companies continue to fare better than smaller companies, and growth-oriented companies have outpaced value equities. Typically, when growth overshadows value, investors are willing to take on more risk, indicating that economic conditions are generally more favorable, and less defensive positioning is needed. We are starting to see evidence of broader equity participation in value, mid-, and small-cap companies over the last month. This will likely lead to better equity returns across more, if not all, equity segments. As expected, earnings growth was limited in the first half of the year, but we expect better second-half earnings and considerably better earnings next year. Developed country international equities have performed well, which can be attributed to the weaker dollar rather than safer economic conditions. Although markets may endure occasional bouts of volatility, well-chosen companies and risk-managed portfolios provide excellent returns when held over several economic cycles. Full-year 2023 earnings are expected to grow in the low- to mid-single digits. We prefer U.S. large-cap companies for stability and consistency, but mid- and small-cap companies are making a compelling case.

	Sector	Overall View	Relative Trend	Rationale
Market Capitalization	Large-Caps			U.S. large-caps were among the leading global equity segments during the first seven months of 2023, with the S&P 500 rising almost 20%. Despite dollar weakness over the past several months, the large-cap segment has once again proven to be a magnet for global investors during both uncertain and prosperous times. While value-oriented stocks held appeal last year with markets under duress, growth companies have demonstrated resiliency in 2023. Any rate instability could allow value companies to mount a vigorous comeback.
	Mid-Caps			Mid-cap companies had a solid first seven months of the year, rising almost 13%. Equity price momentum was briefly curtailed in March and April with reports of potential turmoil in the banking sector. Our analyses indicated this would not be a long-term deterrent to mid-cap stocks. This has proven to be the case. We expect further progress within this segment with additional rate stability.
	Small-Caps			The small-cap sector, though up over 9%, was perhaps disproportionately impacted by the banking issues earlier in the year. While this segment had performed quite well through most of Q1, it fell in Q2, as small-caps are more heavily value-weighted due to larger financial sector exposure. We expect a full recovery in time as rates stabilize. We continue to overweight small-caps.
Style	Growth			Large-cap growth stocks have staged an impressive recovery since Q4 2022. Though not all growth stocks have performed equally, and much of the market's performance is heavily tied to several mega-cap companies, this sector has benefitted greatly from the perception that inflation is better controlled and therefore interest rates will eventually decline. The more stable the interest rate curve and the lower it travels, the better the outcomes for this segment. United maintains a healthy weighting to growth companies of all sizes.
	Value			United maintains a core value stock overweight to protect portfolios from risks both known and unknown. The companies held in our value-based Large-Cap Dividend Strategy maintain healthy balance sheets and remain preferred by experienced and disciplined investors. Our experience has proven select value companies exceed expectations while simultaneously reducing portfolio risk.
Region	United States			We believe better relative performance will be generated from the U.S. stock market over the foreseeable future, with consistent and reliable outcomes. Although large-cap U.S. stocks have considerably outperformed, valuations remain reasonable given anticipated inflation and interest rates declining. However, both mid- and small-cap companies remain undervalued and appear increasingly attractive. The strength of the U.S. employment environment has led to continued overall consumer health. Inflation is now much less of an obstacle and there is no question that the U.S. has made significantly more progress in reducing both actual and prospective inflationary fears. We see the U.S. continuing to take the lead in this regard and in propelling future growth.
	Developed International			Most global central banks representing developed nations followed the monetary policies of the U.S. Federal Reserve. As such, both international monetary policy and the global fight to combat excessive inflation have lagged behind that of the U.S. Success has been gradual, and foreign countries have been slower to contain inflation. For U.S. investors, this is a double-edged sword. Lower relative rates have led to a weaker dollar. This leads to brief periods in which international equity markets outperform the U.S., as was seen in Q1. We expect a stronger dollar will eventually return, but not until there has been more success in reducing inflation globally.
	Emerging Markets			Although we favor emerging market equities over the long term, uncertainties stemming from international conflicts create obstacles to growth. Lack of stability has led to a lack of predictability, creating more hurdles. Investor sentiment changes quickly in this segment. Rather than speculate on political uncertainties, we will wait until conditions change before making changes to allocations. We continue to maintain our baseline weight.

FIXED INCOME

Limit Rate Sensitivity with Short-to-Intermediate Focus

Despite the Fed raising the Federal Funds Rate by 525 basis points on eleven separate occasions over the last seventeen months, U.S. economic output continues to expand. Though the July CPI report showed annualized inflation now running at 3.2%, well below last summer's 9.1% reading, inflation continues to prove difficult to completely control. As active and controversial as the Fed has been over the past three years, it is the investor that sets the yield curve apart from the very shortest of rates. The highly ambitious objective undertaken by the Fed to reduce annualized inflation to 2.0% has been partially achieved, but the overall strength of the U.S. employment environment translates directly to healthy consumer and retail spending, which has prevented inflation from reaching the desired trough. Despite the seemingly unlimited resources and monetary calculus at the Fed's disposal, over two-thirds of GDP remains attributed to the consumer. Ultimately, consumers—not policymakers—are driving the economic engine. The Fed must respect this leadership and bond investors must weigh some complex factors when investing. The long end of the curve is still heavily influenced by current and future expectations of economic output, while the short end of the curve is dominated by Fed activism and capital market liquidity. The Fed has been restrictive, leading to high short-term rates, while the long end of the curve fluctuates based on economic data interpretation. Of late, economic output has been stronger than anticipated and has driven long-term rates past their peaks set in the fall of 2022. The Fed's "higher for longer" mantra remains in place, but at higher rates and longer than originally anticipated. We believe an imminent recession is unlikely and continue to suggest a blend of high-quality, short- to intermediate-term 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 Wealth has reallocated funds previously devoted to intermediate-term securities to shorter-term, investment-grade securities to take advantage of considerably higher yields with lower duration 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.

Positioning		Low Medium High	Rationale
	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 increased due to consistently better economic reports. Yield curve inversion favors shorter bonds paying higher income.

COMMODITIES

Our precious metals view remains neutral. We are conscious of the influence being exerted on specific commodities, particularly gold, by U.S. monetary policy. Federal policies may directly impact the value of the U.S. Dollar, which in turn impacts various commodity complexes. As inflation rapidly declines in the U.S. relative to most global regions, the dollar loses its appeal as interest rates generally decline in line with inflation expectations. Recent strong economic reports have pushed rates higher, strengthening the dollar, and thereby leading to weaker precious metal prices. We feel the dollar will strengthen in time as global inflation is also more broadly reduced. Broad baskets of commodities have seen price reductions and have been reasonably stable for nearly a year. Commodity indexes remain well below 2022 highs.

Since Russia's invasion of Ukraine, the world has been forced to adjust supply and demand expectations. Many countries are now sourcing commonly traded commodities from a variety of other locations. WTI crude oil is currently trading near $80 a barrel, rising in response to continued threats of Russian aggression. Thus far, these periodic threats have resulted in only short-term repercussions with very limited long-term significance.

CONCLUSION

The Fed is not yet satisfied with inflation rates, but the heavy lifting has been completed. This is not to suggest that the Fed's battle is over. Short-term rates remain high, reflective of both current and anticipated Fed activity. The rest of the yield curve has shifted higher, as economic output is clearly stronger than previously anticipated. Equity prices are adjusting to the unexpected rate increases by modestly repricing. We consider this normal and decidedly seasonal. This is a reasonable correction in light of equity gains in excess of 25% from 2022 lows. The promise of stable rates over the next six to twelve months should result in improved economic growth and ultimately, more reliable financial market performance.

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.

All performance referenced is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.

Economic forecasts set forth may not develop as predicted.

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