MARKET INSIGHT MONTHLY

August Update

MONTHLY COMMENTARY

UNITED BANK Wealth Management

In our previous insights, we highlighted a number of positive factors favorably influencing investor behavior. Despite no recent action being taken, the Fed is transitioning away from restrictive monetary policy on a trajectory that will lead to lower rates well into 2025. Though the economy shows some modest signs of slowing, job creation remains healthy, and consumers have not yet curtailed their spending habits. Halfway through 2024, corporate earnings have surpassed expectations and are projected to set record highs this year and next.

Although overall conditions are positive, investors have not favored all sectors or industries equally. Similar to the pattern observed in 2023, investors continue to heavily favor growth-oriented companies within the information technology and communication services sectors. Although eight of the other nine industries have shown positive returns this year, their average returns of just over 6% pale in comparison to the remarkable 18% returns shown by both the information technology and communication sectors. Our Investment Committee remains focused on managing well-diversified equity portfolios for longer market cycles. However, our committee made timely adjustments to our equity exposure in early 2024 by increasing our allocation to domestic growth companies.

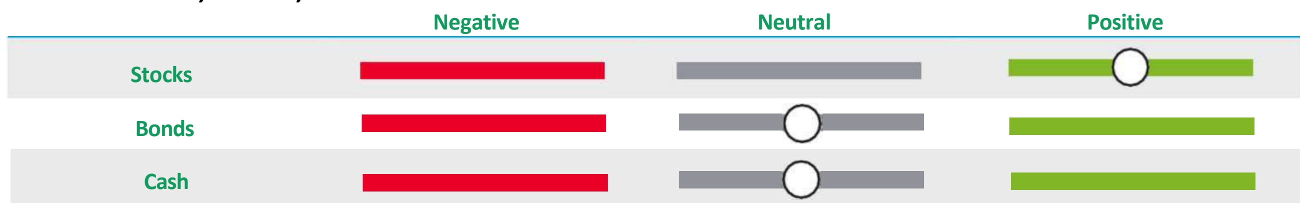
This cyclical and sustainable bull market which began in 2009 is now over 15 years in duration. While that may seem like a long time, it still ranks in the lowest quartile of historic bull market runs. There is no question significant gains have been made over the last 15 years (particularly in the last 5 years), but we do not foresee the positive long-term momentum fading anytime soon. With the exception of 2022, stocks have generally delivered strong annual returns, resulting in significant growth for well-diversified portfolios.

INVESTMENT TAKEAWAYS

- Equity markets consistently show resilience and an ability to process information from our ever-changing world. The key takeaway from the first half of the year is that while the world transforms rapidly, few changes have a lasting impact on financial markets and investors. Even minor political, social, and economic shifts can cause concern, but remaining adaptable allows investors to navigate these changes as they tend to lose significance over time.
- Despite several market volatility-inducing events since 2020, including COVID-19, Russia's invasion of Ukraine, and continued turmoil in the Middle East, the S&P 500 has risen 70% over this four-year period. In spite of these political and global uncertainties, the market has continued to focus on economic realities, shrugging off the negatively speculative scenarios. Those investors who sold during these headline-induced times of anxiety are most likely worse off than those who stayed the course and remained invested.
- Fixed-income investors are more confident as they purchase bonds across the intermediate and long end of the curve. The Fed is expected to start rate reductions in Q3. Fed Funds Futures indicate only two cuts will occur in 2024, but several more are expected in 2025. We see the short end of the curve falling in unison with Fed cuts, but we do not see dramatic change in the long end of the curve.
- Like in 2023, many mega-cap information technology (IT) and communications companies are performing well and carrying indexes to all-time highs. Large-cap stocks remain in favor, but mid-caps have shown positive momentum. Small-caps have yet to establish themselves due to the "higher for longer" rate environment, but our research shows it is only a matter of time until their performance improves.
- We maintain our commitment to risk-managed portfolios and protecting asset values in times of uncertainty and volatility. We believe a global economic transition will continue to develop that ultimately favors technological advancement. This universal trend will impact and advance all corporate enterprises. To this end, we have adjusted our allocations and have increased our exposure to growth companies.
- International developed equity markets continue to outperform emerging markets through June. Much like 2023, the U.S. economy is still outperforming those of almost every other developed nation. The dollar has been range-bound, nullifying any pronounced trend, but has shown recent strength due to reduced rates internationally. We expect developed markets will continue to be preferred over emerging markets. Our emerging market ex-China position implemented in 2023 has proven timely. The Chinese market has recovered of late but is almost entirely driven by internal domestic buying, as political rhetoric is unchanged and new foreign investment is minimal.
- Inflation will continue to decrease over time, though not in a linear fashion. We do not believe interest rates will experience significant upward bias. The current yield curve is favorable for a well-balanced, moderate-duration position. We favor high-quality, intermediate maturities with some exposure to shorter-term maturities and the high-yield segment.

BROAD ASSET CLASS VIEWS

Views on Stocks, Bonds, and Cash



EQUITY ASSET CLASSES

In somewhat of a repetitive manner, the first half of 2024 ended in much the way it started. U.S. large-cap growth companies once again dominated the global equity landscape. Performance variance was heavily segmented by size, style, and geography. The mega-cap “Magnificent Seven” continued to provide exceptional returns, as institutional investors have yet to enact any true, scalable programs to alter this course of action. Market breadth is concentrated and has yet to widen for any length of time. Though earnings in the IT and communications sectors have grown more quickly than in other segments, so too have their stock prices. The variance in valuation is pronounced. The average P/E ratio over the last 15 years is closer to 19 and large-cap growth companies currently maintain a price to earnings (P/E) ratio of approximately 34. Value oriented large-cap companies are closer to 18. Mid-cap companies are averaging a current P/E of 18 while small-cap prices are trading at only 15 times their past earnings. By almost any comparison, it is clear large-cap growth companies are richly overvalued. United believes they remain in favor due to the innovative work provided by many of these artificial intelligence technology firms. This is having a positive impact on all corporate activities including both goods and services, but the downstream bottom-line effects are yet to be fully witnessed. Large investors are currently committing funds to a small segment of companies providing the IT architecture and infrastructure, but many companies across a wide spectrum of industries and sizes will eventually feel the benefit. However, it may take some time before more companies see this benefit translate into consistent top-line revenue growth and bottom-line earnings expansion. Second-quarter earnings look healthy and are likely to set another all-time high. Full-year 2024 earnings are expected to grow 11%. Calendar year 2025 earnings are expected to exceed that with a 14% growth rate. Although we have a small overweight position in small-caps, our most significant allocation will remain in large-cap domestic companies, which have led performance over the last twelve months.

		View	Relative Trend	Rationale
Market Capitalization	Large-Caps			Through the first half of the year, U.S. large-cap stocks are once again leading global equity markets. Growth companies, particularly mega-cap technology and communications companies, performed exceedingly well in 2023 and continue atop the leaderboard in 2024. After a minor pullback in early Q2, large-caps rallied for the remainder of the quarter with the technology growth sector setting new all-time highs. This propelled the broader market to do the same. Participation, or breadth, is expanding to other industries, but investors have clearly demonstrated their overall preference to remain invested in the momentum trade. Valuations are stretched but the prospect of lower rates will likely keep P/E ratios at a premium. We maintain our largest equity allocation to the large-cap segment.
	Mid-Caps			Mid-cap companies had a solid first half of 2024. They rebounded quite nicely after their modest pullback in April. Similar to the large-cap segment, investors showed a preference for the growth style. Earnings are stable, valuations are reasonable, and breadth is expanding. The recent softness in some economic indicators have caused some investor hesitancy in both mid- and small-cap companies. We expect more sustained gains as interest rate stability is restored. Earnings should be healthy in the second half of 2024.
	Small-Caps			The small-cap sector was disproportionately impacted by rising rates through the summer of 2023. Although small-cap companies performed exceedingly well as rates fell in late 2023, intermittent higher rate fears in the first half of 2024 combined with recent reports of an economic slowdown are preventing small-cap advocacy. Further gains should progress as these reports improve throughout the year. Earnings reports are encouraging, and valuations remain among the most attractive of all equity segments.
Style	Growth			Much like last year, large-cap growth companies led the way during the first half of 2024. Though more companies are participating in the current rally, mega-cap growth companies are driving this pronounced upside move. Technology and communications stocks remain dominant year-to-date, but investors are being rewarded for diversifying their growth holdings. Market performance is not as narrow as in 2023 due to consumer spending patterns having extended to discretionary items. United’s increased equity allocation to the growth style has been timely and productive.
	Value			Although United recently lowered our value exposure, we maintain a slight value overweight to protect portfolios from known and unknown risks. The companies held in our value-based Large Cap Dividend Strategy are known for their perennial healthy balance sheets and their favorable attitude towards investors. Value companies have attracted more attention lately due to attractive valuations and reliable earnings. We anticipate further gains in 2024 as lower rates assist value companies with margin expansion.
Region	United States			It is our continued position that better relative performance will be generated from the U.S. stock market than from international markets for the foreseeable future. The U.S. market has more consistent and predictable outcomes. This preference is evidenced by the significant equity rally beginning last fall but has also left valuations quite high in relative terms. Overall valuations are reasonable only in the large-cap segment, despite exceptional earnings growth of late. Both mid- and small-cap companies remain attractive but are heavily dependent on interest rate movement and economic growth expectations. The strength of the U.S. employment environment has led to continued overall consumer health. Recent reports may be indicating a potential minor economic slowdown, but we do not see any pronounced trend developing.
	Developed International			Recent elections throughout the world have not provided significant clarity as to the likely course of economic development, collaboration, or expansion plans. Most of the world has been consumed with fighting inflation. While that battle remains in place, it is less of a factor. Most governments would now like to expand employment and their respective economic base, but plans vary, and many newly elected leaders have little to no history in planning, much less implementing economic development programs. We are doubtful that effective programs will be enacted soon. Our baseline weight is maintained.
	Emerging Markets			Although we foresee emerging market growth over the long term, uncertainties stemming from international conflicts create obstacles to consistency and predictability. Our removal of direct exposure to China was timely. We are encouraged by recent communications between the U.S. and China but are in no hurry to commit additional funds to this space. We continue to maintain our baseline weight.

FIXED INCOME

Steady, Stable, and not Surprising

By the end of June, interest rates had stabilized with intermediate and long rates noticeably lower. The short end of the yield curve has been constant for a full year, as its movement is almost exclusively tied to Federal Reserve activity. The rest of the yield curve has remained elevated but has shown some welcomed weakness as recent economic reports are not quite as robust as early in the year. Inflation reports have been encouraging with the most recent PCE and CPI reports finally showing additional progress in bringing down inflation closer to Fed targets. Though the European Central Bank and a few other central banks have lowered rates, this has not been a universal action. Many countries are still waiting on the Fed to determine next steps before ultimately following suit. It is clear current inflation and future threats are greatly diminished, allowing for potential rate reductions in the U.S. and in other countries across the globe. What was a battle against stubborn inflation threats has now transitioned into an evaluation of economic health. History suggests that financial markets perform very well once the central bank completes its rate increases and rates stabilize, regardless of the higher rate levels. History also suggests that once the Fed begins its rate reduction policies, economic damage may have already occurred. The Fed is often too late to prevent any type of "soft landing". We are seeing several areas of weakness. The unemployment rate has risen to 4.1%. Although June job increases appeared healthy, new payroll jobs reported for April and May were later revised and reduced by over 100,000. Claims for financial assistance for those newly unemployed have risen consistently for several months and retail spending is less vigorous. United anticipates the yield curve will remain stable over the foreseeable future, experiencing only marginal variance. Our decision to extend duration in early October 2023 was timely and remains profitable. Unless another dramatic global event triggers additional inflationary fears, we continue to anticipate a lower inflation/lower rate environment is ahead. Rate cuts by the Federal Open Market Committee in the second half of 2024 should not be as significant as had been predicted at the beginning of the year. We estimate the Fed will reduce the Fed Funds rate one or two times this year and perhaps another one to two times in the first half of 2025. We currently recommend a blend of high-quality, intermediate-term bonds in all fixed income portfolios with appropriate exposure to the shorter-end. 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. 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	High	To protect asset values, United prefers fixed-income portfolios dominated by high-quality bonds. Credit spreads have normalized despite higher rates.
		Short / Int. / Long	
	Duration	Int.	United believes short-term rates are stable, near their peak, and locked into place due to Fed policy. Longer rates are range bound with minor variance.

COMMODITIES

Despite ever-changing world events and continual threats to the supply-chain, commodity prices have been relatively stable in 2024. Common baskets of commodities have increased in the mid-single digits on a percentage basis. West Texas Intermediate Oil has risen about 6% for the year while Brent Crude Oil prices have retreated from their highs and now up about 4% year-to-date. Gold and silver prices have been volatile. They quickly moved higher in Q1 but have remained stable since March. The S&P 500 and several growth style equity benchmarks have performed as well as, if not better than, many well-known commodities, including gold. Most agricultural prices remain subdued and are decidedly lower for the year. Construction and building oriented commodities were fairly strong at the year's onset but have pulled back in recent months. We previously noted that copper prices had risen quite precipitously through April, possibly indicating stronger global demand ahead. However, prices have fallen 10% from their recent highs and lumber prices are down over 10% year-to-date.

CONCLUSION

The first half of the year proved quite profitable for most equity investors. However, like in 2023, the degree of profitability was heavily dependent upon one's risk appetite. Opting for a concentrated approach and holding only the largest and most notable IT and communications companies likely yielded impressive returns. Owning a diversified portfolio that not only participated in the upside but protected values to the downside likely yielded healthy albeit inferior returns. At United, we prefer constructing portfolios that adhere to well-established risk management principles. Our focus is not on chasing short-term trading opportunities, as we are committed to managing our clients' assets in a genuine fiduciary manner. Our philosophy is underpinned by an unwavering emphasis on risk management and asset preservation. We see further gains ahead but are conscious of the performance generated over the last 9 months. We do not anticipate that prices will continue rising to the extent we have observed in recent history, despite the quality earnings growth expected well into 2025. With lower interest rates ahead, we anticipate a modest increase in bond prices. However, the majority of the decrease in rates will likely occur on the short end of the curve, resulting in limited potential for significant overall growth in bond values.

Disclosures

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