MARKET INSIGHT MONTHLY

December Update

MONTHLY COMMENTARY

UNITED BANK Wealth Management

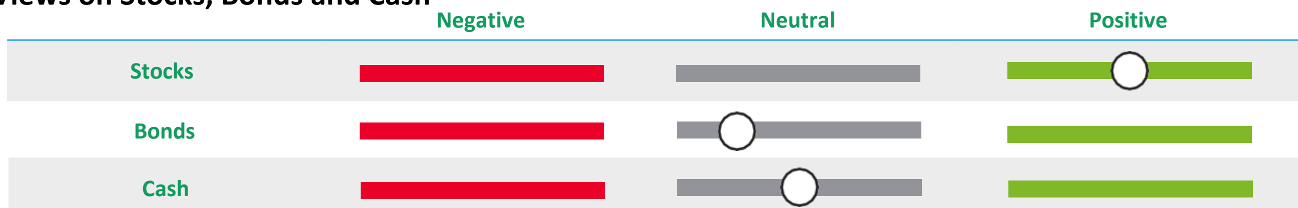
It seems longer than just 11 months ago when the S&P 500 hit an all-time high the first trading day of 2022 and the 10-year treasury was yielding just 1.53%. As we approach the new year, the critical dynamic remains inflation and the policy responses of the Federal Reserve (Fed). Over the coming months, the Fed will take one of several predictable paths. They will increase rates 50 or 25 basis points until there is no need for further action. Interest rates have already increased close to the proposed terminal levels. Future volatility, or lack thereof, will reflect the consistency between what the markets expect and what in fact the Fed actually does. Has inflation peaked, will the Fed be less hawkish, is a recession on the horizon or can it be limited? These are questions being asked and possible scenarios that are being examined. We see evidence that housing and rental prices are declining (which will flow through to inflation data), with commodity and energy prices following suit. This suggests inflation may finally be heading in the right direction so the need for Fed actions may be waning. Though wage increases are still growing, we would rather have citizens employed and contributing to the economy than sitting on the sidelines. While there are always uncertain variables that impact our economy and our portfolios, as we move into 2023, we have more answers than we did throughout much of 2022.

INVESTMENT TAKEAWAYS

- Conditions conducive to a positive equity market environment have not been as favorable in 2022. When we generally evaluate investor interest in owning stocks, earnings, valuation, and expected alternative asset class returns are strongly evaluated. While earnings growth has clearly moderated in 2022, earnings still increased as a whole. But rising rates threatened future consumer confidence leading to a reduction in risk asset holdings. With equity markets down 15-20%, current valuations remain attractive as actual 2022 earnings are stable. But future earnings are the primary variable that investors are worried about. Will the consumer remain vibrant and prevent any severe downturn? Or will higher rates finally depress employment and reduce consumer spending leading to lower earnings? Though asset prices remain depressed from the year's onset, both fixed income and equity securities prices have staged intermittent recoveries throughout the year. As we near year end, equities are well off their lows, rates are well off their highs and inflation has clearly moderated.
- Though we have no doubt the Fed will eventually prevail in their quest to bring down inflation to much more reasonable levels, investors have only recently seen evidence that the Fed's efforts may finally be working. Despite increasing the short-term Fed Funds rate by 425 basis points through their December meeting, inflation may have finally declined to the point where investors can feel some sense of current and future relief. Though it is possible the Fed may be forced to increase rates above any previously established targets, recent CPI figures showed an appreciable decline in both top-line and core inflation.
- United Wealth has stated over the past several months that we believe rates were closer to their apex. Long rates have recently declined, reflecting investor belief that progress against stubbornly high inflation has been made. We remain confident that rates are unlikely to rise significantly from these levels on either the short or long end of the curve. The terminal rate or the likely rate at which the Fed will need to take short rates stands between 5.00-5.25%, 25 basis points higher than their previously estimated range. Even though higher, the open market has reduced rates on both the short and long ends of the curve. The market does not feel the Fed will be forced to continue enacting excessively "hawkish" policies.
- We maintain our value bias within large-, mid- and small-cap companies which better protects portfolios during volatile periods, as has been experienced this year. Companies with strong, less-leveraged balance sheets often are preferred during uncertain environments. Lack of interest rate stability denies growth companies the opportunity to regain momentum. Should rates continue to stabilize, the growth segment should show improvement. Mid- and small-cap companies are showing very attractive valuations.
- 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 compelling economic evidence before any re-allocation. 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 continue to move higher coinciding with Fed activity. A flat to somewhat inverted yield curve is expected as slower growth is likely.

BROAD ASSET CLASS VIEWS

Views on Stocks, Bonds and Cash



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EQUITY ASSET CLASSES

Very few segments of the global equity markets have been untouched by heightened uncertainty throughout most of 2022. Defensive segments such as consumer staples and energy companies have been the clear winners while nearly every other segment has suffered through slower growth, higher interest rates and near record inflation. Over the short-term, Federal Reserve policies to stem inflation have not been friendly to risk asset categories such as equities. And yet, as we approach the new year, better news and additional certainty has brought a degree of welcomed relief. We continue to believe that for longer-term investors both domestic and international equities provide exceptional growth opportunities. While investors have and are likely to endure additional volatility, well-chosen companies provide excellent returns when held over several economic cycles. Domestic earnings grew nearly 9% during the first half of 2022. Second half earnings should still show reasonable increases despite higher rates. While it is possible that earnings may be somewhat negatively revised, we do not feel that earnings will be severely compromised. The recent correction has led to the best valuation multiples in years in nearly all equity segments. 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 historically compelling.

	Sector	Overall View	Relative Trend	Rationale
Market Capitalization	Large Caps			Though record setting earnings were generated in 2021, interest rate increases and inflation have slowed economic growth this year. While earnings will likely set full year records, the rate of growth has slowed impacting investor confidence. While value companies have held up quite well, growth companies are generally more vulnerable to higher interest rates and have noticeably underperformed. The recent market correction created an opportunity in both the value and growth segments as many stocks offered compelling valuations.
	Mid Caps			Mid-cap companies' earnings and stock prices grew dramatically with powerful post-Covid economic expansion. But much like large-cap stocks, mid-caps corrected due to the uncertainty associated with interest rate increases and consumer confidence. With even more attractive valuations than large-caps, longer-term investors should be rewarded at recent prices.
	Small Caps			The small-cap sector has been impacted by interest rate risk like almost all equities. Though this segment was among the strongest performers of 2021, it is generally more susceptible to higher volatility as uncertainty increases. Valuations are attractive due to the correction and this segment has staged an impressive rally. Strong earnings growth potential through 2023 suggests we remain overweight small-caps.
Style	Growth			Large-cap growth stocks are more rate sensitive and have suffered much more heavily than value stocks during this recent correction. To some degree, this growth correction has elements of a reversion to the mean. Growth stocks have outperformed value stocks for decades. Though rates may move higher, we feel that most of the rate move is already priced into the market. Quality growth stocks should be well positioned for longer-term investors. But this will not occur until we see more interest rate stability.
	Value			United maintains a value stock overweight to protect portfolios from unknown 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 lower portfolio risk.
Region	United States			We continue to see the potential for better, not worse, performance in the U.S. stock market into 2023. Investors are adjusting to the new higher rate normal as they have done in prior tightening cycles. The U.S. remains both a place of opportunity and refuge. U.S. earnings growth may slow but full earnings will still likely set new records this year and next. 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 the U.S. markets.
	Developed International			Though most of the world transitioned to a sustainable post-Covid recovery last year, similar inflation concerns to that of the U.S. have impacted countries around the globe. In addition, geographic proximity to the Russian conflict and a limited supply of goods and energy alternatives has put additional stress on consistent and reliable economic output. Therefore, the economic path is more compromised and less certain. We maintain our baseline weight to developed country equities.
	Emerging Markets			Though we believe in EM over the long term, certain governments have shown a lack of discipline on the world stage. This often leads to actions contrary to stability and may create more obstacles than benefits. Investor sentiment can quickly change in this segment and has been affected by the higher degree of uncertainty in general given the many factors facing world leaders. The new composition of the EM (ex-Russia) could present opportunity. EM may present a potentially better opportunity than developed markets.

FIXED INCOME

Limit Rate Sensitivitywith Intermediate Focus

In mid-December, the Fed altered its string of four successive 75 basis point increases in the Fed Funds rate by only increasing the rate by 50 basis points. Though the Fed has now increased the overnight Fed Funds rate by 425 basis points year to date, it appears they are acknowledging some degree of success in driving down inflation. However, they will remain vigilant and further increases are inevitable. The 10-year Treasury rate has now fallen 75 basis points from its peak. Only the short end of the yield curve remains elevated as it directly reflects overnight lending rates as set by the Fed itself. The potential for slower growth in 2023 made recent bond yields quite attractive. We currently continue to suggest a blend of high-quality short-to- intermediate bonds in all fixed income portfolios. Though the economy has experienced higher inflation than normal, companies and municipalities have continued 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. Inflation pressures are lessening though it will take some time for the Fed's ultimate 2.0% goal to be achieved. But the weight of the evidence suggests further improvement in lowering overall inflation. For that reason, United has removed its tactical weight to Treasury Inflation Protected Securities (TIPS) and re-allocated those funds by investing in shorter maturity Treasury Securities which raises income and lowers duration risk.

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.

Positioning		Low / Medium / High	Rationale
	Credit Quality	Medium–High	Credit spreads have recently widened and are more aligned with historical averages.
		Short / Int. / Long	
	Duration	Short–Int.	Concerns over rising short-term rates remain viable although the market has priced in the Fed's terminal rate. Inflation is not quite the threat it has been.

COMMODITIES

Our precious metals view remains neutral. Interest rate movement has a direct impact on the U.S. Dollar conversion rates. The recent rate reductions have weakened the dollar and modestly emboldened precious metal investors. Gold, now priced at near $1,800 per ounce, trades in an inverse relationship to the U.S. Dollar. Broad baskets of commodities have seen prices reductions and recently stabilized. There has been no discernible direction of late. Commodity indexes are down 10-15% from their highs.

In 2022, the Russian conflict has dramatically impacted price stability. Much like other commodities, oil has recently reversed course and is trading substantially below its post invasion highs. WTI is currently trading near $75 a barrel, down 40% from Q1 highs. We expect future price movement will be directly tied to developments stemming from the war and potential changes in global economic growth.

CONCLUSION

After months of volatility and uncertainty some degree of stability has emerged and created a higher degree of clarity moving into 2023. The Fed is clearly determined to bring inflation down permanently, but recently, this rather myopic policy stance has been addressed by Fed officials and in some part, been given less weight. We anticipate some volatility will remain in effect until evidence of a compromise is reached between the Federal Reserve, political bodies and the financial markets. But if rates have risen very close to their anticipated terminal rate and inflation is in a peaking process, the financial markets will fully welcome this more positive transition.

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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