MARKET
INSIGHT
MONTHLY

January Update

MONTHLY COMMENTARY

UNITED BANK
Wealth Management

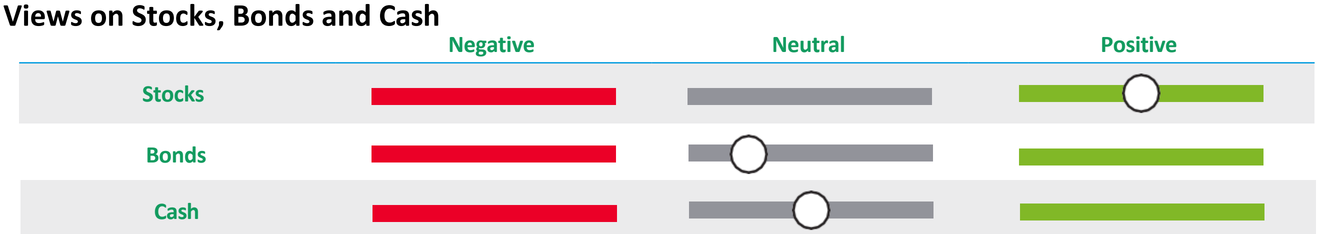
From the onset, 2022 was going to be a transitional year. It was clear the Federal Reserve would increase short-term rates to stem already excessive inflation caused by rampant economic growth in a post-Covid world. What could not be known during the first five to six weeks of last year, was the havoc and disruption that would eventually be caused by Russia's invasion of Ukraine. The Fed was now faced with the same objective but much less control over inflation's ultimate destiny as already stressed global supply chains became even less predictable. With few short-term tools at their disposal, they kept their unanimous focus on significantly higher rates in an attempt to swiftly impose brute policy limiting economic growth. And now, 10 months after the first Fed hike and 11 months after the invasion, it could very well be that the worst is behind us. Inflation seems to have peaked several months ago. Long-term interest rates have declined by 75 basis points from their peak and only short-term rates are elevated, consistent with Fed policy. 2022 corporate earnings actually grew, albeit very modestly, and stocks have rallied almost 12% from their recent lows. The U.S. economy is still adding quality jobs and the unemployment rate is close to historic lows. It is difficult to imagine a full-blown recession with so many people gainfully employed and over 10 million jobs still available. There are still unanswered questions, but 2023 should be more stable and less volatile than 2022.

INVESTMENT TAKEAWAYS

- While earnings growth moderated in 2022, collective earnings still increased over the records set in 2021. Investors expected the Federal Reserve to raise interest rates going into 2022. Post Covid-induced economic growth was worrisome and there was a clear need to stabilize excessive inflation caused by supply chain disruptions. The Russian invasion provoked the Fed to raise interest rates more aggressively than any other time frame over the last 50 years causing volatility and uncertain conditions. In the short-term, investors responded by reducing risk and driving equity prices down some 25% (S&P 500) at their worst levels. Earnings, however, remained quite solid as a whole and valuations were quite attractive. Stocks have rallied some 12% from their lows. While first half 2023 earnings may suffer to a limited degree, second half earnings should show appreciable growth.
- The Fed is beginning to see the fruits of their labor though the journey has been painful. Inflation has been coming down to much more reasonable levels and further reductions are expected. Despite already increasing the short-term Fed Funds rate by 425 basis points through their December meeting, we expect at least two more 25 basis point increases during Q1. Though it is possible the Fed may be forced to increase rates above these established targets, recent CPI figures showed an appreciable decline in both top-line and core inflation. This has resulted in long-rates falling about 75 points adding to fixed income performance. United Wealth has eliminated the need for our tactical position in inflation protected securities (TIPS) and added short-term Treasury exposure. This has reduced duration risk and increased current income.
- United Wealth has stated over the past several months that we believe rates were closer to their apex. We remain confident 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 the Fed will need to take short rates now stands between 5.00-5.25%. The open 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 over the last 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 international developed nations' equity markets have generally outperformed those of emerging markets (EM), both segments considerably lagged the U.S. until Q4 2022. The weakening of the U.S. dollar in Q4, due to lower domestic interest rates, prompted short-term investor interest in international equities. We see this as a somewhat temporary condition due to inflation falling faster in the U.S. We remain comfortable with our 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. 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



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EQUITY ASSET CLASSES

In 2022, investors holding public equities found very few places of refuge. Despite the uncertainty from higher interest rates, inflation and global supply chain disruptions, corporate earnings grew modestly. Equity prices didn't fall due to actual earnings reductions, but due to value compression. Higher rates meant two things to short-term investors. First, they were concerned that future earnings might be jeopardized as the cost of money may lead to higher corporate expenses and/or less consumer spending. And second, higher rates in the near-term offer investors more stable, less risky returns than potentially remaining in stocks. We continue to believe that for longer-term investors both domestic and international equities provide exceptional growth opportunities. While investors may endure occasional bouts of volatility, well-chosen companies and risk managed asset allocation provide excellent returns when held over several economic cycles. At present, 2023 earnings are expected to grow in the mid-single digits. While we acknowledge earnings growth will not be linear, we maintain rates will not be the obstacle in 2023 that they were in 2022. 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			Earnings growth was limited in 2022, but earnings still grew. Stocks declined due to valuation compression vs earnings declines. The large-cap segment held up very well until U.S. dollar weakness in Q4. As rates stabilize, so will the dollar leading to large-cap gains. 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.
	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. Mid-caps are less impacted by a weak dollar and held up better in late 2022.
	Small Caps			The small-cap sector has been impacted by interest rate risk like most equities. It is generally more susceptible to higher volatility as uncertainty increases. Valuations are very attractive due to the correction and this segment has staged an impressive rally. Like mid-caps, they are less impacted by dollar weakness. 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 the 2022 correction. To some degree, this growth correction has elements of a reversion to the mean. Growth stocks have outperformed value stocks for decades. 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. More rate stability will lead to better growth projections.
	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 lower portfolio risk.
Region	United States			We continue to see the potential for better performance in the U.S. stock market in 2023. Investors are adjusting to higher rates 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 year 2023 earnings will still likely set new records. 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 has been higher overseas which led to relatively higher rates resulting in Q4 dollar declines. But we see dollar strength as inflation abates world-wide.
	Developed International			Inflation concerns were global in 2022. Most central banks followed the direction of the U.S. Federal Reserve. As such, policy and economies lagged that of the U.S. As success in the fight on inflation was evidenced in the U.S in Q4, inflation was still high elsewhere leading to higher relative rates and a weaker dollar. This led to short-term international outperformance which we do not feel is sustainable. A stronger dollar will mitigate Q4 '22 results going forward. 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. The new composition of the EM (ex-Russia) could present opportunity. EM did not benefit nearly as much from the weaker U.S Dollar which indicates that several obstacles remain in this segment. We maintain our baseline weight.

FIXED INCOME

Limit Rate Sensitivity with Intermediate Focus

As we move into 2023, prevailing wisdom suggests that further Federal Reserve rate increases will be kept to a minimum should inflation expectations continue to moderate. Though the Fed has now increased the overnight Fed Funds rate by 425 basis points since March of 2022, it appears they are acknowledging some degree of success in driving down inflation. However, they remain vigilant. Two 25 basis point increases are expected during the first quarter of 2023. The 10-year Treasury rate, now yielding just over 3.50%, has fallen 75 basis points from its peak in October of last year. Only the short end of the yield curve remains elevated as it directly reflects overnight lending rates as set by the Fed itself. Yield curve inversion is quite pronounced which indicates potential slower growth in early 2023. But we expect the economy will perform considerably better in the second half of the year. We 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. As indicated, inflation pressures are lessening. United has re-allocated funds previously allocated to inflation protection to shorter-term U.S. Treasury Securities to take advantage of considerably higher yields, with both lower duration and 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		Credit spreads have recently widened and are more aligned with historical averages.
		Short Int. Long	
	Duration		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 though we are conscious of the clear influence being exerted by U.S. monetary policy. Though the Fed has been raising rates to fight inflation, several recent months of better inflation reports have reduced yields on the long end of the curve and significantly devalued the U.S. Dollar. As an inverse relationship exists between the dollar and precious metals, we have seen a pronounced increase in metals prices. We feel that interest rates will stabilize which should also stabilize the dollar. Should that occur, precious metals prices should have limited additional upside. Broad baskets of commodities have seen prices reductions and have been reasonably stable for several months. Commodity indexes remain 10-15% below their highs from 2022.

The Russian conflict has dramatically impacted price stability and unfortunately little resolution appears imminent. The world has had to adjust and source commonly traded commodities from a variety of areas around the globe. WTI is currently trading near $80 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 as we move into 2023. The Fed is clearly determined to bring down inflation and seems to be having success. Though short-rates may go nominally higher, we feel we are close to the end of this cycle. We anticipate volatility will remain in effect but not to the level experienced last year. The second half of 2023 should experience better growth and the financial markets should be decidedly more stable.

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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