MARKET INSIGHT MONTHLY

June Update

MONTHLY COMMENTARY

UNITED BANK Wealth Management

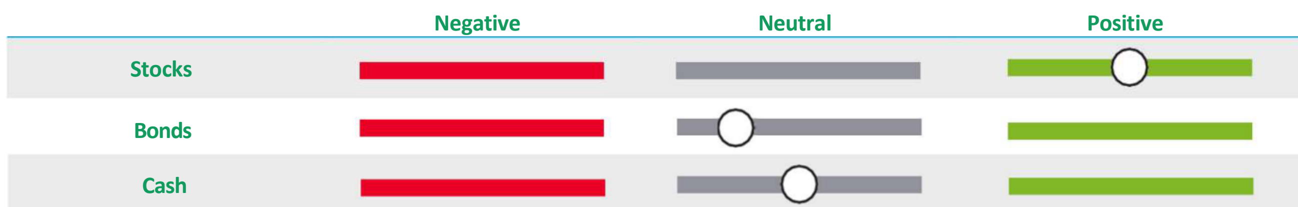
The major headlines over the past eighteen months have been dynamic and often unsettling to say the least. It is not surprising that reactions by investors and financial markets were decidedly cautious, if not defensive. As we have repeatedly suggested, investors should seek guidance to create a longer-term plan that accomplishes their goals and helps them to intellectualize the occasional volatility. Human nature does not allow us complete removal from the potential consequences of actions beyond our control. The greater the potential impact, the greater the immediate emotional response. In time and with sound advice, the fear factor typically dissipates with calmer and cooler heads prevailing. Fewer questions arise and solutions to former problems are realized. But what of good news? Investors typically do not process positive attributes or news as easily. While global markets are clearly in recovery mode, are we synthesizing positive information in the same manner as we did yesterday's negative news? Two activities have recently occurred which deserve attention. First, U.S. Secretary of State Antony Blinken traveled to China to reestablish frayed diplomatic relations with President Xi Jinping. Second, India's Prime Minister Narendra Modi visited President Biden in Washington. Both were acclaimed to be successful visits.

INVESTMENT TAKEAWAYS

- Investors, particularly institutional investors, are feeling more comfortable as the Fed appears to be nearing the end stages of its restrictive monetary policies. By raising the federal funds rate on ten separate occasions and 500 basis points since March of 2022, inflation is no longer the dominant threat it once was, though it remains above the Fed's 2% target. Annualized CPI now stands at 4% and has decreased by over 55% since last summer's high. On one hand, progress is evident. On the other hand, higher rates have led to several negative consequences such as concerns regarding the health of the banking industry. We have never felt this issue had significant merit. The pause in rate increases was refreshing but additional modest increases are likely. Investors will be mindful of the potential consequences, but ultimately the increases will have limited impact on productivity and financial markets.
- The yield curve is sending mixed messages. The very short end (1 to 6 months) of the curve continues to rise as a still restrictive Fed limits complete investor enthusiasm, while nearly every other segment of the yield curve is showing stability, improvement, and yield consistency. In fact, the curve is no longer inverted between 3 and 30 years. Improved inflation and the potential for a somewhat weaker economic environment has taken pressure off long rates. The Fed Funds Futures market is now predicting rates will be stable through year end, then decrease as we enter 2024. United maintains a larger exposure to short/mid-term duration fixed income instruments. This 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, as was experienced in 2022. Companies with strong, less-leveraged balance sheets are often preferred during uncertain environments. With rates stabilizing, and in some cases falling, the growth segment has shown improvement. Mid- and small-cap companies are showing very attractive valuations though this segment has been negatively impacted by unfavorable attention regarding domestic banking health. We feel this topic only applies in isolated situations as banks remain healthy overall.
- International developed nations' equity markets have outperformed those of emerging markets (EM) during the early months of 2023. The U.S. dollar began to decline in the 4th quarter of last year as inflation started to subside. This led to lower rates in the U.S. while most foreign countries were still experiencing both high inflation and rates. This has prompted additional investor interest in international equities. We believe this is a temporary condition due to inflation-fighting success domestically. As global central banks eventually achieve their respective success (i.e., better inflation reports), we expect the dollar to strengthen once again. We remain comfortable with our international exposure and prefer to wait for more compelling economic evidence before any allocation change. We do note that international valuations are becoming attractive.
- We continue to underweight our allocation to fixed income but feel that the rate curve is starting to become appealing. This may lead to re-positioning to our full baseline fixed income allocation. We still favor short to intermediate maturities.

BROAD ASSET CLASS VIEWS

Views on Stocks, Bonds and Cash



EQUITY ASSET CLASSES

2023 has begun with promise as the S&P 500 has gained almost 9% through May. Most global equity segments have performed well with the U.S. large-cap growth segment being remarkably healthy. Inflationary pressures have been reduced and interest rates have steadily declined. Taken in isolation, lower rates are a net benefit for both the equity and bond asset classes. While concerns regarding the health of the of the U.S. banking sector were overblown and are generally regarded as past news, investors have focused on tamed inflation and better international relations with both China and India. In the U.S., the general strength of large-cap companies have fared better than smaller companies and growth-oriented companies have outpaced value equities, reversing last year's trend. Lower rates typically benefit growth companies all things being equal. The banking sector concerns caused investors to be a bit wary of anything other than large-cap companies as access to capital is being tested. We are starting to see evidence of broader equity participation in value, mid and small-cap companies. We acknowledge earnings growth will have limitations in Q2 but expect better second half earnings that lead to double digit growth in 2024. Developed country international equities have performed well. This is mainly attributed to the weaker dollar, not due to a better or safer economic conditions. While 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 as Q2 earnings will start their reporting season in only a few weeks. We expect modest earnings growth over Q1, but perhaps 10% plus growth from one year ago. We prefer U.S. large-cap companies for stability and consistency, yet 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 5 months of 2023 with the S&P 500 rising nearly 9%. Despite dollar weakness over the past several months, the large cap segment has once again proven to be a magnet for investors during both uncertain and prosperous times. As interest rates stabilize, growth companies have demonstrated resiliency and investor interest. Continued rate stability should allow growth companies to make further progress.
Market Capitalization	Mid Caps			Mid-cap companies had a solid Q1 rising almost 4% and have continued their trajectory into Q2. Equity price momentum was briefly curtailed in March and April with reports of potential turmoil in the banking sector. We think this issue is lacking merit and will not remain a viable reason why investors avoid mid-cap stocks. This segment should do well with rate stability and further healing within the banking segment.
Market Capitalization	Small Caps			The small-cap sector was negatively impacted by the banking reports much the same as mid-caps. This segment had performed quite well through May. Valuations are very attractive. We expect further growth and remain overweight small-caps.
Style	Growth			Large-cap growth stocks staged an impressive recovery during the first five months of 2023 As growth stock performance is heavily tied to the direction of interest rates, the lower rate environment propelled growth companies to outperform. The more stable the interest rate curve and the lower it may travel, the better the outcomes for this segment. United maintains a healthy weighting to growth companies of all sizes.
Style	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 reduce portfolio risk.
Region	United States			We believe better relative performance will be generated from the U.S. stock market over the foreseeable future. The U.S. remains both a place of opportunity and refuge. Outcomes are more consistent, predictable and reliable. Valuations remain attractive in both mid and small-cap companies. The strength of the U.S. employment picture and overall consumer health provides the relative preference for U.S. markets. Inflation is less of an obstacle and there is no question the U.S. has made more rapid progress in reducing inflationary impacts. We see the U.S. continuing to take the lead in this regard and in establishing a new economic growth trajectory.
Region	Developed International			Most global central banks followed the direction of the U.S. Federal Reserve. As such, international monetary policy lagged that of the United States. Success in the fight on inflation will be gradual and is taking foreign countries longer to contain. U.S. inflation figures are falling more swiftly. That is a double-edged sword. Lower rates lead to a weaker dollar. This leads to brief periods of time when international markets may outperform as in Q1. We expect a stronger dollar will return later in 2023 and U.S. equities to generate returns in excess of the most other markets.
Region	Emerging Markets			Though we believe in emerging market equities over the long term, current global uncertainty stemming from conflicts are creating obstacles to growth. Lack of stability has created a lack of predictability, thus creating more hurdles. Investor sentiment changes quickly in this segment, but we would prefer not to speculate on the factors that may alter negatives into positives. We maintain our baseline weight in emerging markets.

FIXED INCOME

Limit Rate Sensitivity with Short-to-Intermediate Focus

While prevailing wisdom indicated last month that the Fed may be finished with their rate increases, economic data continues to demonstrate that a slowing economy, much less a recession, is not very likely any time soon. Though the Fed and Chairman Powell paused additional rate hikes in June, it is probable that another 25 basis-point hike will be enacted in July. It is further likely that one more 25 basis-point increase will be instituted before or during the fall months. While the Fed will eventually "pivot" and reduce short-term rates, investors can only predict a general window when this changed policy will take effect. The Fed Funds Futures market is now suggesting rates will not move lower until early 2024. Generally, investors are betting the Fed will have to moderate their restrictive policies sooner versus later. Even Chairman Powell in his testimony to the U.S. Senate suggested that rate increases are only modestly impacting the economy at this point as most of the "heavy lifting" is behind us. Though inflation has fallen nearly 60% since last summer, the Fed is not altering their objective and remains focused on inflation being reduced to 2%, still well below the May reading of 4.0%. The Fed's "higher for longer" mantra remains in place. In response to falling inflation and the perception of a weakening economic picture, ten- and two-year Treasury yields have declined well off their peaks. Only the shortest maturities, those between one and six months, continue to set new highs. With short term yields in excess of 5%, investors are heeding the Fed's message. We continue to suggest a blend of high-quality short-to-intermediate 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 has re-allocated funds previously allocated to inflation protection to shorter-term, investment grade securities to take advantage of considerably higher yields, with both lower duration and 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	High	The increase in rates has widened credit spreads over the past year. Spreads have been impacted by active Fed policy.
		Short / Int. / Long	
	Duration	Short	Concerns over rising rates have lessened with consistently better inflation 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. In 2022, Fed policy to fight inflation led to higher rates and a stronger dollar. This led to depressed gold prices. As inflation is declining in the U.S. more rapidly than many global regions, interest rates are also declining on a relative basis in similar fashion. In turn, a weaker dollar has led to higher precious metal prices. We feel the dollar will strengthen in time as international rates fall and global inflation is also reduced. Broad baskets of commodities have seen price reductions and have been stable for several months. Commodity indexes remain 10-20% below their highs from 2022.

Over the past year, the world has had to adjust supply and demand expectations due to the Russian invasion. Many countries are now sourcing commonly traded commodities from a variety of locations. WTI is currently trading near $70 a barrel, down 40% from 2022 highs. Despite OPEC (Plus) intervention, energy prices are currently tied to potentially weaker global economic growth estimates.

CONCLUSION

The Fed is not yet satisfied with their battle against inflation, but the heavy lifting has been completed. Though short-term rates remain high and are directly tied to Fed activity, the rest of the yield curve has responded favorably to lessening inflation expectations. Examining history, when rates are reduced, investors benefit from holding both equities and bonds. There are certainly several economic variables yet to be resolved. The promise of stable, if not lower, rates should result in better economic growth and ultimately better 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.

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Economic forecasts set forth may not develop as predicted.

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