MARKET
INSIGHT
MONTHLY

March Update

MONTHLY COMMENTARY

UNITED BANK
Wealth Management

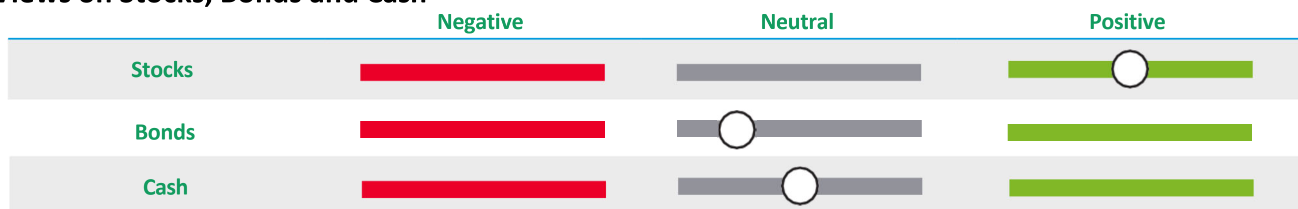
As we approach the final weeks of Q1 2023, investors remain focused on many of the same variables that created the hurdles and volatility in 2022. But what created so much anxiety and worry last year is currently far less punitive. The vast knowledge gained from time and experience is causing less anxiety and has clearly reduced investor pessimism. While the Russian invasion of Ukraine does not show any signs of ending, the global fear exhibited one year ago is not as palpable and the economic consequences are not as dire. Global sourcing of energy and agricultural goods has greatly reduced the need for Russian goods as most of the world is finding alternatives and substitutes. Though inflation was made worse by the invasion, the Fed has made significant progress under difficult circumstances. While they will continue to raise rates modestly as inflation has not yet capitulated, considerable progress has been made to reduce inflation. We are much closer to the peak in short-term rates while long-rates seem to be range bound. Earnings remained solid in 2022 as the market corrected. As a consequence, valuations are reasonable given the interest rate environment. While first half 2023 earnings are likely to remain muted, second half earnings should show appreciable growth, with 2024 earnings looking much healthier.

INVESTMENT TAKEAWAYS

- It has been one year since the Fed began enacting its restrictive monetary policies. By successively raising the federal funds rate since March of 2022, the Fed is beginning to see the fruits of their labor though the journey has been both painful and inconsistent. The current target range stands between 4.50-4.75%. We expect at least two additional 25 basis point increases. While December CPI figures showed an appreciable decline in both top- line and core inflation, January figures showed higher inflation. This seems to indicate that our economy remains reasonably strong with demand for both goods and services quite healthy. This is also consistent with United’s position that a full recession is unlikely this year.
- United Wealth has stated over the past several months 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, has increased by 25 basis points and now stands between 5.25-5.50%. The January inflation reports prompted the open market to be less confident in the potential for Fed easing. United has taken additional steps to protect client fixed income assets by again reducing duration and adding to our shorter-term allocation. This allocation change also increased income and reduced portfolio risk.
- 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.
- International developed nations' equity markets have generally outperformed those of emerging markets (EM), as 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. As stated last month, we believe this was a temporary condition due to inflation falling faster in the U.S. than in the rest of the world. Recently, the stronger dollar has lifted U.S. equites higher, as expected. 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



EQUITY ASSET CLASSES

2023 has begun with some degree of promise. Greater interest rate stability and somewhat reduced inflationary pressures are leading investors to "look through" current obstacles with greater optimism. Despite last year's uncertainty, corporate operating earnings still set new records. Much of the equity pull-back was caused by fear of what could happen versus actually what did happen. Equity prices didn't fall due a recession or earnings reductions, but due to investor fear of what could happen with higher rates. Investors were primarily concerned about two valuation criteria. First, future earnings might be jeopardized as the cost of money may lead to higher corporate expenses and/or less consumer spending. And second, at least in the short-term, higher rates offer investors more stable returns. We continue to believe 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. We acknowledge earnings growth will not be linear yet maintain rates will not be the obstacle in 2023 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 U.S. equity gains. While value companies have held up quite well, growth companies are generally more vulnerable to higher interest rates and have noticeably underperformed. Interest rate stability should allow growth companies to make a strong comeback.
	Mid Caps			Mid-cap companies' earnings and stock prices grew dramatically with powerful post-Covid economic expansion. Mid-caps corrected last year due to the uncertainty associated with interest rate increases but showed very strong late year performance. Valuations are attractive. This segment should do well with rate stability and healthy employment data.
	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 remain attractive. 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 very rate sensitive and suffered more heavily than value stocks during the 2022 correction. This growth correction has elements of a reversion to the mean as growth stocks outperformed value stocks for nearly two 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. Rate stability should lead to better growth outcomes.
	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 will lower portfolio risk.
Region	United States			We continue to believe better relative performance will be generated from the U.S. stock market in the coming year. 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 remains a global obstacle but we feel the U.S. is leading other countries in managing this fight.
	Developed International			Inflation concerns were global in 2022. Most global central banks followed the direction of the U.S. Federal Reserve. As such, international monetary policy lagged that of the U.S. Success in the fight on inflation will be gradual and will take time. But U.S. inflation figures are likely to see better results sooner. That should delay many developed countries from reducing rates as quickly. We maintain our baseline weight to developed country equities. A weaker dollar may benefit foreign equities for a brief time but we expect a stronger dollar to prevail.
	Emerging Markets			Though we believe in EM 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 even more hurdles. Investor sentiment has the ability to quickly change in this segment. But we would prefer not to speculate on the factors that may alter negatives into positives at the moment. We maintain our baseline weight.

FIXED INCOME

Limit Rate Sensitivity with Intermediate Focus

Prevailing wisdom suggests further Federal Reserve rate increases will be kept to a minimum should inflation moderate. The Fed has now increased the overnight Fed Funds rate by 450 basis points with the latest 25 basis point increase on February 1. Chairman Powell has acknowledged some degree of success in driving down inflation from its peak of last summer, but both inflation and employment figures reported for the month of January showed continued economic strength. An additional 25 basis point increase is expected in March and additional rate increases are likely. The 10-year Treasury rate, now yielding just over 3.90%, has fallen from its peak, but rate movement is heavily dependent on economic output. Though the yield curve is inverted which typically predicts slower growth, we feel the Fed's activism in fighting inflation is heavily contributing to the wider spread. We do not expect long rate yields to move beyond their highs of last 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. 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	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 as the Fed continues its battle, but inflation is not quite the threat it has been.

COMMODITIES

Our precious metals view remains neutral. We are very conscious of the clear influence being exerted on specific commodities by U.S. monetary policy. The Fed has been raising rates to fight inflation and will continue along this path until more stability is evident. Though year over year inflation is heading in the right direction, month-to-month inflation reports still show a wide variance and thus impact interest rates, currencies and commodity prices. Long rates are likely to be trading within a range which means that metals such as gold and silver will do the same. Recent rate increases have led to dollar strength further leading to precious metal price reductions. Broad baskets of commodities have seen price reductions and have been reasonably stable for several months. Commodity indexes remain 10-15% 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 $75 a barrel, down about 40% from one year ago. 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 degree of clarity as we move further into 2023. The Fed is determined to bring down inflation and seems to be having relative success. Though short-rates may go higher directly tied to Fed activity, we feel the rate hike cycle is nearing an end. We anticipate continued 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

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