MARKET INSIGHT MONTHLY

November Update

MONTHLY COMMENTARY

UNITED BANK Wealth Management

Decades and perhaps centuries from now, historians will likely review the happenings of the last four years with profound interest, extrapolating the social, political, and economic consequences of such events as the Covid-19 pandemic, the 2020 U.S. presidential election, the actions on January 6, 2021, the Russian invasion of Ukraine, and the most recent Palestinian/Israeli conflict. Economists will pour through vast amounts of data in an attempt to ascertain how the measurable outcomes of these seemingly unrelated global events compare to other periods when upheaval reigned.

This relatively brief four-year period has generated more than its fair share of turbulence, volatility, and uncertainty. For investors, an initial reaction to any one of these potentially overwhelming negative events might be to assume the worst and take action that could reduce one's risk. As we have emphasized in the past, well-intended, but emotional reactions typically lead to less desirable outcomes over the longer term.

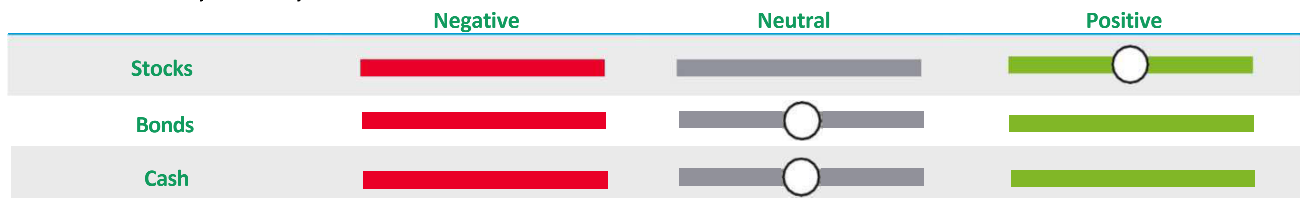
Despite the potential implications of each event, much less all of them collectively, the S&P 500 has provided substantial annual returns since Thanksgiving of 2019. Investors must maintain discipline and recognize both risk and opportunity in the face of adversity. Those who did, were rewarded by staying invested in the face of uncertain times. The United team will continue to carefully assess portfolio exposure and implement prudent strategies for preserving and growing the wealth of our clients.

INVESTMENT TAKEAWAYS

- Once again, the seasonal obstacles of late summer and early fall caused investors to exercise some caution. Higher interest rates, higher inflation, oil and gas supplies, domestic leadership issues, debt ceiling debates and geo-political conflict are all significant and require thorough analysis. However, more time must elapse before short, intermediate, and long-term market impact can be definitively assessed. By late November, the concerns held by many investors earlier this year had dissipated. Interest rates and inflation are significantly lower, energy supplies are ample and less costly, a Speaker of the House has been elected, and budget progress has been made. Geo-political tensions remain, but progress has even been made in the Middle East. As suggested previously, investors with a well-constructed long-term plan need not act upon every news item.
- The Fed has made no changes to rate policy since the summer. Recent comments by Chairman Powell in early November provided markets with a sense that perhaps the Fed was finally pleased with its efforts to reduce inflation to manageable levels. He did not suggest they were finished with restrictive policies, but he did suggest inflation would continue its gradual decline into 2024 and beyond. The Fed Funds Futures market is now predicting short-term rates will start to decline by Q2 of next year. We then expect further moves lower for the rest of the year and into 2025. In a timely tactical change, United recently increased duration, as we believe rates will continue to decline, boosting bond prices.
- We maintain our modest value bias within large-, mid-, and small-cap companies, which better protects portfolios during volatile periods. Companies with strong, less-leveraged balance sheets are often preferred during uncertain environments. After stronger economic reports and unexpected energy supply threats propelled interest rates to multi-year highs just last month, a clear reversal has been established. Lower anticipated inflation along with the Fed seeming to validate their own efforts has led investors to buy bonds in anticipation of lower future rates. In turn, this has propelled equities higher with U.S. large-, mid- and small-cap companies staging an impressive recovery.
- International developed nations' equity markets have outperformed emerging markets thus far in 2023. Much like the large-cap segment in the U.S., predictability has prevailed over uncertainty. However, the U.S. economy is still outperforming international economies. In addition, the U.S. Dollar has shown periods of strength and weakness depending on the success of domestic inflation-fighting efforts. When stronger, the U.S. markets have done well; when weaker, the opposite. The dollar has been range-bound, nullifying any pronounced trend. We expect developed markets will continue to be preferred over emerging markets, and changes in the dollar will be heavily tied to inflation reports and economic output.
- In fixed income, the interest rate curve was very appealing during the prior several months, which prompted our tactical duration extension. We favor 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

Since our last writing, global equity markets have staged an impressive recovery from the late October lows. The prospect of lower interest rates has been considerably more influential than any disturbing domestic or geo-political event. The Middle East conflict is still fresh and could generate any number of negative paths, but fortunately, to date, few ancillary dramas have arisen. Energy prices—a major concern that is always vulnerable to international tension—have noticeably declined. As we continue to reiterate, history has proven that selling stocks in times of duress may reduce immediate anxiety, but it is rarely a successful long-term strategy. At this juncture, we remain committed to a longer-term positive outlook. We will continue to evaluate both global and domestic events and their impacts as they become evident. Despite the previously mentioned recent upheavals, the S&P 500 is approaching its July high and is still up nearly 20% for the year. Q3 earnings surprised to the upside once again and final reports will likely lead to the highest quarterly operating earnings ever reported. The future looks quite bright with 2024 earnings estimates growing at 11% year-over-year. Small-cap and, to some degree, mid-cap companies are disproportionately affected by higher rates, but have both staged impressive Q4 recoveries given the lower rate environment. The same can be said for international companies. Though we are slightly overweight small-cap stocks, the overwhelming portion of our equity allocation has been and will remain in large-cap domestic companies, which have led performance over the last twelve months.

		View	Relative Trend	Rationale
Market Capitalization	Large-Caps			Year-to-date, U.S. large-cap stocks are among the leading global equity segments. The large-cap segment has once again proven to be a magnet for global investors during both uncertain and prosperous times. While value-oriented stocks held appeal last year with markets under duress, growth companies, particularly mega-cap tech and communications companies, have demonstrated dramatic resiliency in 2023. We will remain overweight in this segment.
	Mid-Caps			Mid-cap companies are having a solid year but returns were reduced over the last quarter by unexpected late summer and early fall interest rate increases. Earnings are stable and valuations are attractive. We expect more sustained gains as stability is restored within the fixed-income markets. Earnings should be very healthy in 2024.
	Small-Caps			The small-cap sector has been disproportionately impacted by dual concerns in 2023. They were more heavily affected by the banking crises earlier this year and then by rising rates. While small-cap companies had recovered nicely after the initial banking issues, the rate fears prevented additional buying until recently. Rate reductions are now providing investors a buying opportunity. We predict attractive valuations and earnings growth in 2024.
Style	Growth			Large-cap growth stocks have staged an impressive recovery since Q4 2022, though not all growth stocks have performed equally well. Much of the market's performance is heavily tied to seven mega-cap companies. This sector has benefitted greatly from the perception inflation is better controlled and therefore interest rates will stabilize and eventually decline. This segment should continue to perform well with additional companies benefitting from lower rates. United maintains an appropriate and healthy weighting to growth companies of all sizes.
	Value			United maintains a core value stock overweight to protect portfolios from known and unknown risks. The companies held in our value-based Large Cap Dividend Strategy maintain healthy balance sheets and remain preferred by experienced and disciplined investors. Our experience has proven select value companies exceed expectations while simultaneously reducing portfolio risk.
Region	United States			We believe better relative performance will be generated from the U.S. stock market over the foreseeable future, with more consistent and reliable outcomes. Although large-cap U.S. stocks have considerably outperformed, valuations remain reasonable given lower anticipated inflation and interest rates levels. However, both mid- and small-cap companies remain undervalued and appear increasingly attractive with the recent pullback. The strength of the U.S. employment environment has led to continued overall consumer health. Inflation is now much less of an obstacle and there is no question the U.S. has made progress in reducing both actual and prospective inflationary fears. We see the U.S. continuing to take the lead in this regard and in propelling future growth.
	Developed International			Most developed nations' central banks follow the monetary policies of the Fed. As such, both international monetary policy and the global fight to combat excessive inflation have lagged that of the U.S. Success has been gradual, and foreign countries have been slower to contain inflation. For U.S. investors, this is a double-edged sword. Lower relative rates may lead to a weaker dollar, but higher inflation reports lead to the reverse. This results in brief periods in which international equity markets may under or outperform the U.S. based on exchange rates rather than economic performance. We expect a range bound dollar that will be generally stable going into 2024.
	Emerging Markets			Although we foresee emerging market growth over the long term, uncertainties stemming from international conflicts create obstacles to consistency and predictability. Lack of stability has led to a lack of quantitative data and subjective faith. Our removal of direct exposure to China should provide greater certainty. We are encouraged by recent conversations between Biden and Xi but will wait for more proof before altering allocations further. We continue to maintain our baseline weight.

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FIXED INCOME

Investors pivot. When will the Fed follow suit?

As explained in last month's issue of the Monthly Insight, our Investment Committee voted to remove a sizable allocation to our shortest-term fixed income allocation in early October. We then extended duration by allocating more weight towards the intermediate segment of the yield curve. Consistently lower headline and core inflation, as measured by CPI, PPI and PCE reports, suggested the Fed might finally begin the process of reducing its restrictive policies. Step one has been to socialize or publicize a potential change was being considered. We believe Chairman Powell and the Fed's decision to maintain the current rate policy since July of this year indicates a start to this change. Furthermore, we thought Powell's comments during the post-FOMC meeting press conference confirmed the Fed's anticipated inflation path. In turn, Powell's comments altered investor sentiment and created a pivot point in bond yields. When our October Insight publication was written, the 10-year Treasury yield was trading between 4.90 and 4.95%. As of this writing, the yield is just below 4.50%. Thus, bond prices have increased as a result of lower rates. Our average duration remains slightly less than well-known bond benchmarks or common aggregates, but our return to "average" duration anticipated most investors would do the same. In this way, we are preparing our fixed income portfolios for eventual rate reductions. We currently suggest a blend of high-quality, intermediate-term bonds in all fixed income portfolios with less exposure to the shorter end where applicable. 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 rates are near their peak. As the curve is flattening, opportunity exists in extending duration in anticipation of eventual rate reductions in 2024.

COMMODITIES

Our general view towards commodity prices is neutral. Most of the well-known commodity benchmarks and indices are heavily influenced by price movement in energy and/or precious metals. In more granular terms, oil and gold prices are typically weighted the heaviest. As Federal Reserve policies directly impact the value of the U.S. Dollar, which in turn impacts various commodity complexes, commodity price direction is not only tied to global supply and demand factors, but also to government policy. This makes price forecasting even more precarious. Year-to-date, broad baskets of commodities are generally flat to down, while the volatile price of oil is down in the mid-single digits. Gold has increased nearly 10% per ounce influenced by a now weaker dollar and its flight to safety perception given world events. Generally, commodity indexes still remain substantially below their highs from 2022. With global interest rates remaining relatively high, we cannot make the case for higher commodity prices.

Over the past eighteen months, the world has had to adjust in many ways. How the world produces, manufactures, and transports various items, including commodities, has changed due to the ongoing conflicts in Eastern Europe and the Middle East. The long-term lack of any consistent U.S. energy policy stems from the absence of political compromise. This leaves the U.S. and the world dependent on the winds and whims of multiple undemocratic and often uncooperative regimes. As new and stable supply chains develop and mature, prices are likely to be better understood and underlying value better predicted.

CONCLUSION

As has been suggested over the last several months, seasonal and cyclical influences tend to play a negative role from August through October. This year was no exception. Additional inflation fears materialized in August due to OPEC supply cuts. A debt ceiling bill was nowhere in sight in September. Congress was without a Speaker of the House. Labor strikes were commonplace. Terror showed its ugly face in the Middle East and interest rates climbed to multi-year highs. However, in each case, solutions have been or are being found. All events require assessment as to risk and duration. No two events are identical but, with some perspective, the risk related to each of these issues can be weighed independently. Markets went through a reasonable correction in light of the heightened uncertainty, but as more solutions are found and less anxiety clouds decision-making, investors take comfort in increased stability and certainty. The promise of stable rates over the next six to twelve months should solve multiple issues, resulting in significantly reduced anxiety and, ultimately, more reliable financial market behavior and 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.

All performance referenced is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.

Economic forecasts set forth may not develop as predicted.

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