MARKET INSIGHT MONTHLY

November Update

MONTHLY COMMENTARY

UNITED BANK
Wealth Management

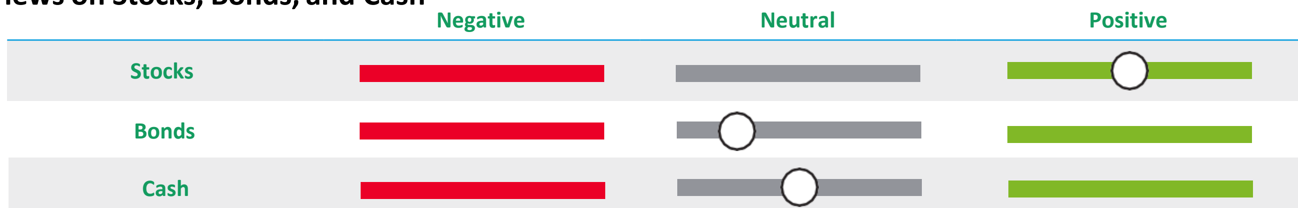
Ongoing inflation concerns and a major policy shift by the Federal Reserve has been and continues to be the dominant market driver this year. Investors have responded to back-to-back reports of easing inflation with positivity. Below-consensus readings of the Consumer Price Index (CPI) and Producer Price Index (PPI) the past few weeks pushed equities prices up and bond yields down significantly. Like CPI, October PPI also surprised, at a respective 5.4% and 8%. Year-over-year rates for both and are now their lowest since the summer of 2021. Yields across the curve declined on the inflation news, with the two-year Treasury moving from a 4.65% yield to 4.33% in a single session, the most since 2008. Though better inflation figures are welcome, Fed officials, for now, are not backing off their inflation fight. Their attempt to talk down market expectations for an early pause or end to rate hikes was heard but not entirely believed by investors. Earnings for the third quarter came in better than feared and have helped stabilize the market alongside the lower-than-expected inflation data. Although Republicans have reclaimed the majority in the House of Representatives in the midterm elections, they performed less-well than expected, swinging from a nine-seat deficit to only a slight majority. This will likely limit any major changes from a tax and spending perspective, and result in a more predictable and centrist policy approach. Markets have historically responded positively following midterm elections that result in divided control of Congress.

INVESTMENT TAKEAWAYS

- Despite the number of global events causing anxiety and uncertainty, domestic corporate earnings have continued to grow. A strong employment environment has generally led to positive consumer spending. Through the third quarter of 2022, S&P 500 operating earnings have increased 7% above the comparable time from 2021. Though asset prices remain depressed from the year's onset, both fixed income and equity securities prices have staged a strong recent recovery as reports indicate that inflation may finally have or is in the process of peaking.
- Though we have no doubt the Fed will eventually prevail in their quest to bring down inflation, investors have only recently seen evidence that the Fed's efforts may finally be working as intended. Despite increasing the short-term Fed Funds rate by 375 basis points thus far in 2022, inflation, as measured by both the Consumer Price Index (CPI) and Personal Consumption Expenditures Price Index (PCE), the Fed's preferred inflation gauge, has only modestly declined. Though it is possible the Fed may be forced to increase rates above any previously established targets, October's CPI release showed an appreciable decline in both top-line and core inflation.
- Though this transitional phase to higher rates has been uncomfortable, as stated previously, we believe that rates will eventually find an appropriate level and are closer to their rate apex. The terminal rate or the likely rate at which the Fed will need to take short rates stands between 4.75-5.00%. With the 1-year Treasury Bill currently yielding approximately 4.78%, the open market has already taken rates to that desired terminal level. Should inflation reports continue showing improvement, we doubt the open market will drive rates dramatically higher along any part of the yield curve.
- 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 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

With few and limited exceptions, global equity markets have been affected by heightened uncertainty during 2022. Significantly higher prices brought upon by Covid-related supply chain disruptions, the Russian military aggression in Ukraine and changes in global work force demographic have created an historic inflationary environment last seen over 40 years ago. The less stable interest rate environment has resulted in much less certainty and higher volatility for risk-oriented assets. We continue to believe that for longer-term investors both domestic and international equities provide exceptional growth opportunities. While investors may endure occasional volatility and reduced asset value, 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. Current estimates suggest first half earnings for 2023 may grow over 5%. While it is possible that earnings may be somewhat negatively revised, we do not feel that earnings will be severely compromised given the strong employment reports. 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 present a very compelling case as attractive valuations at present levels are rarely seen.

	Sector	Overall View	Relative Trend	Rationale
Market Capitalization	Large Caps			Though still the safest equity asset segment, large-cap companies are not immune to volatility and overall economic conditions. Though record setting earnings were generated in 2021, interest rate increases in 2022 have been an impediment to earnings. 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 value and growth segments as many stocks offered compelling valuations. We believe investors will be rewarded by buying U.S. stocks during this corrective phase. Earnings are still likely to set new records this year and into 2023.
	Mid Caps			In 2021, mid cap companies' earnings and stock prices grew dramatically with powerful economic expansion. The recent 2022 correction is heavily due to the uncertainty associated with interest rate increases meant to stem inflation. Even more than large-caps, attractive multi-year valuations are available and longer-term investors should be rewarded at current prices.
	Small Caps			Much like mid caps, the small cap sector has been impacted by interest rate risk. Though this segment was among the strongest performers of 2021, it is generally more susceptible to higher volatility as uncertainty increases. Valuations became even more attractive due to the correction and this segment has been one of the strongest YTD. 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 current move is priced in and quality growth stocks should be well positioned for longer-term investors.
	Value			United maintains a value stock overweight to protect portfolios from unknown risks. The companies held in our value-based Large Cap Dividend Strategy maintain sterling 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			As we have seen this year, we continue to see the potential for better performance in the U.S. stock market during the remainder of 2022 and 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.
	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 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, government intervention often creates 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 Sensitivity with Intermediate Focus

Though the Fed has increased the overnight Fed Funds rate by 375 basis points year to date, it is clear more rate increases will be implemented in their attempt to stem inflation. It should be noted that investors in the public fixed income markets have already driven short-term rates to the expected maximum levels targeted by the Federal Reserve. The 10-year Treasury rate, which stabilized over the summer before rising further due to higher inflation reports in the early fall, has fallen 40 basis points from its peak. In general, energy and many agricultural commodity prices have been falling, not rising. Should slower growth result, current bond yields may be 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. Though inflation pressures appear to be lessening, some inflationary fears remain. Thus, we continue to promote inflation protection in fixed income portfolios via a position in Treasury Inflation Protected Securities (TIPS). Should inflationary pressures abate further, we would consider removing this hedge.

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 interest rates/inflation remain viable with the prospect of a return to normalized economic growth with reduced government stimulus.

COMMODITIES

Our precious metals view remains neutral heavily due to a reasonably strong U.S. dollar. The very recent interest rate reductions have somewhat weakened the dollar and modestly emboldened precious metal investors. Gold, now priced at near $1,750 per ounce, trades in an inverse relationship to the U.S. dollar. Broad baskets of commodities which had also increased in price for several months post-Russian invasion have recently stabilized and have had no discernible direction of late. Commodity indexes are down 10-15% from their highs.

The global demand for goods and services improved over the last 18 months with the world distancing itself from Covid. 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 $80 a barrel, down 35% 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 certainty has established a quality posture. While inflation seems to be reversing course and declining, the pace of its decline remains an issue. The Fed is clearly determined to bring inflation down permanently no matter the short-term economic consequences. But recently, this rather myopic policy stance has been addressed by Fed officials and in some part, been given less prominence. 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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