MARKET INSIGHT

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UNITED BANK
Wealth Management

With inflation now reduced from well over 9% to 2.5% as reported in the August 2024 Consumer Price Index, the Fed can concentrate its efforts on reducing interest rates to better align with current inflationary trends. The recent 50-basis-point cut in the Fed Funds rate was somewhat unexpected, as most economists had predicted only a 25-basis-point cut. Chairman Powell explained in his post-meeting press conference that the Fed considered a 25-basis-point cut in July, but delayed action awaiting additional economic data. Reading between the lines, the larger September reduction may have been enacted to acknowledge that a 25-basis-point cut could have been taken sooner.

Current estimates suggest short-term rates may fall to 3% in the second half of 2025. All things being equal, this should translate into a productive bond market. Although short-term rates are likely to follow the Fed path, long-term rates may not fall as rapidly, if at all, as long-term rates have already declined in anticipation of Fed action. Prior reports showing lower inflation and modest economic growth prompted institutional investors and United Wealth Management to move money into longer-term fixed income months ago. Our investment committee extended the duration (a proxy for average maturity) in our fixed income portfolios twice over the last year, which has been profitable for our clients.

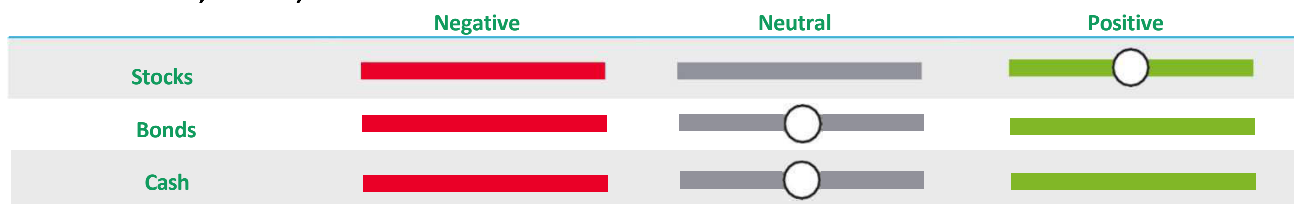
In the past, stocks have typically shown strong performance between the last rate hike and the first rate cut. However, they tend to underperform once the Fed begins to cut rates, which is almost exclusively in response to deteriorating economic conditions. Our team does not believe this to be the case right now, considering the solid state of the U.S. economy, employment, consumer activity, and spending. Although historical data indicates that presidential elections have not significantly impacted financial markets, the S&P 500 has generated positive returns in 9 out of the last 12 presidential election years between the end of the 3rd quarter through the first half of the following year, with an average gain of over 15%. With lower rates, record-setting earnings, and reasonably tamed inflation on the horizon, we maintain a positive outlook on the financial markets.

INVESTMENT TAKEAWAYS

- The long awaited "Fed Pivot" finally arrived. After 14 months with short-term rates in excess of 5%, the Federal Reserve took decisive action in September by reducing the Fed Funds rate by a larger than expected 50 basis points. We may not know for months why they chose this stronger-messaged action and whether they were attesting to economic weakness or simply acknowledging inflationary worries were no longer a concern. Given current economic strength, we believe it to be the latter.
- Over the last quarter, the anticipated actions of the Fed were the primary factor driving investor behavior. Equity investors recognized that lower rates typically result in a preference for assets with higher risk, namely equities. Fixed income investors attempted to lock in higher coupon rates, recognizing lower rates ahead would reduce future income streams. Both asset classes have performed well leading to strong gains over the first nine months of the year.
- Though investors have witnessed several less-than-stellar economic reports, no single area of the economy has clearly signaled a recession is at hand, or even a pronounced slowdown is imminent. Employment reports, consumer spending, housing starts, building permits and manufacturing data are all weaker than one year ago, but collectively are not weak. Third-quarter GDP growth may not be as strong as in the second quarter, but the U.S. economy is still expanding.
- As we have mentioned in several previous publications, the stock market typically does very well during a presidential election year and 2024 is following suit. Despite Vice President Harris being elevated to run on the Democratic ticket and the assassination attempts made against former President Trump, investors have not changed or weakened their resolve. Investors have maintained their positive sentiment and seem unphased by campaign rhetoric. Investors appear to believe both political parties will lead at least one major governing entity and history tells us that investors usually benefit when there is little chance of new partisan laws being enacted.
- We maintain our commitment to risk-managed portfolios and protecting asset values in times of volatility. We have also maintained our belief that opportunity exists, and portfolios should be positioned to capitalize on economic expansion. Over the last eighteen months, United adjusted its asset allocation and increased exposure to growth sectors. Much like in 2023, growth companies—particularly large-cap growth companies—have continued to show remarkable strength and exceptional relative earnings.
- International equity markets continue to lag the performance of domestic equities. Continuing the 2023 trend, the U.S. economy is still outperforming almost every other developed nation. The dollar has been range-bound, nullifying any pronounced trend, but has shown recent weakness due to reduced rates and a Federal Reserve willing to be unexpectedly accommodative. Our emerging market ex-China position implemented in 2023 has proven timely. The Chinese market continues to struggle as many Western nations have become unified in their aversion to political stances taken by the Chinese government.
- Inflation has not disappeared, but its impact has been severely minimized. We expect short-term rates to fall directly in line with Fed actions. We do not believe interest rates will experience significant upward bias. The yield curve is favorable for a well-balanced, moderate-duration position. We favor high-quality, 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

The first nine months of 2024 ended in much the way they started, with U.S. large-cap growth companies once again dominating the global equity landscape. Second-quarter S&P 500 earnings set another all-time high, 2024 earnings are expected to grow 10%, and 2025 earnings are expected to grow nearly 15%. United continues to hold the largest portion of its equity allocation in the large-cap segment. The mega-cap "Magnificent Seven" have continued to provide exceptional returns, as the presumed growth rates for these companies have been on too positive a trajectory to cause institutional investors to alter course. However, market breadth is broadening, and a wider range of sectors are also moving higher. Typically, when a temporary and mild equity pullback has occurred, new buyers are eager to participate in the potential upside, with each new rally expanding the number of companies participating. While earnings in the IT and communications sectors have grown more quickly than in other segments, so too have their stock prices, which has led to concerns regarding valuation. By most historic standards, large-cap stocks are somewhat expensive, and some investors may consider the large-cap market to be overvalued. As interest rates continue to fall, equity valuations can remain elevated for extended periods of time. We believe this will be the case. Our investment team anticipates that growth companies, particularly those in the IT sector, will remain in favor due to the innovations being made by artificial intelligence technology firms. Technological advances are having a positive impact on all downstream industries, but the bottom-line effects are yet to be fully realized. Investors are currently committing funds to companies providing IT architecture and infrastructure, and many companies across a wide spectrum of industries and sizes will eventually benefit as a result. However, there may be lag time before these down-stream companies see consistent top-line revenue growth and bottom-line earnings expansion.

		View	Relative Trend	Rationale
Market Capitalization	Large-Caps			Throughout the first three quarters of the year, U.S. large-cap stocks have once again led global equity markets. Growth companies, particularly mega-cap technology and communications companies, performed exceedingly well and continue atop the leaderboard in 2024. After several minor pullbacks in April and in the late summer, investors used pullbacks to buy large-cap equities each time. This propelled the broader market to do the same. Participation, or breadth, is expanding to other industries, but investors have clearly demonstrated their overall preference to remain invested in the momentum trade. Valuations are stretched, but the prospect of even lower rates ahead will likely keep P/E ratios at a relative premium. Our largest equity allocation is to the large-cap segment.
	Mid-Caps			Mid-cap companies are having a solid year and have rebounded quite nicely after each modest pullback in April, July, and September. Similar to the large-cap segment, investors showed a preference for the growth style. Earnings are stable, valuations are reasonable, and breadth is expanding. The recent softness in some economic indicators have caused minor investor hesitancy in both mid- and small-cap companies. We expect more sustained gains as interest rates continue their downward path, and earnings should be healthy into 2025.
	Small-Caps			The small-cap sector was disproportionately impacted by rising rates through the summer of 2023. Although small-cap companies performed exceedingly well as rates fell in late 2023, intermittent higher-rate fears in the first half of 2024, combined with recent reports of an economic slowdown, have prevented small-cap advocacy in full. Further gains should progress as these reports improve throughout the year. Earnings reports are encouraging, and valuations remain among the most attractive of all equity segments.
Style	Growth			Large-cap growth companies continued to lead the way during the first nine months of 2024. Though more companies are participating in this upward move, mega-cap growth companies are driving this pronounced advance. Technology and communications stocks remain dominant year-to-date, but investors are being rewarded for diversifying their growth holdings. Market performance is not as narrow as in 2023 due to consumer spending patterns having extended to discretionary items. United's increased equity allocation to the growth style has been timely and productive.
	Value			Although United lowered our value-style exposure, we still maintain a slight value overweight to protect portfolios from known and unknown risks. The companies held in our value-based Large Cap Dividend Strategy are known for their perennial healthy balance sheets and their favorable attitude towards investors. Value companies have attracted more attention lately due to attractive valuations and reliable earnings. We anticipate further gains in 2024 as lower rates assist value companies with margin expansion.
Region	United States			It is our continued position that better relative performance will be generated from the U.S. stock market than from international markets for the foreseeable future. The U.S. market has more consistent and predictable outcomes. This preference is evidenced by the significant equity rally beginning nearly one year ago. Valuations are only reasonable in the large-cap segment, despite exceptional earnings growth. Both mid- and small-cap companies remain attractive as interest rates fall and economic growth expectations remain in place. The strength of the U.S. employment environment has led to continued overall consumer health. Recent reports may be indicating a potential minor economic slowdown, but we do not see any pronounced trend developing.
	Developed International			Like the U.S., most of the world has been consumed with fighting inflation. While that battle remains ongoing, it is less of a factor globally. Most governments would now like to expand employment and their respective economic bases, but plans vary, and many newly-elected leaders have little history in planning, much less implementing, economic development programs. We are doubtful that effective programs will be enacted soon. Furthermore, military conflicts in both the Middle East and Ukraine remain a threat to broad stability and economic growth. Our baseline weight is maintained.
	Emerging Markets			Although we foresee emerging market growth over the long term, uncertainties stemming from international conflicts create obstacles to consistency and predictability. Our removal of direct exposure to China was timely. We are encouraged by recent communications between the U.S. and China but are in no hurry to commit additional funds to this space. We continue to maintain our baseline weight.

FIXED INCOME

Steady, Stable, and Unsurprising

It is refreshing to finally see the Federal Reserve reduce rates, in essence declaring that current inflation and future threats have greatly diminished. However, the circumstances surrounding the rate cut were somewhat unexpected. In Chairman Powell's remarks following the Fed decision to reduce the Fed Funds rate by 50 basis points, he suggested that the Fed could have reduced rates by 25 basis points in July but chose not to. For the better part of two years, the Fed has prided itself on doing what it said it would but, in this case, it took no action back in July. The Fed had also implied that an initial 25-basis point cut would likely be the preferred course of action. Powell defended the move to cut rates by 50 basis points in September as semi-consistent with his prior remarks, implying this was the equivalent of two rate cuts. It remains to be seen if the Fed has lost any credibility, but it is clear that future rate cuts are likely this year and in 2025. We expect short-term rates to fall another 50 to 75 basis points this year and fall another 100 basis points by this time next year. The yield curve has already started to shift as predicted, with short-term rates falling directly in concert with the Fed's actions. The belly of the curve (2 years to 7 years) has begun to fall as well, though the long end of the curve has remained relatively stable. At some point over the next twelve months, we expect a normalized yield curve will return. We maintain our position that the economy is too strong to pull long-term rates much lower. We do not expect a recession in the near future, despite some slower economic reports. Our decision to extend duration in early October 2023 was timely and remains highly profitable. Our recent decision to further extend duration to more directly align with benchmark duration was also timely and profitable. Unless another dramatic global event triggers additional inflationary fears, we continue to anticipate a lower inflation/lower rate environment ahead. We currently recommend a blend of high-quality, intermediate-term bonds in all fixed-income portfolios with appropriate exposure to the shorter-end. Quality companies and municipalities continue to perform well across the quality and size spectrum. High-yield bonds issued by stable and 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				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				United believes short-term rates will continue to decline and will mirror actions taken by the Fed. Longer rates will remain close to present levels.

COMMODITIES

Commodity prices have been relatively stable in 2024. Common baskets of commodities have increased in the mid-single digits on a percentage basis. West Texas Intermediate Oil has turned negative for the year, while the price of Brent Crude Oil has retreated from its high and is now down mid-single digits for the year. On the other hand, natural gas prices have recently climbed due to supply disruption caused by Hurricane Helene. Gold prices have been volatile but have performed well due to falling domestic interest rates, which led to a weaker dollar. The lower the dollar, the higher the price of gold. Silver is range bound but is currently trading closer to its annual high. Most agricultural prices remain subdued and are decidedly lower for the year. Construction and building-oriented commodities were fairly strong at the year's onset but have pulled back in recent months. For instance, the price of copper is heavily tied to Chinese economic performance and, currently, copper is mildly positive. Lumber prices are well off their annual highs but are making a slight comeback from their July lows.

CONCLUSION

The first nine months of 2024 proved quite profitable for most equity and fixed-income investors. Investor return was heavily dependent on the level of risk taken. Year-to-date, investors have been heavily rewarded for taking excessive risk. Opting for a concentrated approach and holding only the largest and most notable IT and communications companies likely yielded impressive returns. Owning a diversified portfolio that participated in the upside and protected values to the downside also yielded healthy returns—but with considerably less portfolio risk. At United, we prefer constructing portfolios that adhere to well-established risk management principles. Our philosophy is underpinned by an unwavering emphasis on risk management and asset preservation. We see further gains ahead but are conscious of the tremendous performance generated over the last year. We do not anticipate prices will dramatically contract, as quality earnings growth is expected well into 2025. With lower interest rates ahead, we also anticipate a modest increase in bond prices. However, the potential for significant overall appreciation in bond values is limited, as the short end of the curve will likely see the greatest decrease in rates.

Disclosures

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