MARKET INSIGHT MONTHLY

September Update

MONTHLY COMMENTARY

UNITED BANK *Wealth Management*

As if on cue for this time of year, investors once again find themselves faced with choices. Just a few months ago, equity prices were steadily rising, inflation was declining, hundreds of thousands of new jobs were being added, and interest rates, while noticeably higher, were stable, range-bound, and predictable. As of this writing in late September, equity prices have modestly fallen for almost two straight months, inflation has modestly increased (in large part due to supply constraints within the energy sector), job growth has been curtailed, and prior employment reports have been revised downwards as interest rates have unexpectedly risen to 15-year highs in many areas of the yield curve.

Are we to believe so many facets of our economic well-being seemingly changed overnight?

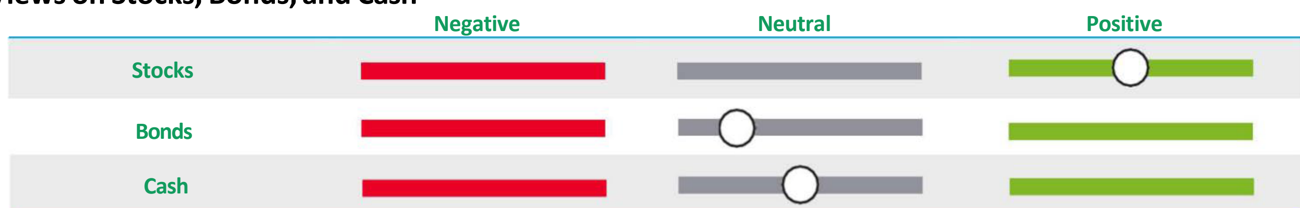
The recently renewed inflation concern is likely transitory and could easily dissipate. The slow-down in job growth was anticipated and, after a very healthy resurgent stock market, a pause was not unexpected, particularly at this time of year. Q3 earnings to be reported shortly may very well be the catalyst that sparks a positive turnaround. As is the case with many things, including investing, balance is key and patience is a virtue.

INVESTMENT TAKEAWAYS

- The period between late summer and early autumn has been known for experiencing added volatility and occasional market corrections. Over the past 50 years, August, September, and October have ranked in the bottom half of all months in terms of frequency of gains and market performance. Of course, nothing happens in a vacuum. Equity prices have performed well for nearly a year, having increased in eight of the past ten months and six of the seven months in 2023. A pull-back or round of profit taking is not unexpected or unwarranted. We see this modest correction as reasonable and consistent with prior adjustments given the level of additional concern caused by slightly higher rates. It does not cause us alarm or change our positive growth outlook for the remainder of the year and into 2024.
- The short end of the yield curve (1 month to 2 years) continues to rise in concert with Fed policy. While nearly every other segment of the yield curve had been showing reasonable stability and yield consistency, surprisingly strong economic data of late has lifted rates to multi-year highs. The Fed Funds Futures market is now predicting these recent higher rates will be maintained through year-end and into Q1 2024. We then expect gradual decreases through the remainder of 2024. United maintains a larger exposure to short- and mid-term fixed income instruments. This calculated 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. Companies with strong, less-leveraged balance sheets are often preferred during uncertain environments. After months of moderate economic reports and positive relative performance, the stronger recent economic reports have propelled interest rates to multi-year highs. This negatively impacts mid- and small-cap companies more than large caps. Recent credit quality downgrades in the banking sector disproportionately impact smaller-sized financial institutions and have sent mid- and small-cap indices lower, as they are more heavily represented in the mid and small segments. Still, we still do not believe rates will be unmanageable or have a lasting impact.
- International developed nations' equity markets have outperformed emerging markets thus far in 2023 but still lag the S&P 500. Much like the large-cap segment in the U.S., predictability has prevailed over uncertainty. This is not to say that international economies are outperforming that of the U.S., as they are not. Valuation metrics and poor relative performance in 2022 led some investors to speculate that conditions would likely not deteriorate further. 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.
- We continue to underweight our allocation to fixed income. However, the rate curve is becoming appealing, which may lead to re-positioning to our full baseline fixed income allocation. We continue to favor short to intermediate maturities.

BROAD ASSET CLASS VIEWS

Views on Stocks, Bonds, and Cash



EQUITY ASSET CLASSES

We have made mention of some potential seasonal and cyclical disruptions in the market at this time of the year. True to form, investors are once again experiencing some limited equity declines. From recent market highs established two months ago in late July, the S&P 500 is down mid-single digits, but still up over double digits for the year. The growth-heavy Nasdaq is down slightly less than 10%, but still up over 25% for the year. There is nothing about these declines or their causes that is particularly concerning. Although we do not expect interest rates to continue this upward trend indefinitely (on either the long or short ends of the curve), we are critically aware that investors are not immune to attractive offers. Ever-increasing yields are becoming attractive. We have tactically allocated more fixed-income capital to shorter-duration bonds to protect asset values, as we assessed the overall economy to be stronger than most believed. This action has proven beneficial, as we have been able to maintain our fixed-income asset levels and generate additional income as a result. The higher rate environment is having an uneven impact on the equity markets. Small-cap and, to some degree, mid-cap companies are disproportionately affected by higher rates and their recent performance has been more pronounced to the downside. 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 and in 2023. Large-cap corporate earnings have been stable, and we expect better second-half earnings and considerably better earnings next year. Markets have rebounded strongly from their 2022 lows and this recent pause is reasonable and expected, as we stated in last month's Market Insight. Developed nations' international equities have performed relatively well, but this is more attributed to the weaker dollar earlier this year rather than better economic conditions.

		View	Relative Trend	Rationale
Market Capitalization	Large-Caps			Year-to-date, U.S. large-cap stocks are among the leading global equity segments despite the recent pullback. 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.
	Mid-Caps			Mid-cap companies had a solid first seven months of the year, but interest rate increases over the past two months are creating obstacles to sustained buying in this segment. 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 was disproportionately impacted by concerns within the banking industry earlier this year. While small-cap companies had performed quite well through July, recent rate increases have put a damper on new investor purchases. This segment is particularly affected by any change in rates. We expect a full recovery in time as rates stabilize and continue to overweight small caps.
Style	Growth			Large-cap growth stocks have staged an impressive recovery since Q4 2022. Though not all growth stocks have performed equally, and much of the market's performance is heavily tied to several mega-cap companies, this sector has benefitted greatly from the perception that inflation is better controlled and therefore interest rates will eventually decline. However, much like the rest of the stock market, growth stocks have modestly suffered during this summer correction due to rate increases. United maintains a healthy weighting to growth companies of all sizes.
	Value			United maintains a core value stock overweight to protect portfolios from risks both known and unknown. 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 that 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 consistent and reliable outcomes. Although large-cap U.S. stocks have considerably outperformed, valuations remain reasonable given 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, despite the recent limited increases, and there is no question that the U.S. has made significantly more 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 behind 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 underperform or outperform the U.S. based on exchange rates rather than economic performance. We expect a stronger dollar will eventually return, but not until there has been more success in reducing inflation globally.
	Emerging Markets			Although we believe in 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. Investor sentiment changes quickly in this segment. Rather than speculate on political uncertainties, we will wait until conditions change before making changes to allocations. We continue to maintain our baseline weight.

FIXED INCOME

Limit Rate Sensitivity with Short-to-Intermediate Focus

Despite the Fed raising the Federal Funds Rate by 525 basis points on eleven separate occasions over the last eighteen months, U.S. economic output continues to expand, and inflation continues to prove difficult to bring securely under control. The Fed is not willing to compromise its restrictive stance, so investors have drawn a single, but all-important conclusion: Interest rates must travel higher to curtail economic output. The overall strength of the U.S. employment environment translates directly to healthy consumer and retail spending. This demand prevents consumer prices from dropping, thus keeping inflation elevated. As over two-thirds of GDP remains attributed to the consumer, a healthy and employed populace is the ultimate barrier to lower prices. Despite the seemingly unlimited resources and monetary calculus at the Fed's disposal, consumers ultimately drive the market. The Fed must respect this leadership. The long end of the yield curve is heavily influenced by current and future expectations of economic output. It has now reached multi-year highs. United anticipated that this move would likely be stronger than the markets had anticipated as employment conditions remain favorable. We have guarded against higher rates and reduced fixed income values by remaining shorter in our duration, and we remain committed to this position. The Fed's "higher for longer" mantra has been extended. It is now more than likely that short-term rates will remain elevated well into 2024. We continue to suggest a blend of high-quality, short- to intermediate-term 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 reallocated funds previously devoted to intermediate-term securities to shorter-term, investment grade securities to take advantage of considerably higher yields with lower duration 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	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	Short	United remains committed to our shorter-duration allocation. With interest rates higher on the short end of the curve, we protect asset values while earning more income.

COMMODITIES

Our general view towards commodity prices is neutral. Most of the well-known commodity benchmarks and indices are heavily influenced by energy and/or precious metals price movement. In more granular terms, oil and gold prices are typically weighted the heaviest. As federal 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/demand factors, but also by government policy. This makes price forecasting even more precarious. Year-to-date, broad baskets of commodities have only marginally increased, while gold has increased 5% per ounce. Oil prices have increased over 10% to date, not particularly due to heightened demand, but more so due to OPEC+/Russia limiting supplies as global economic growth forecasts soften. Commodity indexes remain 10-20% below their highs from 2022. With global interest rates remaining relatively high, we cannot make the case for appreciably 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 Russian invasion of Ukraine. As new and stable supply chains develop and mature, prices are likely to be better understood and underlying value better predicted.

CONCLUSION

As suggested in last month's Market Insight, seasonal and cyclical influences may play a negative role this time of year. August through October has a propensity for unfavorable surprises. Though earnings have remained stable, yields are at multi-year highs and may go higher, inflation has yet to stabilize at targeted levels, a federal spending bill is nowhere in sight, a possible federal government shutdown is on the horizon, and striking workers permeate major industries. Undoubtedly, each of these issues will be resolved in time. However, current conditions lead to uncertainty and some degree of risk abatement. With some perspective, we consider much of this turmoil to be somewhat normal and not exceptionally worrisome. Markets are undergoing a reasonable correction in light of equity gains in excess of 25% from the 2022 lows. All of these conflicts are known and solvable. The promise of stable rates over the next six to twelve months should result in significantly reduced anxiety, consistent economic growth, and, ultimately, more reliable 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.

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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