MARKET INSIGHT MONTHLY

September Update

# MONTHLY COMMENTARY

UNITED BANK Wealth Management

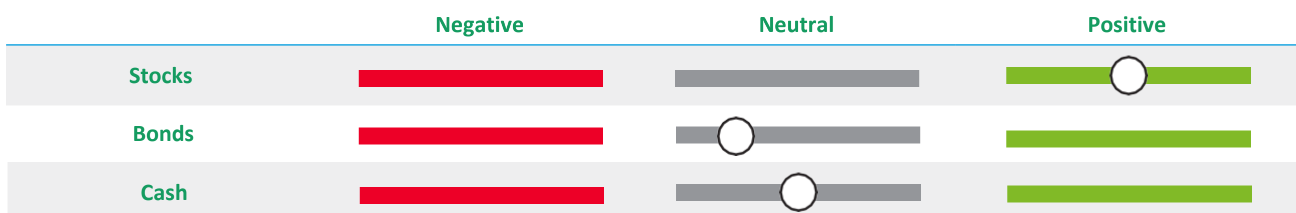
With Labor Day a distant memory, the relative calm of summer has given way to increased anxiety. The domestic stock market has continued to move upward with more confidence ascribed to large-cap companies. However, three factors are creating a more volatile environment. First, the continued threat imposed by the COVID-19 delta variant has made investors more conscious of economic and market risk. Though vaccinations are clearly the answer, memories of 2020 shut-downs and vast unemployment remain vivid. Second, China's government has suggested that several of their own companies, particularly those within the IT industry, are perhaps too permissive and too "western" in their vision and revenue path. This is causing global investors some concerns as the westernized financial markets in both China and Hong Kong could sustain consequences with any change. And lastly, the recent tax proposals suggested by the current U.S. administration in power have unambiguously targeted not only the wealthiest U.S. citizens but also many individuals and families segmented as merely affluent. The markets are reacting to the number of people who could be affected by the proposed tax changes and resultant economic impact. Despite these potential obstacles, U.S. unemployment continues to improve. The Federal Reserve remains fully accommodative even though we will see a gradual reduction in monetary stimulus.

## INVESTMENT TAKEAWAYS

- We remain overweight in our global equity allocation. We continue to favor stocks over bonds based on our expectation that a strong economic and earnings recovery will extend into next year.
- As the recovery progresses, we expect economically sensitive cyclical stocks will perform well. We also favor growth companies with strong current earnings and strong future earnings growth potential.
- Our positive view of small caps is supported by evidence from prior recoveries. Historically, this segment performs very well during early and mid-stage bull markets. Valuations remain reasonable.
- Cyclical stocks have established market leadership in Europe and Japan. Western Europe and other developed nations may emerge from the pandemic more quickly due to higher vaccination rates. Thus, developed nations may see their equities markets outperform emerging markets (EM) in the near term.
- Stringent oversight by the Chinese government over the IT sector has contributed to pressure in the EM segment.
- We continue to underweight our allocation to fixed income. Although we've seen higher rates this year in general, the Fed's accommodative monetary policy may limit the risk of large moves in the future. Higher rates will eventually put modest pressure on total bond returns though future economic improvement will result.
- We favor a blend of short to intermediate bonds with an emphasis on high credit quality.

## BROAD ASSET CLASS VIEWS

**Views on Stocks, Bonds, and Cash**



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# EQUITY ASSET CLASSES

We continue to favor stocks relative to bonds based on our expectation that a stronger economic environment will remain in place. Record setting earnings have been reported so far this year and will likely continue into next. As the recovery progresses and interest rate increases are sustainable, we still expect cyclical stocks to outperform. We expect companies from developed nations based in both Europe and Asia to continue their transition more quickly into a post-COVID environment. International developed equities have outperformed emerging markets in the near term due to higher vaccination rates. Chinese government pressure is affecting emerging market growth.

| | Sector | Overall View | Relative Trend | Rationale |
|---|---|---|---|---|
| Market Capitalization | Large Caps | | | The greater financial strength enjoyed by most large cap companies guided investors' preferences last year during the pandemic. Once again as modest uncertainty surfaces, large cap companies have performed well on a relative basis. Large cap companies remain both a refuge and a favored asset class for consistent and reliable returns. |
| | Mid Caps | | | Mid caps enjoy many of the cycle characteristics of small caps, and therefore, are performing well as this durable recovery continues. Mid cap stock valuations remain attractive. |
| | Small Caps | | | Our small cap view remains positive, supported by the continued economic expansion and strong earnings rebound. Valuations are attractive based on strong earnings growth prospects through 2022. |
| Style | Growth | | | We believe growth stocks will continue to garner investor support from strong current earnings and strong future expectations. Continued industrial innovation will motivate investors for years to come. |
| | Value | | | We expect cyclical value stocks to outperform defensive value stocks as the economy expands. Value stocks have lagged their growth counterparts for over a decade. We expect that over time, a reversion to the mean will eventually be positive for value stocks. |
| Region | United States | | | We see the potential for more gains in the U.S. stock market during the second half of 2021 despite the lingering COVID threat. The significant stimulative and supportive resources deployed within the U.S. have paid, and will pay, economic dividends in the future. Despite the recent increased tax proposals, the U.S. economy will remain vibrant and maintain its forward momentum. For these reasons we continue to favor U.S. equities. |
| | Developed International | | | The developed international equity markets have been held at bay due to uneven vaccine distribution. Investors have favored countries with stronger health protocols. As the vaccine becomes more universally accepted, developed countries are likely to demonstrate more reliable forward economic momentum and financial market growth. |
| | Emerging Markets | | | Emerging market economies have lagged other global regions this year. After stellar 2020 performance, COVID vaccine availability in lesser developed countries combined with the Chinese government's political rhetoric against their own markets have made investors less secure in the near term. With vaccination rates even less than those in Japan, the Asian EM segment has lagged modestly behind their developed counterpart. We expect vaccinations to rise worldwide over the next year. This should eventually favor EM. |

# FIXED INCOME

**Limit Rate Sensitivity With Intermediate Focus**

We continue to suggest a blend of high-quality short-to-intermediate bonds in all portfolios with fixed income exposure. The 10-year Treasury yield now stands at 1.31%, but we continue to believe the rate will rise to levels between 1.75%—2.00% over the next 6 to 12 months. As the economy continues to improve and as more economic sectors participate in the full recovery, the cost of money will undoubtedly also rise. In our view, compensation for longer-maturity and rate-sensitive bonds remains unattractive.

The continued economic expansion allows for high yield bonds issued by stable but growing companies to be a productive use of fixed income capital. We remain committed to a modest high yield position in both corporate and municipal bonds. Further, the expanding economy has and will likely continue to produce modest inflationary pressures. Therefore, reasoned inflation protection in fixed income portfolios has been and continues to be warranted.

We favor municipal bonds for tax-sensitive accounts. Federal stimulus and prospects of higher personal tax rates provide support to muni markets.

| Positioning | | Low / Medium / High | Rationale |
|---|---|---|---|
| | Credit Quality | Medium–High | Credit spreads remain elevated, although not as pronounced, but the economic outlook may be supportive. |
| | | Short / Int. / Long | |
| | Duration | Short | Concerns over rising interest rates/inflation with the prospects of economic acceleration increase interest-rate risk. |

# COMMODITIES

Our precious metals view is neutral with gold remaining close to its 52 week low. The attractiveness of precious metals is further reduced by the improving economic outlook, rising interest rates, and the stability, if not strength, in the U.S. dollar.

The global demand outlook has improved recently as a post-pandemic environment comes into view. Though falling recently, higher oil prices over the past year have increased the amount of profitable available production in the near term. Our concerns remain on the supply side, as higher prices could lead to increased U.S. shale production, while more OPEC+ (including Russia) production is likely on the way.

# CONCLUSION

As referenced in many of the 2021 monthly insights, our confidence in a full economic recovery remains high despite the clear danger that COVID and its variants pose. The U.S. consumer and small business owners have contributed to this massive economic rebound and it does not appear they will implement revenue-inhibiting measures moving forward. Rather than increase obstacles to growth, businesses are taking measures to assure revenue as well as assuring the health of all concerned.

As we examine market risks, we continue to believe these risks are known, manageable and will not likely impact the continued expansion. The market will continue to look forward to a prosperous, post-pandemic environment.

Disclosures

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