MARKET INSIGHT MONTHLY

October Update

# MONTHLY COMMENTARY

UNITED BANK Wealth Management

Notwithstanding the recent decline, equities had been performing exceedingly well over the past twelve months, with limited volatility and few short-term corrections. From the lows reached in October of 2022 to the recent summer highs in late July, the S&P 500 had increased 28% while the Nasdaq had increased 39%. As we have noted in previous issues of our Market Insight, market performance has shown itself to be vulnerable during the late summer and autumn months, and equities are often at risk of a short-term pause or mild correction following such strong performance.

Though interest rates are modestly higher than at the year's start, they were relatively stable and reasonably predictable through July. This stability and consistency allowed investors to assume a higher risk appetite and select stocks over bonds. However, as time marched on into August and September, headwinds began to develop. Energy supplies were threatened, and the Fed began to emphasize short-term rates may be higher for much longer, causing bond investors to push rates above their previously set upper boundaries. The result has been a reasonable equity market correction in most benchmarks.

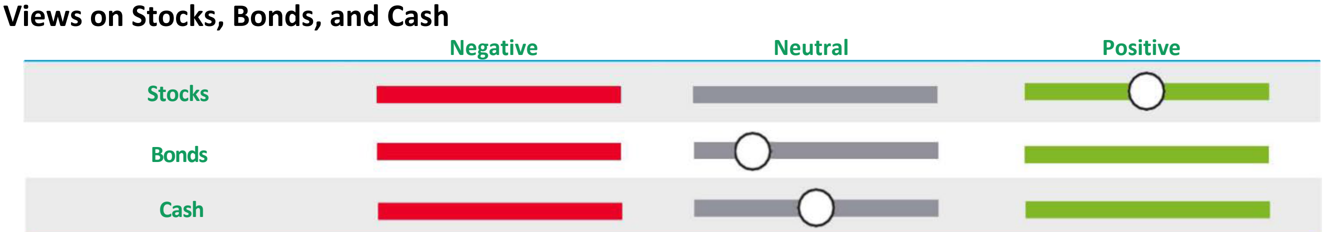
As some degree of stabilization started to unfold in early October, conflict in the Middle East reared its ugly head once again. Dormant geo-political concerns drew the world's attention for the second time in as many years. Though investor confidence seems to have weakened, we encourage our clients to reflect on where we were just one year ago and the long-term value of staying invested. Diversified, risk-managed portfolios remain essential. We continue to monitor global developments and have tactically altered portfolios to minimize risk when and where appropriate.

## INVESTMENT TAKEAWAYS

- 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. On one hand, interest rate increases are appealing to investors seeking to add yield and income. On the other hand, it has taken some investment capital away from equity markets. We see this overall correction as reasonable and consistent with prior adjustments. The clear attractiveness of consistent, low-risk returns of over 5% cannot be denied for short-term-focused investors. Although conditions on several international fronts may present additional obstacles that are not easily solvable, investors with a solid, well-constructed long-term plan and approach need not be alarmed.
- Though the Fed made no changes to rate policy in September, the short end of the yield curve (1 month to 2 years) continues to remain high in concert with Fed policy. Surprisingly strong economic data combined with energy supply and global activity fear has lifted intermediate and long-term rates to multi-year highs. The Fed Funds Futures market is now predicting short-term rates will be maintained well into 2024. We then expect gradual decreases into 2025. United has recently reduced short-term fixed income exposure and slightly increased duration, as we believe rates are unlikely to rise significantly higher.
- 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, 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 impacted 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. We believe rates are in the peaking process and equities will rebound once interest rate stability has been achieved.
- 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. 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.
- In fixed income, the interest rate curve is becoming appealing, which will lead us to re-position to our full baseline allocation when the rate peaking process is manifest. We continue to favor short to intermediate maturities.

## BROAD ASSET CLASS VIEWS

### Views on Stocks, Bonds, and Cash



# EQUITY ASSET CLASSES

As we have previously noted, seasonal and cyclical disruptions in the market are common at this time of the year, but unexpected geo-political conflicts are contributing to the volatility we are currently experiencing. Although the world and investors have come to expect a certain baseline level of instability in the Middle East, those expectations of "normal" tensions were shattered on Saturday, October 7. Global investors are now faced with a new set of variables that may potentially lead to different investment conclusions. In the near term, investors are concerned about military escalation and significant economic disruption, especially to the already vulnerable energy supply. While the future remains unclear, history has proven that selling stocks in times of duress may reduce immediate anxiety but is rarely a successful long-term strategy. At this point, we remain committed to our longer-term vision. We will continue to evaluate both global and domestic events and their impacts as they become evident. The national debt ceiling dilemma remains outstanding, potentially leading to the threat of a government shutdown in November. Yet to date, with many of these recently created obstacles factored in, the S&P 500 is down only single digits from its high in July and is still up double digits for the year. Earnings are currently being reported for Q3 and, though early, they are once again surprising to the upside. 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. Markets have rebounded strongly from their 2022 lows, and this recent pause, although stressful, is reasonable as we stated in last month's Market Insight.

| | | 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. We will remain overweight in this segment. |
| | **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 well. Much of the market's performance is heavily tied to seven mega-cap companies. This sector has benefitted greatly from the perception that inflation is better controlled and therefore interest rates will stabilize and eventually decline. However, much like the rest of the stock market, growth stocks have modestly suffered during this recent correction due to rate increases. 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 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 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

### An Opportunity Has Presented Itself: Extend Duration

One year ago, the United Bank Investment Committee made a tactical fixed income allocation change by voting to reduce duration in our fixed income portfolios to mitigate potential damage resulting from increasing interest rates. At the time of our decision, the 10-year Treasury bond yielded 3.85%. Currently, the 10-year Treasury is yielding approximately 4.90% and, unfortunately, investors who had not shifted their portfolios towards the front-end of the yield curve would have seen a sizable reduction in their fixed income values. Our Investment Committee believes interest rates are in the peaking process. While they may still travel a bit higher in the near-term, we do not believe they will increase significantly beyond current levels. Therefore, in our most recent tactical shift, we have voted to remove a sizable allocation to our shortest-term fixed income allocation in favor of extending duration. However, our average duration will remain slightly less than well-known bond benchmarks or common aggregates, thus still protecting asset values relative to common standards. In this way, we are preparing our fixed income portfolios for eventual rate reductions. We expect further progress will be made on reducing inflation, and further expect that rates will not be held as high once the Fed is more comfortable with their progress. We 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 | | 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 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 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 by government policy. This makes price forecasting even more precarious. Year-to-date, broad baskets of commodities have been nearly flat, while oil is up close to 10% and gold has increased nearly 5% per ounce. Both oil and gold were recently trading much lower and have only advanced due to the Middle East turmoil of the last few weeks. 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. Commodity indexes remain substantially 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 conflicts in Eastern Europe and the Middle East. 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, albeit short-lived. August through October has a propensity for unfavorable events and surprises. Yields are at multi-year highs, inflation has yet to completely stabilize, a debt ceiling bill is nowhere in sight, another federal government shutdown could be on the horizon, striking workers permeate major industries, and Middle East turmoil has flared up once again. Undoubtedly, each of these issues will be resolved in time, but the uncertainty of current conditions both globally and domestically necessitates additional risk assessments nonetheless. With some perspective, the risk related to each of these issues can be weighed independently, and some risks are greater than others. Markets are undergoing a reasonable correction in light of the heightened uncertainty, and we remain cognizant that equity gains in excess of 25% were generated from the 2022 lows through late July. Profit taking and corrections are expected. Furthermore, 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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