MARKET INSIGHT MONTHLY

May Update

MONTHLY COMMENTARY

UNITED BANK *Wealth Management*

History demonstrates markets may react to election results for a very short period of time, reverting back to its primary trend almost immediately thereafter. After examining equity market performance from mid-May to election day over the past six Presidential elections dating back to 2000, the S&P 500 rose five out of six times with an average gain of over 7%. The notable exception was in 2008, when the market was already in midst of the Global Financial Crisis. Furthermore, four out of six of those years ended positive by year-end, with the only additional exception being the year 2000 when investors were beginning to feel the fuller effects of the dot-com bubble.

When one examines the next full calendar year after an election, five of the six years turned in positive performance, averaging a 22% gain. The only negative year was 2001 when the high-tech industry was still suffering from excessive valuations and little earnings growth. It is our contention institutional analysts and investors tend to evaluate the true data propelling economic function which simply cannot be altered in the few months immediately preceding or following an election no matter its importance and potential impact. Campaign promises and action supporting political changes take time to implement. The factors and variables which lead to change are often elusive and not as predictable as one may think.

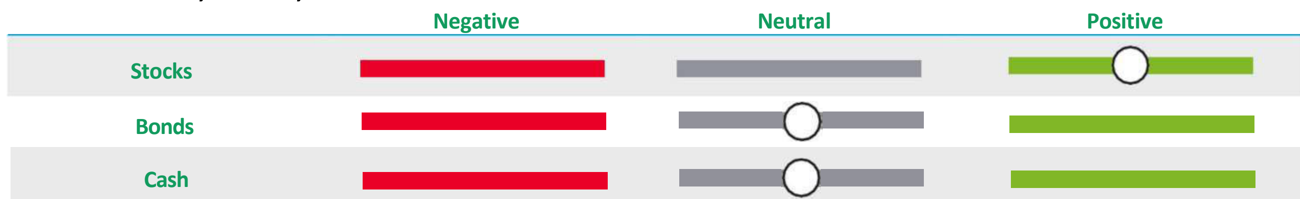
We have no reason to believe recent market history will not repeat itself again during this campaign cycle and the general economic conditions will once again prevail as the major factor being considered by investors come election time. We remain focused on quality employment figures and continued progress bringing inflation to even lower levels.

INVESTMENT TAKEAWAYS

- The modest equity pullback in April can be attributed to two factors. The first being that investors had not experienced any reasonable or normal pullback since this rally began in October of last year. Second, recent inflation threats leading to unexpected rate increases caused investors to rethink their risk parameters and lock in short-term trading gains. Investors had been able to tolerate the higher rate structure in Q1, but starting in April, investors could no longer withstand the pressure of what may happen if the Fed tightens rates once again. Rates traded up and out of their previous ranges as a result, which negatively impacted equity markets.
- The general expectation that rates would not go appreciably higher was compromised. The higher levels of risk that investors had assumed changed quickly, leading to the brief, but overdue market correction. However, in very late April, new inflation and economic reports offered more encouraging news and refreshed investors are now extending the bond and stock market rallies. The Fed is likely to lower interest rates in 2024. The larger question is timing and magnitude. Investors and consumers are still experiencing an actionable wealth effect by both spending and investing more. The market correction was also a healthy reminder that fundamentals and valuation matter.
- In a partial repeat of 2023, many mega-cap technology and communications companies are performing well and carrying indexes ever higher. Unlike 2023, more companies are participating in this rally and general market breadth is healthier. Large-cap growth stocks remain in favor, though mid-caps have shown positive momentum. Small-caps have yet to establish themselves due to “higher for longer” rate environment. We think it is only a matter of time until this segment improves.
- The Fed has made no changes to interest rate policy since July of 2023. Chairman Powell has stated, and in April reemphasized, future Fed actions will be data-dependent. With that being said, we believe it is possible one to three rate reductions, at most, may occur this year.
- We maintain our commitment to risk-managed portfolios and protecting asset values in times of uncertainty and volatility. We feel a global economic transition will continue to develop, which ultimately favors technological advancement. This universal trend will impact and advance all corporate enterprises. To this end, we have adjusted our allocation and now slightly favor growth companies in our domestic mid-cap, small-cap, and international developed allocations. In our large-cap segment, we also increased exposure to growth, yet maintained a very modest value overweight. This growth adjustment has been beneficial to date for all managed portfolios containing equities.
- International developed nations' equity markets continue to outperform emerging markets through April. Much like 2023, the U.S. economy is still outperforming those of almost every other developed nation. The U.S. Dollar has oscillated between 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, but has shown recent strength due to slightly higher rates. We expect developed markets will continue to be preferred over emerging markets. Our emerging market ex-China position has been timely and profitable since implemented in 2023. The Chinese market has recovered of late but is almost entirely driven by internal domestic buying.
- Inflation is unlikely to decrease in a linear fashion. Nonetheless, we do not believe interest rates will experience significant upward pressure. Some degree of volatility and trading uncertainty is expected. The current yield curve is favorable for a well-balanced, moderate duration position. We favor intermediate maturities with some exposure to shorter-term maturities and the high-yield segment.

BROAD ASSET CLASS VIEWS

Views on Stocks, Bonds, and Cash



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EQUITY ASSET CLASSES

After a very strong first quarter, equities retraced some of their gains in April. Over the past several months, United has been suggesting the very pronounced bullish leg which began last October could eventually succumb to some level of consolidation and profit taking. To some degree, it was overdue. Many short-term technical measures indicated an overbought equity market has existed since January. This in turn led United to proceed with some temporary caution as our readers may recall from our prior Insights. When combined with the last quarter of 2023, the stock market generated some of the best five-month sequential returns in its history with little volatility and not so much as 2.5% pull back. From the highs in March to the lows in April, the S&P 500 shed nearly 6% intraday. However, the market has already begun a new leg higher. The large- and mid-cap sectors have been quite resilient. The small-cap segment continues to struggle with the higher interest rate dilemma, but it is our estimation that small-caps will eventually stage a more consistent and potentially powerful upward bias once the threat of higher rates has been eliminated. Market leadership is expanding and market breadth, meaning the cumulative number of stocks advancing vs declining, has recently set new highs in both the number of stocks advancing and the volume of shares being traded on those same advancing companies. Leadership is more inclusive and encompasses more industries. Expanding breadth is a sign of a healthy market. With just over 90% of the S&P 500 having reported first quarter earnings, 78% of them beat estimates. The future looks quite bright, with full-year 2024 earnings estimates increasing and now expected to grow close to 10%, year-over-year. Although 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.

		View	Relative Trend	Rationale
Market Capitalization	Large-Caps			Through April, U.S. large-cap stocks are among the leading global equity performers. Growth companies, particularly mega-cap tech and communications companies, performed exceedingly well in 2023 and are doing the same, year-to-date. Some consolidation of gains is taking place as a modest amount of profit taking was expected given the significant rally since last October. Broad participation, or breadth, is expanding to other segments and industries, which increases a market's bullish longevity. Some tech companies may have a more difficult time attracting as much capital as they did in 2023 as valuations are stretched. We will maintain our large commitment to the large-cap segment.
	Mid-Caps			Mid-cap companies are having a solid year but saw a modest pullback with the interest rate increases in April. Similar to the large-cap segment, investors are showing a preference for the growth style, but leadership is broadening. Earnings are stable and valuations are reasonable. We expect more sustained gains as interest rate stability is restored. Earnings should be healthy in the second half of 2024.
	Small-Caps			The small-cap sector was disproportionately impacted by rising rates through the summer of 2023. Once again, higher rates have made investors' less enthusiastic in the short term. Although small-cap companies performed exceedingly well as rates fell in late last year, rate fears are serving as a current obstacle. We expect this will change with lower inflation reports as the year progresses. Earnings reports are encouraging and valuations remain attractive.
Style	Growth			Much like 2023, large-cap growth companies have led the way this year through April. While more companies are participating in the current upside move and more segments of the economy are being represented, growth remains dominant. Investors are being rewarded by diversifying their growth holdings as market performance is not as narrow as in 2023. United has recently increased our growth weighting across all domestic segments.
	Value			Although United recently lowered our value 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 of late due to attractive valuations and reliable earnings. We anticipate further gains in 2024 as lower rates prompt a broadening 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. However, due to the significant rally since last fall, valuations, despite quality earnings, are only reasonable in the large-cap segment. Large-cap growth valuations remain elevated and were subject to most of the recent pullback. Both mid- and small-cap companies remain attractive but are heavily dependent on interest rate movement. The strength of the U.S. employment environment has led to continued overall consumer health. Inflation is now much less of an obstacle, but it remains the main focus of the Fed and therefore has almost a daily impact on investment outcomes.
	Developed International			Much like the U.S., most developed countries have shown significant progress in battling inflation and stabilizing interest rates. Like the U.S., international central banks are challenged with bringing down rates too quickly. We see continued global progress against inflation and international interest rates eventually declining which will permit further growth opportunity. We maintain our baseline weight to international equity but should global tensions ease, additional exposure may be warranted.
	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 has been timely and profitable. 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 not Surprising

Interest rates were modestly higher during the first quarter. They were little changed during the month of March and began to show an upward bias during April as higher inflation threats crept back into investor worries. Apart from the short end of the yield curve, which has been constant for the better part of ten months, the rest of the yield curve has remained elevated as investors digest consistently healthy economic figures. These better economic conditions have prevented inflation from falling anywhere close to the 2% Fed target. While major progress has been made in reducing inflation from its 2022 peak, the final push to the Fed's targets has been a struggle. It is conceivable, if not probable at this point, the only way to reach 2% inflation will be through economic contraction. While certainly not preferable, it is probable that could be the consequence of more severe tightening. Bond investors should realize net gains from their current holdings as lower rates in the future will undoubtedly raise bond values. United anticipates the yield curve will remain fairly stable over the foreseeable future, experiencing only marginal variance. Our decision to extend duration in early October 2023 was timely and remains profitable. We generally returned to "average" duration portfolios but kept a slight bias to short-term securities as a precaution against a strong economy and inflation that might not fall as rapidly as hoped, which has been the case. Unless another dramatic global event triggers additional inflationary fears, we do not anticipate a change in the lower inflation/lower rate environment, but it is taking more time to achieve than the Fed anticipated. Further, rate declines in 2024 will not be as significant as had been estimated at the year's start. We currently recommend a blend of high-quality, intermediate-term bonds in all fixed income portfolios with appropriate 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	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	Between Short and Int.	United believes short-term rates are stable, near their peak, and locked into place due to Fed policy. Longer rates are range bound with minor variance.

COMMODITIES

Despite ever changing world events and continual supply-chain threats, commodity prices have been relatively stable in 2024. Speculative influences within the commodity markets are always a factor and this year is no exception. The ugly and time-worn cold war perspective from both Russia and China to elevate concern and add fuel to world risk has led both of their central banks to purchase abnormally large quantities of gold. As the Chinese stock market has been among the world's worst performers over the last 5 years, with fewer international investors willing to add new equity capital and Chinese citizens looking for a better return, gold-buying has become a more common trend of late. Similarly, Russian stocks have staged a strong rally over the past year, but they have been removed from emerging market indexes. Due diligence is questionable, and it is assumed that much of the equity and gold market rally is attributed to Russian central bank buying. West Texas Intermediate and Brent Crude Oil prices have retreated from their highs and have lost about half of their gains. They have now increased less than 10% this year with little quantitative data suggesting materially higher demand or lower supply. Broad commodity benchmarks have also increased less than 10% through April, as most agricultural prices remain subdued. We do note copper prices are rising possibly indicating stronger vs. weaker global economic conditions ahead. Interest rates are modestly higher from year-end, pushing the dollar higher.

CONCLUSION

Over the past several months, United suggested investors had factored in nearly every positive attribute driving equity markets ever higher. We felt that while economic conditions remained healthy, short-term overbought conditions were likely to cause some institutional investors to pause. April provided a modest and brief break in the rally. All markets need some time to digest significant movement, up or down, and reassess conditions. The limited pullback has given way to another rally, extending gains. As we have offered for some time, markets, over the longer-term, are a reflection of consumer well-being. We continue to be encouraged by employment reports, retail sales and housing starts. Although mortgage rates are substantially higher than in recent memory, residential home prices continue to increase as housing supply remains limited. Currently, the Russian war in Ukraine, the Israeli action in Gaza and the U.S. presidential elections have limited impact. Both wars are contained at the moment, and do not pose supply-chain obstacles. We will continue to closely monitor all global events but see general expansion of economic activity.

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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Economic forecasts set forth may not develop as predicted.

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