

The Investment Perspective

A Quarterly Newsletter From Sabal Trust Company

second quarter 2011

“Reality of Risk”

The first quarter served as a reminder to all investors of the present risks lurking in the global financial markets in the form of uncertainty and heightened volatility. Investor sentiment shifted by oscillating between states of extreme euphoria and unbridled optimism to that of a tone of caution and risk aversion.



Tailwinds

While the market faces an array of hurdles, positive growth drivers exist. Corporate financial strength remains solid with approximately \$2 trillion in cash reserves that can be utilized for acquisitions, hiring activity, capital expenditures, increased dividends, and share buybacks. Accommodative monetary and fiscal policies remain firmly entrenched as policy makers remain intensely focused on providing support for the underlying economy. The extension of the Bush-era tax cuts, combined with potential pent-up demand could be the driving catalysts that move markets.

Headwinds

Geopolitical risks continue to increase market stresses as social uprisings and political struggles in the Middle East morph into potentially disruptive sets of events. In addition to the turmoil in the Middle East, other exogenous factors including the Japanese catastrophe, the growing fiscal deficit, and lingering stresses in the labor markets continue to elevate uncertainty across capital markets. **The ultimate impact of this landscape altering reality is unknown and could prove disruptive to the evolving global recovery.**

Energy Prices

Geopolitical risks elevated concerns over a potential global oil supply shock and resulted in premium pricing for oil. The Middle East and North Africa, the epicenter of the crisis, produces approximately one third of global daily oil production. Limited excess production capacity exists, but the contagion effect of the social unrest has markets focused on Saudi Arabia and their ability to provide a supply buffer until the geopolitical environment normalizes. **Higher energy prices dampen demand and alter spending patterns as consumers adjust their budgets for the inflated costs.**

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Sabal Trust Company

Investment Management
IRA & Trust Services

Stock Focus

Bank of Montreal

Stock Symbol: BMO Long Term Earnings: 9%
Market Capitalization: \$35.8B 2011 P/E: 12.8x
Dividend Yield: 4.2% Return on Equity: 14.4%

Founded in 1817, Bank of Montreal (BMO) is a diversified, Canadian-based banking institution providing commercial and personal banking services. BMO combines a strong banking franchise with a profitable capital markets operation and a growing U.S. banking presence as seen by the recent acquisition of Marshall & Ilsley Bank. The dividend yield, one of the more attractive in the banking sector at 4.3%, is well covered by cash flow from operations. The future earnings growth prospects are encouraging and valuations are extremely attractive.



Interest Rates

The push/pull dynamic of factors will likely result in a range bound pattern for interest rates over the coming months. A steeper yield curve evolved over the last few months as investors anticipated elevated future inflation. However, structural influences, including continued deleveraging, the impact of sustained high energy prices on underlying economic growth, the flight to safety due to lingering geopolitical risks, and domestic unemployment and housing challenges could push interest rates down for an extended period.



Inflation

Increased demand, stockpiling, and speculation activities elevated global commodity prices sparking inflationary fears. More recently, a supply shock in the oil markets sent energy prices skyrocketing, exacerbating those fears. Domestically, even in the face of elevated commodity costs, inflation remains subdued due to structurally high unemployment and excess slack in manufacturing capacity. An accommodative Federal Reserve continues to influence the economic environment by providing additional liquidity, and *it is unlikely that a policy shift will take place until signs of sustainable employment growth emerge.*

Municipal Bond Markets

Structural pressures on municipalities exist and are largely attributable to fiscal deficits and the

economic fallout of the “great recession”, not longer-term obligations. *Talk of mass defaults across the municipal landscape ensued without regard for the fact that default rates for investment-grade municipals hover around 0.05%, considerably less than corporate bond default rates.* State governments legally cannot declare bankruptcy and because these entities require continual access to the credit markets, it imperative that debt payments are not missed because doing so would dramatically increase future borrowing costs. Prudent strategies within the municipal bond space involve utilizing general obligation bonds, which are backed by the full taxing authority of the underlying municipality or state. Using revenue bonds should be limited to essential service bonds, including water, sewer and electric utility issues that service stable user populations.



Our Outlook

The emotional pendulum is swinging once again due to heightened geopolitical discord and social unrest, elevated energy prices, and inflated commodity prices. Uncertainty fuels volatility, which creates opportunities for investors deploying prudent, well diversified, long-term oriented investment strategies. During times like this, *remaining focused on risk control and containment is critical to achieving investment success.*

