Sabal Trust

Market Update: January 3, 2019

Through late December, the markets continue to exhibit heightened levels of volatility and the most commonly asked questions are "why is the market so volatile?" and "how long will the volatility last?" The Sabal Trust Investment Strategy Group continues to discuss and analyze the former and have shared a number of the pressure points with our teammates and clients over the last several weeks. Any answer to the latter is more elusive; yet, it provides each of our relationship management teams an opportunity to have important touch points with our clients.

Primary Contributors to Volatility:

- Trade challenges with China continue to influence strategic and tactical decision making from corporations, businesses and investors alike. While the difficult work of negotiations remains ahead, there is a brief window to negotiate tariffs, intellectual property protections, barriers to market access, cyberespionage, and other complex national security issues signal tremendous uncertainty about the ultimate outcome. Negotiations can be a messy process, especially as they play out in the media.
- The economy has reached peak earnings growth and over the last several years is transitioning from a very low interest rate environment to a "neutral" rate environment. Rising bond yields compete more readily for investment dollars, which have recently been allocated to equities.
- Market returns during the last two years were strongly influenced by the successful, high growth companies (Facebook, Amazon, Alphabet, and Netflix) in technology, consumer services, and social media spaces, which had enjoyed explosive price appreciation during most of this year. This resulted in stretched valuations beyond all reasonable valuation metrics and eliminated any margin of safety in these popular stocks.
- The Federal Reserve increased interest rates for the 4th time this week. Policy makers forward looking statements, coupled with parts of the yield curve that are inverted, continue to fuel speculation about the sustainability of the economic cycle.
- A year-end institutional push for liquidity is resulting in a broad selling of assets regardless of quality, size, style, etc.

The investment team continues to frame the 2019 macro themes that will influence the markets. We also are analyzing how the Sabal Dividend Growth strategy should be positioned against this backdrop.

Investment Themes:

1. Maturing of Global Growth Cycle
2. Monetary Policy Adjustments
3. Public Policy Initiatives
4. Lower Market Return Profile
5. Elevated Market Volatility

Our Outlook for 2019:

- The shift to the later stages of the economic cycle bring with it the continued re-rationalization of asset pricing and valuation.
- Volatility will likely remain elevated even as the economic backdrop remains healthy.
- The return profile of the equity markets will be positive, but lower given the shifting outlook on earnings.
- Fixed income returns will likely be limited to the coupons.
- Cash will remain competitive from a short-term perspective given the higher interest rates.
- A rapid improvement of the trade environment would be a positive influence to our outlook
- Prolonged trade negotiations, an unexpected exogenous shock (Brexit situation, etc.), overly aggressive Federal Reserve, and further political polarization could dampen our outlook on the markets.
- Regarding the Sabal Dividend Growth strategy, we remain focused on solid, predictable cash flows from dividend-paying stocks, which is prudent and appropriate given our client mandate. The portfolio's income continues to grow even during those periods where stock prices fluctuate. We will continue to strategically re-position the Sabal Dividend Growth Portfolio in 2019 as the volatility profile of the market plays out. Any changes will be designed to protect our clients' underlying capital from the inherent risks in the market.

Going Forward:

Signposts indicate the economy could be reaching a late-cycle stage. After several years of strong market gains, asset allocations could be stretched in favor of risk-assets. Consequently, investors should regularly revisit their ability and willingness to incur risk across their investments. Given the lingering political headwinds and the potential risk of exogenous shocks, asset allocation levels in portfolios should be carefully monitored. Therefore, re-evaluating asset allocation targets and moving back to guidelines will help protect assets in the event volatility remains elevated.