Investment Environment & Outlook

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Sabal Trust

Market Environment

During the 1st quarter, markets recorded their strongest start to the year since 2012 as the extreme selling pressure that defined 4Q18 appeared in the rearview mirror. While a more positive pricing environment has developed, the contributors to last years market volatility, including trade questions with China, peak earnings growth, and a less accommodative Federal Reserve have not dissipated. Shifting to the later stages of the economic cycle will bring the continued re-rationalization of asset pricing and valuation. Volatility will inevitably return even while the economic backdrop remains healthy. Consequently, investors should remain focused on their ability to take risks that will ultimately impact their family legacies.

WEAKER GDP

GDP momentum continues to weaken with growth peaking at (+3.5%) in 3Q18 and 4Q18 GDP slowing to (+2.2%). We expect further declining of growth rates through the balance of 2019. Questions surfaced about the durability of the consumer as 4Q spending slowed across both durable and non-durable goods.

We continue to monitor the impact of capital expenditures on productivity gains and consumer confidence to determine the sustainability of the cycle. While slowing, economic growth remains positive.

MANUFACTURING

We believe the ISM Manufacturing index is an important gauge of economic health as it measures new orders, deliveries, production, inventories and employment. Expanding business activity indicates underlying economic health and optimism about the future prospects of the economy. Conversely, contracting inputs signal that the economic footing is less stable.

After falling sharply at the end of 2018, the ISM index rebounded in January and again in February as new orders and production activity increased, which indicates healthy economic activity. Careful attention needs to be paid to lingering headwinds, including the strong U.S. Dollar and trade issues.

EMPLOYMENT

A solid economy continues to fuel the longest stretch of improving employment growth in history. The February unemployment rate edged slightly lower to 3.9%. The labor force participation rate remained unchanged at 63.2%, which continues to indicate an economy at full employment. Impacts from the partial government shutdown and adverse winter weather appear minimal.

Wage inflation continues to percolate as February wage growth reached (+3.4%) y/y. Finding workers in a supply constrained market is more challenging, naturally leading to upward pressure on wages as companies compete to attract and retain workers.

Interest Rates

INFLATION

In February, core inflation (ex. Food & Energy) slightly increased (+0.1%) due to higher housing and medical prices and is (+2.1%) y/y. Yet, headline inflation data fell to an 18 month low at an annual rate of (+1.5%), primarily due to lower energy inputs. Declining energy costs have dampened business inflation measures (Producer Prices).

Tight labor markets and increasing wages are yet to prove inflationary. For now, it appears that the Federal Reserve remains ahead of inflation, allowing policy makers to be patient by pausing their rate adjustment activity.

INTEREST RATE OUTLOOK

In March, the Federal Reserve significantly reversed their forward-looking interest rate guidance by telegraphing no further rate increases in 2019 and only one increase next year. Policy makers cited slowing domestic economic growth and mounting global headwinds as catalysts for this shift.

Future policy decisions will require time to assess and any rate adjustments must factor in the economic impact of the on-going trade negotiations as well as global growth pressures. Today, the markets are pricing in rate cuts in 1Q20 and actually started to factor in a cut later this year.

Consumer Influences

CONSUMER CONFIDENCE

Consumer confidence fell in March and remains in a soft-patch after declining in 4 of the last 5 months. In fact, confidence levels reached their lowest point in close to a year. Consumers tempered their optimism about economic conditions and expressed concerns over the labor markets and overall business conditions.

We believe that consumer confidence levels are important due to their high correlation with consumer spending. Benefits from tax cuts and the “wealth effect” from elevated asset prices that positively influence consumption patterns could be waning. Any material, negative shift in sentiment is an early warning signal that requires attention.

HOUSING MARKET

After three straight months of declining existing home sales, February data including both single and multi-family units, recovered (+11.8%). Early sales data indicates a surge to even higher levels after the Federal Reserve signals a pause in rate increases during March.

February home prices rose (+3.6%) and the increase now represents over 84 consecutive months of y/y price gains. Affordability indexes should be monitored as rising input costs (material, labor, and borrowing) further elevate the cost of purchasing a home. Since housing is a leading economic indicator, signs of softening demand could signal tougher economic times ahead.