Investment Environment & Outlook

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Sabal Trust

Market Environment

Investors continue to maneuver their way through the 1Q19 earning season with lowered expectations, yet a great anticipation of forward guidance from corporate management teams. Stock price returns are linked to corporate profits and actual earnings. Inevitably, the wheat will separate from the chaff during this earnings season as investors reward companies with sustainable earnings models and look with disfavor on those that fall short of expectations. Shifting to the later stages of the economic cycle will bring the continued rationalization of asset pricing and valuation. Volatility remains a potential risk 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.

SURPRISE GDP PRINT

After peaking last year and slowing to (+2.2%) in 4Q18, GDP unexpectedly accelerated in 1Q19. The surprising results were driven by trade (imports) and inventory rebuilding, which tend to have the greatest variability between quarters. Questions remain about the consumers durability as 4Q18 and 1Q19 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.

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.

In April, the ISM fell to its lowest level since the end of 2016 as new orders and production activity declined. 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 March unemployment rate remained at 3.8%. The labor force participation rate remained unchanged at 63.2%, which continues to indicate an economy at full employment

March wage growth grew (+3.2%) 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. We will continue to monitor corporate profit levels as input costs rise (wage inflation) and top-line revenue growth slows.

Interest Rates

INFLATION

In March, core inflation (ex. Food & Energy) slightly increased (+0.1%) due to higher housing and medical prices and is (+2.0%) y/y. Headline inflation data recovered from an 18 month low and reached an annual rate of (+1.9%), primarily due to higher energy inputs. Even with higher energy costs, business inflation measures (Producer Prices) remain muted.

Tight labor markets and increasing wages are yet to prove inflationary. For now, it appears that the Federal Reserve remains ahead of inflation, easing policy guidance in response to lower inflation expectations.

INTEREST RATE OUTLOOK

During the 1st quarter, 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

After hitting a soft-patch and declining in 4 of the last 5 months, consumer confidence rebounded in April. Consumers expressed a greater optimism about the economy as well as 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

Existing home sales fell again in March (-4.9%), which includes both single and multi-family units. These declines occurred even after the Federal Reserve signals a pause in rate increases during March. Conversely, new home sales, which represent approximately 11% of housing sales, increased (+4.5%)

February home prices rose (+3.6%) and 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.