Investment Environment & Outlook

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Sabal Trust

Market Environment

During the first four months of 2019, markets recorded their strongest annual start since 2012 as dovish central bank policies helped to ease investor anxieties; yet, enduring sources of volatility remained beneath the surface. These included elevated uncertainty around trade, fiscal policy initiatives, and cyclical risks as the expansion enters its 11th year. In May, volatility returned in dramatic fashion leaving investors to ask: "why is the market so volatile?" The primary risks today appear to be geopolitical and tied directly to the trade impasse between the U.S. and China. The uncertainty of the situation will likely result in continued volatility until some resolution unfolds.

ECONOMIC INDICATORS

Economic indicators (leading, coincidental, or lagging) are statistics providing a pulse on the economy. Leading Economic Indicators (LEI) are highly correlated to the economic cycle. LEI components include the Purchasing Managers Index, durable goods orders (a survey of manufacturing activity), consumer confidence, and interest rates.

The April LEI's increased for the third straight month driven primarily by higher stock prices and healthy financial conditions, which indicates continued economic momentum. Yet, second order impacts from the trade war could show up in future data releases.

TRADE POLICY

Global trade risks remain elevated given the unresolved trade issues between the U.S. and China. Even with potential bi-lateral trade agreements between the U.S. and other trading partners, the situation remains fluid as protectionist tones cast a cloud over an otherwise positive economic environment.

Increased input costs from tariffs and trade barriers ultimately will dampen global trade, slow economic momentum and lead to market repricing. We continue to monitor the trade negotiations as they play out in the court of public opinion.

PMI SURVEY

We believe the ISM's Purchasing Managers Index (PMI) is an important gauge of economic health as it measures employment activity, new orders, deliveries, production and output, as well as inventory levels. 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 May, the ISM slowed to its weakest pace in close to a decade 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.

Interest Rates

INFLATION

In April, core inflation (ex. Food & Energy) slightly increased (+0.1%) due to elevated housing and medical prices and is (+2.1%) y/y. Headline inflation data recovered from an 18 month low and reached an annual rate of (+2.0%), primarily due to higher energy inputs. Even with amplified 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 inflationary pressures. However, elevated costs from a prolonged trade dispute and lingering tariffs could ignite inflationary pressures.

INTEREST RATE OUTLOOK

After significantly reversing their forward-looking interest rate guidance last quarter by telegraphing no further increases in 2019, the Federal Reserve remains firmly on hold. Policy makers cited a desire to be “patient” as they monitor and assess slowing domestic economic growth and mounting global headwinds.

“Data dependency” indicates that future policy decisions require time to assess and any rate adjustments will factor in the economic impact of the on-going trade negotiations as well as global growth pressures. The credit markets continue to factor in rate cuts as part of the next policy move.

Other Influences

CONSUMER CONFIDENCE

Consumer confidence surprised economists by surging higher in May. This closely-watched sentiment indicator is again close to a two decade high. Consumers expressed a greater optimism about the economy, the labor markets, and overall business conditions even with growing trade-related uncertainty.

We believe that consumer confidence levels are important due to their high correlation with consumer spending. Any material, negative shift in sentiment is an early warning signal that requires attention. Consequently, any elevated concerns over trade matters could negatively impact consumption patterns.

ENERGY PRICES

Much attention is paid to OPEC output quotas; yet, the U.S. is now the world’s largest producer of crude. This fundamental shift has dampened the impact OPEC producers have on the markets and put downward pressure on oil prices. Lower energy prices benefit consumers and free up disposable income to be spent elsewhere. Declining energy inputs also keep inflation subdued as shipping, transportation and other input costs fall.

After falling for four consecutive months, energy prices slightly increased in April (+1.7%). Tracking future energy and other input costs will assist in gauging inflationary pressures.

Fixed Income Observations

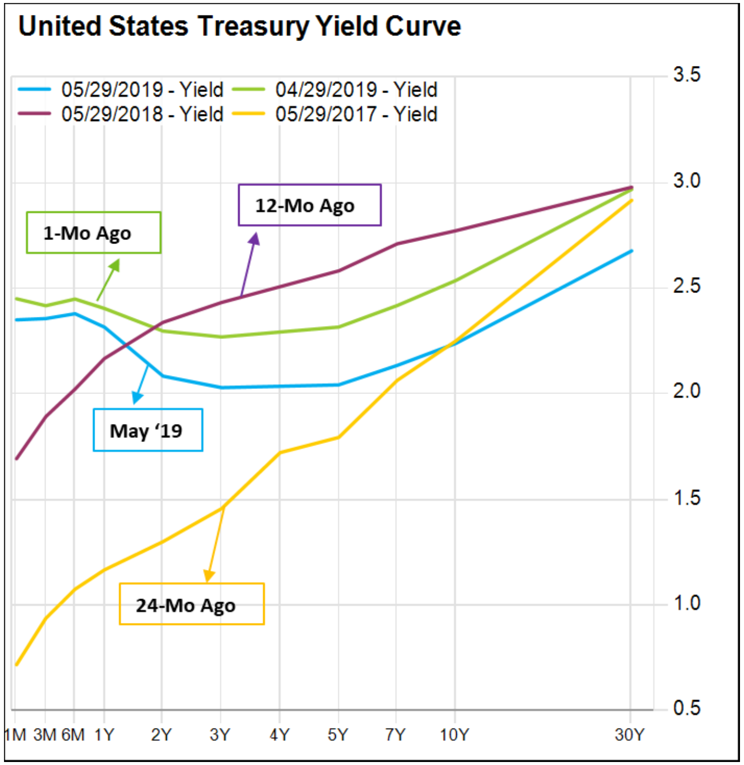
Since the outset of the year, the Federal Reserve captured bond investors' attention by adopting a noticeably more dovish tone resulting in parts of the yield curve inverting for the first time in over a decade. In May, 10-year Treasury yields plunged in the face of a less optimistic outlook for global economic prospects. Bond investors tend to possess a more dispassionate view than their stock market counterparts. They now appear even less sanguine about economic growth prospects. Against this backdrop, policy makers confirmed their desire to be "patient" and "data-dependent" in their assessment of the economy. Bond portfolio structures, specifically duration targets, should also be reviewed given the changing interest rate environment, as the yield curve remains flat-to-inverted and officials maintain a more dovish tone on rates.

YIELD CURVE

- FOMC minutes from the May 1st policy meeting brought no surprise as a "patient" approach was reconfirmed and the policy rate was left unchanged at 2.25%-2.5%. While the Fed minutes showed no strong inclination for moving interest rates, the market is pricing in a 95% probability of a rate cut by the end of next January. Investors are intensely focused on the June 2019 meeting as they look for signs of officials backing off their "patient" stance to make way for the possibility of a rate cut later this year.

- As a result of worsening trade-war concerns between US and China, US Treasury yields experienced a significant decline during the month, pushing the 10yr to its lowest level since September 2016 by closing at 2.13%. While the 2yr-10yr spread still remains positive at 15 bps, the 3mo – 10-yr Treasury spread has inverted again, sinking to -21 bps, which is the lowest since 2007.

- The shifting shape of the yield curve signals a changing environment, and requires investors to remain vigilant. During these periods, a measured approach is always prudent. An inverted yield curve is just one of many signposts investors should monitor with respect to the economy and the underlying markets.



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