Investment Environment & Outlook

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Sabal Trust

Market & Economic Environment

Historically, trading activity during the summer months, especially August, tends to be quiet as investors enjoy the last remnants of summer before a push toward year-end. However, extreme daily market volatility and streaming news headlines related to the on-going trade dispute and Federal Reserve policy making gripped investor attention and has shaped sentiment since the latter part of July. Nobody knows with certainty how the evolving story lines will play out, but what is clear is that volatility will remain a constant for investors.

MONETARY POLICY

As Federal Reserve officials attempt to navigate through a tumultuous period, they face difficult decisions as they address mixed economic signals coupled with political pressure from the administration. The policy bias remains firmly toward lower rates and the primary questions that remain unanswered are related to the magnitude and pace of future rate changes.

CAPACITY UTILIZATION

Capacity utilization rates measure how efficiently companies use their limited resources. Increasing rates could signal a growing cost structure, which is inflationary since it requires companies to raise prices to preserve profit margins. July's reading of 77.5% remains slightly below the long-run average, which signals that inflation is contained in the economy's manufacturing segment.

INFLATION

In July, core inflation (ex. Food & Energy) increased +0.3% due to elevated housing, auto, and health care inputs and is now +2.2% y/y. Headline inflation increased to an annual rate of +1.8% from higher energy prices (+2.5%). Moderate consumer and business inflation measures (Producer Prices) support the Federal Reserve's continued bias for lower interest rates.

TRADE ISSUES

2nd quarter earnings calls offered more clarity into the economics of the trade war. Tariffs have increased costs, influenced decision-making, and disrupted purchasing patterns. While the threat of tariffs as a negotiation tool risks damaging long-term trading relationships, only the pace and success of ongoing negotiations will dictate the ultimate impact on global trade and economic momentum.

RETAIL SALES

Consumer confidence levels remained resilient in July against a backdrop shaped by trade war salvos and questions about the economic cycle. Confidence influences consumer spending. July retail sales (+0.7%) driven by elevated spending in 10 of the 13 major categories, including: restaurants, electronics, and general merchandize. Going forward, consumer confidence and spending will directly influence the durability of the current economic cycle.

HOUSING

Year-over-year, new home sales increased approximately +4.3%. Yet, after an unusually strong June period, July 's figures plunged (-12.8%), which was the largest monthly decline in 6 years. Investors should continue to monitor affordability indexes as rising material and labor prices elevate the cost of purchasing a home. Housing is a leading economic indicator and any sign of softening demand could signal tougher economic times ahead.

Fixed Income Observations

The divergence of opinion continues to influence sentiment. First, there appears to be a lack of consensus among Federal Reserve officials regarding monetary policy as they grapple with their dovish interest rate policy. Given current economic data and the prevailing sentiment to remain ahead of potential weakness, it is likely that the Fed will move again and lower rates in September. The second source of divergence rests with the bond market participants as they continue to telegraph their souring sentiment on the economy versus the general optimism expressed by their stock market counterparts.

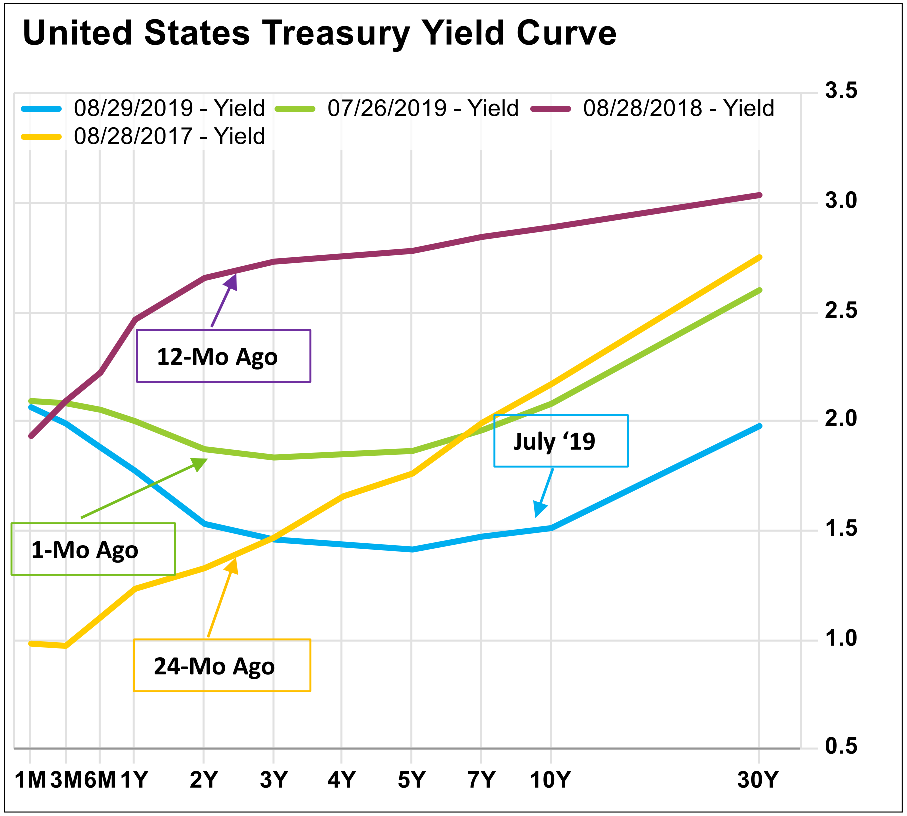
YIELD CURVE

- While the July FOMC meeting minutes show divided sentiment among policy makers, the global economic crosscurrents continue to influence the bias toward lower interest rates.

- Amid heightened trade concerns, the long end of the U.S. Treasury Yield curve flattened as the 30-yr yields reached record lows of 1.9%. The 2-yr/10-yr spread fell into the negative territory and closed the month at -2.7 bps. 10-yr yields are their lowest level since 2016 and closed at 1.5%.

- At the much-anticipated Jackson Hole meetings, Chairman Powell signaled further policy easing. The markets continue to price in two rate cuts by year end.

- From a broader perspective, the shifting shape of the yield curve signals a changing economic 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 that investors should monitor with respect to the economy and the underlying markets.



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