Investment Environment & Outlook

October 2019

Volume 6, Issue 10

Sabal Trust

Market & Economic Environment

After markets stabilized in September, equity volatility quickly returned at the start of the 4th quarter. Over the last month, investors shrugged off mixed economic signals, weaker consumer-confidence data, and an attack on Saudi Arabia's major oil complex that threatened to disrupt global energy supplies. While the Federal Reserve lowered benchmark rates again, it was Washington D.C. that captured investor attention as political uncertainty escalated with the prospects of impeachment proceedings. Investors should remain on guard for the unexpected as we move though earnings season, sort through forward guidance, and deal with greater uncertainty. Volatility will remain a constant for market participants during the last quarter of the year.

MONETARY POLICY

Against a tepid economic backdrop, a less sanguine view of the global economy, and modest inflation, the Federal Reserve lowered interest rates by another 25bps in September. Due to elevated global risks, the policy bias points toward additional rate reductions. The primary unanswered questions are related to the magnitude and pace of future rate adjustments.

EMPLOYMENT:

The unemployment rate fell to 3.5% in September reaching new 50-year lows. Slowing job growth, coupled with downward revisions of previous labor market data are late stage economic signals. Also, portions of recent job growth are related to temporary government census jobs. Even with seasonality and monthly data revisions labor markets remain tight and could lead to inflationary wage growth.

MANUFACTURING

September ISM manufacturing data fell further below the critical 50 level, signaling potential economic challenges. While manufacturing accounts for only 11% of the economy, activity levels are highly correlated with capital expenditures, suggesting that business investment could remain under pressure. The continued trade impasse will weigh on our manufacturing infrastructure and adversely impact economic growth trends.

TRADE WAR IMPACT

Companies continue their efforts to offset upward cost pressures from tariffs by shifting supply chains and implementing cost-saving measures. Even so, effects of the U.S.-China trade war are negatively influencing business confidence levels. The slowdown of spending, CAPEX, and manufacturing activity could negatively influence corporate earnings and limit future stock market gains.

GLOBAL ECONOMIC GROWTH

The Organization for Economic Cooperation and Development cut its 2019 global growth forecast to 2.9%, which represents the slowest pace in a decade. Based on the manufacturing data from Germany, the Eurozone's largest economy could be on the edge of recession. Again, another reason the Federal Reserve remains poised to lower interest rates .

CONSUMER CONFIDENCE

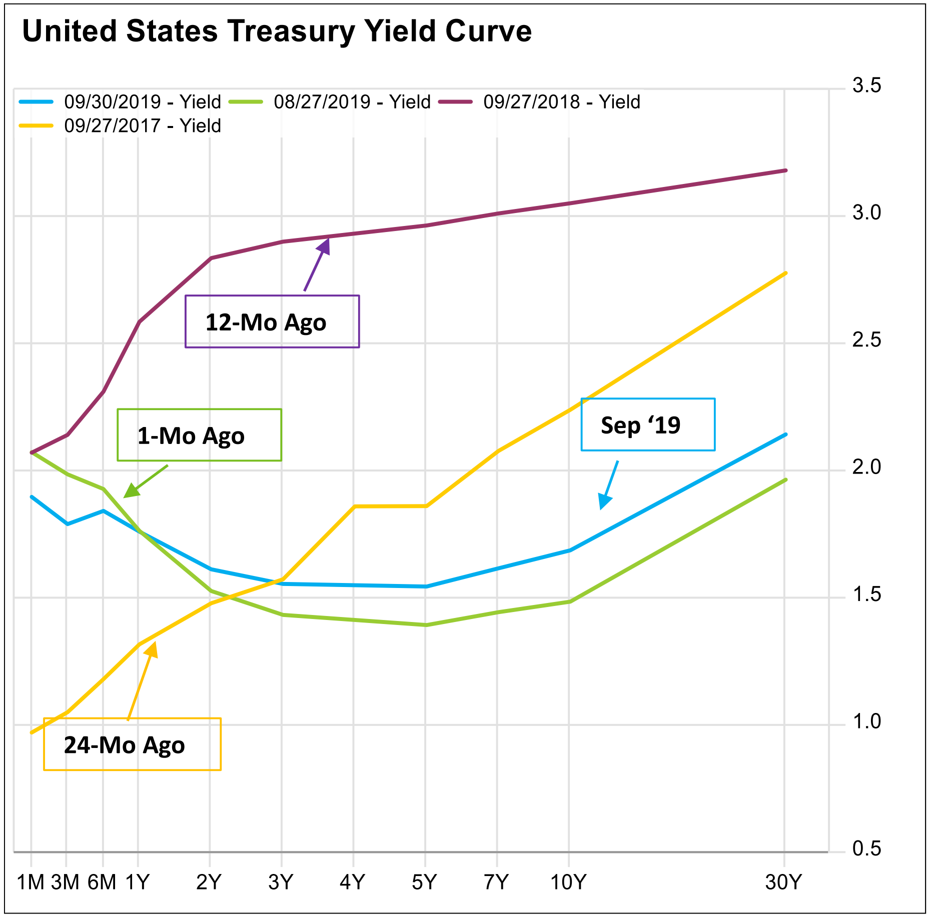
Consumer spending fuels two-thirds of economic growth. Confidence levels offer direct insight into future spending activity. September's confidence measures fell sharply to a three-month low impacted by the trade war and slowing manufacturing activity. A sustained deterioration will call into question the potential for continued consumer spending.

Fixed Income Observations

While the FOMC lowered the overnight benchmark rate, there appears to be a lack of firm consensus among Federal Reserve officials regarding future monetary policy as they grapple with their dovish interest rate outlook. Given current economic data and the prevailing sentiment to remain ahead of potential weakness, it is likely that the Fed will move to lower rates again before the end of the year. Bond market participants continue to telegraph their sour sentiment on the economy and recent stock market volatility could indicate that their stock market counterparts are starting to agree.

YIELD CURVE

- The FOMC voted 7-3 in favor of cutting interest rates by another 25 basis points bringing the target range to 1.75%-2.0%. Policy makers also lowered rates on excess reserves. In addition to these policy decisions, the Federal Reserve intervened in the repo markets during September to ensure the smooth transactions of overnight liquidity.
- The sentiment among FOMC policy makers regarding future interest rate policy remains divided. However the global economic risks and crosscurrents continue to point toward lower interest rates. The markets are pricing in a 75% probability of another rate cut by the end of the year.
- Since the rate announcement, the yield curve adjusted slightly with an almost-parallel downward shift. 2-year yields declined approximately 14bps and the 10-year yield fell 10 bps. The 2yr-10yr spread, while no longer inverted, remains still low at 5.5 bps.
- From a broader perspective, the shifting shape of the yield curve signals a changing economic environment and requires investors to remain vigilant. A flat to slightly 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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