Investment Environment & Outlook

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Sabal Trust

Market & Economic Environment

The ongoing Coronavirus outbreak is not only an unfolding human story, but one that has economic and financial implications. It's the latter that has global financial markets on edge as investors seek safe-haven assets. Nobody knows how this story will play out and what the ultimate human and economic toll will look like. The impact from the virus will adversely alter the positive trajectory for the domestic economy and the promising signs that had appeared within the global economy. Economic forecasts remain in limbo and require re-calibration given the fluidity of the environment.

FEBRUARY CORRECTION

The S&P touched all-time highs in mid-February, but the week of Feb 24th marked the worst decline since the financial crisis of 2008 as the Coronavirus spread outside of China. By month end, 96% of the S&P 500 companies were in correction, marked by a decline of +10%. To provide some context, since 1946 the S&P's average intra-year decline is 13.8% even while annual returns have been positive 70% of the time.

POLITICS

Democracy in action can be messy as confirmed by the early stages of the Democratic primary season. The divisiveness and sparring among candidates will continue as the field is narrowed leading up to the national political conventions. For now, markets continue to grapple with the Coronavirus impact; however, the reaction function will take hold as a frontrunner emerges and refines their policy platform.

CONSUMER CONFIDENCE

Consumer confidence influences decision-making and is highly correlated to spending activities, which fuels the domestic economic engine. While the consumer confidence index touched new highs in February, the impact of the Coronavirus on confidence levels is yet to be felt. Monitoring any change in confidence and consumption trends will be critical to assess the economic impact of the viral outbreak.

INFLATION - CPI

The Consumer Price Index (CPI) measures the change in prices paid by consumers for goods and services. January core inflation (ex. Food & Energy) edged higher by +0.2% due to higher rents, health care, education and clothing costs. While, headline inflation data reached an annual rate of +2.3%, overall inflation trends remain muted. In fact, the recent downward slide in energy prices due to Coronavirus concerns could dampen any inflationary pressures.

ENERGY PRICES

Last year's geopolitical tensions fueled higher energy prices. Today, markets face a completely different scenario. China represents approximately 13% of global oil demand and the Coronavirus has adversely impacted demand. The International Energy Agency (IEA) now expects a contraction in global oil demand for the first time in over a decade. The degree of the slowdown will be dependent on the effectiveness of containment activities over the coming months.

INDUSTRIAL PRODUCTION

While there were signs of stabilization, recent manufacturing and industrial data slid due to halts in production of the Boeing 737 Max as well as declining utility output because of the unseasonably warm winter weather. Worsening supply chain disruptions from the ongoing Coronavirus outbreak will begin to weigh on the manufacturing sector and investors must pay careful attention to company guidance.

Fixed Income Observations

Federal Reserve officials have different policy levers at their disposal, including conventional (interest rates) & unconventional (Quantitative Easing) measures. The probability is high that policy makers will cut interest rates during their March meeting as a pre-emptive response to the growing impact of the Coronavirus. The efficacy of rate policy given an unprecedented health outbreak is questionable. A more effective approach could involve signaling to the markets that the Fed stands by with any and all liquidity measures designed to support the environment if the situation becomes worse than expected.

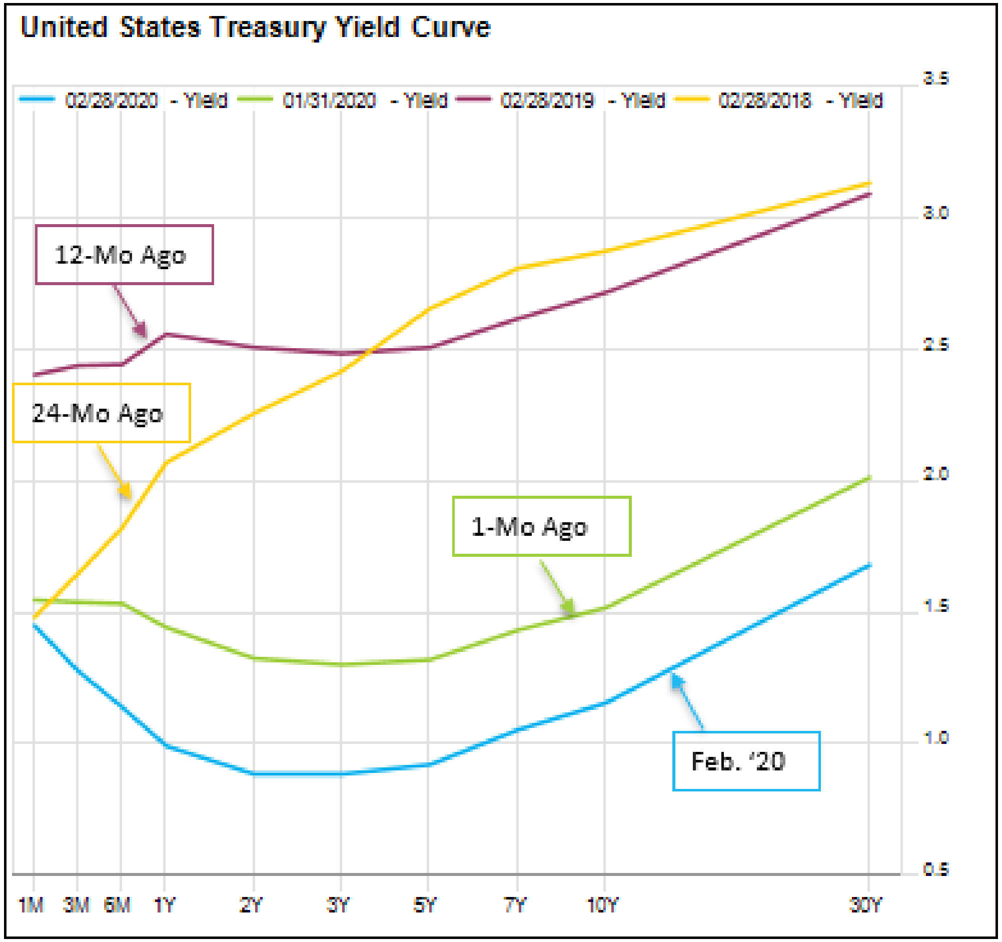
YIELD CURVE

- Growing concerns over the Coronavirus wreaked havoc on global markets during February and triggered a flight to quality. This resulted in a significant downward shift in the U.S. Treasury yield curve.

- With U.S. Treasuries experiencing a major price rally, 10-year yields hit all-time lows and closed February at 1.14%, over 36 bps down for the month. The 30-year Treasury yield closed at record lows of 1.67%, down over 32 bps in February. Spreads between 3-month and 10-year Treasuries also plunged to September 2019 lows, closing at -15.16 bps.

- Mounting fears of recession resulted a partial yield curve inversion in February. Investors remain intensely focused on potential policy responses and other preventative measures from governments around the world, the Federal Reserve as well as other central banks to address fears of economic contraction.

- With a likely economic rebound delayed, markets are highly anticipating policy intervention via rate cuts. Fed Fund futures now indicate that investors are pricing in a quarter point rate cut in the March meeting and almost a full point of easing by the end of the year.



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