Investment Environment & Outlook

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Sabal Trust

Market & Economic Environment

The market's behavioral tug of war continued in August as big tech companies and growth/momentum strategies re-gained their foothold over their value/cyclical brethren after pausing in July. Investor optimism about the ongoing recovery is pitted squarely against the realities of the recession gripping global economies. Currently, the positive sentiment is fueled by investor expectations of additional support measures, the Fear Of Missing Out, as well as potential COVID vaccines and treatments. Even if markets continue their ascent, be cognizant of the underlying challenges that remain on the road to economic recovery by remaining patient and disciplined.

HOUSING DATA

While still depressed from levels last year, existing home sales in July saw the largest monthly increase since 1968 as they surged +24.7%. This increase occurred amidst a challenged economic backdrop with high unemployment. Clearly, pent up demand exists, which is being fueled by historically low mortgage rates and low housing inventory. July's robust housing starts (+22.6%) and surging new building permits (+18.8%), an indication of future activity, also point to signs of additional strength and optimism in the housing market. The lack of available supply combined with elevated demand from a new home ownership cohort has resulted in an imbalance causing housing market tightness. Will these recent sales trends be sustainable over the coming months? Home sales can have an economic multiplier effect from a 1st and 2nd order perspective, which is why this critical part of our economy (approximately 17%) should be carefully monitored.

RETAIL SALES

July retail sales (+1.2%) were lighter than expected. Even as economic re-opening activities slowed, consumer spending continued to rebound off the lows seen during the depths of the health crisis. With consumers driving close to 70% of GDP growth, the future trajectory of COVID-19 cases, consumer confidence and spending will directly influence the strength of the economic recovery that is underway.

LABOR MARKETS

As the economic recovery continues, the August jobs report indicated the manufacturing, retail, leisure and hospitality segments improved. While the Unemployment Rate fell to 8.4% from 10.2%, the Labor Force Participation rate edged higher to 61.7%, the number of permanently unemployed increased. The mixed data reflects the stops and starts that investors should become accustomed to as the economy continues the healing process.

CONSUMER PRICE INDEX

Even with July CPI strength, inflation remains stubbornly low. Over the last several years, inflation has run below expectations allowing policy makers to be more accommodative with their engagement in the economy. The recent adjustments in the Federal Reserve mandate framework signal the challenges of managing inflation levels using the available policy tools.

PRESIDENTIAL ELECTION

The virtual conventions are in the rear-view mirror. November's election will occur against one of the most unique, extraordinary, and unpredictable periods of our nation's history. Only with the election's outcome will investors gain clarity on policy initiatives. When the element of uncertainty is removed, businesses and individuals can better define risks and ultimately adapt their decision-making to the environment that ultimately unfolds.

Fixed Income Observations

The Federal Reserve recently adjusted the strategy to execute on their core mandates. They adopted a new inflation framework by focusing on a 2% average target over time and not an absolute level, which is a departure from Bernanke inflation targeting regime. Regarding their employment mandate, instead of solely focusing on the aggregate unemployment rate, they will use qualitative measures to focus on increasing opportunities for marginalized segments of the labor markets. Ultimately, these tactical shifts signal that interest rates will remain lower for longer than originally anticipated, which will create a challenging environment for all bond investors for the foreseeable future. As we expressed before, lowering credit quality requirements in the search for yield is tempting, but it is likely to carry unintended consequences. We continue to recommend avoiding a push for yield that could increase company-specific and credit-related risks.

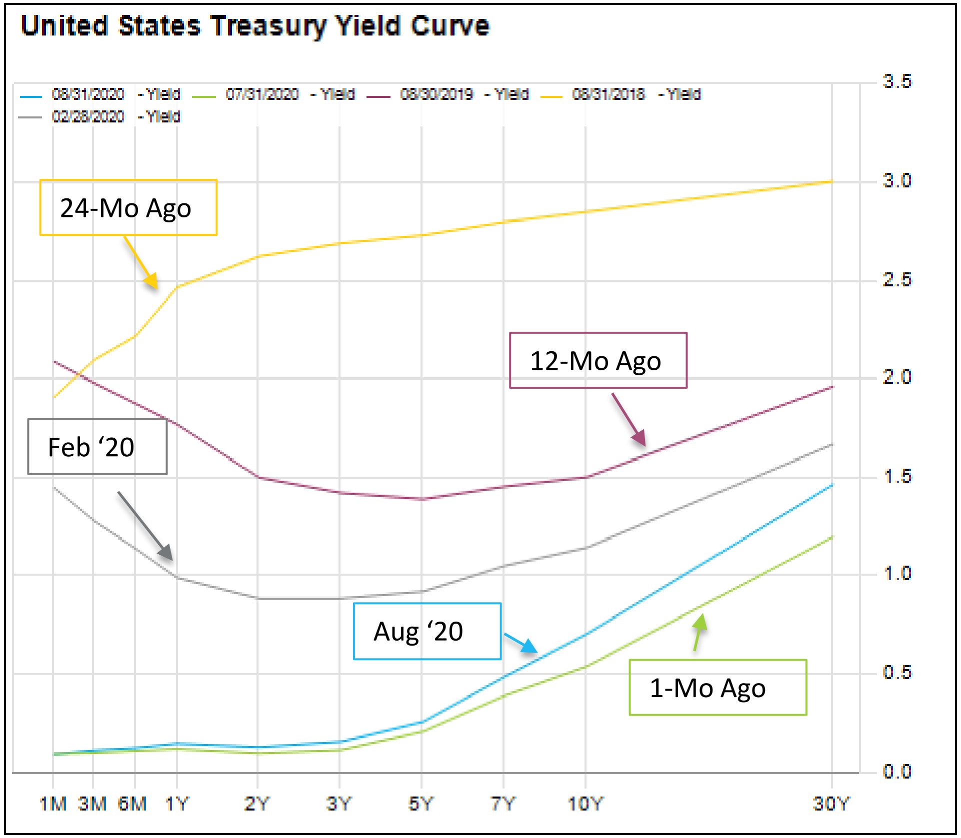
YIELD CURVE

- Against the backdrop of the mandate adjustments, policy makers remain dovish for the foreseeable future as interest rate policy is expected to remain accommodative for several years. Federal Reserve Chairman Powell continues to pledge to "do whatever it takes" in support of the economic recovery.

- In response to the Fed Chairman's remarks during the virtual Jackson Hole Symposium, yields experienced significant volatility at month end.

- During August, the Treasury Curve bear-steepened. The 10-yr yields recovered from previous lows and moved 17 bps higher on the month closing at 70.5 bps. The 30-yr yield closed at 1.47%. 5yr-30yr spread steepened significantly (+22 bps) during August, closing at 120.5 bps. The 2yr-10yr spread also ended steeper on the month, closing at 57bps.

- In the current economic environment, a measured approach is always prudent. To capture yield, we recommend adjusting duration or utilizing the barbell strategy. Another strategy would involve swapping out credit risk with call risk as needed.



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