# Investment Environment & Outlook

**May 2021**

*Volume 8, Issue 5*

Sabal Trust

# Market & Economic Environment

Recent market strength reflects the ongoing economic recovery as evidenced by companies reporting quarterly revenue and earnings exceeding investor expectations. Many companies emerged from the pandemic in a position of strength. However, deep scars from shuttered business and lost jobs signal that hard work remains. The Biden Administration entered office with an ambitious agenda of wide-ranging policy initiatives that are focused on providing financial, economic and social support. The true impact of the policy measures remains unknown. Now the discussion of tax policy designed to pay for the spending activity will take center stage. History tells us that taxes influence behavior and decision-making. Investors should monitor this debate as it unfolds over the coming months.

## INFLATION MEASURES

Inflationary pressures continue to build as goods and services rebound from the pandemic-lows. In addition to supply chain disruptions, gasoline prices surged in March +9.1%. Excluding food and energy, core prices increased the most since 8/20. Companies across different economic sectors continue to report higher input costs, which could pressure profit margins. While policy makers continue to believe these inflationary pressures are temporary, market participants feel differently. As the economic recovery evolves and cyclical forces build, we could see further upward moves in the inflation data.

## ISM MANUFACTURING

While manufacturing accounts for only 11% of the economy, activity levels are highly correlated with business expenditures. The post-COVID manufacturing rebound suggests that business investment will accelerate amidst economic strengthening. April's ISM manufacturing output pullback was not due to softening end-demand but related to elevated constraints and bottlenecks within manufacturing supply chains. Future manufacturing data add clarity to the economic recovery and could trigger a policy response if supply constraints linger leading to rising input costs.

## GROSS DOMESTIC PRODUCT

Gross Domestic Product (GDP) measures economic activity and is the sum of all goods and services produced during a specific time frame. GDP during the second half of 2020 signaled a recovery as we pushed our way past the most severe economic contraction since the Great Financial Crisis of 2008/09. 1Q21 GDP surged +6.4% on the back of fiscal stimulus designed to replace lost income and repair the economic damage. Elevated savings rates give consumers additional purchasing power. When coupled with the additional fiscal support point, stronger economic growth for the balance of the year is likely.

## LABOR MARKETS

The labor markets continue to heal. However, April non-farm payrolls disappointed with only 266,000 jobs created falling well short of expectations. The unemployment levels edged higher +0.1% to 6.1% and the labor force participation rate was little changed at 61.7%. Average hourly earnings increased and were influenced by the well-documented labor shortage that could partially be the result of extended unemployment benefits that exceed wage levels. The report ignites the debate over additional fiscal stimulus measures, inflation pressures, and the most appropriate course of policy action.

# Fixed Income Observations

After a volatile start to the year, bond markets settled into a more normal cadence during April as the Federal Reserve maintained their pledge of low interest rates through the end of 2023. During the current earnings reporting season, companies are offering a growing chorus of commentary on increased input costs. However, Federal Reserve officials remain firm in their belief that these issues will have only a temporary effect on inflation. When the Federal Reserve adjusted their inflation framework last year by adopting average inflation targets, they signaled a willingness to keep interest rates lower for longer even in the face of higher prices. The unsettled debate will continue especially if the current inflationary pressures do not prove to be transitory, which adds to uncertainty in the stock and bond markets.

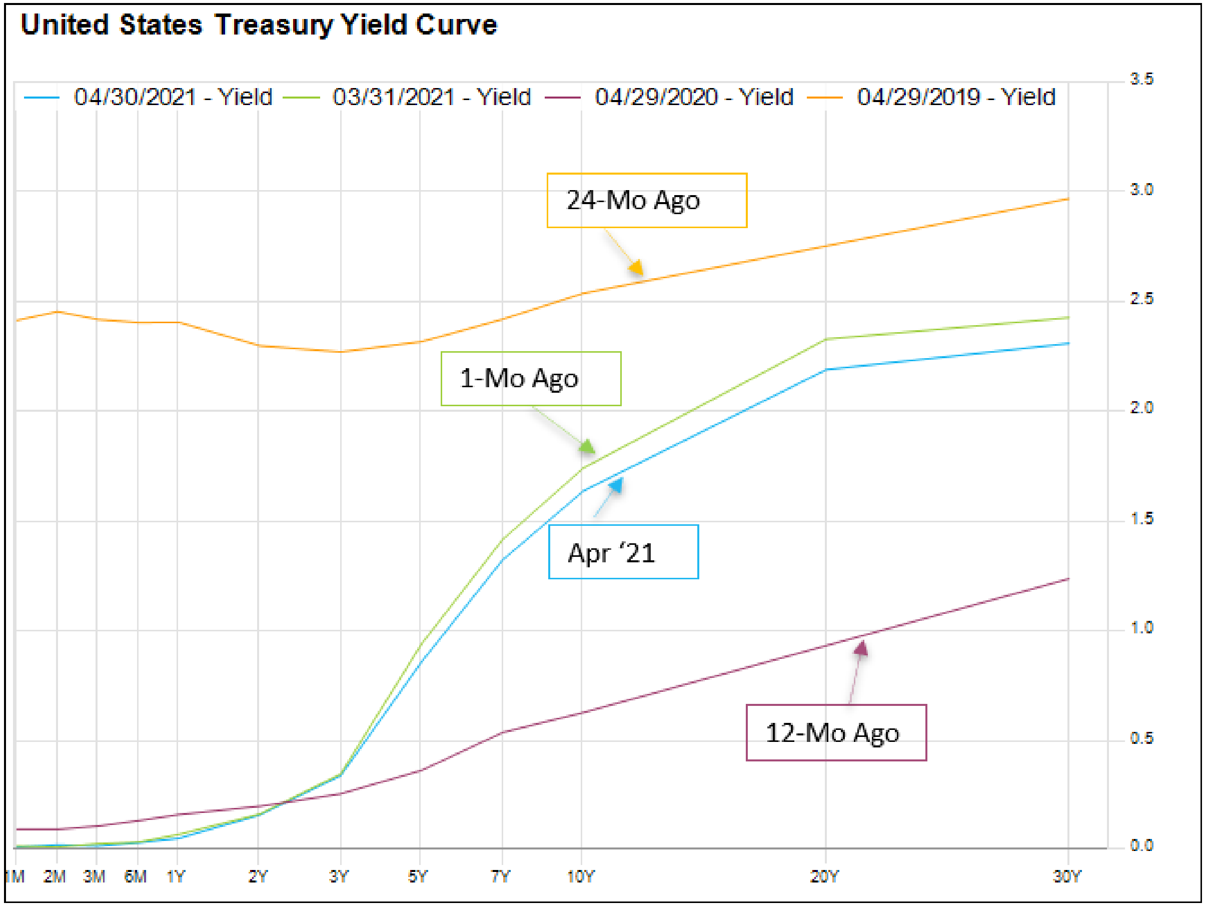
## YIELD CURVE

- During April's FOMC meeting, Federal Reserve officials preserved their dovish tone and made no changes to policy rates or its bond buying program. This continued accommodation stabilized the yield curve which experienced dramatic steepening during the 1st quarter.

- While yield volatility faded, we do anticipate curve steepening to return in the coming months. Any increase in yields could inevitably weigh on bond performance, which had been challenged so far this year.

- Long-dated yields fell by 10-14 bps during April and 10-yr yields retreated below 1.63%. 30-yr yields also closed out the month at 2.30%.

- 2yr–10yr spreads narrowed by ~11 bps, while 5yr-30yr exhibited more stability and only compressed by 3bps in April.




Volume 8, Issue 5 May 2021

Sabal Trust

SABALTRUST.COM