Investment Environment & Outlook

July 2021

Volume 8, Issue 7

Sabal Trust

Market & Economic Environment

Transitioning from a low interest rate environment will bring an element of uncertainty and market volatility. We believe volatility is a positive opportunity for a high-quality, well-balanced portfolio. To prepare for this transition, ensure that you are appropriately positioned between stocks and bonds. Proactive adjustments will place you in a better position to deal with any uncertainty the markets bring. Market pricing continues to reflect the on-going economic recovery. Inflation, interest rates, and higher taxes will be eventually be reflected in asset prices as investors factor these variables into their decision-making activities.

BANK DIVIDEND POLICY

The Federal Reserve restricted banks' ability to pay dividends and repurchase shares in 2020. The ongoing Stress Tests show banks are adequately capitalized to withstand an economic shock. In June, the Fed ended restrictions on capital returns for 23 of the nation's largest banks. They now have greater autonomy over their capital allocation plans, which signals stability within our financial system.

CONSUMER PRICE INDEX

Surging demand and supply chain shortages recently pushed core inflation readings (ex food & energy) to 28-year highs. In part, due to recovering prices in hard-hit parts of the economy (airfare, hotel, rental cars). However, signs of more sticky price increases are evident in housing and food costs. Future monetary policy depends on whether this pricing is transitory or more permanent.

DURABLE GOODS ORDERS

Durable goods are big-ticket purchases including industrial machinery, computer equipment, aircraft and other long-duration assets. Order activity levels are an important signal into the nation's supply chains, which have been hamstrung by bottlenecks as of late. Durable goods orders rebounded in May and grew at their fastest pace since January, which confirms the evolving economic recovery.

MANUFACTURING ACTIVITY

Manufacturing is highly correlated with business expenditures and economic growth. The on-going manufacturing rebound suggests that business investment will continue to accelerate. However, the shortage of workers and bottlenecks within supply chains are taking a toll on overall production levels. Lingering supply constraints that lead to higher input costs could trigger a policy response.

FEDERAL RESERVE CREDIT FACILITIES

As COVID-19 ravaged the economy, the Federal Reserve moved interest rates to crisis era lows and provided extensive liquidity. Last month, the Federal Reserve started to sell corporate bonds and ETF's from their portfolio that were purchased through emergency lending facilities. Unwinding support measures signals a belief that a solid foundation exists for the on-going economic recovery.

WAGES

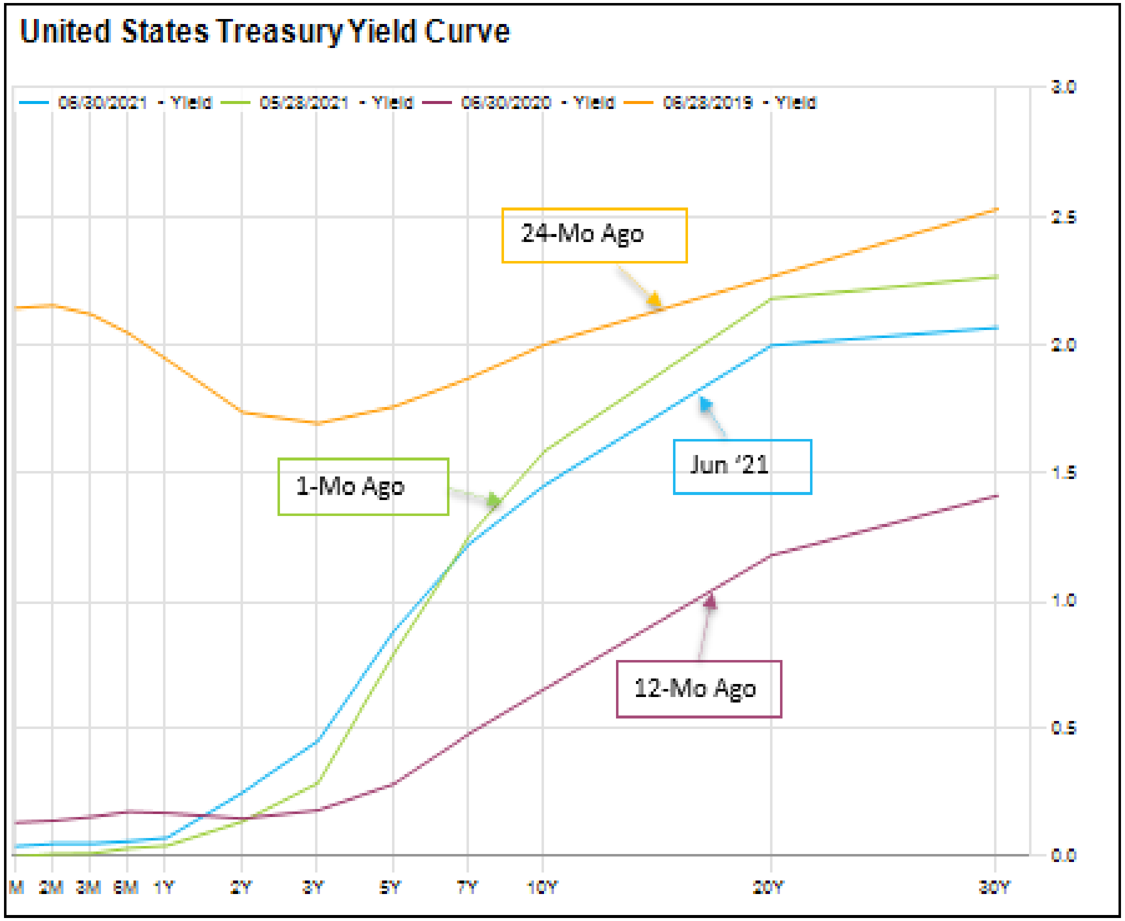
The National Federation of Independent Businesses collects data from businesses from across the country. Current surveys indicate supply chain bottlenecks and inventory challenges. Also, 48% of the respondents cannot fill open positions and believe this will lead to upward pressure on compensation. Consequently, they plan to increase the prices of their goods and services, which is inflationary.

Fixed Income Observations

Bond markets remained skeptical of the Federal Reserve's stance on inflation. Before the Federal Reserve's recent commentary about interest rate lift-off, the markets displayed little concern about this eventuality, which was concerning unto itself. Reality set in as policy makers sparked an intense debate about the temporary nature of inflation data and the timing of interest rate increases. While rates remain at low levels and policy makers believe the inflationary pressures are largely transitory, officials now anticipate rate increases by the end of 2022, which is sooner than anticipated. As the Federal Reserve continues to frame the conversation about pulling back on policy accommodation, investor perceptions and bond market pricing will respond accordingly.

YIELD CURVE

- In the June FOMC meeting, the Federal Reserve rattled the credit markets with a slightly hawkish tone. The new dot plot showed a more aggressive path for rate hikes and Chairman Powell signaled a tapering of their asset purchases in the upcoming meetings.
- While a large chunk of earlier losses were reversed in the second quarter, YTD performance for most FI indices remains negative. As the Federal Reserve starts withdrawing policy accommodation, price volatility and curve steepening is likely to return, which could weigh on future bond performance.
- Inflation expectations and the Fed's policy response will determine the path of the credit markets in 2021. In the current economic environment, a measured approach is always prudent. We continue to recommend against compromising credit quality in search for better yields.



Sabal Trust

SABALTRUST.COM