Investment Environment & Outlook

November 2021

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Sabal Trust

Market & Economic Environment

Historically, October has delivered powerful blows to investors, including the 1929 market crash and Black Monday in 1987. However, after the swoon in September, the markets rewarded investors last month. Stock surged on the back of strong corporate earnings and the ability of companies to pass along higher input costs. While issues of supply chain disruptions, higher taxes and tighter monetary policy remain firmly entrenched, we are encouraged by the strong corporate earnings reports. We remained prudently positioned with a bias towards safety, bolstering the likelihood of better performance in an uncertain market environment.

EARNINGS SEASON

Third Quarter earnings season is underway. Companies have reporting strong revenue and earnings results that are exceeding expectations. Reported y/y earnings are growing at their third highest rate since 2010. Catalysts that we are monitoring in our stocks' earnings reports include support of current dividend policies, inflation commentary and the impact on margins as well as their forward revenue and earnings guidance.

3Q GDP

Gross Domestic Product (GDP) measures economic activity. After surging earlier this year, 3Q21 GDP downshifted to +2% growth. The Delta variant, reduced fiscal stimulus, and supply chain constraints influenced the economy. Businesses continued to invest and spend capital. However, declining savings rates and disposable income levels could be a precursor for weakening consumer demand ahead of the upcoming holiday season.

DEBT CEILING DEBATE

Annual deficits and a large national debt are not unusual. However, the recent debt ceiling debate exposed politicians' inability to impose fiscal discipline. Partisan politics took precedence over the development of a cohesive, long-term strategy to fix our nation's financial picture. The debt ceiling crisis was simply delayed until the 1st week of December. This situation could have serious market moving implications if not addressed properly.

WAGES

Higher wages support consumer spending. Due to the shortage of available workers, companies are boosting wages and benefits to attract talent. During the 3rd quarter, the employment-cost index, a broad measure of labor costs, increased the most since 2001. Labor costs are +3.7% y/y. While inflationary, higher wages give consumers the financial flexibility to spend on goods and services. Wage growth will directly influence consumer spending behavior.

CONSUMER SPENDING

While consumer spending moderated during the 3rd quarter, hopes are high for the upcoming holiday season. The National Retail Federation anticipates holiday retail sales to be 8.5 to 10.5% higher than last year. Answers to questions surrounding supply chain disruptions and availability of product to meet consumer demand will determine whether the holiday spending season delivers investors with a year-end present or a lump of coal.

PRICING POWER

Pricing power refers to the ability to increase prices without impacting demand. Against an inflationary backdrop, consumers have been willing to pay higher prices for products ranging from groceries to household goods to technology. SDG portfolio companies, including Pepsi, Coke, Proctor & Gamble, McDonald's and UPS have successfully increased prices without negatively affecting demand. We will be watching for the durability of demand going forward.

Fixed Income Observations

During the early days of the COVID-19 crisis, the Federal Reserve actively purchased debt instruments with the intent of providing liquidity to the financial system. As we move further away from the pandemic's epicenter, the global economy continues its recovery. Today, policy makers are more comfortable that substantial progress is being made toward their policy mandate. Federal Reserve officials point to signs of strength and sustainability as they announced the tapering of their asset purchase program. Again, the reduction of bond purchasing activity is not the same policy shift as raising interest rates. However, investors will look for clues of further policy shifts.

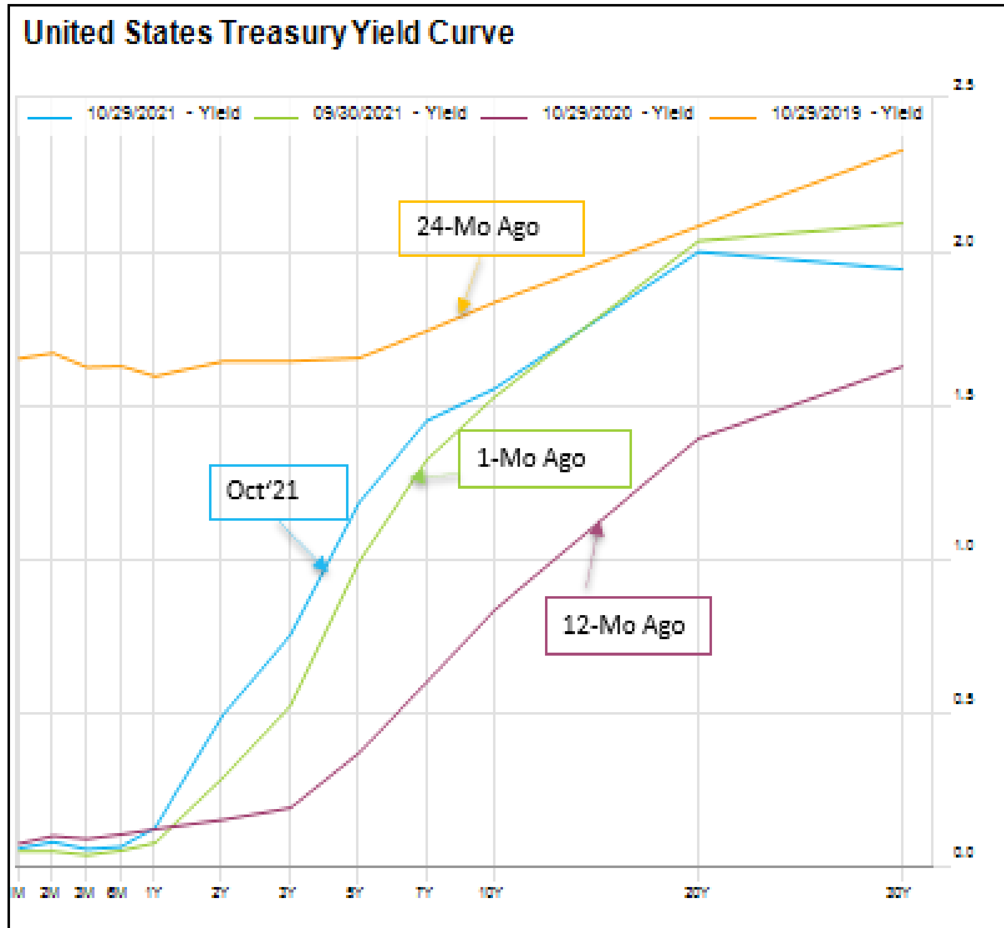
YIELD CURVE

- During November's FOMC meeting, policy makers announced they will start winding down their asset purchases this month. The announcement brought no surprise as the news was already priced in.

- Federal Reserve members continued to deliver hawkish tones during scheduled commentaries and seemed more willing to fight inflation than originally anticipated. Concerns over inflation, supply chain challenges and global economic growth sparked debates over a potential "policy mistake".

- Treasuries experienced a volatile month with intra-month swings of over 25 bps across the curve. The curve ended flatter in October. Long-end yields dropped while belly of the curve increased. 30-yr yields sank back under 2%, closing the month at 1.93%. 10-yr closed just over 1.55%, after it briefly hit six-month highs. 2-yr yields almost doubled since last month, closing at ~0.50%.

- The Federal Reserve's response to inflation, employment and economic growth will determine the path of the credit markets. In the current economic environment, we recommend low duration and high credit-quality credits.



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