OUR VIEW

A Quarterly Newsletter from Sabal Trust Company

Third Quarter 2017

TRANSITORY?

Against a fluid market and economic environment, it is critical to continually examine portfolio strategies to ensure the integration of long-term investment goals and objectives. Strong equity markets, modest economic growth, low inflation, and increasing political uncertainty characterize the current "risk-on" trading environment. Investors search for answers amidst a cacophony of economic and political voices as they ask: "Where do we go from here?"

THE ECONOMIC CYCLE:

As the current economic cycle reaches 8 years in length, mixed data confirms its modest, uneven growth. In the 1st quarter, the economy stumbled into a "soft patch" even as corporations reported solid earnings growth. Federal Reserve officials labeled the period "transitory". They based their views on constructive factors including continued policy stimulus, signs of global growth reaccelerating, improved hiring activity, and robust consumer confidence. ***While these positive elements could extend the economic cycle, signals indicate that we are moving into the later stages of the recovery and investors should look for signs of a shifting landscape.***

FEDERAL RESERVE POLICY:

Interest rate normalization and subsequent market volatility remain a reality for all fixed income investors. The effect of low interest rates and unprecedented monetary policy has been called into question. Designed to ignite economic growth since the financial crisis, this accommodation activity could result in unintended consequences across the global financial system. Investors remain focused on the ultimate impact of liquidity and monetary accommodation removal, which will take time to implement and execute. As interest rates rise, bond prices fall and only an appropriately structured portfolio will protect against these moves.

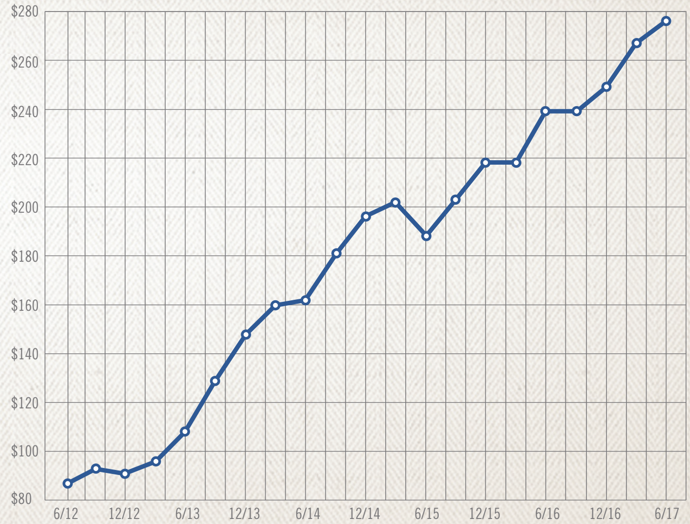
INFLATION EXPECTATIONS:

The Federal Reserve also describes the lack of recent short-term inflationary pressures as "transitory" and they remain committed to further interest rate increases. Only time will tell if their interpretation is correct and if wage growth or the reflation of global economies push input and consumer prices higher. Despite elevated levels of monetary stimulus, the deployment of various policy tools over the last several years, and recent economic growth across merging markets, the Consumer Price Index (CPI) remains under the Fed's 2% target level.

Stock Focus: Lockheed Martin

Lockheed Martin, a defense contractor, operates in the following segments: Aeronautics, Missiles & Fire Control, Rotary & Mission Systems, and Space Systems. LMT will benefit from increased domestic defense spending and elevated global defense systems demand. The company exhibits robust cash flows and offers excellent earnings visibility through long term service contracts. The F-35 program will drive future revenue, earnings, and distributions as well as support their commitment to returning more than 50% of free cash flow to shareholders.

Stock Symbol: **LMT**
Market Capitalization: **$81B**
Dividend Yield: **2.6%**
Long Term Earnings: **5.0%**
2017 P/E: **22.4x**
Return on Equity: **199%**



FULL EMPLOYMENT?:

Have we reached the natural, long-run rate of unemployment? Supporting evidence includes the fact that the unemployment rate reached a 16-year low at 4.3%. Yet, the pace of job creation is slowing. Which, coupled with softening payroll data and fewer discouraged workers dropping out of the labor pool, also indicates the economy is moving into the later stages of its cycle. Furthermore, ***the depressed labor force participation rate, influenced by structural issues (demographics) could cause the Federal Reserve to reassess their thoughts regarding interest rate policy.***

CONSUMER OPTIMISM:

U.S. consumers, a critical driver of economic growth, remain resilient as seen by strong spending data due to rising household wealth, growing incomes, and low unemployment. While not matching levels seen in previous recovery periods, current spending levels remain supportive of the economic cycle. Political uncertainty could quickly alter sentiment and the willingness of consumers to freely spend their resources. Yet, consumer confidence recently reached multi-year highs, which further fuels the potential for future consumption.

FISCAL STIMULUS – POTENTIAL AND RISK:

Expectations remain elevated that fiscal stimulus measures designed to boost anemic economic growth will pick-up where monetary policy has fallen short. The Administration's agenda of lowering costs through tax and regulatory reform was embraced by the markets as seen by upward price moves since the election. Infrastructure spending designed to stimulate economic growth is also fueling expectations. However, ***the reality of governing, combined with constant distractions, and questionable political capital threatens the ultimate timing and effectiveness of legislative change and the impact on the economy.***

OUTLOOK:

To realize success, adopt an intellectually honest assessment of the unfolding environment, avoid underappreciating investment risks, and remain focused on a longer-term investment horizon. Portfolios consisting of high-quality stocks and bonds allow for the successful navigation through periods of rising uncertainty. Investing in fundamentally sound, transparent companies that generate excellent cash flows and possess high earnings predictability position investors for success. Bonds, also a critical component of any diversified portfolio, offer capital preservation, income production, and risk reduction characteristics.

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