

# OUR VIEW

A Quarterly Newsletter from Sabal Trust Company

Fourth Quarter 2018

## “SETTING EXPECTATIONS”

Expectations directly influence decision-making. It is natural for each of us to be influenced by the environment around us. Currently, strong equity markets and relatively low volatility are shaping investor's return expectations. Periodically, expectations of the future can become detached from what is realistic. This usually occurs when an environment moves to an extreme, or in today's case as we move into the later stages of a lengthy economic cycle. ***Protecting your family's assets involves adopting realistic expectations and remaining disciplined.***

## CYCLE INDICATORS:

Solid economic growth and moderate inflation continue to fuel investor sentiment resulting in the broader stock market averages reaching all-time highs. Consumer and business confidence are also supporting the economic cycle. However, the growth trajectory of the economy could slow over the coming quarters due to the waning impact of the tax cuts and potential demand adjustments related to trade tensions. ***Consequently, investors should ask challenging questions about the durability and sustainability of the current cycle.***

## CONSUMER SUPPORT:

A healthy consumer continues to fuel a robust domestic economy, which has now experienced the longest stretch of improving employment growth in history. The unemployment rate hovering around multi-decade lows, combined with an improved labor force participation rate, indicates an economy operating at full employment. This historically leads to upward pressure on wages. ***Low unemployment, rising incomes and consumer confidence at all-time highs bode well for continued consumer spending.***

## HOUSING INFLUENCES:

Housing, a key economic driver, represents over 15% of GDP. Existing home sales in June declined for the 4th consecutive month and are now growing at their slowest pace in over two years. The decline in mortgage applications as well as elevated housing prices appeared to negatively influence purchasing activity. Affordability indexes should also be monitored as rising input costs (material, labor, and borrowing) further elevate the price of purchasing a home. ***A material slowdown in home ownership could result in investors adjusting downward their expectations of overall economic growth.***

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## Stock Focus: AMERICAN WATER WORKS

Founded in 1886, American Water Works provides water and wastewater services across 40 states to a diverse customer base, including commercial, industrial, residential. AWK operates wastewater treatment facilities, transmission pipes, storage, pumping and other infrastructure equipment. AWK, a consistent generator of cash flows, is committed to growing its dividend stream at 10%. The company should benefit as an aging domestic water infrastructure receives badly needed upgrades.

**Stock Symbol:** AWK

**Market Capitalization:** \$16B

**Dividend Yield:** 2.1%

**Long Term Earnings:** 8.1%

**2018 P/E:** 25.9x

**Return on Equity:** 10.0%



## VALUATION MATTERS:

"How much are you willing to pay for \$1 of earnings?" is a critical question as the markets trade near all-time highs. A company's ability to steadily generate cash flows and earnings determine value. History demonstrates that the valuation pendulum swings to extremes and tends to be correlated with investor sentiment. The Price-Earnings valuation ratio measures the price of a company relative to its underlying earnings. The S&P 500 P/E is 16.9x compared to the 5-year average of 16.4x and 10-year average of 14.5x. ***The market is fairly valued given the underlying earnings as investors have not pushed valuation levels to unreasonable or unsustainable levels.***

## MID-TERM ELECTIONS:

Over the last few years, political discourse disintegrated with the extreme polarization of ideas and positions. The discord will likely reach a fevered pitch with the upcoming November elections. Yet, historically the S&P 500 is higher during the 12 months following the mid-term elections. The results at the ballot will inevitably influence the debate on how the political leaders fundamentally handle the domestic economy, wage growth, and position the U.S. on the global stage. ***Policy decisions ultimately create winners and losers in the marketplace, which means investors need to maintain a long-term focus to address events unfolding in Washington D.C.***

## BOND MARKET SIGNALS:

The bond market offers a more dispassionate view of the economic future compared to its equity market brethren. Monitoring credit signals is a valuable exercise for investors. The yield curve is a representation of yields that could be earned by investors from similar type bond instruments across different maturities. The shape of the curve provides valuable information about investors' economic expectations. A normal, upward-sloping curve indicates investors' expectations of a healthy economy and higher inflation. An inverted curve is a signal of a recessionary environment. ***Currently, the flattening yield curve is suggesting the economic cycle is reaching its later stages.***

## OUR OUTLOOK:

Setting realistic expectations and managing emotions are important for all investors, especially as we reach the later stages of the economic cycle. While the markets continue to reflect a healthy economy, remain disciplined and focused as seemingly benign market conditions can change quickly.

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