Investment Environment & Outlook

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Sabal Trust

Market & Economic Environment

During April, investors reacted viscerally to inflation data, the reality of higher interest rates, the ongoing war in Ukraine, and mixed corporate earnings. Extreme market volatility saw the S&P plunge -8.8%, the most since March 2020, while the NASDAQ sunk -13.2%, its worst decline since October 2008. The range of outcomes related to global economic growth, armed conflict, and central bank policy responses remain wide and uncertain, which make navigating the current environment challenging. Defense is the best offense during these types of environments by focusing on what you can control: asset allocation, high quality investments, and a growing stream of cash flows.

1st QUARTER EARNINGS SEASON

Earnings season is underway. Many companies have reported revenue and earnings exceeding expectations. Companies continue to mention supply chain challenges and inflationary pressures. We are pleased that stocks in our portfolio continue to report the ability to pass along elevated input costs through higher prices, which supports their attractive dividend policies.

GROSS DOMESTIC PRODUCT

1st quarter GDP, the broadest measurement of the economy, fell by -1.4%. This was the weakest quarter since the COVID-induced shutdowns during 2020. A growing trade deficit (imports exceeded exports), slower inventory building, and diminished government stimulus contributed to the decline. While healthy consumer and business spending could signal a resumption of growth, elevated inflation and higher interest rates remain near-term headwinds.

RUSSIA UKRAINE

Russia's war in Ukraine continues to exact a terrible humanitarian toll. As the conflict rages on, global leaders are framing out additional economic sanctions designed to punish Russia's leaders. The talk of an embargo on Russian crude is accelerating, but there remain many questions about how to service the energy demands of Europe due to their reliance on Russian-produced energy.

CONSUMER PRICE INDEX (CPI)

March's Consumer Price Index (CPI) increased +1.2% reaching y/y growth of +8.5%, the fastest since 1981. Businesses continue to report higher input costs from labor, transportation and raw materials. Consequently, companies are raising their prices to preserve margins and bottom-line earnings. These input costs (food, energy, shelter, etc.) reinforce the reality of higher interest rates.

PRODUCER PRICES

Producer prices are costs that manufacturing companies charge each other for inputs. Higher producer prices reduce profit margins unless companies have pricing power and pass on these costs to consumers. The PPI signals the future direction of prices. Recently, producer prices increased +11.2% y/y due to global inflationary pressures. This reading, when combined with CPI data, confirms the Federal Reserve's tightening of monetary policy.

WAGES

April's broad measure of hourly wages, increased +5.5% y/y. Higher wages support consumer spending. However, wage increases are not keeping pace with inflation, which recently hit +8.5% y/y growth, a 40-year high. Diminished buying power reduces consumers' financial flexibility and could dampen spending activity. Rising labor costs fueling inflationary pressures further support a higher rate environment ahead.

Interest Rate Observations

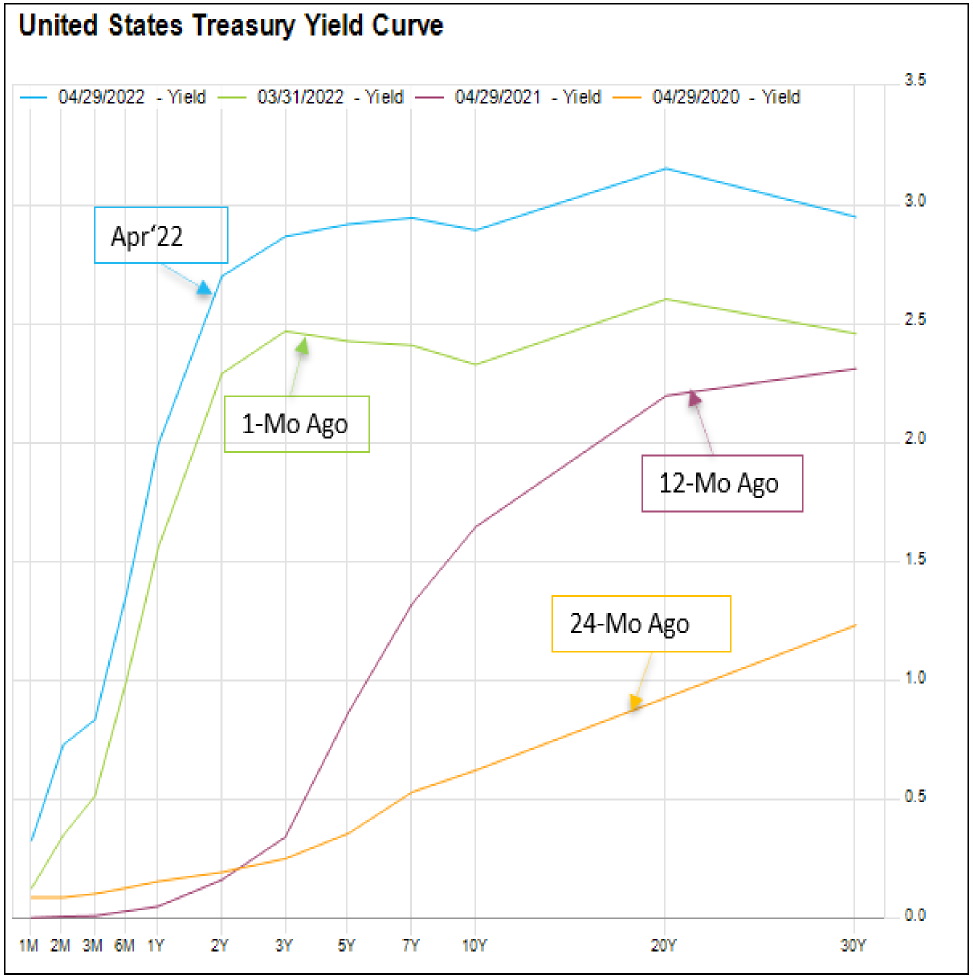
The unpleasant ride for bond investors continues due to elevated credit market volatility. As expected, the Federal Reserve aggressively increased rates during their May meeting to combat inflation which is at 40-year high. While they discussed additional rate increases, Chairman Powell commented about the "neutral rate" of inflation, which the markets interpreted as more dovish. However, the reality is that higher interest rates will impact demand and economic growth. Policy makers' highwire act of attempting to navigate a "soft landing" for the economy while battling generationally high inflation is on full display with far reaching implications if there is policy a misstep.

YIELD CURVE

- The Federal Reserve raised the Fed Funds rate by 50bps, the most aggressive rate hike in 22 years. Chairman Powell signaled similar moves in future meetings. While he minimized the possibility of a highly debated 75bps hike, his perceived 'dovish' tilt triggered extreme volatility in the credit markets. U.S. Treasuries immediately responded by rallying. Front-end yields plunged, while long-end yields lifted to steepened the curve.

- Earlier this year, front-end yields rallied the fastest. However, in Q2 the long-end caught up by climbing 75 bps vs only a 35-40 bps lift on the front-end. The 30-yr note currently yields 3.13% as the 10-yr is at 3.04%. The yield curve fully erased the pockets of inversion briefly seen earlier this spring as the 2s10s spread widened to Feb/March levels.

- Over the past few years, our conservative approach toward the credit markets generated positive returns through a very challenging, low yield environment. As the narrative shifts, our strategy continues to provide downside protection as we encounter a volatile, rising rate environment. We recommend maintaining high quality, shorter-duration exposure, which, will continue to add value for clients by minimizing the impact of volatility induced by uncertainty and rising rates.



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