Investment Environment & Outlook

June 2022

Volume 9, Issue 6

Sabal Trust

Market & Economic Environment

During May, the markets ended flat. However, elevated daily volatility resembled that of a bumpy roller coaster ride. Slowing economic growth, higher interest rates, the reduction of fiscal support measures and compressed corporate profits fueled volatility. In fact, at one point during the month the S&P flirted with bear market territory (-20%) for the year. However, risk assets surged during the last week of May on hopes the Federal Reserve would be less aggressive with interest rates. We believe volatility will remain in place through the summer months and the most effective way to navigate this environment is to have the proper asset allocation strategies using high quality stocks and bonds.

1st QUARTER EARNINGS RECAP

Earnings season is almost complete. While many companies reported revenue and earnings exceeding expectations, forward guidance was less robust. Supply chain challenges and inflationary pressures negatively impact profit margins. We are pleased that almost all companies in our portfolio reported solid earnings and pricing power, which supports their attractive dividend policies.

CONSUMER CONFIDENCE

Consumer confidence directly influences spending. Confidence eased in May, as consumers' outlook on incomes and the economic environment was less optimistic. A more cautious consumer expressed greater concerns over the labor markets and could be early signs that the Federal Reserve's policy tightening process is beginning to impact the economy. An engaged consumer is critical to support economic growth.

RUSSIA UKRAINE

The war in Ukraine continues to exact a terrible human toll. The European Union plans to implement new sanctions. In addition to removing more Russian banks from the Swift financial transactions network, European leaders agreed to impose an embargo on Russian oil. Reducing Europe's reliance on Russian energy is likely to bring higher energy prices, which could fuel additional inflation until alternative sources of energy come on-line.

LABOR AND EMPLOYMENT

May's labor report exceeded expectations but marked the slowest growth since April 2021. The Unemployment Rate was unchanged at 3.6%. The Labor Force Participation rate edged higher to 62.2%. Companies continue to compete for scarce talent. However, annual wage increases slipped 0.4% to 5.2%, which could signal that labor cost inflation has peaked and is moderating. Policy makers will carefully monitor this input cost in future data releases.

CHINA LOCKDOWNS

China's draconian "COVID Zero" policy lockdowns exacerbated the inflationary impact of supply chain bottlenecks. Without rolling out effective vaccinations and only relying on mass testing and further lockdowns, future COVID variants in China will result in uneven functioning of global supply chains. For this reason, we believe global companies and governments will establish partnerships and make strategic investments in supply chain redundancies.

TRADE BARRIERS

The Biden Administration discussed the idea of removing certain tariffs on Chinese imports. Historically, reducing trade barriers and easing tariffs lower costs and ignite purchasing activity. Yet, realizing the positive impact of lower tariffs will take time. With elevated tensions between the U.S. and China, trade policy is yet another variable that investors should monitor as we move toward the mid-term elections.

Interest Rate Observations

The Federal Reserve remains committed to battling inflation as they telegraphed the path toward higher interest rates. Investors expect 50bps increases at each of the next two FOMC meetings. This cadence gives policy makers optionality to monitor additional inflation readings. Buying time could show inflation data peaking, which might impact the pace of future rate changes. Will the Federal Reserve use their blunt policy tools to successfully navigate the economy to a "soft landing" without causing a recession and create unintended consequences? Only time will tell.

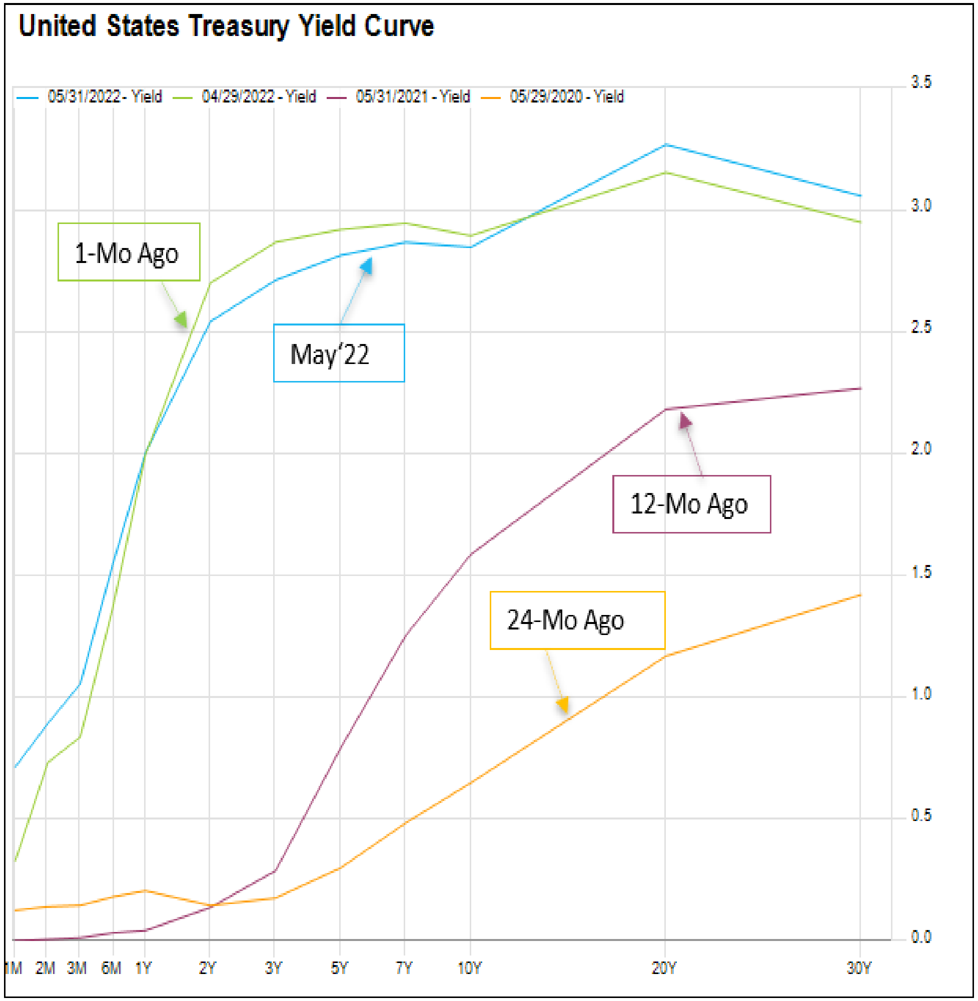
YIELD CURVE

- Amid Federal Reserve commentary and economic data, investors oscillated between inflation concerns and fears of an economic slowdown. Investors debated peak inflation and whether that could sway policy makers from their current path of aggressive policy tightening.

- The latest FOMC minutes indicated 50bps rate hikes at the next two meetings while maintaining flexibility afterward. Additionally, the Central Bank started balance sheet normalization. The pace of balance sheet reduction is expected to ramp up over the next few months.

- At the start of May, anticipation of an aggressive Federal Reserve pushed yields to 3-year highs. However, later in the month, fears of recession triggered a rally in U.S. Treasuries and yields plunged in the belly of the curve. The long end sold off, steepening that segment of the curve.

- As the Federal Reserve expeditiously tightens financial conditions to battle inflationary pressures, volatility is likely to persist which will weigh on future bond returns.   Over the past few years, our strategy generated positive returns through very challenging, low yield conditions. As the narrative shifts and we encounter volatility through higher rates, our conservative approach toward credit continues to add value for clients by providing downside protection.



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