Sabal Trust

Investment Environment & Outlook

December 2023

Volume 10, Issue 12

Market & Economic Environment

It was a November to remember as stock and bond markets surged last month. Resilient consumer spending, solid economic growth, cooling inflation and a Federal Reserve that appears to be in a holding pattern drove the broad-based gains. The positive moves were in stark contrast to the downward volatility investors experienced during the previous few months. Investors will now turn their attention to the trajectory of economic growth, inflation and interest rate policy as we move into the new year. Despite being out of favor for most of 2023, high-quality, low-volatility dividend strategies fully participated in November's positive market moves.

SOFT LANDING?

The Federal Reserve has a poor track record of trying to navigate the economy to a "soft landing" and not causing damage to the financial system. The wide range of 2024 economic forecasts invites investor uncertainty. Growing signals point to a mild recession in 2024. For this reason, we continue to invest in companies with high quality earnings and cash flows that support a growing dividend stream even as economic growth slows.

CONSUMER SPENDING

Consumer spending accounts for about 70% of gross domestic product (GDP), making it the most influential component of economic growth. Growing incomes provided consumers the financial flexibility to spend. However, the recent slowdown in income growth and the depletion of savings resulted in consumers growing more cautious about their spending. The ability for consumers to spend freely will shape future economic growth.

EXPECTATIONS

Asset prices reflect investors' opinions and expectations. In 2024, the bond markets will be a battleground of expectations. Bond investors continue to anticipate 4 rate cuts in 2024, compared to a Federal Reserve resolute on keeping rates higher for longer. This divergence of opinions will create volatility. Owning high quality bonds allows our clients to withstand price volatility while collecting a secure, regular stream of income.

MANUFACTURING

The manufacturing sector accounts for 11% of the total economy. The latest data showed a widespread decline in 14 out of 17 industries. This is the 13th month in a row manufacturing has contracted. New orders, backlogs, and factory production dropped, indicating lower demand. During recent earnings calls, companies discussed the more conservative management of inventory levels, suggesting uncertainty surrounding the economic outlook.

INFLATION

The economic and market impact of the Federal Reserve's inflation fighting efforts has been significant over the past two years. Inflation is showing signs of easing, which is good news for both consumers and investors. The latest inflation report was the lowest since July 2022. However, work remains to bring inflation back to the Fed's 2% goal. This implies interest rates will remain higher for longer, even though rate hikes appear to be over.

BOND AUCTIONS

The U.S. Treasury relies on investors to purchase bonds to help fund the government's day-to-day operations. The recent political and economic developments in the U.S. have raised doubts about our government's fiscal sustainability and credibility. As a result, some of the major holders of U.S. debt have reduced their appetite for buying more Treasury securities. This could have serious implications for U.S. borrowing costs and global financial stability.

Equity Strategy Commentary

PORTFOLIO DIVIDEND HIGHLIGHTS

- SDG companies grew their dividend streams at **+6.3%** y/y based on recent declarations. 5-year CAGR of **the SDG Portfolio is 5.8%****. We expect a future 3-year annual growth rate of **+6.7%** for the SDG Portfolio as a whole.

- On average, SDG portfolio stocks increased their dividends consecutively for approximately **26 years***.

- The top 10 stocks have increased their dividends consistently for approximately **52 years***.

- The SDG Portfolio pays a dividend equal to **200% of the S&P's dividend.**

COMPANY DIVIDEND HIGHLIGHTS

- ACN grew their dividend by over 15% y/y. 31% of SDG companies produced double digit dividend growth.

- As we lap strong dividend growth, the growth rates are **slowing and normalizing**. This is expected with the ebb and flow of the economy and corporate earnings that are foundational to shareholder returns.

- The growth of variable dividends for COP have slowed leading to a flattening of dividend growth by the company. This manifested itself with y/y growth slowing from 125% to 76% and now to single digit growth.

- Dividend increase declarations included: MSFT (+10.3%).

*Calculation is based on number of consecutive calendar y/y dividend increases.
**Calculation was changed in 10/22 to reflect Portfolio level dividend growth.

RECENT COMPANY NOTES

- **Pfizer**: PFE confirmed the anticipation of finalizing the $43B all-cash acquisition of Seagen (SGEN) by the end of this year or early 2024, pending FTC approval. The European antitrust authorities already approved the deal last month. This acquisition will boost PFE's prominence in the Oncology sector. SGEN portfolio includes advanced medicines, late-stage development projects, and innovative expertise in Antibody-Drug Conjugates, which are an excellent fit for Pfizer's Oncology lineup. SGEN is projected to add over $10B in risk-adjusted revenues by 2030.

- **Merck:** MRK announced an agreement with Japanese pharmaceutical company Daiichi Sankyo to jointly develop and commercialize three cancer drugs. MRK will pay Daiichi $4B upfront and $1.5B in additional payments over the next 12 months. There will be an additional $16.5B in payments based on future sales metrics. The companies plan to share development expenses. Daiichi will retain exclusive rights to the drugs while MRK will receive royalties.

SDG Dividend Tracker

unaudited as of 12/06/2023

Company	Position size	Yield	Declared	Date	Last quarter	Last year	Company growth YOY %	5 yr company growth	Proj 3 yr company growth
Accenture Plc Class A	3.0%	1.5%	1.29	9/28/2023	1.12	1.12	15.2%	10.8%	11.0%
UnitedHealth Group Incorporated	3.0%	1.4%	1.88	11/8/2023	1.88	1.65	13.9%	16.1%	13.0%
Bank of New York Mellon Corp	2.0%	3.5%	0.42	10/17/2023	0.42	0.37	13.5%	8.7%	10.0%
Paychex, Inc.	3.0%	2.9%	0.89	10/12/2023	0.89	0.79	12.7%	9.7%	5.0%
Microsoft Corporation	3.0%	0.8%	0.75	11/28/2023	0.75	0.68	10.3%	10.2%	10.0%
Prologis, Inc.	3.0%	2.9%	0.87	9/6/2023	0.87	0.79	10.1%	12.6%	10.0%
NextEra Energy, Inc.	2.0%	3.2%	0.47	10/13/2023	0.47	0.43	10.0%	11.0%	8.0%
PepsiCo, Inc.	3.0%	3.0%	1.27	11/16/2023	1.27	1.15	10.0%	7.4%	5.0%
Home Depot, Inc.	3.0%	2.6%	2.09	11/16/2023	2.09	1.90	10.0%	15.2%	2.0%
Nasdaq, Inc.	3.0%	1.6%	0.22	10/18/2023	0.22	0.20	10.0%	9.0%	8.0%
McDonald's Corporation	3.0%	2.3%	1.67	10/4/2023	1.52	1.52	9.9%	8.3%	6.0%
Amgen Inc.	2.0%	3.1%	2.13	10/24/2023	2.13	1.94	9.8%	10.0%	8.0%
General Mills, Inc.	3.0%	3.7%	0.59	11/14/2023	0.59	0.54	9.3%	2.9%	5.0%
Fastenal Company	3.0%	2.3%	0.38	11/20/2023	0.35	0.35	8.6%	18.2%	9.0%
Air Products and Chemicals, Inc.	2.0%	2.7%	1.75	11/15/2023	1.62	1.62	8.0%	10.1%	10.0%
Waste Management, Inc.	2.0%	1.6%	0.70	11/6/2023	0.70	0.65	7.7%	8.5%	5.0%
Xcel Energy Inc.	2.0%	3.4%	0.52	8/23/2023	0.52	0.49	6.7%	6.4%	6.0%
United Parcel Service, Inc. Class B	2.0%	4.2%	1.62	11/1/2023	1.62	1.52	6.6%	12.2%	8.0%
Chevron Corporation	2.0%	4.2%	1.51	10/27/2023	1.51	1.42	6.3%	6.2%	5.0%
Merck & Co., Inc.	2.0%	2.9%	0.77	11/28/2023	0.73	0.73	5.5%	8.7%	5.0%
Johnson & Johnson	2.0%	3.0%	1.19	10/19/2023	1.19	1.13	5.3%	5.8%	5.0%
JPMorgan Chase & Co.	2.0%	2.7%	1.05	9/19/2023	1.05	1.00	5.0%	10.3%	5.0%
Aflac Incorporated	3.0%	2.4%	0.42	11/1/2023	0.42	0.40	5.0%	10.1%	7.0%
Texas Instruments Incorporated	3.0%	3.3%	1.30	9/21/2023	1.24	1.24	4.8%	13.8%	11.0%
General Dynamics Corporation	2.0%	2.1%	1.32	8/1/2023	1.32	1.26	4.8%	7.5%	8.0%
AbbVie, Inc.	3.0%	4.3%	1.55	10/27/2023	1.48	1.48	4.7%	10.5%	9.0%
Best Buy Co., Inc.	2.0%	5.0%	0.92	11/21/2023	0.92	0.88	4.5%	16.6%	9.0%
Coca-Cola Company	2.0%	3.1%	0.46	10/19/2023	0.46	0.44	4.5%	3.4%	2.0%
Duke Energy Corporation	2.0%	4.4%	1.03	10/23/2023	1.03	0.99	4.1%	2.2%	4.0%
Verizon Communications Inc.	3.0%	6.9%	0.67	9/7/2023	0.67	0.64	3.9%	2.0%	1.0%
PNC Financial Services Group, Inc.	2.0%	4.5%	1.55	10/2/2023	1.55	1.50	3.3%	12.4%	6.0%
Realty Income Corporation	2.0%	5.6%	0.77	11/8/2023	0.77	0.74	3.2%	3.0%	5.0%
Procter & Gamble Company	2.0%	2.6%	0.94	10/10/2023	0.94	0.91	3.0%	5.6%	5.0%
Southern Company	2.0%	3.9%	0.70	10/16/2023	0.70	0.68	2.9%	3.2%	8.0%
Cisco Systems, Inc.	2.0%	3.3%	0.39	11/15/2023	0.39	0.38	2.6%	3.9%	5.0%
Pfizer Inc.	2.0%	5.6%	0.41	10/4/2023	0.41	0.40	2.5%	3.8%	5.0%
BlackRock, Inc.	2.0%	2.6%	5.00	11/8/2023	5.00	4.88	2.5%	11.8%	8.0%
ConocoPhillips	2.0%	2.0%	1.14	11/2/2023	0.46	1.11	2.3%	31.8%	2.0%
Medtronic Plc	2.0%	3.5%	0.69	8/17/2023	0.69	0.68	1.5%	7.4%	5.0%
Union Pacific Corporation	2.0%	2.2%	1.30	11/28/2023	1.30	1.30	0.0%	11.2%	8.0%
Mid-America Apartment Communities, Inc.	3.0%	4.4%	1.40	9/12/2023	1.40	1.40	0.0%	8.7%	3.0%
U.S. Bancorp	2.0%	4.9%	0.48	9/12/2023	0.48	0.48	0.0%	8.6%	10.0%
		3.19%					6.3%	9.4%	6.7%

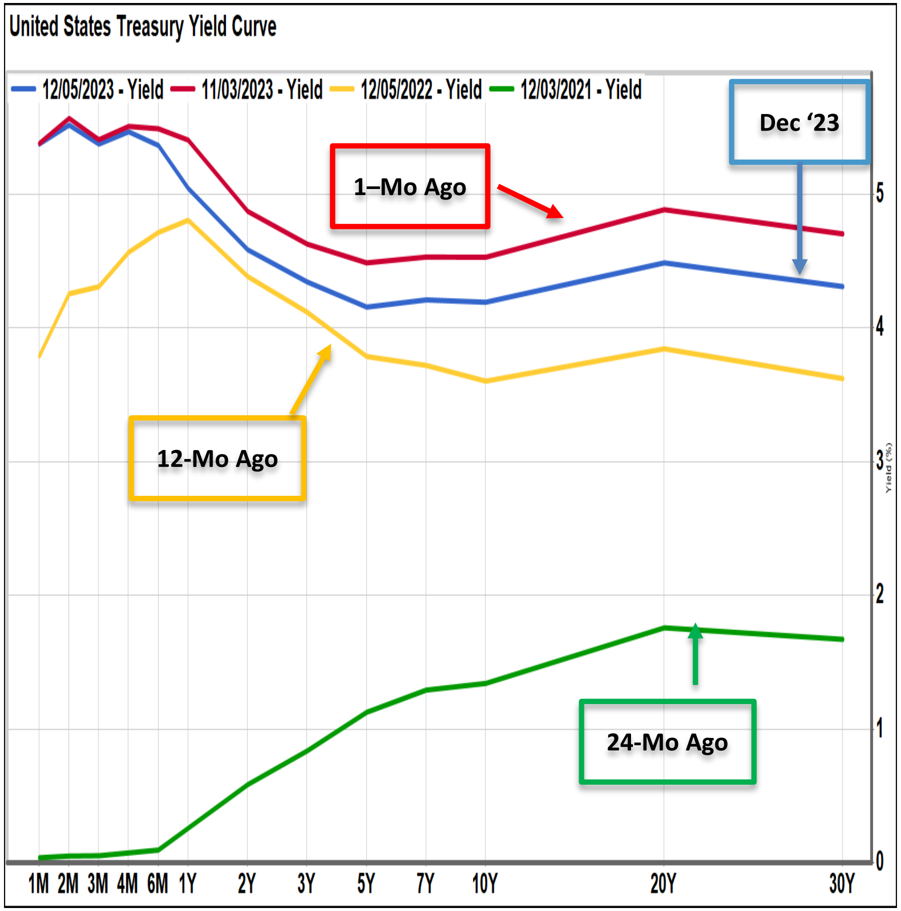
*COP initiated a special dividend that will be determined quarterly and paid out between the regular dividend. Through the year we are taking the average and adding the special dividend to the quarterly dividend.

Interest Rate Observations

All eyes are on the upcoming FOMC meeting on Dec 12-13th. After several meetings of holding rates steady, the bond market is eager to see if Fed Chair Powell will offer dovish remarks that signals rates are going to be lower in the future. With the Fed reiterating each meeting that its policy is data dependent, bond market investors rushed to buy bonds after softening economic and labor market data prints in the month of November. The outsized buying in November produced the highest returns for bond investors since the 1980s. Given the outsized returns last month, the extreme bullishness in bonds isn't completely unreasonable as headline inflation has halved and Core PCE, policy makers' preferred inflation gauge is now at 3.5% below the Federal Reserve's year-end target of 3.7%

YIELD CURVE

- The progress against inflation spurred bets that the Federal Reserve will slash its policy rate 5 times in 2024, equal to rates being lower by 125 basis points. Meanwhile Federal Reserve Chairman Powell pushed back on suggestions of premature policy easing last week. He stated that inflation expectations are still anchored in the economy and easing too early could prevent inflation from returning to its long-term average of 2%.
- The 2-year and 10-year Treasuries spread remains more inverted on Dec 6th than November 30th (-35 to -48.2bps).
- The rapid bond rally that sent 10-year yields plunging by 75bps from its cyclical peak, may have gone too gone too quickly. As we manage fixed income positions, we are waiting patiently to take advantage of any correction in the bond market.
- The falling yields in November reduced bond market volatility which helped both bond and stock investors.
- We believe the next policy change will be to lower rates. However, we are not sure of the timing. Once that occurs, we do know that 5% rates earned on cash will quickly dissipate. That is why we are actively working with clients to move some of their cash holdings back into high quality bonds.



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