Sabal Trust

Investment Environment & Outlook

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Market & Economic Environment

The positive market momentum investors enjoyed during the 1st quarter came to an abrupt halt in April. Are the broad declines a temporary pause or the start of something more prolonged and severe? Stock prices reflect expectations of future earnings. Solid corporate earnings during the current earnings reporting season are a healthy and positive sign. Companies following up with earnings momentum through the rest of the year will be critical for stock prices to continue their moves higher. Even so, remain vigilant because investors will start factoring in the upcoming November Presidential election into their decision making, which will shape the trajectory of stock prices.

1st QUARTER GDP

Weaker than expected 1st quarter GDP, signals the U.S. economy slowed from the strong growth rates experienced last year. More cautious consumers and businesses impacted overall spending. While employment remains solid and wages are growing, depleted savings rates and elevated inflation continue to influence consumer's behaviors as they seek more value from their purchases. The willingness and ability to spend will shape the course of economic growth through the balance of the year.

STAGFLATION

Slowing economic growth and stubbornly high inflation raised the specter of stagflation. The 1970's were characterized by stagflation when surging oil prices fueled inflation, reduced demand and slowed economic growth. Today's environment is markedly different. The economic foundations are stronger and monetary policy solutions are different even if it is taking longer to bring inflation back to the Federal Reserve's 2% target.

FOMC MEETING

The Federal Reserve held interest rates steady during their recent FOMC meeting. Policy makers acknowledged a "lack of further progress towards their 2% inflation objective" but they did not provide clarity on the path of future interest rate policy. Given the timing of future FOMC meetings, the need for more economic data points, and November's Presidential election, rates will stay higher for longer.

LABOR & WAGES

There is a delicate balance between wages, consumer spending, and economic growth. Strong labor markets and low unemployment boosted wages. Higher incomes gave consumers greater purchasing power. However, elevated wages prompted companies to increase their prices to preserve profits. The recent slowdown in wage growth may ease these inflationary pressures, potentially allowing for a sustainable economic expansion while positioning the Federal Reserve to begin lowering interest rates sooner rather than later.

MILITARY AID PACKAGE

Congress recently approved a $95B military aid package to provide weapons, munitions and training for Ukraine, Israel and Taiwan. Defense contractors including General Dynamics (artillery shells) and L3Harris (night vision goggles and communications equipment) are direct benefactors. While their programs are well-funded by the Department of Defense's annual budget, this package gives greater clarity on their revenues and earnings over the next few years.

ECONOMIC DIVERGENCE

The economic engine hitting on every cylinder requires participation from all consumers. The current environment presents a challenge for low-income consumers, who are feeling the squeeze of inflation and rising interest rates more acutely than their higher-income counterparts. This divergence in experiences reflects today's unique economic stresses, where the cost-of-living increases have a disproportionate impact on those with less financial cushioning.

Interest Rate Observations

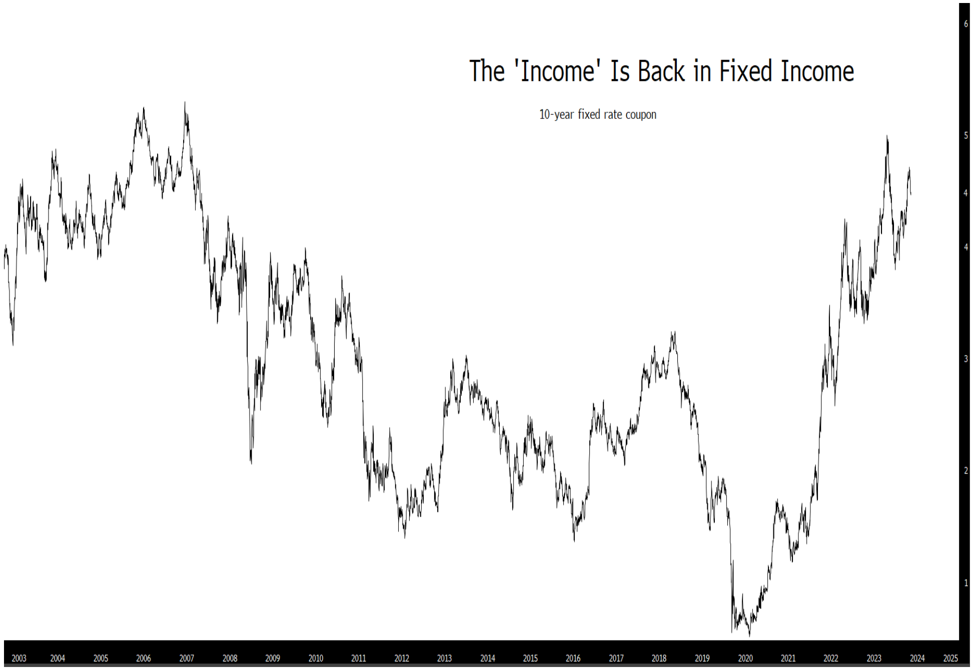
The income is back in fixed income. After years of near zero income from bonds, fixed income is reverting to its traditional role in a portfolio as investors are now experiencing a return to normal. While market participants continue their debate on when the Federal Reserve will cut rates, it's important for investors to realize they can lock in solid income for years to come, regardless of where yields are on any given day.

Treasury bonds are considered the safest asset to own and are the basis of valuation for virtually all financial assets. Today's Treasury yields are attractive with the entire yield curve offering at least 4% or more and paying twice the amount of interest now than during the 2010's. After the brutal bond price reset that started in 2022 due to rampant inflation and the fastest Fed tightening cycle in decades, Treasuries are in a much safer position to protect interest income. When you start out with higher income, it takes a significant move higher in yields to introduce losses compared to when you start with low income where even small move higher yields can introduce losses.

From our perspective, the yield curve will normalize which will bring short term yields lower. However, due to inflation worries and higher debt levels, we don't see yields in medium-to-long term bonds changing materially from where they are today.

YIELD CURVE

- During the month of April, the 10-year Treasury yield increased 48bps to 4.68%. Through the first week of May, the 10-year yield fell back to 4.49%, a (-19) bps move after soft economic data and a dovish Federal Reserve meeting.
- In the chart on the right, you can see the chart of the coupon on the 10-year fixed rate bond is now at levels not seen since 2008.
- While rising yields mean falling bond prices, it is a good reminder of the value added from a well-constructed bond ladder. As shorter-term bonds mature, these funds can be re-invested to lock in high yields that will be more resilient to interest rate risk and provide higher income and a greater total returns.
- As we approach the end of the rate hiking cycle, we continue reviewing cash balances and identify opportunities to purchase high quality bonds before rate cuts take place.



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