Sabal Trust

Investment Environment & Outlook

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Market & Economic Environment

Market volatility can be unnerving for any investor. A variety of factors are contributing to the market's current instability, including interest rate policy and the timing of rate cuts, stubborn inflation, slowing economic growth, geopolitical tensions and the incredibly fluid Presidential election cycle. Adding to this environment are growing questions about AI and the sustainability of earnings from individual technology companies that have driven stock market returns over the last year. Even the bond markets experienced elevated volatility over the last several weeks with yields plunging and prices surging as investors fled to safety and away from risk assets.

2Q ECONOMIC GROWTH

The U.S. economy expanded during the 2nd quarter at an annualized rate of 2.8%, surpassing most expectations. Consumer and business spending as well as government outlays fueled this growth. However, there were indications of a slowdown, particularly in the service sector and durable goods. The moderation in growth, coupled with inflation aligning with the Federal Reserve's target, suggest rate cuts as early as September.

RECESSION INDICATORS

The Sahm Rule is a recession indicator developed by a Federal Reserve economist. It recently was triggered, signaling a potential economic downturn. Since the 1950's, it has been a reliable predictor of recession and examines the movement of the unemployment rate and its moving averages. Given its past accuracy, this development is a significant signal that warrants attention from investors and policymakers alike as they navigate the economic landscape

CORPORATE EARNINGS

Most companies have surpassed earnings expectations during the current earnings season, which supports the soft-landing thesis. The Financial sector has been a major driver of this growth, contributing to the S&P 500's highest annual earnings increase since late 2021. Additionally, the Health Care and Financial sectors generated consistent revenue growth for the S&P, marking fifteen straight quarters of expansion.

CONSUMER SPENDING

Consumers are the primary driver of economic growth. The consumer has remained incredibly resilient in the face of higher prices and elevated interest rates. Falling inflation and lower interest rates could fuel continued spending. Yet, the recent slowdown in income growth, the depletion of savings and uncertainty around the election could result in more cautious spending activity. The ability for consumers to spend freely will shape future economic growth.

POLITICAL ENVIRONMENT

Unprecedented events over the last month, including President Biden's withdrawal from Presidential election and the assassination attempt on President Trump significantly altered the political landscape. With the Republican and Democrat tickets set, voters will focus on the respective platforms including the economy, inflation, foreign policy, immigration, taxes and regulation. Inevitably, there will be more surprises approaching November, which underscores the need to have a solid, well balanced investment plan.

MARKET ROTATION

Momentum from a handful of stocks has been one directional over the last year. The Magnificent 7 stocks produced remarkable price performance. The dramatic rotation starting in July saw money flow from high-flying growth stocks into value and dividend stocks. The current rotation sparked discussions on the resilience of tech giants and their ability to rebound. Slowing economic growth could accelerate interest rate cuts that might further support stocks that have lagged during this recent bull market run.

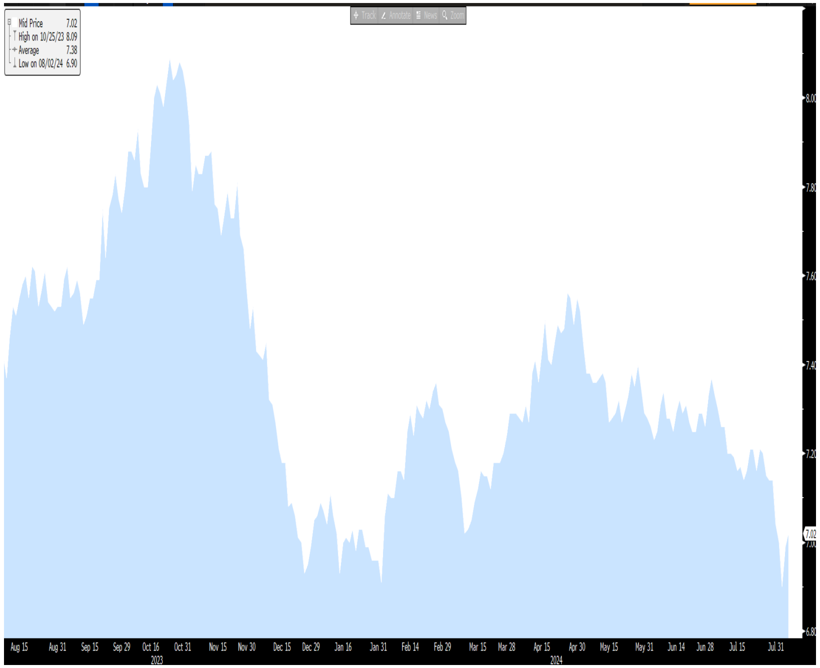
Interest Rate Observations

During July, interest rates were consistently lower across the Treasury yield curve. Inflation data softened as tightness in the labor markets showed signs of improvement. This supported the argument that Federal Reserve policy makers were on track to achieve a soft-landing. Bond investors rushed to lock in yields across the credit markets from Treasuries to Corporates. Consequently, yields fell dramatically and spreads grinded modestly tighter. Interestingly, corporate issuers were eager to tap the debt markets as highly rated corporations issued $110 billion of new debt during the month.

The July FOMC meeting was the first meeting during this tightening cycle where rate cuts were discussed even though the committee unanimously voted to keep its policy rate unchanged. Federal Reserve Chairman Powell laid the groundwork for lower interest rates in September. After the meeting, Treasury yields fell across the curve and the U.S. Dollar slipped against its developed-market peers. Traders continued pricing in a minimum of two rate cuts this year. At the start of August, the soft-landing narrative was uprooted by the softer-than-expected July jobs data as unemployment rose to 4.3% well above expectations. Yields plummeted and bond prices experienced their best one-day performance since 2023.

YIELD CURVE

- During the month of July, 10-year Treasury yields decreased (-37) bps to 4.03%. Through the first week of Aug, the 10-year yield fell further to 3.95% after labor market data cooled.
- The chart on the return shows the 30-year mortgage rate has which has now fallen to 6.55% to the lowest rate in two years.
- With bond yields at generational highs, it is a good reminder of the value added by 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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