Sabal Trust

Investment Environment & Outlook

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Market & Economic Environment

Technology and growth stocks, fueled by the enthusiasm of Artificial Intelligence, led May's market rally. Renewed investor interest in non-technology stocks such as utilities broadened the price moves during the month. Amidst the optimism, Federal Reserve policy decisions on interest rates, inflationary pressures, the path of economic growth, and November's Presidential election loom on the horizon. These catalysts will influence investor sentiment and market pricing. To navigate this uncertainty, a strategy focused on diversification is essential. Diversified portfolios put investors in a better position to withstand market volatility and mitigate risk.

1st QUARTER EARNINGS

1st quarter earnings growth (+8%) was stronger than expected. The "Magnificent 7" companies remained the primary driver with earnings growth of approximately 51%. Earnings are expected to broaden in the second half of the year. As a result, analysts expressed optimism about the economy as they revised S&P earnings estimates higher. Even so, inflation remains a lingering concern as 54% of companies reported shrinking profits. Elevated inflation impacts consumer behavior and corporate performance.

CONSUMER CONFIDENCE

Consumer confidence levels continue to fluctuate. A strong labor market and solid wage growth boosted consumer confidence in May. This renewed optimism reversed declines seen over the last several months. However, growing concerns about a recession over the next 12 months and a less positive outlook on the economy could dampen future spending activity. Mixed signals reflect the complexity of predicting economic, consumer and market trends.

RETAIL SALES

Consumers' willingness and ability to spend remains in focus. Recent sales data signaled an unanticipated deceleration of growth. Inflation expectations ticked higher, which contributed to the stalling of retail sales. During 1Q24 earnings calls, companies discussed consumer behavior focused on bargain hunting and stretched budgets. A resilient consumer is critical to support economic growth.

TRADE TARIFFS

Trade tensions increased last month as President Biden placed major tariffs on a variety of Chinese produced products, including electric vehicles, steel, aluminum, batteries and medical equipment. Higher costs from tariffs and trade barriers dampen global trade, slow economic momentum and lead to market repricing. The true inflationary impact of these actions remains unknown. U.S.-China trade tensions will increase in their intensity later this year with the Presidential election..

MIDDLE-INCOME CONSUMERS

Even when lower income consumers were pinched by sticky inflation earlier this year, middle income consumers remained resilient. The middle-income consumer cohort is a critical component of the economic growth engine. They are now getting squeezed. Credit card delinquencies are surging across all age groups. Consumers are growing concerned about the job outlook, which is not a good omen for the White House in an election year.

CONSUMER PRICE INDEX

The Consumer Price Index (CPI) measures the cost of goods and services. Recent CPI data increased less than forecast. However, not all inflation inputs showed signs of moderation. Shelter costs remained elevated (+5.5% y/y) and energy increased (+2.2% y/y). Core services costs remain above 5%, which is a critical measure monitored by the Fed. More time is required to see the impact of higher rates on battling resilient inflation.

Interest Rate Observations

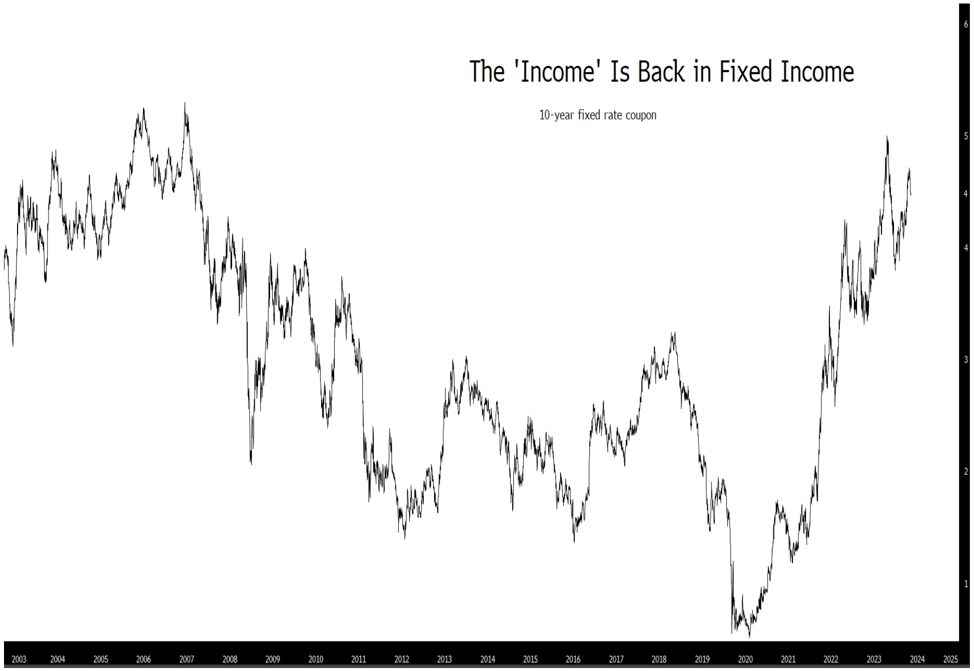
The post pandemic world ushered in a rapid repricing of bonds on the back of the historic rate hiking cycle that fixed income investors had not experienced in a generation. At the end of May, the Bloomberg US Aggerate bond Index was yielding 5.1%. With bonds yielding over 5%, they once again offer fundamental advantages in an investment portfolio. Specifically, bonds provide attractive income, downside resilience and negative correlations to equities. For some historical context, the average yield in the aggregate bond index since 2010 is only 2.6%.

The yield curve has now been inverted for 2 consecutive years. We find it attractive to position client portfolios with durations between 4 and 5 years. This specific area of the yield curve offers strong returns should yields fall if a recessionary environment unfolds. This part of the yield curve also reduces interest rate risk if rates where to increase from here.

Overall, we see current yields in the 5-year to 10-year area of the yield curve as good indicators of where yields will be for years to come. Bonds have regained their attractiveness as they provide strong ballast in portfolios along with attractive income.

YIELD CURVE

- During the month of May, the 10-year Treasury yield decreased -18 bps to 4.5%. Through the first week of June, the 10-year yield fell further to 4.4% after economic data showed consumer spending slowed in the month of April.
- 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. Bonds are back indeed.
- 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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