Sabal Trust

Investment Environment & Outlook

July 2024

Volume 11, Issue 7

Market & Economic Environment

The prices of Large Cap stocks continue to surge as they deliver on earnings. These stocks have now recorded the 3rd best start to the year in the last quarter century. Interestingly, during the 2nd quarter, most U.S. equities declined outside of the "growthier" Mega-cap 7 stocks. This bifurcation between stock performance makes it challenging for investors to keep pace with the S&P. Markets can and do experience corrections, which create opportunities for investors. History tells us that markets can be unpredictable, especially during an election year. Slowing economic data, election-year politics, and higher interest rates are hurdles the market must overcome for investors to enjoy healthy returns in the second half of 2024.

BANK STRESS TESTS

The Dodd-Frank Act Stress Test assesses the economic impact of shocks on bank capital levels. The recent test shows that 31 of the largest U.S. banks have the capacity to manage through a severe economic/financial shock including a -40% decline in commercial real estate prices and a -55% plunge in equity prices. These tests are critical to ensure the strength of our financial system and instill consumer confidence in our banking system

PRESIDENTIAL ELECTION

Politics took centerstage as the recent Presidential debate unfolded. Given the performances, there is heightened uncertainty leading up to the conventions later this summer. Elections usually do not drive the markets' long-term performance. But short-term fluctuations around candidate platforms create investment opportunities. Voters will inevitably focus on the economy and lingering inflation. There will be a lot to digest with the inevitable twists and turns before November.

LEADING ECONOMIC INDICATORS (LEI)

The Leading Economic Indicators (LEI), which are highly correlated with the economy, recently declined more than expected. The labor markets remain solid, but higher interest rates and inflation continue to weigh on consumer sentiment. The LEI's have been contracting since March 2022, indicating slowing economic growth. Against this backdrop it is important to remain invested in well-run companies that can generate stable cash flows and solid earnings.

GROWTH vs. VALUE

The Russell 1000 Growth stocks +21% continued to dominate their Russell 1000 Value counterparts +5% during 1H24. Strong earnings and healthy expectations fueled Growth stocks (particularly technology). While momentum is firmly entrenched, leadership rotations occur when markets reach extremes (i.e. valuations). These cyclical shifts can be swift and violent. However, investors continue to place a premium on growth as they focus on the earnings potential of Growth and Value stocks.

BUDGET DEFICITS

Deficits matter. The U.S. Government continues to run it largest deficit on record during a peacetime economic expansion. The widening gap between receipts and outlays is anticipated to reach $1.9T or 7% of GDP in FY24. Unchecked deficit spending crowds out private investments, increases debt servicing costs and limits resources the government can spend on entitlement programs. If politicians lack the political will to fix the issue, we could be spiraling toward a debt crisis that would have dire financial consequences.

INFLATION DATA

Investors remain focused on stubborn y/y inflation pressures (+3.3%). Inflation continues to moderate, yet the Federal Reserve's 2% target remains elusive delaying any pivot toward lower rates. Lower energy prices benefitted the Consumer Price Index (CPI), but housing and rental prices remained elevated. Two months of slowing inflation is welcomed, but more data is required for policy makers to assess the timing of the first rate cut.

Market Dashboard

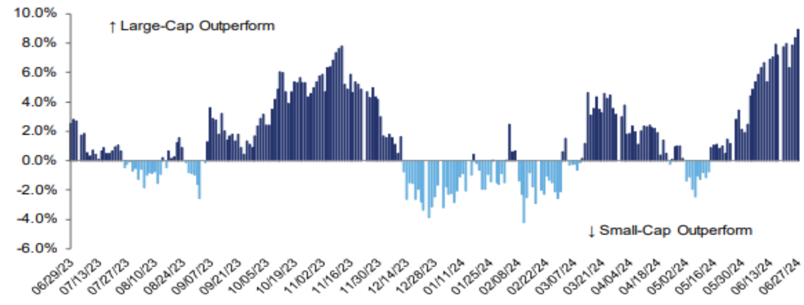
U.S. Equity

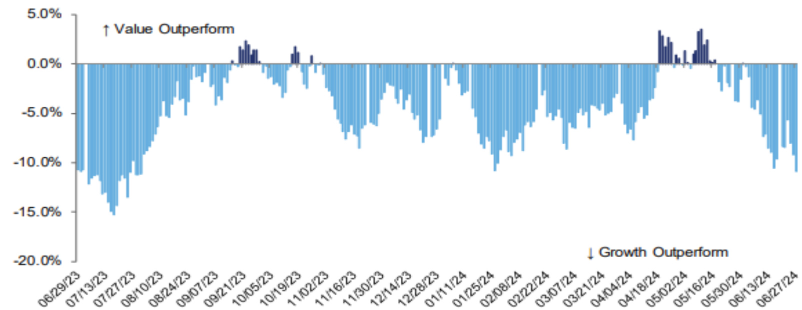
Returns though Friday June 28, 2024

US Equity	WTD	MTD	MAY	APR	QTD	Q1 2024	YTD	1 Year	3 Year	5 Year
FT Wilshire 5000	0.09	3.14	4.72	(4.36)	3.31	9.95	13.58	25.18	8.39	14.56
Standard & Poor's 500	(0.06)	3.59	4.96	(4.08)	4.28	10.56	15.29	26.67	10.08	15.18
FT Wilshire US Large Cap	0.03	3.78	4.80	(4.01)	4.40	10.29	15.14	26.87	9.63	15.37
FT Wilshire US Large-Cap Growth	0.28	7.47	6.49	(4.17)	9.67	11.86	22.67	38.01	11.41	19.59
FT Wilshire US Large-Cap Value	(0.23)	0.04	3.14	(3.86)	(0.80)	8.59	7.72	16.23	7.44	10.76
FT Wilshire US Small Cap	0.39	(1.45)	4.16	(6.61)	(4.13)	7.99	3.53	14.59	1.36	9.15
FT Wilshire US Small-Cap Growth	0.34	(0.40)	3.76	(7.00)	(3.89)	8.17	3.96	13.29	(1.55)	8.22
FT Wilshire US Small-Cap Value	0.44	(2.46)	4.54	(6.22)	(4.37)	7.84	3.13	15.95	4.09	9.73

Source: Wilshire

Relative Performance – Rolling Three Months Returns





Data Source: Bloomberg

Global Equity

Non-US Equity	WTD	MTD	MAY	APR	QTD	Q1 2024	YTD	1 Year	3 Year	5 Year
MSCI ACWI-ex-USA (Net)	0.38	(0.09)	2.90	(1.79)	0.96	4.68	5.69	12.38	0.20	5.62
MSCI EAFE (Net)	0.36	(1.61)	3.87	(2.56)	(0.42)	5.78	5.34	12.53	2.54	6.56
MSCI EM (Net)	0.06	3.94	0.56	0.45	5.00	2.37	7.49	12.40	(5.19)	3.10
MSCI ACWI-ex-US Small cap (Net)	0.14	(1.06)	3.24	(1.46)	0.66	2.11	2.78	12.22	(1.61)	6.24

Global Equity	WTD	MTD	MAY	APR	QTD	Q1 2024	YTD	1 Year	3 Year	5 Year
MSCI ACWI (Net)	0.13	2.23	4.06	(3.30)	2.87	8.20	11.30	20.91	5.34	10.86
MSCI ACWI Minimum Volatility (Net)	0.01	1.18	1.85	(2.62)	0.35	4.71	5.07	10.05	2.53	4.72

Source: Wilshire

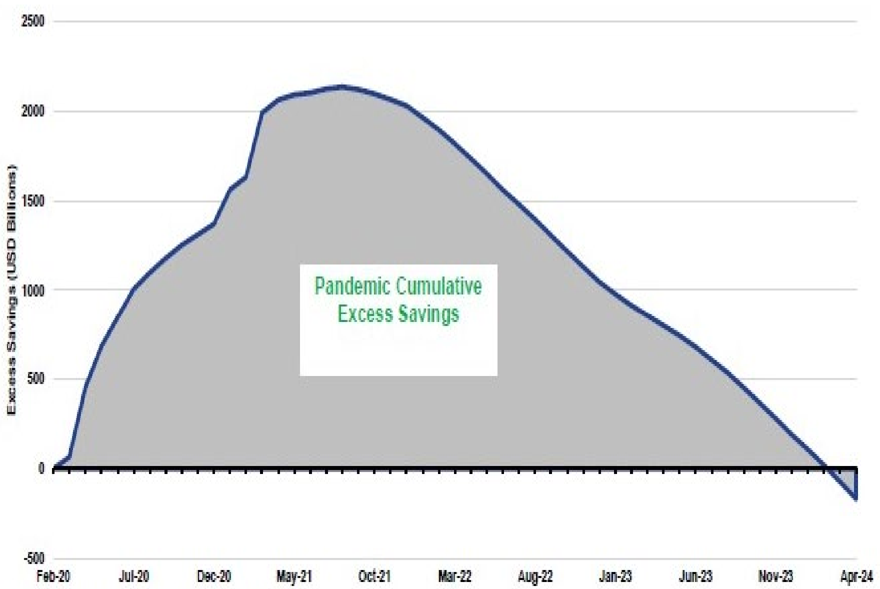
Interest Rate Observations

Since the Federal Reserve's last rate hike in July 2023, the "higher for longer" narrative shaped the macro environment in 1H24. Entering the year, market participants priced in soft growth and slowing inflation that would lead to expected rate cuts. However, 1Q24 unfolded differently than expected as upward shifts in growth and inflation upended the outlook. Expectations for 2H24 are for further increases in GDP by around 3% , as well as 17% y/y earnings growth in the SP&500. These elevated forward-looking expectations are being priced in at the same time underlying U.S. demand is starting to soften. Consumer spending contribution to GDP halved in the Q1 2024 and was revised down further by 60 bps. This is supported by other data on consumer spending, such as the chart below showing how excess pandemic savings have turned negative.

We believe expectations remain overly optimistic going into 2H24. We expect a slowing economy, but not to the degree that would dramatically impair labor markets or equity markets. Interest rates will continue to be volatile as bond investors remain reactive to economic data. Policy makers continue to push out anticipated interest rate cuts as they assess more economic data. Inflation's slow move toward their 2% target now has Federal Reserve officials penciling in one rate cut in 2024 and four cuts in 2025.

YIELD CURVE

- During the month of June, the 10-year Treasury yield decreased -10 bps to 4.4%. Through the first week of July, the 10-year yield fell further to 4.35% after labor market data cooled.
- The chart on the right indicates that excess savings consumers accumulated during the pandemic years have now been spent.
- 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.



Source: Federal Reserve Bank of San Francisco & FTS

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