Sabal Trust

# Investment Environment & Outlook

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# Market & Economic Environment

Weak economic data, an unexpected rate hike by the Bank of Japan, and an unwinding of foreign exchange trades fueled extreme volatility to start the month of August. Volatility measures reached levels not seen since the depths of the Pandemic. Fortunately, the violent sell-off was brief as investors focused on the growing likelihood of the Federal Reserve lowering interest rates. Strong corporate earnings also offset weak economic data, which helped fueled the recovery in stock prices during the month. Even the bond markets experienced elevated volatility with yields falling and prices rising as investors fled to safety and away from risk assets.

## SEPTEMBER'S HISTORY LESSON

Since the 1950's, September has challenged investors, with the S&P 500 and Dow Jones often experiencing significant losses during the month. Upcoming economic data releases, interest rate decisions and a Presidential election will influence investor sentiment. Markets hovering near all-time highs leave little room for error. Balanced and diversified portfolios will allow investors to manage through market fluctuations if history repeats itself.

## MANUFACTURING SECTOR

The manufacturing sector represents approximately 10% of the U.S. economy. Manufacturing activity declined for the 5th straight month and pushed deeper into contraction territory. Declining orders and backlogs indicate less optimism amidst growing political uncertainty surrounding the Presidential election. The Leading Economic Indicators (LEI) confirm manufacturing's malaise by pointing to weaker economic growth in the second half of 2024.

## CONSUMER HEALTH

The depletion of Pandemic-level savings leaves less of a financial cushion as consumers fuel purchases with credit card debt. 7.2% of all credit cards are 90-day delinquent, the highest level since 2011. These trends require monitoring. Nevertheless, consumers continue to spend as evident by Walmart's latest earnings where sales and transaction volumes grew and exceeded expectations.

## RATE CUT EXPECTATIONS

Investors cheered as Federal Reserve Chairman Powell reinforced expectations of rate cuts in September during the Fed's Jackson Hole Symposium. With inflation trending toward their 2% target, Powell indicated "the time has come" to cut rates. While this is welcome news, a tone of caution is warranted. Currently, the markets are pricing in 4 rate cuts before year end and another 5 by the end of 2025. As expectations adjust and converge to actual policy decisions, volatility could return like we saw earlier this year.

## LABOR MARKET

The Unemployment rate recently touched 4.3% up from a 53-year low seen in April 2023. Part of the increase is related to workers returning to the labor force, which is a good development. However, the Department of Labor's dramatic downward revision to job growth by 818,000 jobs over the last 12 months complicates the reality of the environment. Growing uncertainty about jobs could weigh on consumer sentiment and their willingness to spend.

## INFLATION

Recent inflation data fell to +2.9% y/y, the first time under 3% since March 2021. These readings fueled enthusiasm around a first rate cut in September. While still elevated, shelter and food costs, continue moderating, which should bring relief to households whose budgets remain stretched due to higher costs. Consumers remain focused on value purchases via trading down and hunting for promotional activities.

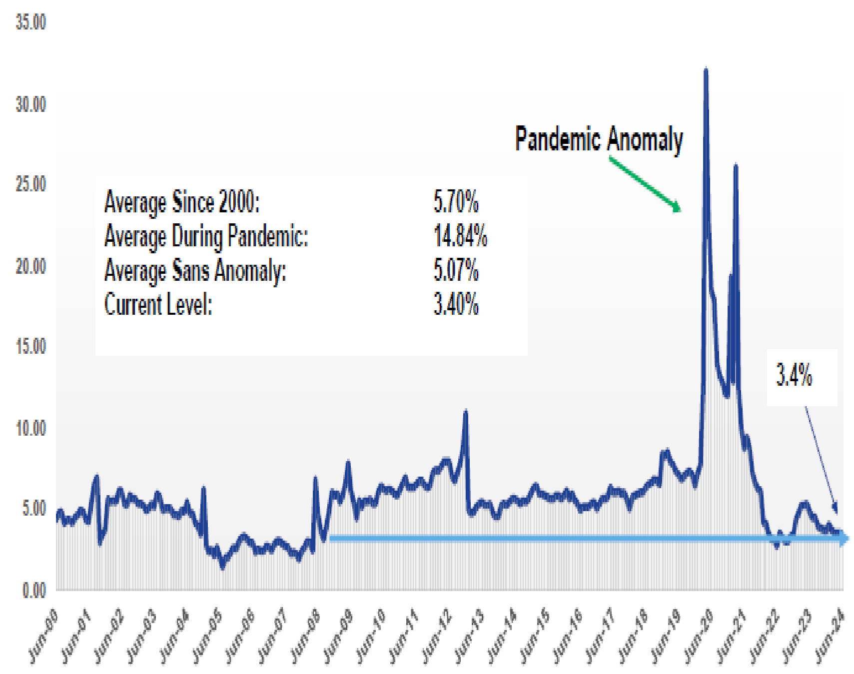
# Fixed Income Observations

August delivered the most turbulence all year as equity volatility spiked on the back of a surprisingly weak jobs report. Surging global equity market volatility resulted in a flight to quality pushing bond prices higher leading to positive returns for fixed income investors. Yields fell dramatically resulting in the largest move in interest rates all year. Key economic data throughout August showed a slowing economy. Manufacturing activity contracted, pending home sales continued its yearlong downtrend, and unemployment increased to 4.3% from 4.1%.

Falling inflation data for the third straight month was greeted enthusiastically by investors. This is important because the Federal Reserve's reaction function is driven by trends in data. During the Federal Reserve's Jackson Hole Economic Symposium, Jerome Powell delivered a speech opening the door to the first pivot in their 2-year hiking cycle. Chairman Powell was clear the path ahead for rates is lower. From this point forward, market participations will have to navigate the pace at which policy makers lower interest rates to its "neutral rate." Lastly, it is important to note that the "neutral rate" is not necessarily accommodative to the economy like the Quantitative Easing (QE) period, but also is not overly restrictive as seen during the rate hiking cycle over the past 2 years.

## Macro Observations

- The chart on the right is the **US Personal Savings as a % of Disposable Income**
- The latest release of the personal consumption figure notes that spending is outpacing the growth of disposable income. Consumers abandoned normal savings habits to support spending needs. Presently, excess savings have declined as the Covid non-spending anomaly dissipated, which we discussed in June's report. As inflation continues to cool, many expect consumers to gradually increase savings.
- Increased savings leads to a slowing economy as consumers spend less and companies must reduce inventory at lower prices. This reduces profit margins and slows hiring activity.
- We have reached the end of the rate hiking cycle. Money markets will offer lower rates going forward and we advise moving excess cash to short term Treasuries that can offer better returns and greater enhanced protection for portfolios.




Source: Bloomberg, LLC

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