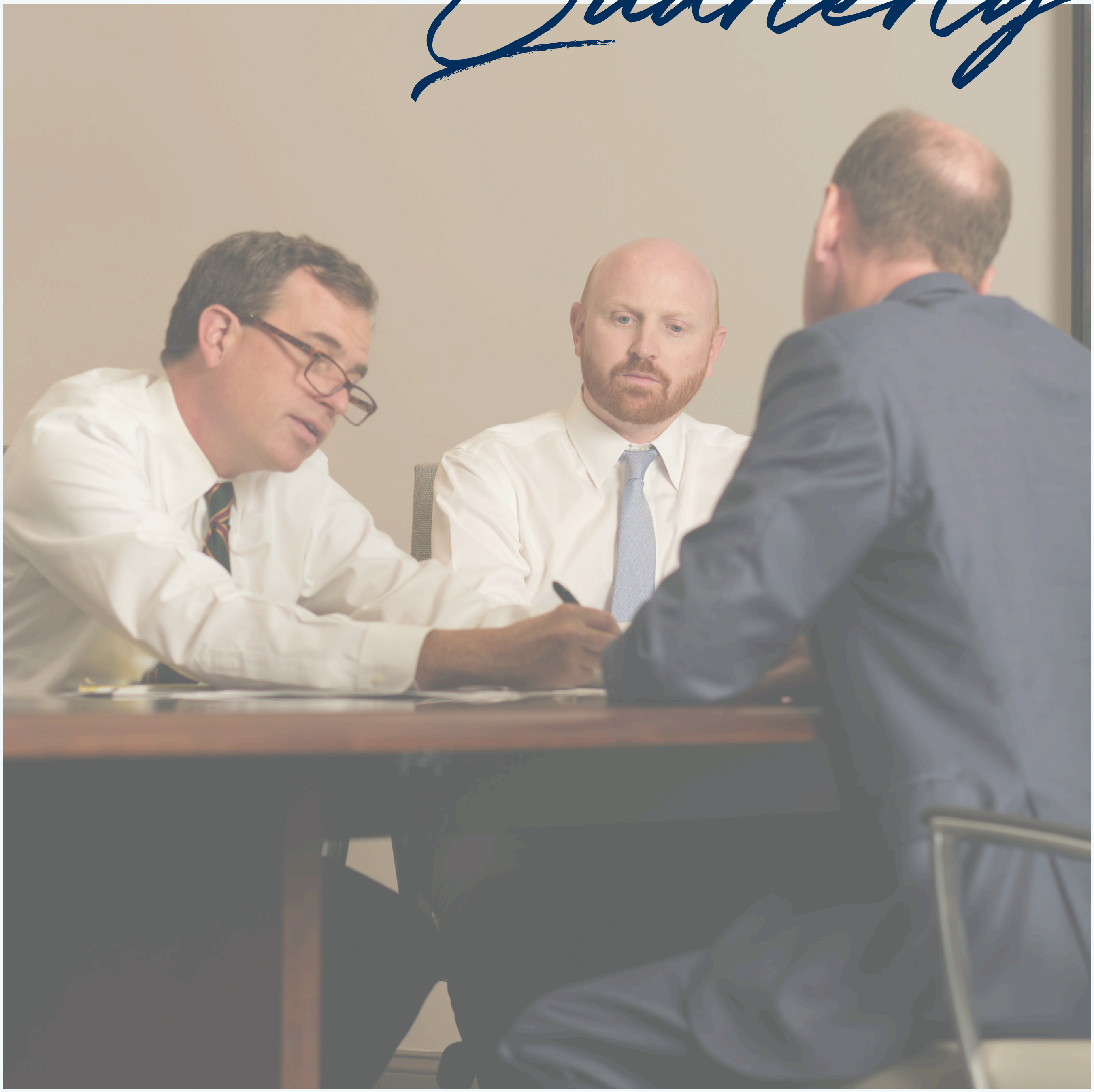
EST 1913
COLONIAL TRUST
COMPANY

4TH QUARTER
2023

COLONIAL TRUST *Quarterly*



IN THIS ISSUE

MARKET RECAP

THE STRONG FIRST HALF OF 2023 CONTINUED INTO THE THIRD QUARTER, WITH THE S&P 500 HITTING A 52-WEEK HIGH ON JULY 31ST, LEAVING THE MARKET UP 20.6% ON THE YEAR.

That marked the high for both the quarter and the year, August and September then saw market weakness. For the third quarter, the S&P 500 fell 3.6% and ended down 6.6% from the July high. The Dow Jones fell 2.6% for the quarter and the Nasdaq Composite fell 4.1%. The selloff was not isolated in the United States, as the MSCI EAFE developed market index fell 4.7% and the MSCI Emerging Markets index fell 3.7%.

The equity markets reacted to an upward shift in interest rates, particularly on the long end of the yield curve. The 2yr treasury rate ended the 2nd quarter at 4.90% and the 3rd quarter at 5.04%. The 10yr treasury rate rose from 3.84% to 4.57% over that period, while the 30yr treasury rose from 3.86% to 4.70%. Rising yields caused the Bloomberg Aggregate Bond Index to lose 3.23% for the quarter.

OFFICE ADDRESS:
233 S. Pine St.,
Spartanburg, SC 29302

MAILING ADDRESS:
PO Box 1724
Spartanburg, SC 29304

WE MOVED!

We are excited to announce that our Spartanburg office relocated in August. This new and improved office is located at 233 S. Pine St.(corner of Glendalyn Ave. and S. Pine St.), just two blocks from our old office of 24 years.

While we enjoyed serving our clients from the corner of Palmetto and Pine, we simply outgrew our space and need more room. Our new space is designed to serve our clients better and provide a more comfortable environment for our employees. We are confident that this move will enable us to continue delivering the highest level of quality you have come to expect from us. We look forward to welcoming you to our new office and continuing our successful partnership.

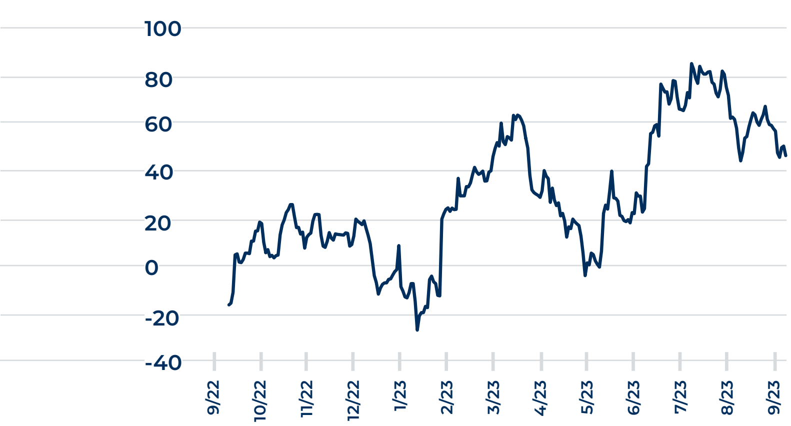
ECONOMY AND MARKETS INTO YEAR END

IN OUR LAST NEWSLETTER, WE SUGGESTED THE POSITIVE EFFECTS OF A STRONG LABOR MARKET COULD OFFSET HIGHER INTEREST RATES AND POCKETS OF ECONOMIC WEAKNESS, PROMOTING ECONOMIC GROWTH.

Additionally, we highlighted the broadening of equity market participation away from a handful of large tech companies at the end of the second quarter. Here, we will provide updates on those points and our thoughts on the remainder of 2024.

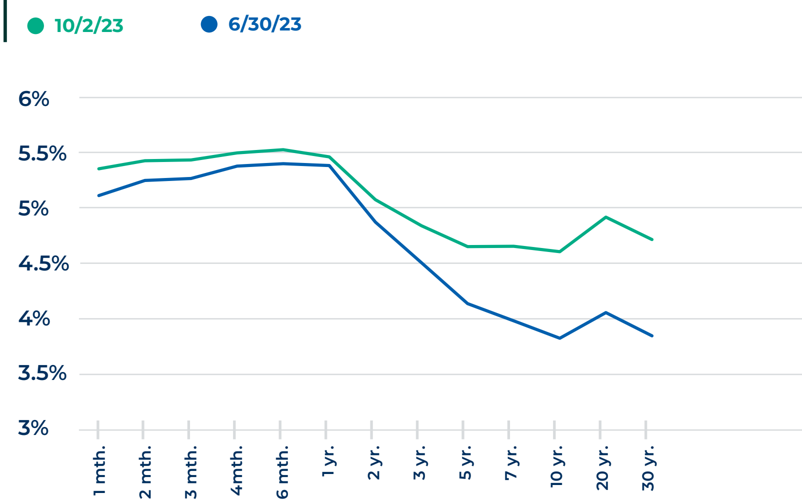
During the last week of the quarter, the revision to 2nd quarter GDP showed 2.1% growth, well above the 1.2% expected in June. The Atlanta Fed GDPNow™ forecast for 3rd quarter growth stood at 4.9% as the quarter ended. The Citi Economic Surprise Index measures economic releases compared to Wall Street expectations and a positive reading means releases are better than expected. This index has been positive for the quarter, pointing to economic releases surpassing expectations. However, it peaked in July and has trended lower in August and September.

CITI ECONOMIC SUPRISE INDEX



This surprising economic strength has kept the Federal Reserve engaged, vigilant, and either raising rates or forecasting future rate hikes. The Fed Funds rate was increased by 0.25% in the Fed's July meeting. During the September meeting, Jay Powell indicated the Fed was willing and ready to raise interest rates further if inflation does not moderate. The Fed's Summary of Economic Projections (SEP) highlighted that the Fed expects rates to be higher for longer and does not anticipate meaningful rate cuts in 2024 as had previously been hoped.

TREASURY YIELD CURVE



Persistent inflation, strong economic growth, massive fiscal deficits, and a hawkish Federal Reserve caused interest rates to increase substantially for the quarter, particularly longer-term rates. Rates moved higher across the yield curve, but 10yr and 30yr yields increased by 0.80% and 0.89%, respectively. Higher long-term treasury yields impact the cost of capital across the economy and slow demand for credit-sensitive economic activity. For example, 30yr mortgage rates ended the quarter at 7.74% according to Bankrate.com, up from 7.15% on June 30th. Higher mortgage rates and elevated housing prices pushed the National Association of Realtor's Housing Affordability Index to an all-time low.

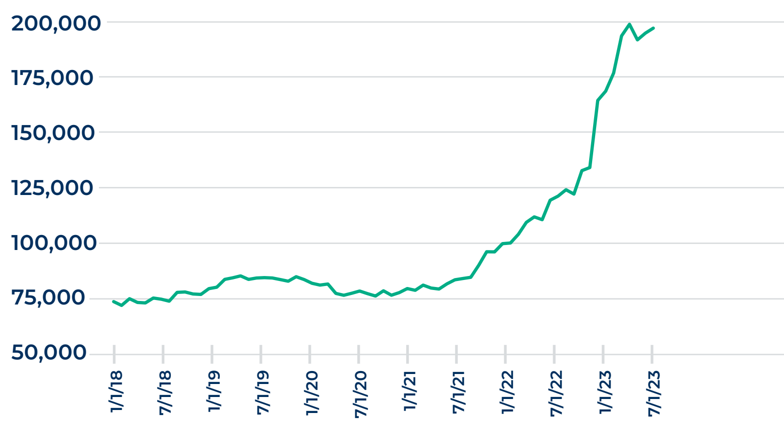
LONG-TERM INTEREST RATES REACHED A SIXTEEN-YEAR HIGH.

These rates are slowing the economy. While a strong labor market served as a bulwark against economic weakness, now, job growth is slowing. Non-farm payroll growth downshifted in the third quarter. The average monthly gain in the first half of the year was 257k, down to 172k in July and August, and has been below 200k in the last three months. Additionally, every monthly jobs report of 2023 has been revised lower from its original print. The number of job openings has also fallen in 2023, with the JOLTs report showing 1.6 million fewer job openings in July compared to December 2022. The unemployment rate remains low at 3.8%, signaling few layoffs; though, tightness in the labor market is lessening.

THE HOUSING MARKET APPEARED TO REBOUND IN THE SECOND QUARTER, BUT THIS WAS SHORT-LIVED DUE TO HIGHER MORTGAGE RATES.

The uptick in existing home sales in the first half of 2023 weakened in the third quarter, with August data approaching the lows seen in January. New home sales rose through July, but the August read showed a 9% reduction in new home sales. We don't expect a significant reduction in home values due to supply constraints, but elevated mortgage rates have existing homeowners locked into low mortgage rates and unable to move with affordability remaining an issue for new home sales. The manufacturing sector has been contracting for eleven months as measured by the ISM Purchasing Managers Index (PMI). The September read for ISM PMI was 49.0, with a reading below 50 signaling contraction. The good news on this front is improvement for three consecutive months from the read of 46.0 in June. Other good news in the manufacturing sector is the investment in manufacturing capacity in the US. Spurred by the Chips Act, the Inflation Reduction Act, and onshoring post-pandemic. There has been a 66% increase in construction spending for manufacturing in the last year. Manufacturing construction represents only 10% of US construction spending and is roughly half the spending on residential construction. The impact of this spending on the broader economy is limited, but it is unquestionably good news for the manufacturing sector.

US CONSTRUCTION SPENDING - MANUFACTURING



THE MANUFACTURING SECTOR SEEMS TO HAVE BOTTOMED AND LOOKS SET TO RETURN TO GROWTH.

The service sector continues to point to strength. The ISM Services PMI remains firmly above 50, at 54.5 in August and up from 52.7 in July. Travel remains strong, with TSA Checkpoints up 1.6% in the third quarter over the second quarter and 11.0% higher than the third quarter of 2022. Retail sales continue to increase, with sales up 3.6% in August over the prior year (less auto dealers, construction, and gas stations). There is some belief that "revenge travel" may have run its course, but thus far consumer spending on services continues to post respectable growth.

The US consumer remains strong. Personal income rose 0.2% in the first two months of the quarter and spending rose 1.3% to a new all-time high. Inflation and higher interest rates have caused the savings rate to fall during the quarter, with an August savings rate of 3.9%, down from 4.9% in June. Revolving credit reached a new high in July of $1.27tn, up 5% from December. Slowing job growth and inflation have consumers concerned about the future, while they continue to spend now. This is illustrated in the Consumer Confidence Index, where the Present Situation Index remained high at 147.1 for September, while the Expectation Index fell from 88.0 in July to 73.7 in September. This paints a picture of a consumer who is growing more concerned about their prospects, which may cause consumers to moderate spending going into the fourth quarter.

WHEN YOU COMBINE THESE ASSESSMENTS OF DIFFERENT SECTORS OF THE ECONOMY YOU GET A MIXED PICTURE, MUCH LIKE OUR ASSESSMENT LAST QUARTER.

The differences are the areas of strength have changed. Employment is weaker, but manufacturing appears to be improving. The economy continues to post solid growth but may slow due to higher interest rates. Many have pointed to the thesis of rolling recessions moving through the economy, with certain areas contracting while others grow, and the baton passed between sectors as we move through this rate hiking cycle. There is evidence supporting this thesis, but there is no sector of the economy that can offset a contraction in consumer spending if it comes. There are many known challenges for the consumer: inflation, slower job growth, high credit card balances, and falling confidence. As we enter the fourth quarter, there are other risks to the consumer: resumption of student loan payments, labor strikes, and a possible government shutdown in 45 days. Our reading of the economic data leads us to expect moderating economic growth going into year-end. Wall Street forecasts for 4Q GDP are for 0.5% growth, which is down from over 2% in the first two quarters of the year. We expect the lagged effects of higher interest rates will manifest in the economy, reducing growth. We don't expect a recession in the next few quarters, but when the speed of growth is reduced, the economy has less ability to manage through surprises.

The combination of slower projected growth and higher interest rates took its toll on the markets during the last two months of the quarter. As mentioned above, the S&P fell 6.6% from July 31st to quarter end. The Bloomberg Aggregate Bond Index also slumped in the final two months of the quarter, returning -3.2% as rates rose. Not only did interest rates increase during the quarter, but the market's expectations for future interest rates rose as well. There was a uniform 0.5% increase in expectations for the Fed Funds rate in 2024, indicating the markets now don't expect significant rate cuts in 2024. The Fed has jawboned the market into believing it will keep rates higher for longer. This has implications for both the economy and for markets, causing a selloff during the quarter.

Markets begin the fourth quarter with a decidedly negative sentiment as investors assess the impact of higher rates on earnings and valuations. Earnings, as measured by the S&P 500, have fallen for three consecutive quarters. Thus far the largest decline in earnings was in the second quarter, where earnings fell 5.4% according to Factset. Third quarter analyst estimates call for earnings to decline by 0.2% and return to growth of 9.4% in the fourth quarter. The fall in earnings over the last year was due to margin compression, with revenue growth in each of the last three quarters. Wall Street expects profit margins to improve over the next few quarters as inflation and wage pressures subside.

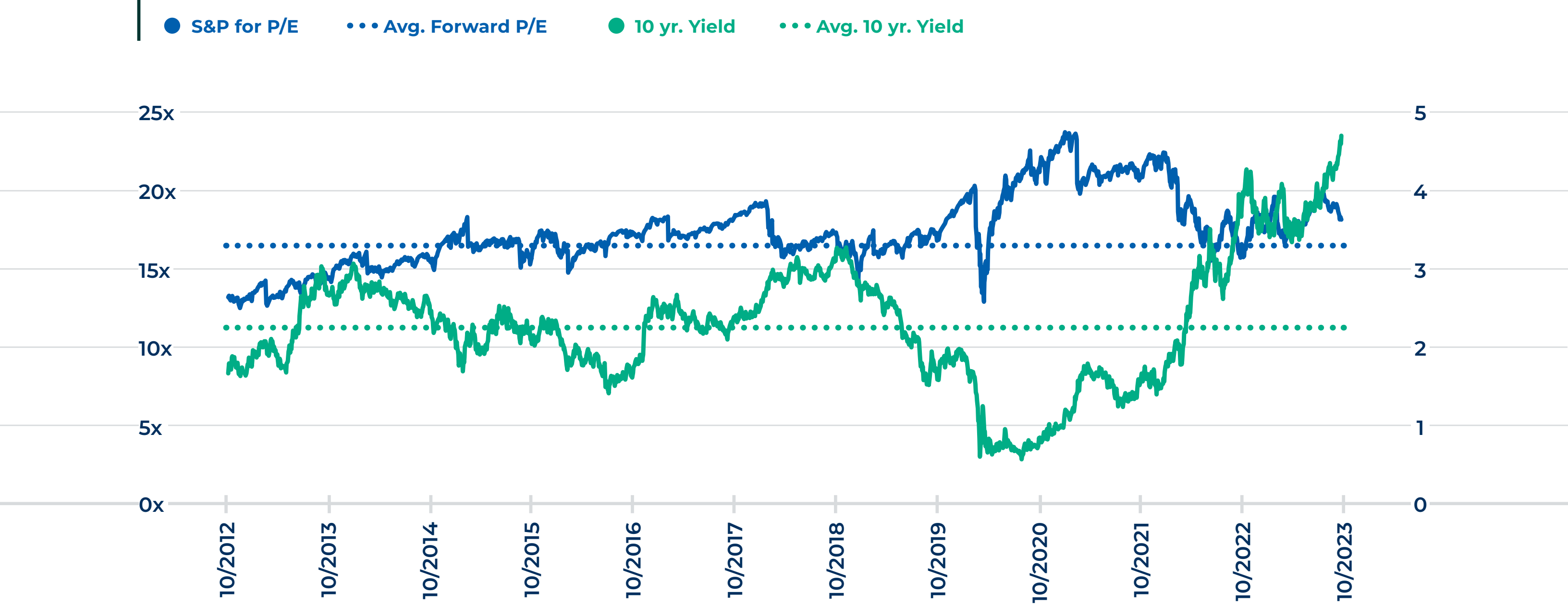
EXPECTATIONS OF A RETURN TO EARNINGS GROWTH AND IMPROVING MARGINS ARE A POSITIVE FOR EQUITY MARKETS.

Additionally, we are now beginning to see Wall Street analysts increase their near-term expectations for earnings in the 3rd and 4th quarters and 2024. Earnings estimates for 2023 were reduced by 13% over the last year but have found a bottom and have increased from $217/share to $220/share over the last 90 days. Revenue estimates for 2023 continue to climb and the improvement in earnings estimates is signaling the worst of the margin compression may be behind us.

ARMED WITH EXPECTATIONS ABOUT EARNINGS, WE CAN TURN OUR ATTENTION TO VALUATIONS.

The forward 12-month P/E ratio for the S&P 500 is 17.4x. This is below the five-year average ratio of 18.0x, but above the ten-year average of 16.6x. This metric was 18.4x at the beginning of the third quarter. A combination of rising earnings expectations and lower stock prices brought the forward P/E back toward its ten-year average. The market appears to be fairly valued assuming the "average" market environment over the last decade. However, the last decade brought us historically low interest rates, which allow for higher valuations. The average yield on a 10yr treasury over that period was 2.25% and today stands at 4.67%. From 2002 through 2006, the 10yr yields were in this current range and the forward P/E ratio averaged 15.8x. This points to a market that is not wildly overvalued, but the equity market needs bond yields to find a ceiling to assess valuations. A key input into equity valuations is interest rates and when the 10yr yield is rising 0.2% per week, it is difficult to determine fair value for future cash flows.

VALUATIONS



WE ENDED THE THIRD QUARTER WITH A REVERSAL OF THE BROADENING OUT OF THE RALLY SEEN IN THE SECOND QUARTER.

We mentioned in our last update the S&P 500 equal weight outperformed the S&P 500 index for the month of June, a trend which reversed in the third quarter. The concentration in the mega-cap tech stocks increased during the quarter, as the returns of the Magnificent Seven beat the broad market for the quarter by 2.26%. Market leadership is consolidating in these large companies with strong balance sheets and durable growth as investors turn to these names in a time of elevated volatility.

We expect equity market volatility to continue into year-end due to the persistent increase in long-term yields that began in July. Yields are rising due to concerns about higher inflation and profligate spending in D.C. The Fed and commercial banks have reduced their holdings of Treasury and agency bonds by $1.6 trillion, while we are running deficits equal to 7.6% of GDP. There is concern that the supply of Treasury bonds is overwhelming demand and bond vigilantes are pushing yields higher.

THE ECONOMY SEEMS TO BE MOVING THROUGH ROLLING RECESSIONS.

Earnings expectations are rising; however, long-term yields continue to increase. If this continues unabated, these dynamics could change the trajectory for the economy and markets. We are closely reviewing the economic and market data to evaluate the direction of rates and markets. Additionally, we are reviewing balance sheets and fundamentals of the investments we own to ensure we are comfortable with their ability to manage through higher rates. We know market volatility causes consternation for our clients and does for us as well. We try to change our strategy when there is a fundamental change in the economy. When there are fast changes in market signals we try to discern if they are short-term noise or long-term sea changes. We will be busy doing this as we enter the fourth quarter. As always, we value your confidence and friendship. If you have any questions about the current market or economic situation, do not hesitate to reach out to your relationship manager. We hope that our clients and friends have a wonderful and prosperous fourth quarter and take time to spend with family and friends as the holidays approach.

OUR LEADERSHIP

H. Walter Barre

Bert D. Barre, CFA

Barry D. Wynn

Camp R. Wynn, CFA

Henry E. Batts III, AWMA®

Charles W. Clementson

James C. Fiske, CFP®

Jamison W. Hinds, JD

Karen H. Longhurst, ATFA, CTFA

Pamela G. McCauley

Ansley J. Mitcham

Kathryn A. Smith, CPA/PFS, CFP®

Lorie L. Barton

W. Charlton Wieters, CTFA

Matt Van Name, CFP®, CRPS®, AIF®

Jordan R. Taylor, CPA

LOCATIONS

SPARTANBURG

233 S. Pine St.
Spartanburg, SC 29302

864.582.3356

GREENVILLE

101 E Washington St.,
Suite 200
Greenville, SC 29601

864.370.0737

COLUMBIA

6 Calendar Ct.,
Suite 1
Columbia, SC 29206

803.782.7646

CHARLESTON

578 East Bay St.,
Suite B
Charleston, SC 29403

843.577.0444

COLONIALTRUST.COM