

Synovus Market Update

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Opinions by David Grimaldi and Daniel Morgan



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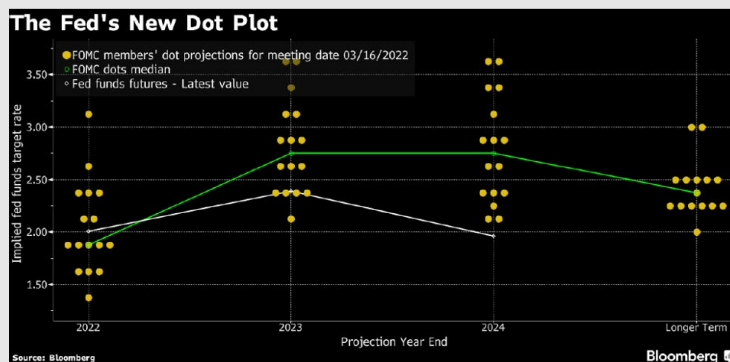
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Ready, Set & Go...The Federal Reserve Starts Raising Rates

Daniel Morgan, Senior Portfolio Manager

The Federal Reserve has finally started to raise interest rates after the fourth quarter gross domestic product (GDP) increased at an annual rate of 6.9%, as consumer spending came in strong, up 3.3%, and private investment jumped to 32%. In addition, Non-Farm Payrolls added 678,000 workers in February, after posting 467,000 just one month earlier (although payrolls are still 3 million below their January 2020 peak), and the Hourly Wage Growth was up 5.1%. Unfortunately, despite all the positive data, the U.S. is faced with a surge in inflation.

A mixture of massive government stimulus, tightening labor markets, surging commodity prices, and supply constraint bottlenecks have caused the Consumer Price Index and the Producer Price Index to skyrocket to 7.9% and 10%, respectively in February. The Fed's dual mandate — that inflation must be more than 2% (the fourth quarter 2021 Personal Consumption Expenditures Index rose to 5.5%) and maximum employment reached (the unemployment rate in February fell to 3.8%) to begin tightening — was satisfied. Accordingly, during the recent March meeting, the Fed decided to start tapering quantitative easing by raising the Fed Funds Rate to 0.25%-0.5% and reducing the \$8.9 trillion of U.S. securities held on its balance sheet. Notably, the Federal Reserve's so-called dot plot, which it uses to signal its outlook for the path of interest rates, shows officials expect to raise the fed funds rate six more times this year, based on median projections. The Fed had kept its benchmark rate steady after sweeping into emergency action amid the coronavirus pandemic in March 2020 with a full percentage-point cut. The increase represents the first interest rate hike since 2018.



Source: Bloomberg

Federal government stimulus packages have come at a steep price, as they have contributed significantly to increasing inflation and added mounds of debt. The Congressional Budget Office (CBO) has projected that the federal government's total tax revenues will be \$4.390 trillion, on a total outlay of \$5.544 trillion in 2022. Accumulated debt, held by the public, will hit \$24.5392 trillion, resulting in an annual debt interest expense of \$305 billion. Considering these developments, the consensus forecast for real GDP in 2022 is now \$20.152 trillion, 3.7% year-over-year, and the Fed is now projecting a much lower growth rate for GDP in 2022 of 2.8% year-over-year. However, these estimates may be optimistic, as real GDP only rose 2.09% from 2019 to 2021, as higher consumer prices tend to squeeze out consumer spending, which accounts for two-thirds of total GDP.



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Understanding Money Supply and Inflation

David Grimaldi, Foreign Exchange Sales Consultant

Recently, Speaker of the House Nancy Pelosi argued that government spending does not increase inflation. “The government spending is doing the exact reverse, (it is) reducing the national debt. It is not inflationary,” she said. Secretary of Transportation Pete Buttigieg went further, saying spending would “ease inflationary pressures.” What is true, is that the U.S. has been printing money and raising the M2 money supply. This figure was followed closely by the Fed until July 1993, when Federal Reserve Board Chair Alan Greenspan testified before Congress that the Fed would no longer use the monetary aggregates to guide Federal Open Market Committee (FOMC) policy because the relationship between M2 and economic activity had broken down.¹

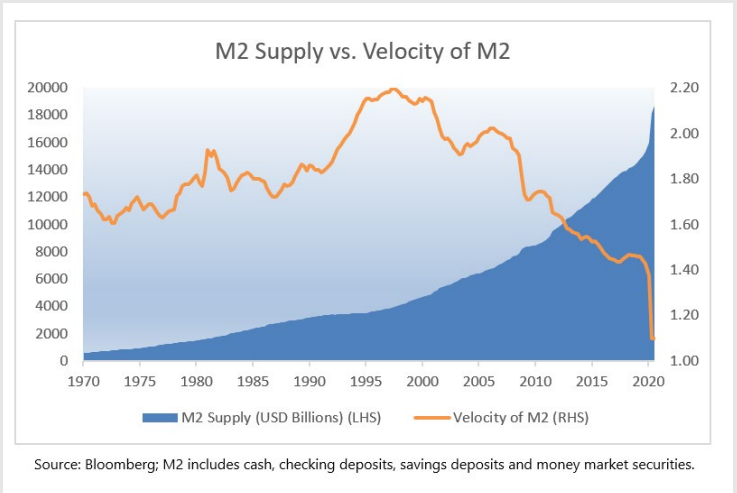
Neither Pelosi nor Buttigieg gave a supporting economic analysis on why M2 increases decrease inflation, so I will hold my judgment until they do. In contrast, is the increase in M2 by 40% this year driving inflation? What is M2 in the money supply, and why is it important? Investopedia describes M2 as a measure of the money supply that includes cash, checking deposits, and easily-convertible near money. The Fed supplies currency to U.S. and the World, the world can hold U.S. currency, and currency makes up only 10% of M2. The other 90% of M2 exists because people want to hold money in the form of checking accounts (10%), retail money market funds (10%), small-time deposits (13%), and savings deposits (57%).²

The Federal Reserve has a dual mandate of regulating inflation and balancing unemployment. M2 serves the critical purpose of measuring inflation. The U.S. economy is greatly affected by inflation and interest rates, which influence spending, investment, employment, the U.S.



M2 is a measure of the money supply that includes cash, checking deposits, and easily-convertible near money.

Dollar, and trade. Money supply growth was a factor behind high inflation in the 1970s, as the government ran up fiscal deficits and the Fed adopted loose monetary policies to boost employment.³ Some economists warn that a surging money supply may exacerbate a rise in U.S. inflation, which is already accelerating at its fastest rate in more than a decade.⁴



Source: Bloomberg

Another aspect of M2 that is needed to increase inflation is called velocity. The velocity of money is the frequency at which one unit of currency is used to purchase domestically produced goods and services within a given time. In other words, velocity is the number of times one dollar is spent to buy goods and services per unit of time.⁵ Velocity in its simplest form is the number of times money changes hands. Michael Ashton, AKA the Inflation Guy, holds to the monetarist viewpoint that there has been a virtuous cycle in which lower inflation has led to lower interest rates, which has caused lower velocity. People have not been in a hurry to invest their cash since low-interest rates also mean lower returns. Ashton says the Fed's recent stimulus efforts risk reversing that cycle. While the Fed assumes it can eventually bring inflation under control by raising rates, he says this may instead boost velocity by making people less willing to hold cash.⁶ Velocity has remained historically low (1.123%) as banks are struggling with record deposits after the U.S. government ramped up fiscal spending, while the Federal Reserve is buying unprecedented amounts of bonds. Also, the low level of interest rates has reduced the penalty for holding



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savings in low-earning accounts. This has shown up as a steady decline in the velocity of money, diminishing the impact of money supply on the economy.⁷

Why is inflation at 40-year highs, if M2 and velocity do not have the inflationary impact we saw in the decade of the 1970s? Economists fear that government money printing is one shoe setting up for the other shoe – velocity – to drop. Ashton also stated that the COVID-19 pandemic stimulus checks and tax relief, combined with the reopening of the economy, fed consumer demand but did not replace product inventories. The result: shortages that lead to higher prices. "Having supply chain difficulties is part of what inflation looks like," Ashton says.⁸ Additionally, new oil regulations and the shutdown of the Keystone pipeline have set the tone for the markets, while the Biden administrations plan to phase out fossil fuels is driving up oil prices. The market feels the Fed is behind the curve in raising rates. In summary, if investors and consumers draw on deposits, further boosting demand, coupled with supply chain disruptions, while commercial credit from banks increases, we could see a tsunami of demand outpacing output.

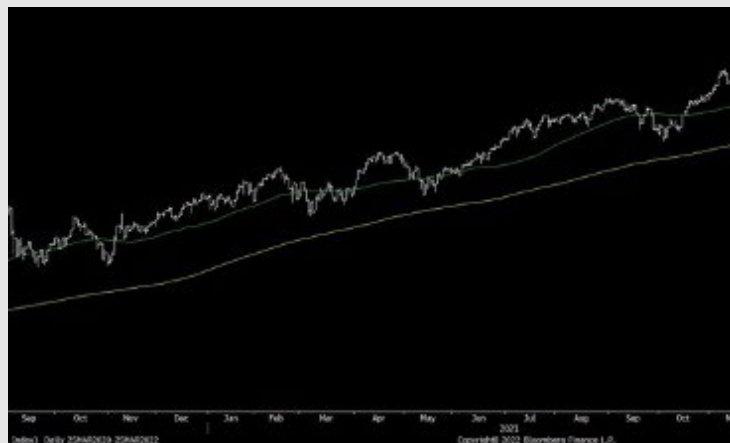
Technology Corner: Are Technology Stocks in a Bear Market Phase?

Daniel Morgan, Senior Portfolio Manager

With the tech-laden S&P Information Technology Index down 9.7% year to date, while trading at a P/E ratio of 30x trailing earnings, investors are trying to determine if this is the beginning of a bear market for the technology sector, or a golden buying opportunity to accumulate high-quality names at a discounted price. The technology sector seems to sell off when any news of more Fed tightening surfaces, resulting in the possibility of slower future economic growth leading to lower IT spending. Well, technical indicators are pointing to rougher seas ahead!

The S&P 500 Index and S&P Info Tech Index are exhibiting negative signs; both show that the 50-day moving average has crossed the 200-day moving average, creating what technical analysts refer to as the "Death Cross." The Death

Cross is a chart pattern that indicates the transition from a bull market to a bear market and occurs when the market/securities short-term moving average (50-day moving average) crosses from above to below a long-term moving average (200-day moving average.) The indicator gets its name from the alleged strength of the pattern as a bearish indication, and analysts who believe in the reliability of the pattern say that a security or index is dead once this bearish moving average crossover occurs. The last time the S&P Information Technology Index formed the infamous Death Cross was in April 2020. However, the technology sector eventually rebounded after reporting solid first-quarter earnings reports. It will be interesting to see if that scenario plays out again.



Source: Bloomberg

With market technicals now favoring the bears, there seems to be a flight to value within the technology sector, as lower multiple, more mature growth names are out-performing their once high multiple, fast-growth brethren. For example, the once high-flying darlings Netflix (-38% year-to-date), Advanced Microsystems (-23% year-to-date), Adobe (-22% year-to-date), and Paypal (-41% year-to-date) have gone through a drastic re-evaluation of expectations for their future profit growth. In contrast, more mature technology names like IBM (-3% year-to-date),



The Death Cross, when the 50-day moving average crosses the 200-day moving average, often indicates a bear market.



Hewlett Packard Enterprise (+6% year-to-date), Citrix Systems (+7% year-to-date), and Corning (+2% year-to-date) have posted respectable returns so far this year. To that end, these mature growth companies, IBM (5.2%), Hewlett Packard Enterprise (2.9%), Citrix Systems (1.1%), and Corning (+2.8%), have strong cash-flow, healthy share repurchase programs, and pay a decent dividend yield. In contrast, typical high growth, high multiple technology companies pay little or no dividend and use their profits solely to generate future growth.

Despite this near-term re-evaluation of growth in the technology sector, the space remains relatively healthy, and monumental, seismic growth trends in Cloud, AI, 5G Telecom, and Smartphones are still intact.

Data centers, including Cloud Computing, AI/Deep Learning, and Networking, following muted spending trends in the first half of 2021, have seen spending bounce back solidly in the second half of the year with robust momentum sustained into 2022 (up 30% year-over-year). Capital expenditure for the top 4 U.S. cloud/hyper-scale data centers (Amazon's AWS, Microsoft's Azure, Google's GCP, IBM's Cloud) should increase 30% in 2022. Data center capital expenditure is forecasted to reach \$180 billion in 2024, as the market grows at a 15.7% compound annual growth rate. In the fourth quarter of 2021, the top Cloud Service Providers, including Microsoft, Alphabet, and Amazon cloud-related revenue, posted an average growth

rate of 34% year-over-year, showing strong growth across each company (MSFT +26%, Alphabet +45%, and Amazon +40%). The increase in capital expenditure should filter down, driving strong order/shipment trends for the leaders in cloud data center networking semiconductors: Nvidia, Intel, Advanced Micro, Broadcom (switching/routing and NIC), and Marvell (optical connectivity and data center interconnect.)

In the 5G/Telecomm wireless infrastructure arena, anticipate strong growth over the next few years on continued 5G infrastructure buildouts, with 5G base station (BTS) deployments growing by 21% in 2022 and 9% in 2023. Global 5G base station deployment continues to be led by China. Global ex-China deployment should continue to lead the 5G infrastructure buildout in 2022 (up 40% year-over-year) driven by continued momentum in North America activity, which increased in the second half of 2021, followed by Europe. Broadband access remains strong into 2022, as bandwidth usage at consumer premises remains robust due to the "work from home trend," pushing an upgrade of bandwidth by service providers to increase capacity at consumer premises.

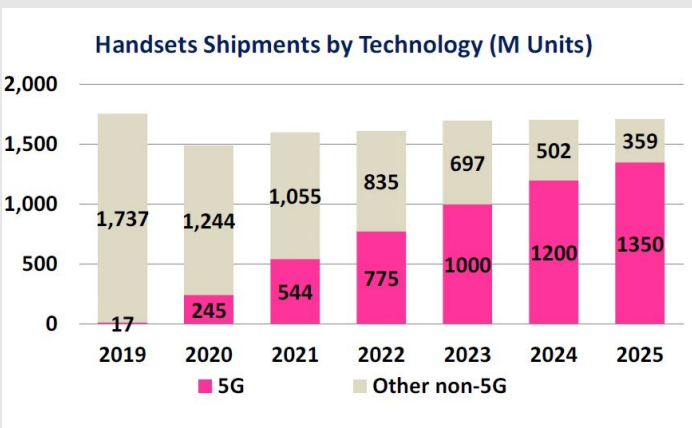
Smartphones continue to gain traction as the 5G handset upgrade cycle continues. In 2021, the total number of estimated iPhone unit shipments was 241 million (versus 190 million in 2020), an annual growth rate of 26% year-over-year. By the end of 2022, the number of iPhone unit





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shipments should reach 250 million, a growth rate of 4% year-over-year. However, unit volume will likely flatten at 250 million units in 2023. Driven by the transition to 5G, smartphone fundamentals remain strong and on track to increase 40% year-over-year to 775 million units in 2022 and increase another 30% to 1000 million units in 2023, assuming a 50% 5G adoption rate. And, while demand for legacy 4G phones is likely to weaken, demand for both 5G and iPhones should remain strong. Notably, Chinese 5G handsets finished 2021 up 65% year-over-year, to 266 million units, representing an 81% penetration rate.



In summary, despite near-term headwinds faced by the technology sector and negative technical indicators, the technology space is not dead. Many of the positive catalysts in the technology sector – Cloud, AI, and 5G build-outs – are all still in place. Although market concerns about higher rates and slower future economic growth are warranted, the technology sector is not exhibiting the characteristics that led to the “Dot.com Bust.” During that period, funds for the Y2K computer glitch and the buildout of the internet simply dried-up as the economy slipped into a recession, followed by the terrorist attacks on 9/11 that lengthened the downturn.

Second Quarter 2022 Currency Outlook

David Grimaldi, Foreign Exchange Sales Consultant

Federal Reserve Chairman Jerome Powell and FOMC members took the first steps toward raising rates to 3% this year. Powell also claims “excellent progress” on reducing the balance sheet going into the May meeting. Inflation is the main concern, as the Fed was determined to send that message to the market. These steps taken by the Fed have maintained my view that the U.S. Dollar (USD) from Q4 2021 and Q1 2022 will continue to strengthen into mid-year and U.S. Treasury yields will rise. The Ukraine/Russia conflict seemed to produce more aggressive safe-haven dollar buying versus some pairs. There is currently a new strain of Covid-19 that is just appearing in the U.S. but its impacts most likely will not lead to shutdowns, as we saw previously.



The steps the Fed has taken, maintain my view that the U.S. Dollar (USD) from Q4 2021 and Q1 2022 will continue to strengthen into mid-year and U.S. Treasury yields will rise.

EURUSD (Neutral/Bearish)



The European Central Bank (ECB) is now looking at Q4 for the first possible rate increase. While the Ukraine/Russia conflict has added uncertainty to this picture, the



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outlook has not changed at this time. Further incursions into NATO member countries will change this outlook. The USD should continue to climb, as production and inflation should outpace Europe. The test of key 1.0800 support occurred earlier than expected. This was my target level from my Q4 call when EUR broke 1.1700. EUR/USD could be corrective from these levels over the next few months depending on the outcome in Ukraine. Any moves back to 1.1400 should meet new selling, as the Fed aims to be more aggressive in hiking rates in comparison to Europe. From these levels, I prefer to wait to sell at better levels.

USD JPY (Bullish)



USD/Japanese Yen (JPY) broke above the monthly trend line going back to 1998 this month. My Q1 target was 122, and at the time I am writing we are on the monthly highs at

121.86. It looks like we could test 126 this summer before we see a pullback in this pair. Treasuries yields have responded to Fed hikes as they have touched levels, we have not seen in three years. Japan is still seeing inflation under 2% and maintaining ultra-easy monetary policy. Japan has a history of intervening to strengthening its currency, but I would not expect to see the central bank step in until 140.00.

GBPUSD (Neutral/bearish)



Great Britain Pound (GBP)/USD did trade lower in the first quarter, but the move was more muted, as the change was only 2% lower from January levels. GBP has assumed a safe-haven status versus the Euro (EUR) since the Ukraine crisis. The Bank of England hiked for the third time to .75%, as some economists are worried that inflation could



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reach double digits this year. Expectations of rate hikes and inflation have increased since the Ukraine crisis as the energy impact has increased costs. Expectations are for the U.K. to raise rates to 2.2% this year trying to fight inflation. The GBP/USD Weekly chart is starting to look more bearish as the 90/30 Day moving average have crossed, which could setup for further losses.

AUDUSD (Neutral/Bullish)



Australian Dollar (AUD)/USD is also benefiting from being geographically removed from the Ukraine conflict. While my outlook was the AUD/USD was oversold last year and would be buoyed from their economy reopening from the strict Covid lockdowns, the currency is starting to look more bullish into month-end. China has locked down again to fight the newest strain, which could impact Australia as their economy is tied closely to the Chinese. Unemployment is at a 13-year low, but wage pressure is not present like it here in the States. The Royal Bank of Australia has hinted this month at the possibility of raising rates by year end, which is adding to the AUD buying.

USDCAD (Bearish)



USD/Canadian Dollar (CAD) is seeing the impact from higher oil prices as it is 3% lower over the last two weeks. The Ukraine conflict continues to put a strain on global oil demand, and the CAD is showing signs of strength as a result. The Bank of Canada raised interest rates 0.25% to 0.50% in March to combat rising inflation due to rising revenue for commodity producers and higher costs for consumers. The economic recovery seems firmly entrenched and further rate hikes this year are expected, up to 1.25% by year end. Outlook is for a test of 1.2000 by year-end if oil prices surge in high demand summer months.

We're here if you have questions.

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Source Footnotes:

¹<https://www.forbes.com/sites/nicksargen/2022/01/04/whos-right-about-inflationthe-feds-critics-or-the-markets/?sh=1b8f3ae15b65>

² <https://seekingalpha.com/article/181627-the-m2-inflation-correlation>

³<https://www.reuters.com/business/economists-eye-surging-money-supply-inflation-fears-mount-2021-06-17/>

⁴<https://www.reuters.com/business/economists-eye-surging-money-supply-inflation-fears-mount-2021-06-17/>

⁵<https://fred.stlouisfed.org/series/M2V>

⁶<https://www.bloomberg.com/news/articles/2021-09-14/inflation-guy-michael-ashton-sees-more-on-the-way-as-investors-worry>

⁷<https://www.forbes.com/sites/nicksargen/2022/01/04/whos-right-about-inflationthe-feds-critics-or-the-markets/?sh=1b8f3ae15b65>

⁸https://madison.com/business/investment/personal-finance/how-to-protect-your-spending-power-from-inflation/article_f0560602-457b-5a14-9f8c-de91b9f02f73.html

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