# Synovus Market Update

December 8, 2022

Click on the article headline to view online!

**Daniel Morgan**
Senior Trust
Portfolio Manager

**David Grimaldi**
Foreign Exchange
Sales Consultant

**Christopher Brown, CIMA®, CRPC™**
Financial Advisor,
Synovus Securities, Inc.

## When will the Federal Reserve stop raising rates?

Daniel Morgan, Senior Portfolio Manager

Federal Reserve Chairman Jerome Powell may not recall former Fed Chairman Alan Greenspan's bond market inverted yield curve "conundrum" comment, but that doesn't mean the curve will begin to steepen -- in fact, a deeper inversion is possible. The Treasury yield curve has usually stopped flattening at the end of interest rate hikes but expect there is a risk of the curve inverting further. As the market prices in a later, harder landing, long-term interest rates should remain pegged, with the 10-year hovering at 3.75% - 4.25%, while short-term rates climb as the Fed calibrates its policy rate somewhere at, or above, 5%, which should keep the two-year note yield higher. With a probability of a recession now standing at 65%, do not be surprised if the 10-30 year section of the UST is sticky as the 1-3 year section reacts to the Fed's tightening actions, furthering inverting the curve.

With that all said, do not be astonished to see that the peak of U.S. Treasury yields could have already occurred in the 10-30 year area, and as the Federal Reserve prepares to pause rate hikes in early 2023, the yield curve may bull flatten before bull steepening. Though the economic landscape is fraught with risks that data surprise further to the upside, think longer-term Treasury yields are in the process of making a top. Volatility is likely to remain a market feature for some time, so a retest of the recent yield highs wouldn't be a surprise.

Elevated core services inflation may keep interest rates higher for longer than the stock market investors have expected. Especially based on the recent rally in the S&P 500 Index, which has rebounded 9% from mid-October lows. This rally maybe somewhat premature as the PCE deflator, that is the preferred inflation gauge for the Fed, now stands at 6.3%. The PCE deflator is expected to drop from 6.3% to 4.8% by 1Q23 and further fall to 3.5% by 2Q23 (according to Bloomberg Intelligence). Historically, the Fed will stop tightening once the Fed Funds rate intersects with the PCE deflator. So with the Fed Funds rate now at 3.75%-4.00% and expected to peak between 4.5% -5%, and the PCE deflator expected to drop to 4.8% to 3.5% in the 1Q/2Q of 2023, that would indicate that the Fed should pause next Spring! These estimates maybe be overly optimistic as the Fed's tool kit can only control demand-based inflation, not supply-constraint based inflation. If these expectations were not to come to fruition expect the stock market to react on the downside and UST yield curve to react accordingly.

**Historically, the Fed will stop tightening once the Fed Funds rate intersects with the PCE deflator.**

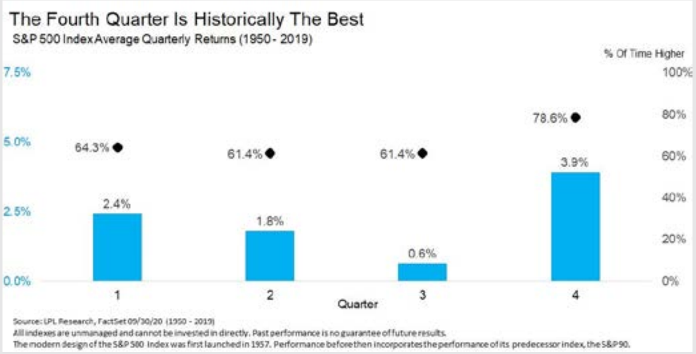
Continued from previous page

# December Market Update: A Santa Claus rally for stocks or just a lump of further losses?

Christopher Brown, CIMA®, CRPC™ , Vice President

The holiday season is upon us. It can be a time for family, reflection, and positive seasonal market returns for stocks. The S&P 500 is up over 12% from mid-October and up over 8% since the mid-term elections. Historically, the fourth quarter has provided higher returns for the S&P 500 accounting for nearly 80% of the time when measured against all quarterly returns, averaging 3.9% since 1950, also known as the "Santa Claus Rally."

Chart 1




*Source: https://lplresearch.com/2020/10/01/october-and-the-fourth-quarter-in-six-charts/*

2022 has brought one of the most challenging market conditions for both stocks and bonds in over 30 years. Inflation has been the catalyst for the Federal Reserve's wrecking ball of rising interest rates. The sharp movement for interest rates this year has created mass volatility throughout the markets but, knowing where to navigate in the cross winds of risk may provide the difference of a manageable voyage or choppy seas ahead. Let's start by defining the current headwinds of the markets.

### Inflation (Consumer Price Index)

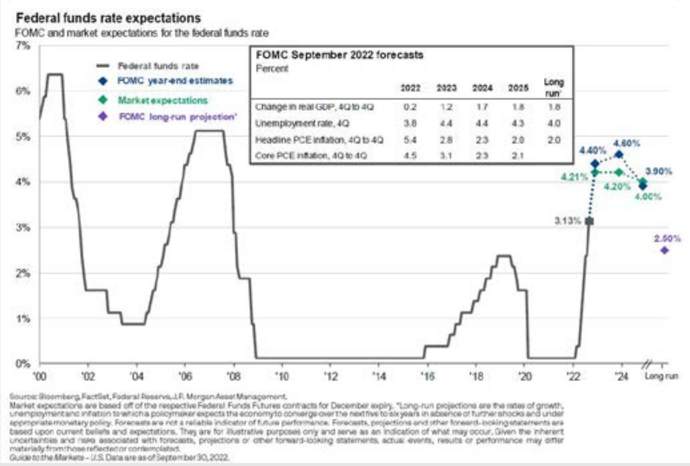
Inflation is still the number one headwind for the markets at this time since it accounts for the direct increase for prices paid for housing, wages, energy, and food. As of October 2022, the U.S. inflation rate stands at 7.7%. Though lower than the expected 8% forecast, inflation is still more than 3 times higher than the target that the Federal Reserve is trying to achieve even when measuring by their defined metric, Price Consumption Expenditures (PCE Index), currently at 6.0% as of Dec. 1st.

### The Fed

The Federal Reserve is still on track to continue their quantitative tightening, or QT, policy throughout 2022 and into 2023. At this time, the bond market as priced in two additional rate hikes of .50% for over the next two FOMC meetings (Dec. 15 and Feb. 2) bringing the Fed Rate to 4.75% to 5% and an additional .25% rate hike in March 2023.

**The challenge will be reducing inflation and creating enough consumer demand reduction to lower prices even further into 2023 without pushing the U.S. economy into a recession.**

Chart 2




*Source: https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/*

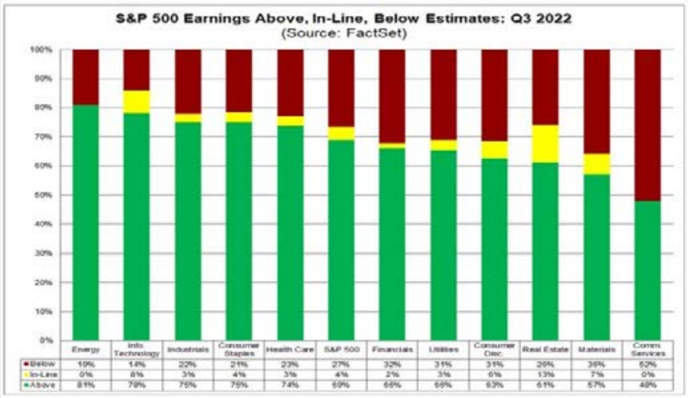
Continued from previous page

The challenge will be reducing inflation and creating enough consumer demand reduction to lower prices even further into 2023 without pushing the U.S. economy into a recession. The JP Morgan 4th Quarter Guide to the Markets chart maps out the forecasted Fed Funds rate for 2023 through 2025.

### Corporate Earnings

According to the FactSet Earnings Insight report, 94% of the S&P 500 companies reporting Q3 earnings results, 69% of S&P companies have reported positive earnings per share (EPS) and 71% of S&P companies have reported a positive revenue surprise.[1] Earnings growth for Q3 was 2.2% and if this growth rate sticks with the rest of the total S&P firms reporting, this will mark the lowest earnings growth in 2 years. For earnings guidance in Q4 2022, or the forecast for future earnings performance, 55 S&P companies have issued negative EPS guidance and 27 S&P companies have issued positive EPS guidance, which provides a bit of a mixed bag of projected performance going into the end of the year. Despite the quarter over quarter decrease in the number of S&P companies citing the term "recession" on their earnings calls, companies have been more pessimistic than normal on their Q4 2022 performance outlook with analyst expectations of a decline in earnings of -2.1% for Q4 2022 but earnings growth of 5.2% for current year (CY) 2022.

Chart 3




*Source: advantage.factset.com*

Looking forward to Q1 2023 and Q2 2023, analysts are projecting earnings growth of 1.6% (Q1 2023) and 0.9% (Q2 2023) and earnings growth of 5.7% for CY 2023. You can see, in Chart 3, the percentage of companies in each sector of the S&P 500 above, in-line, or below their earnings estimates.

### Markets finishing 2022 on Santa's Nice list?

With the current headwinds described above, there is potential holiday cheer that can spread throughout the markets into year end. Although inflation is still above the current Fed target, the rate of inflation is declining, which provides hopes for the markets in a reduction

Continued from previous page

of the Feds QT policy may be coming to an end within the next few months. Most of the shock and awe of the markets have been dealt with and it is possible that the worst of the market volatility is behind us. The Federal Reserve has increased interest rates by .75% for the past four rate hikes and now we may be looking at the first projected .50% rate hike since May 2022. This can also provide signs to the markets on opportunities for heavily discounted sectors of the market such as the semiconductor sector. Also, Q3 earnings season EPS and growth were better than expected and though Q4 earnings estimates may be projected lower, the U.S. consumer still remains strong in the face of declining inflation.

The last point is biggest difference in the markets now for new and current stock investors is “TINA” vs “TARA”. When interest rates where close to 0% during the Fed’s previous Zero Interest Rate Policy (ZIRP), there was an acronym that stipulated, “There is No Alternative” (TINA). It’s either stocks or dividend paying stocks or earn nothing in cash and/or bonds. Now, the risk-free rate of return on CDs and T-bills within 12 months are paying over 4.5%. TINA has changed to TARA or “There Are Reasonable Alternatives.” Stocks now have to compete with 4%+ risk free U.S. T-Bills or FDIC insured CDs. This may provide some hesitation for wealthy investors with large cash positions, who are near or in retirement, to reassess their options and allocation percentages into the stock market.

I remain cautiously optimistic for stocks going into 2023. Santa may still come down the chimney bearing gifts but, we may just end up with socks or slippers instead of the big gift of a rally that we have been waiting for.

## Fourth Quarter 2022 USD reversal?

David J. Grimaldi, ™ Foreign Exchange Sales Consultant

### EURUSD (Neutral/Bullish)


As I wrote in my Q4 update, EUR/USD has notably broken out of the trend channel we have been in since January. It has since broken above my moving average indicators and turned positive. While I was looking for better levels to resell EUR, I have changed that to looking for better levels to BUY EUR. What has changed in a month? Ukraine has reclaimed land lost to the invading Russians and seems to have once again regained momentum in the war. Despite the Ukrainians resistance, there have been more calls for a diplomatic solution, notably from the unusual agreement from far left of the Democratic Party and the GOP. The Europeans seemed to have met many of their goals for natural gas reserves to get them through the winter. China continues to use Covid as an excuse to keep large amounts of their population under house arrest, which has crushed demand for oil by slowing production and shipping. Inflation in the U.S. may have peaked, and though it won’t reach 2% levels from 2 years ago, the

**Inflation in the U.S. may have peaked, and though it won’t reach 2% levels from 2 years ago, the market sees the Federal Reserve ending its tightening cycle soon.**

Continued from previous page

market sees the Federal Reserve ending its tightening cycle soon. Most economists are looking for another recession in 2023 (we had a two-quarter recession in 2022). Price action in USD trading has indicated the market was overbought, which could trigger more U.S. Dollar selling as the market thins out over the holiday season. Notably good value should be any move back to parity, and even better a move back to .9800.

### USDJPY (Neutral/Bullish)


USDJPY has had a nice correction where it looks advantageous to enter a new long position with a tight stop loss. It is important to be wary of the Bank of Japan continued operations of intervening in the currency as it approaches 150.00. The interest rate conditions in Japan and the U.S. still favor a stronger U.S. Dollar, and this could continue into the second quarter of 2023. Japan has not faced the same Inflation crisis as the rest of the developed nations, as their current inflation rate is 3.7%. Japan has maintained a zero-interest rate policy through due to more favorable inflation conditions, and they won't change that now that markets are focusing on the timing of rates hikes to stop and then reverse.

### GBPUSD (Neutral/Bullish)


The growth in the United Kingdom has significantly lagged other developed countries since December 2019. GDP growth is -0.4% over this period, the lowest among G-7 countries. The Bank of England has been raising rates to fight inflation that has risen to a 11.1% rate in October. The Organization for Economic Co-operation and Development (OECD) sees U.K. interest rates rising further from 3% currently to 4.5% by April next year, while unemployment will lift from 3.6% to 5% by the end of 2024. Higher energy prices will weigh on consumption and depress growth. Like the EUR/USD, GBP has seen a significant short squeeze, and has broken the 1.2000 psychological barrier ahead of Thanksgiving. The Daily chart is beginning to look bullish, as market players are anticipating recession in the U.S. and a slowdown in rate hikes. The weight of U.S. policy decisions will take precedent, and though we may see volatility and move lower in GBP, it could be that we have seen the bottom in GBP/USD.

Continued from previous page

## We're here if you have questions.

If you have questions or want to talk with a Synovus financial advisor to learn more, go to **Synovus.com or call us at 1-888-SYNOVUS (1-888-796-6887).**

***Past Economic Insights newsletters are available at:**

**https://www.synovus.com/personal/plan-and-invest/economic-insights/**

[1]https://insight.factset.com/sp-500-now-projected-to-report-a-year-over-year-decline-in-earnings-in-q4-2022