Synovus Market Update

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Opinions by Daniel Morgan and Robert Hanberry

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Economic Update: T-Minus Zero Ready for Lift-off!

Dan Morgan, Senior Trust Portfolio Manager

Economic growth is beginning to slowdown, as the easy comparisons from the Covid impaired 2020 are dissipating. Gross Domestic Product (GDP) for the 3Q21 came in at 2.0%, which was below the consensus estimate of 2.6%. We did see 4Q21 GDP rebound to 6.9%, while Consumer Spending jumped to 3.3%, as Private Investment increased 32%. However, GDP growth is expected to fall from the record 5.7% in 2021, to a more muted 3.8% in 2022.

Along with the slowdown in economic growth, inflation has proven not to be “transitory.” The Consumer Price Index (CPI), an inflation gauge that measures costs across dozens of items, rose 7% in December from a year earlier, the fastest pace since June 1982. Excluding food and energy prices, the so-called core CPI increased 5.5% year over year and 0.6% from the previous month. That compared with estimates of 5.4% and 0.5%. For core inflation, it was the largest annual growth since February 1991. Shelter costs, which make up nearly one-third of the total rose 0.4% for the month and 4.1% for the year. That was the fastest pace since February 2007. Used vehicle prices, which have been a major component of the inflation increase during the Covid pandemic due to supply chain constraints that have limited new vehicle production, rose another 3.5% in December, bringing the increase from a year ago to 37.3%.

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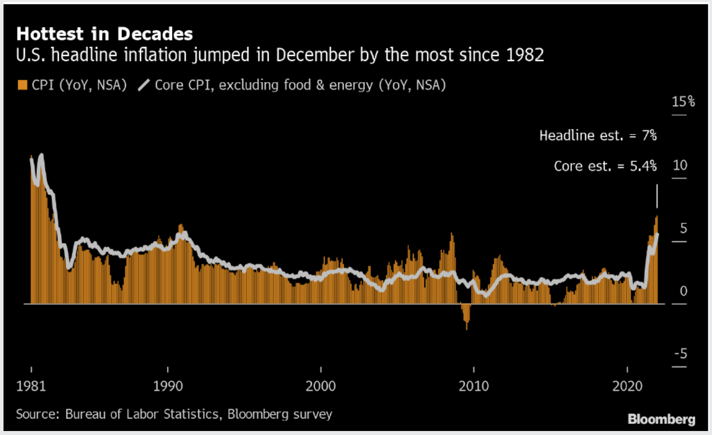

Source: Bureau of Labor Statistics, Bloomberg

The U.S. jobless recovery continues to be choppy as December’s non-farm payrolls come in at 211,000. Payrolls are still 3.6 million below their Jan. 2020 peak. Wage growth continues to climb as Average Hourly Wages hit 4.7%.

These economic indicators give the Fed the green light to raise rates at their upcoming March meeting. The Fed mandate that inflation (PCE Index at 4.4%) must be over 2% and the economy will need to be at full employment (UE rate is 3.9%) to begin tightening, has been achieved! With the CPI sky-rocketing to 7% in December, the Fed is telegraphing that rates will begin to rise in March. With further hikes in 2023. In addition, the Fed has signaled that it will begin to reduce the $9.0 billion of U.S. securities held on its balance sheet.

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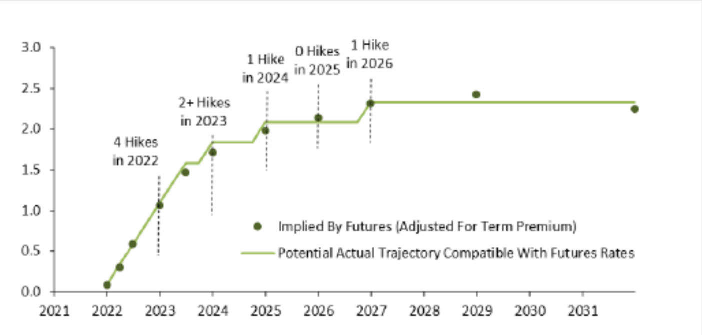
All these factors create some serious headwinds heading into 2022. With fiscal stimulus winding down, consumer inflation the highest since 1982, commodity and oil prices soaring, rates rising and an elevated S&P 500 P/E ratio of 25x earnings the market has a tough hill to climb!



Source: Cornerstone Macro

Technical Analysis

Bob Hanberry, Senior Portfolio Manager

2021 was one of the least volatile years for the S&P 500, with a max drawdown of -5.2%. This ranks ninth since 1950 in terms of smallest intra-year declines and history has shown that calm markets are rarely repeated the following year. Volatility tends to pick up, particularly in mid-term election years highlighted in the chart below. One of the main reasons for the low volatility in 2021 is interest rates have remained at very low historical levels. Rates on the 10-year treasury have spent the last nine months between 1.20% and 1.70% and recently pushed through the high end of that range. If rates continue to move higher, we would expect heightened volatility, especially from the speculative pockets of the market. After three great return years for the S&P 500, 2019 +31.49%, 2020 +18.40%, and 2021 +28.71%, a market correction of 10 to 15 percent would be a normal occurrence.

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S&P 500 Performance Following Low Volatility Years

Low Vol Year	Max Drawdown	Full Year Performance	Next Year Performance	Next Year Max Drawdown
1995	-2.5%	34.1%	20.3%	-7.6%
2017	-2.8%	19.4%	-6.2%	-19.8%
1964	-3.6%	13.0%	9.1%	-9.6%
1958	-4.4%	38.1%	8.5%	-9.2%
1954	-4.4%	45.0%	26.4%	-10.6%
1961	-4.4%	23.1%	-11.8%	-26.4%
1993	-5.0%	7.1%	-1.5%	-8.9%
1972	-5.1%	15.6%	-17.4%	-23.4%
2021	**-5.2%**	**26.9%**	?	?
1991	-5.6%	26.3%	4.5%	-6.2%

Source: TradeView

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Technology Corner: Is the recent sell-off in the Technology Sector warranted?

Daniel Morgan, Senior Portfolio Manager

With the tech-laden NASDAQ Composite down -13.9% YTD, compared to just a – 9.31% YTD drop in the S&P 500 Index, it appears funds are flowing away from high-tech growth stocks toward more mature defensive names. Technology stocks seem to sell-off when any news of Fed tightening surfaces or Government Stimulus spending appears to be waning. The Fed is now telegraphing the possibility of a hike in the Fed Fund's rate as early as the upcoming March meeting. With further hikes in 2022 now expected.

Another trend that is impacting the market is the movement of dollars away from tech companies that are without time-tested business models. While battle-tested bell-weather tech names are holding up much better. For example, in the NASDAQ Composite approximately 45% of its members that have lost money or have negative earnings over the past trailing four quarters. This compares to the S&P 500 Index, which has approximately 6% of its members with negative earnings over the past trailing four quarters. This has led to a "huge" outperformance for the S&P 500 Index vs the NASDAQ Composite. The markets are experiencing a "Flight to Quality" as investors move away from unproven emerging growth companies found in the NASDAQ Composite to time-tested, battle-harden, more mature growth companies found in the S&P 500 Index. For example, profit deficient tech names like Lyft (-45%), Uber (-42%), Robinhood (-85%) and Rivian Automotive (-64%) all are trading far below their 52-week highs.

One contributing factor to the weakness in the Technology Sector is the negative relationship between Inflation and the Market's P/E Ratio. The market was once laughing off inflation as "transitory," but sustained higher prices appear permanent. In the past, during periods of higher Inflation, as indicated by the recent increase in both the CPI/PPI (the CPI set 39 year high of 7% in the month of December), the market's P/E ratio typically will compress. That is during times of low inflation the market can tolerate higher P/E multiples. While during high inflation periods the P/E ratio of the market will compress. The S&P 500 Index P/E is 25x vs a 10-year average of 19.9x. While NASDAQ Composite currently trades at a P/E multiple of 116x vs a 10-year average of 40x. Therefore, with most technology stocks trading at high P/E multiples, sustained inflation causes a re-evaluation of their multiples.

Recent results from Salesforce, Adobe and Netflix have all pointed toward softer profit growth for 2022. Salesforce expects between $7.22 billion and $7.23 billion in revenue in its fiscal fourth quarter, raising its previous guidance, and coming in on par with analyst expectations of $7.22 billion. But Salesforce said earnings per share for the December quarter will fall between 72 and 73 cents, lower than analyst expectations of 81 cents. Adobe echoed the Salesforce guidance, stating revenue in its fiscal first quarter, which goes through Feb. 2022, will be $4.23 billion, trailing analysts' predictions for revenue of $4.34 billion. For the full year, Adobe expects sales of $17.9 billion, which is below analysts' average estimate for revenue of $18.16 billion. Finally, Netflix recently reported its fourth quarter results that showed subscriber growth that missed targets. Netflix added 8.28 million global paid net subscribers in the 4Q 2021. But that's fewer than the 8.5 million subscribers Netflix added in Q4 2020, and below management's forecast for the quarter. Netflix said it expects to add 2.5 million subscribers during the first quarter of 2022, far below the 3.98 million it added in Q1 2021. Meanwhile, analysts had expected 6.93 million new subscribers in the first quarter.

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Despite this recent softening in the enterprise software space and the Internet Subscriber Service segment, the Semiconductor Sector points to a strong foundation for the Technology group heading into 2022. The semiconductor sector is the plankton of all technology hardware, as smart phones, PCs, and servers all use chips as the brains that drive these devices. Despite the shortages, recent earning results from Micron (PCs, servers, and smart phones) Broadcom (smart phones and broadband) and Nvidia (gaming, datacenter, and AI), point to foundational strength in the tech sector.

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Datacenter or Cloud Computing (AI/Deep Learning, Networking, and Optical) following a muted spending trend in the first half of 2021, have seen spending bouncing back solidly with strong momentum sustained into 2022 (up 30% YoY). Expect the top four US cloud/hyperscale datacenter (AMZN's AWS, MSFT's Azure, GOOGL's GCP, and IBM's Cloud) capex to increase 19% in 2021 and with accelerating growth of 30% in 2022. For the automotive end-market, demand continues to remain strong driven by strong semiconductor content growth (10-12% per year) on increased feature set, ADAS/autonomous penetration, and strong adoption of electrical (EV) cars. In wireless infrastructure, anticipate strong growth over the next few years on continued 5G infrastructure buildouts, with 5G base station (BTS) deployments growing by 21% and 9% in 2022 and 2023. 5G smartphone volume has been resilient as the device volume forecast now stands at 750 million units in 2022 (up 38% YoY). This implies that the industry reaches a 50% 5G adoption rate by 2022, reaching the milestone faster than the 4G.

Probably one of the most important indicators of future sales growth in the Technology Sector is Global IT Spending, which rebounded +9.5% in 2021 and is projected to grow by 5.5% in 2022. Worldwide IT spending is projected to total $4.5 trillion in 2022, an increase of 5.5% from 2021, according to the latest forecast by Gartner, Inc. Digital tech initiatives remain a top strategic business priority for companies as they continue to reinvent the future of work, focusing spending on making their infrastructure bulletproof and accommodating increasingly complex hybrid work for employees going into 2022. Enterprise software is expected to have the highest growth in 2022 at 11.5%, driven by infrastructure software spending continuing to outpace application software spending. Worldwide smartphone sales to end users totaled 328.8 million in the second quarter of 2021, up 10.8% YoY. Despite supply restrictions caused by Covid-19 related production disruptions and component shortages, worldwide mobile phone sales increased by 10%.

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In summary, despite the recent pull-back in technology shares, the sector remains fairly healthy with growth trends in Cloud, AI and 5G still all in place. The market is going through a process of shaking out the excess, as unproven companies are left on the side of the road, while dominate tech leaders with battle-tested business models should resurface from the dust.

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What you need to know about the LIBOR Transition

On March 5, 2021, the ICE Benchmark Administration (IBA) announced plans to cease publishing the one-week and two-month London Interbank Offered Rates (LIBOR®) after December 31, 2021 and all other tenors after June 30, 2023. LIBOR is being replaced because the IBA, LIBOR's administrator, won't have access to input data necessary to calculate the rate's settings on a representative basis beyond the cessation dates. Synovus offers several LIBOR alternatives, including the Term Secured Overnight Financing Rate (Term SOFR), Daily SOFR, the Bloomberg Short-Term Bank Yield Index (BSBY), as well as Prime and Treasury Rates. The bank also continues to evaluate other reference rates to ensure we can offer the most appropriate index for each product and client. If you have a loan or obligation tied to LIBOR that matures after the LIBOR cessation date, your Synovus Relationship Manager will contact you to discuss an appropriate successor rate. Synovus is committed to making this migration as seamless as possible for our customers and will communicate additional details as they become available.