

Synovus Market Update

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The Federal Reserve raises rates again

Daniel Morgan, Senior Portfolio Manager

The Federal Open Market Committee (FOMC) raised its target for the federal funds rate by 50 basis points to a new target of 0.75%-1.00% as widely expected and will begin to reduce the securities holdings on its balance sheet on June 1, according to a post meeting statement. The FOMC repeated that it "anticipates that ongoing increases in the target range will be appropriate," but did not give any clear signal on the size or pace of further tightening measures. There were no dissenting votes cast at the meeting. The balance sheet reduction measures will begin with caps of \$30 billion in U.S. Treasury securities and \$17.5 billion of mortgage-backed securities (MBS) per month for the first three months. After that, the caps will be raised to \$60 billion per month for Treasury securities and \$30 billion for MBS. Any maturing amounts over the caps get reinvested, so the caps represent how much is being allowed to roll off each month. The FOMC said that it will slow and then stop the balance sheet reduction when "reserve balances are somewhat above the level it judges to be consistent with ample." Weeks later after the meeting Federal Reserve Chairman Powell reiterated that raising rates by half percentage-point increments at the next two meetings is likely to be appropriate, though the central bank is prepared to change course depending on incoming data. ■

Buy dollars wear diamonds

David Grimaldi, Foreign Exchange Sales Consultant

I began my career in foreign exchange trading back in the 1990s. Many of my grizzled colleagues had been currency traders since the beginning of what we now recognize as the modern foreign exchange market. The early 1980s produced many legendary stories from foreign exchange traders. Dressed in suits and ties, most traders yelled orders into their phones at their brokers and then smashed those same phones if their trades did not get filled. Caffeinated traders shouted over their desks to their sales teams to close deals, and they ended their days spending too many hours having too many drinks while retelling their victories at Smith and Wollensky. I recall many of my mentors in the trading world wistfully retelling how easy it was to make money trading so long as they were buying U.S. dollars. The expression they used was "buy dollars, wear diamonds." To my former colleagues, holding a long dollar position meant that their kids would get Cabbage Patch Dolls and Air Jordans under the Christmas Tree since the dollar predictably continued to appreciate. The Plaza Accord of 1985 changed the U.S. dollar's upward trend with few exceptions. Since then, the dollar has been in a



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predominantly sell dollar period. However, recent global events may indeed, be the catalyst to return the U.S. dollar to its former dominance while the rest of the G10 currencies “fall out of bed.”

After 1973, currencies from the largest economies were allowed to float as they ended their adherence to the gold standard, giving central banks more control over interest rates, money supply, and velocity. Consequently, the need for currency hedging and speculation arose in addition to a demand for liquidity among international businesses -- all of which could be provided by banking institutions. On a trade-weighted basis, the dollar appreciated a whopping 77% from its low in mid-1980 to its most recent peak in February 1985.¹ This was mostly due to Federal Reserve Chairman Paul



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Volker raising interest rates to break the inflation of the 1970s, President Ronald Reagan's tax cuts, which attracted global capital, and a robust U.S. economy. After a strong first quarter in 2021, the U.S. GDP contracted at a rate of 1.4% in the first quarter, which could mean that we have stagflation for the first time in 50 years. Many economists believe that the Fed is behind the curve in raising rates to fight inflation and that the rescue plan for a recession may play out very differently than what we have seen in the past. “What’s different from 2008, different than 2001, different than the COVID-19 crises is that the cavalry isn’t here. There’s no giant injection of liquidity to create the V-shape. We’re going to go down and then we’re going to grind until there’s a new story that shows up and then take back off again,” said Michael Novogratz.²

The Fed might welcome a rising greenback that calms imported inflation. Société Generale estimates that a 10%-dollar appreciation will cause U.S. consumer





inflation to decline by 0.5 percentage points over a year.³ If dollar gains continue, the Fed won't need to tighten monetary policy as aggressively as anticipated; notably, the dollar surge of the past week has also seen money market bets on Fed rate hikes stabilize.⁴ It is unlikely the Fed can or will hike interest rates to the levels that Paul Volker did (despite inflation now at proportional levels from 40 years ago). Therefore, keeping the dollar strong is in President Joe Biden's interest to help fight inflation.

The global and economic events of 2022 suggest that we could be heading toward another period where the U.S. dollar may once again reign as king, as reserve currency alternatives attempting to claim the crown are now in question. Presently, the U.S. dollar's closest contender is the Chinese Yuan. However, the Yuan's rise to the top seems unlikely considering China's many liabilities, notably the country's support of Russia in the war against Ukraine. And China has similar designs on Taiwan. If China is not pulling the strings in Russia, it is at least in the discussions. Furthermore, China is committing genocide against the Muslim Uyghurs, and the Chinese government is responsible for the forced sterilization and enslavement of an estimated one million Uyghurs. As the west reacted uniformly against Russia, a similar Chinese invasion of Taiwan would undoubtedly produce a similar boycott response.

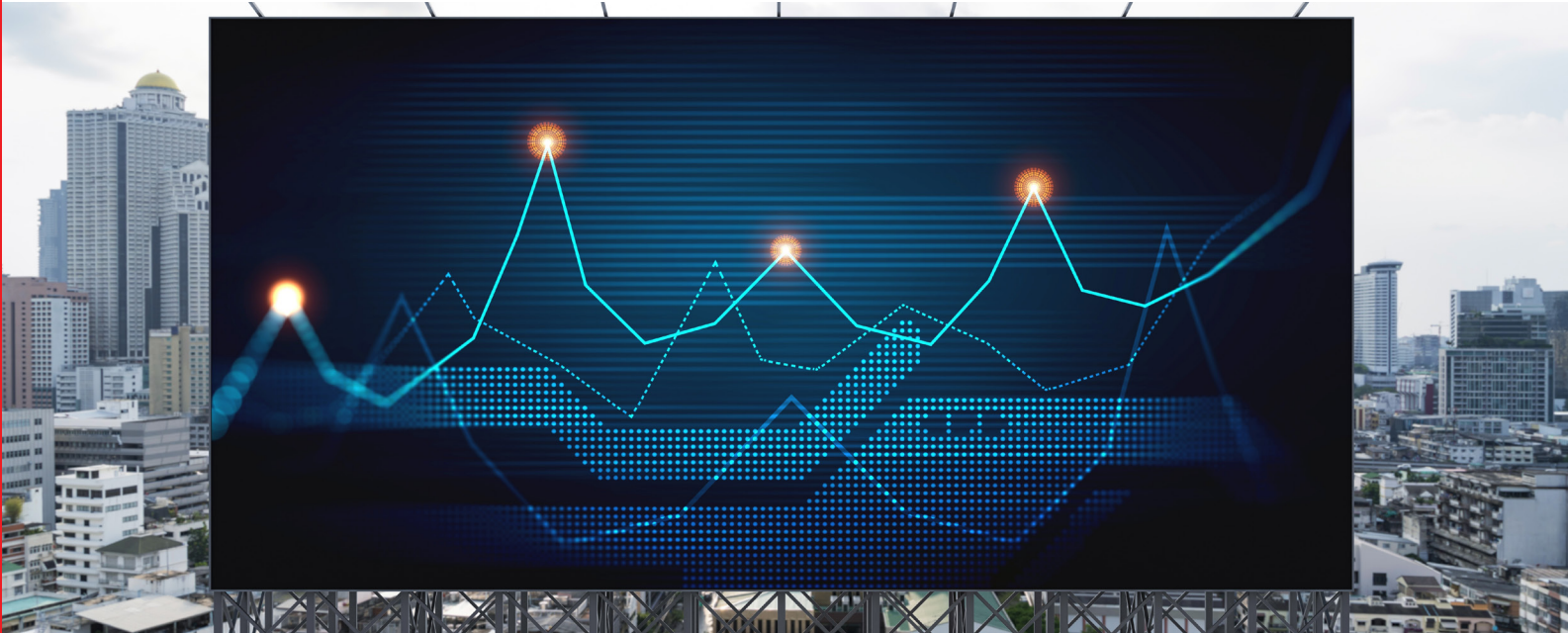
The continuation of the COVID-19 lockdowns in Shanghai and Beijing has created mass starvation of the population since the communist party's response has been even more draconian than they were two years ago when the pandemic began. The repression

of the Hong Kong people and the coverup of the COVID-19 pandemic have added to China's isolation on the world stage. Furthermore, communist Russia and communist China have cracked down on blockchain and cryptocurrency mining during the last year due to a lack of centralized control, sending a powerful message to investors that private money is not safe from seizure by authoritarian governments. Unsurprisingly, the events of 2022 have set Western and Communist nation relations back to where they were 30 years ago. Meanwhile, for the first time in 80 years, Europe has realized that they are not immune to invasion, and last month they announced steps toward reducing dependence on Russian oil over the next six months, which will undoubtedly exacerbate already problematic inflation pressures.

The Biden administration is attempting to remake America according to its preferred political policies, and its objectives are to eliminate carbon emission vehicles and fossil fuels and end offshore drilling. President Biden claims that the oil crisis began with the Ukraine invasion. However, oil prices were elevated before the war in Ukraine due to the new regulations and demand and post-COVID-19 demand. Oil markets are future-looking, and prices would drop if the administration opened new offshore drilling or loosened regulation, which would reduce inflationary pressures. However, if Biden were to reverse these policies, he would alienate the extreme left of his party. Therefore, we should expect oil prices to remain high for some time. And, since most oil purchases require petrodollars, the U.S. dollar should remain strong. While cryptocurrencies have become popular over the past 10 years as countries expand their balance sheets



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and weaken their currencies, the threat of regulation to this space has injected some caution for investors. Time magazine recently said that cryptocurrency regulation would be good for investors. Cryptocurrencies are completely decentralized peer-to-peer systems, and there is purposefully no centralized computer server that can be shut down to end the existence of the currency.⁵ Therefore, no government can prevent someone from downloading a wallet and connecting to a crypto network.

Cryptocurrency has been pilloried by governments for this very reason, as they are afraid of a lack of control over illegal activity. Although such reasoning seems convincing on its face, cash transactions from illegal activity already exist without government controls. The difference between cash and cryptocurrency is that crypto lives outside



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government influence. Money managers who were initially skeptical of blockchain are now trying to invest and develop their own cryptocurrency solutions for traditional finance. In April 2022, Blackrock counted itself as the new disciple of blockchain and cryptocurrency, even though CEO Larry Fink once called crypto “the index of money laundering.”⁶ Fink told shareholders that events in Ukraine could speed up a centralized adoption of digital currencies. Indeed, centralized governments are trying to develop digital currencies specifically to spy on financial transactions. In October 2021, the Biden administration proposed legislation to Congress for banks in the U.S. to share information with the IRS to monitor all deposits or withdrawals of \$600 or more.⁷ The administration stated that its reasoning was to crack down on citizens not paying their taxes. This "guilty until proven innocent" reasoning coupled with governmental overreach to monitor the cash deposits of everyday citizens leads one to conclude it would be difficult to adopt a willingly accepted global government-



regulated centralized digital asset. While digital currency is the future and should hold up well due to institutional interest and investment, a centralized cryptocurrency should create some trepidation due to the potential political ramifications.

Last month's collapse of Terra stablecoin sent shockwaves through the crypto market wiping out \$400 billion of market capitalization. Terra, or UST, is a Singapore based algorithmic stablecoin that fell over 99% as the result of heavy selling in low volume market conditions, breaking its peg to U.S. dollars. "People have lost their life savings through crypto investments, and there aren't enough protections in place to safeguard consumers from these risks," Massachusetts Senator Elizabeth Warren wrote in a statement to Time Magazine. "We need stronger rules and stronger enforcement to regulate this highly volatile industry."⁹ Although the effects of this crash may not be over, the collapse of Terra is another in a long line of algorithmic crypto failures and is not representative of the market. The crypto space is still in its infancy, and shocks like this will keep doubters firmly in those camps. Blockchain and all the advantages it provides is clearly the future of payments, even if that future resides alongside fiat currencies.

The U.S. Dollar Index (DXY), which measures a basket of currencies versus the U.S. dollar has just reached levels we have not seen since 2003. The EUR, which is second to the U.S. dollar in global transactions, traded as low as 1.0350 this month and could test levels later this year back to when it was a new currency in 2002. The actions taken by communist

Russia and China have rocked financial markets and could potentially create additional financial hardship should the conflict drag out or expand beyond Ukraine. Emerging currency markets in South America and Asia also suffer in a strong U.S. dollar environment due to capital outflows, increased borrowing costs, and the devaluation of local currencies.

One of the first books I read as a young trader was Market Wizards by Jack D. Schwager, who famously profiled billionaire hedge fund investor Paul Tudor Jones. Jones recently said he "can't think of a worse environment than where we are right now for financial assets. Clearly, you don't want to own bonds and stocks" due to tight financial conditions and rising interest rates.⁸ If stagflation emerges, and fiscal and monetary options are limited to fight inflation, the dollar will continue to a place where investors will park their assets until conditions improve. After 2008, the economy looked bleak until the iPhone came along and helped ease the U.S. and the world out of the Great Recession. If the politics remain in place and the Fed is limited, the economy may have to grind until there is a new story to launch the markets upward again. ■



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Technology Corner: How can investors compare today's "Tech Wreck" to the "Dot.Com Bubble" in YR2000?

Dan Morgan, Senior Trust Portfolio Manager

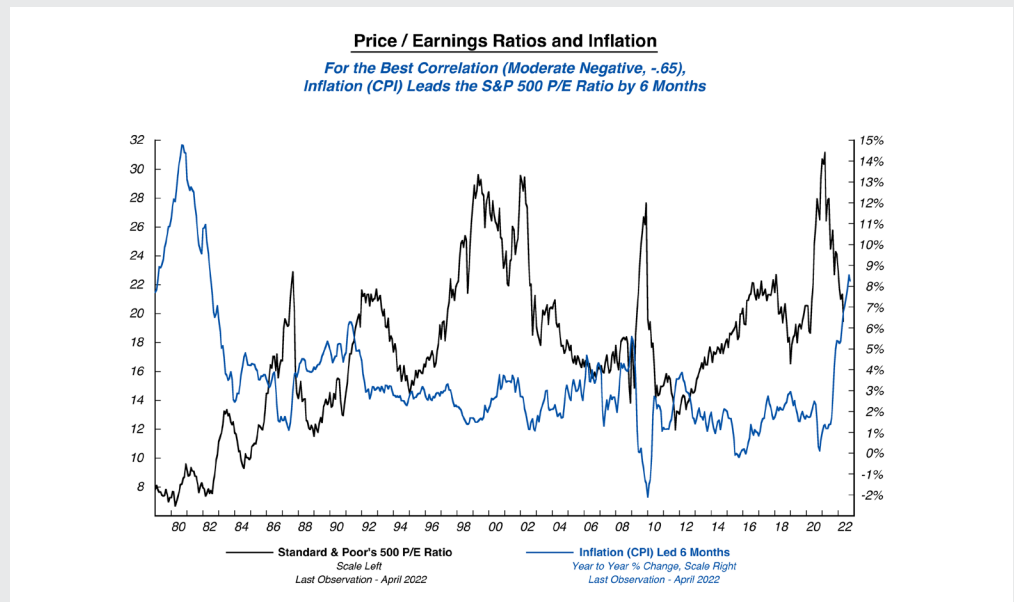
It appears funds are flowing away from high multiple Tech growth stocks toward defensive names.

Technology stocks seem to sell off when any news of Fed tightening surfaces or concerns about future economic growth arise. The "Dot.com Bubble" was characterized by the end of a massive spending boom to convert all software to be Year 2000 (Y2K) compliant and the tail-end of a huge buildout by corporate America to create an Internet presence. When IT spending started to dry up at the 2H2000, followed by the 9/11 Terrorist Attack the following year, this resulted in a massive devaluation of the Technology sector. But, despite today's "Tech Wreck" sell-off appearing very similar to the "Dot.com Bubble" there are many important broader Tech industry indicators that are much different that point to a positive outlook for the sector going into FY 2022.



There is a negative correlation between inflation and market P/E valuations.

First, we must understand the inverse relationship between inflation and the market price over earnings (P/E) ratio. Unlike in YR2000 when inflation was low, today the market is starting to come to grips that higher prices may be here to stay. In the past during periods of higher inflation (as seen during the 1970's Stagflation cycle), and as indicated by the recent increase in the Consumer Price Index (CPI), April's CPI was 8.3% YoY, the market's P/E ratio typically will



SOURCE: Pierce & Company

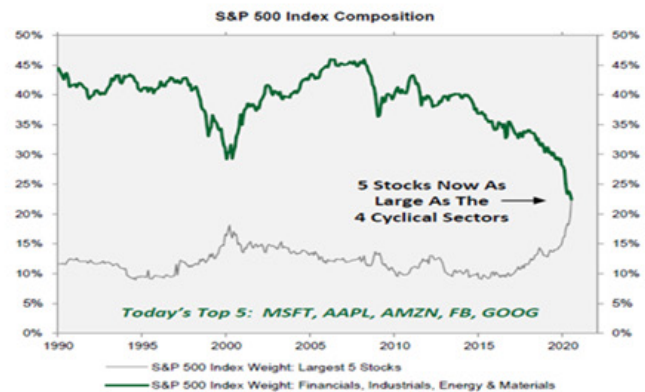
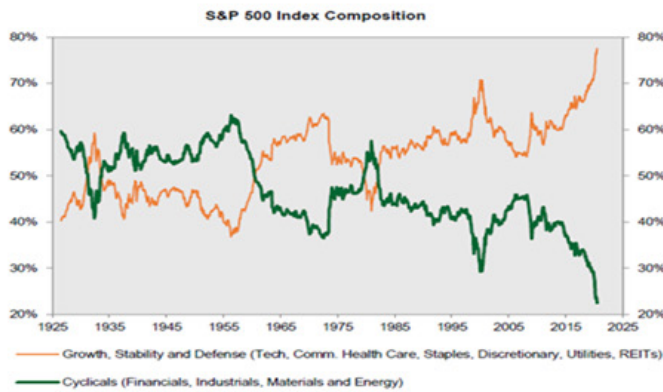
compress. Conversely, during times of low inflation the market can tolerate higher P/E multiples (as seen during the late 1998-2000 period). Therefore, there is a negative correlation between inflation and market P/E valuations. The NASDAQ Composite P/E is 38x, which is still fairly lofty. Therefore, with most Technology stocks trading at high P/E multiples, sustained inflation causes a re-evaluation of their multiples!



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These 5 Stocks Are As Large As These 4 Sectors!

MSFT + AAPL + AMZN + FB + GOOG = FINANCIALS + INDUSTRIALS + MATERIALS + ENERGY



Spending on Technology continues to be strong. Worldwide IT spending is projected to total \$4.4 trillion in 2022, an increase of 4% from 2021, according to the latest forecast by Gartner, Inc. As the Technology sector has been impacted by geopolitical disruption, inflation, currency fluctuations and supply chain challenges are among the many factors, yet contrary to what happened at the start of 2020, CIOs are accelerating IT investments as they recognize the importance of flexibility and agility in responding to disruptions. As a result, purchasing and investing preference will be focused in areas including analytics,

cloud computing, seamless customer experiences and security. Inflation impacts on IT hardware (e.g., mobile devices and PCs) from the past two years are finally dissipating and are starting to spill over into software and services. Software spending is expected to grow 9.8% to \$674.9 billion in 2022, and IT services is forecast to grow 6.8% to reach \$1.3 trillion.

How do the valuations in the Technology Sector compare to the Dot.com Bust of 2000? Today the S&P Information and Technology Index trades at a Median P/E of 26.9x, compared to the peak during the Dot.com Craze in 2000, when the Tech Index traded as high as 62x Median P/E. Therefore, compared to YR2000 today's Technology sector does not appear to be as overvalued. This compares to the S&P 500 at 20x Median P/E. Today, this represents a Tech multiple premium over the broader market of 1.35x, which is not excessive.

S&P 500 Index Information Technology Index Valuation vs YR2000

S5INFT	May 10, 2022	May 10, 2000
Median Best PE	18.7x	30.7x
Avg Best PE	21.9x	42.9x
Median PE	26.9x	62.0x
Avg PE	38.8x	81.2x

Source: Bloomberg



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Finally, back in YR2000 many of the large mega-cap Technology stocks like Apple, Alphabet, Microsoft and Amazon were not nearly as well capitalized as they are today. In YR2000, many Technology stocks were not profitable and had unproven business models. Amazon for example, went public in 1997 and did not get out of the “red” until posting a profit in FY2003 of just \$35.3 million. In FY2021, Amazon posted a profit of \$33.3 billion. At the moment, not only are these bell-weather Technology companies combined market cap larger than entire industry

groups in the S&P 500 Index, but these names hold huge piles of cash on their balance sheets – Apple \$202.6 billion, Alphabet \$169.2 billion, Microsoft \$132.4 billion, and Amazon \$96.0 billion. Many of these top Technology stocks could use their cash to weather any storm or make acquisitions to boost future growth. ■

We're here if you have questions.

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*Past Economic Insights newsletters are available at: <https://www.synovus.com/personal/plan-and-invest/economic-insights/>

¹<https://www.clevelandfed.org/en/newsroom-and-events/publications/economic-commentary/economic-commentary-archives/1985-economic-commentaries/ec-19850901-the-dollar-in-the-eighties.aspx>

²<https://www.cnbc.com/2022/05/06/bitcoin-btc-falls-sharply-as-126-billion-wiped-off-crypto-market.html>

³<https://www.reuters.com/business/dollar-surge-leaves-trail-destruction-2022-04-29/>

⁴<https://www.reuters.com/business/dollar-surge-leaves-trail-destruction-2022-04-29/>

⁵<https://www.coindesk.com/markets/2014/02/25/why-regulating-bitcoin-wont-work/>

⁶<https://www.forbes.com/sites/ninabambysheva/2022/04/13/blackrocks-newest-investment-paves-the-way-for-digital-assets-on-wall-street/?sh=559bc0555b6d>

⁷<https://www.nytimes.com/2021/10/11/business/irs-bank-accounts.html>

⁸<https://www.msn.com/en-us/money/markets/paul-tudor-jones-says-he-cant-think-of-a-worse-financial-environment-for-stocks-or-bonds-right-now/ar-AAWS4y8?ocid=BingNewsSearch>

⁹<https://time.com/6177567/terra-ust-crash-crypto/>

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