Synovus Market Update

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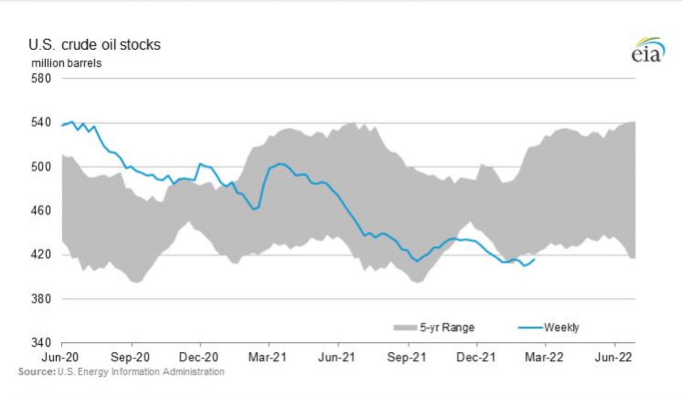
Oil Update: Tight Supply and Demand Increases

Wade Fowler, Senior Trust Portfolio Manager

As we approach the two-year mark from the Spring 2020 pandemic lows in the financial markets, we have seen historic returns for many investment asset classes. However, few asset prices have seen a more rapid rise than crude oil. The global oil benchmark known as Brent crude has increased 500% from its low in April 2020. This huge increase in price for oil has been driven primarily by a steadily improving fundamentals. As reopening has occurred across the world, demand for crude oil products continues to increase while supply has been both artificially restrained by OPEC nations and slow in returning to previous levels for a range of reasons by many significant U.S. producers. The resulting tight supply/demand balance can be seen clearly in the crude oil inventory figures published by the U.S. Energy Information Administration. Crude oil inventories in the U.S. have not been this low in a very long time.



Source: FactSet, EIA

In addition to the fundamental factors that combine to dictate oil prices, there is an ever-present risk premium for the potential of supply interruptions. The recent surge in price over the past two months can be largely attributed to the Russian military action in Ukraine. While we can not know the exact path forward for this conflict, it appears likely that some portion of Russian oil exports are at risk of interruption given how the situation is developing. Russia currently exports approximately 4 million barrels per day of crude oil and 2 million barrels per day of refined oil products. The European Union, China and other parts of Asia are the primary buyers of Russian energy products. If a significant portion of this supply is interrupted, it would have an immediate impact on the countries who purchase from Russia, but also on the prices of all energy products globally. Other oil producers will increase production to offset some of the lost Russian supply, but at least in the short run a supply crunch would likely result. Without enough supply to meet global demand, the price will rise to the point of demand destruction, which is likely significantly higher. While we hope for a peaceful resolution to the conflict in Ukraine as soon as possible to limit the danger to those in harm's way, we should not expect relief at the gas pump until the risk of Russian supply interruption recedes.

Technology Corner: Are the FAANG Stocks No Longer Bullet Proof?

Daniel Morgan, Senior Portfolio Manager

With the tech-laden S&P Information Technology Index down -13.5% YTD, compared to just a – 8.2% 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 that future GDP growth will slow down potentially impacting enterprise/consumer IT spending. The Fed is now telegraphing the possibility of a hike in the Fed Fund's rate as early as the upcoming March meeting.

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With further hikes in 2022 now expected, it appears that the days of throwing a dart against the wall and hitting a FAANG stock that eventually becomes a big winner may be over. With all five FAANG stocks (Meta/Apple/Amazon/Netflix/Alphabet) trading down YTD, investors are reconsidering their approach to trading big technology stocks. Gone, may be the days in which the FAANG stocks drove the market higher and attracted blind money flows. The FAANG group is being impacted by many factors:

- concerns of higher rates
- lofty P/E valuations (AMZN 65x/NFLX 35x)
- slower user growth
- tougher comparisons after the spike in usage during the Pandemic

Stocks like Meta (FB) that have fallen short of high investor expectations during recent earning reports have paid dearly in the market.

Many of the FAANG stocks are flushed with cash on their balance sheets that could be used to weather any storm or make acquisitions to boost future growth.

Many of the key FAANG stocks that saw a large increase in sales and profits related to COVID-19 economic trends (work-from-home, boost in on-line shopping, and entertainment-at-home) are experiencing tough earning comparisons for FY2022 vs FY2021. After posting huge profit growth in 2021, Meta's and Alphabet's projected FY2022 EPS-GAAP YoY Growth rates are only -10.6% and +3.3%, respectively. This is startling after the shares had made big gains after the post COVID sell-off. These slower projected EPS growth rates for all the FAANG stocks (that collectively represent 25% of the S&P 500 Index) is spilling over into other more speculative areas in Technology into companies with no profits or un-tested business models.

The fourth quarter earnings season actually kicked off nicely with both Apple and Alphabet crushing estimates. Apple reported its largest single quarter in terms of revenue ever, with sales growing over 11% year-over-year, despite supply challenges and the lingering effects of the pandemic. Apple's much watched performance barometer iPhone revenue came in at $71.63 billion vs. an estimated $68.34 billion, up 9% year-over-year. It was another strong showing for Apple in its most important quarter of the year which includes holiday sales. Every one of Apple's product lines grew year-over-year from last year, except for iPad sales, despite management warnings from October that supply issues could hurt the company's sales.

It appears that the days of throwing a dart against the wall and hitting a FAANG stock that eventually becomes a big winner maybe over.

This was followed by a surprise on the upside with Alphabet. Google parent Alphabet reported better-than-expected fourth-quarter earnings and revenue. The company also announced a 20-for-1 stock split that will go into effect in July. Alphabet's two highly followed growth drivers advertising and cloud both beat expectations. Advertising revenue came in at $61.24 billion for the quarter, up 33% from $46.2 billion in the same period a year earlier. Further, Google Cloud posted revenues of $5.54 billion vs an estimate of $5.47 billion, 45% year-over-year.

Meta (Facebook) kicked off the slide in the FAANG stocks with reporting a massive loss in its newly created Reality Labs segment. Specifically, Meta posted $877 million in revenue in the quarter, but reported a surprising operating loss of $3.3 billion. Facebook also missed estimates with user numbers. Daily Active Users (DAUs) were 1.93 billion vs an estimated 1.95 billion. Monthly Active Users (MAUs) were 2.91 billion vs an estimated 2.95 billion. Facebook said it's being hit by a combination of factors, including privacy changes to Apple's iOS and macroeconomic challenges. It blamed the lower-than-expected growth in part on inflation and supply chain issues that are impacting advertisers' budgets. To add cold water to the campfire, Facebook said revenue in the first quarter will be $27 billion to $29 billion, while analysts were expecting sales of $30.15 billion. Management's guided 1Q22 revenue range only equates to a 3% to 11% year-over-year revenue growth rate.

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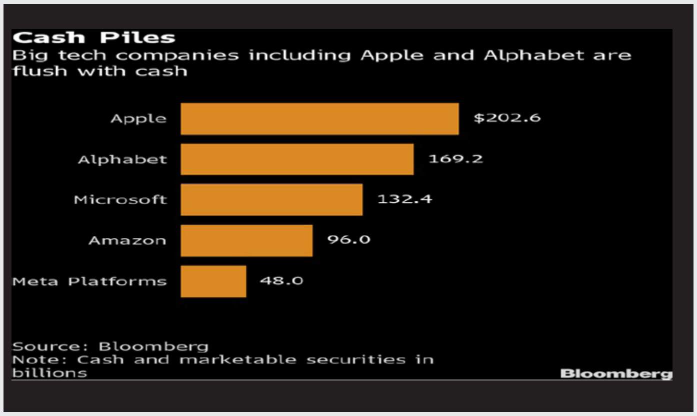
Amazon closed down the FAANG reporting season with a beat on Earnings per Share (adjusted) of $5.80 (helped by a one-time $11.8 billion pre-tax gain in Rivian stock) vs an estimated $3.57 billion expected. Amazon guided for first quarter revenue of between $112 billion and $117 billion, below the average estimate of $120 billion. While 4Q21 revenues came up short at $137.4 billion vs an estimated $137.6 billion. Despite these weaker-than-expected sales numbers and disappointing guidance, Amazon gave investors enough confidence that growth will recover in the upcoming year. Amazon stock was boosted by the announcement that the monthly Prime membership fee will go from $155.88 per year (or $12.99 a month) to $179.88 per year (or $14.99 a year). This extra revenue will help offset soaring fulfillment costs that hit $179 million in the



Source: TradeView

4Q, +96% YoY. Amazon's flagship cloud franchise AWS posted revenues of $17.8 billion vs $17.37 billion, equating to 40% YoY growth. Amazon also disclosed revenue from its fast growing advertising business for the first time. Amazon's advertising services grew 32% year-over-year to $9.7 billion during the quarter. Amazon's advertising segment growth rate compares favorably to Alphabet's and Meta's advertising revenue growth in the most recent quarter that grew 33% and 22%, respectively.

Despite these near-term head winds, the FAANG Group and the Tech sector of today appears to be on a much stronger foundation than back in the late 1990's as many Dot.Com companies had little profits.! Many of the FAANG stocks are flushed with cash on their balance sheets that could be used to weather any storm or make acquisitions to boost future growth.

With all this said, it appears the days of every FAANG stock being a big winner may be over. Nvidia has already passed Meta in regards to market-cap at $583 billion, compared to $550 billion. Yesterday's hot Tech stock is often the tomorrow's forgotten darling. Everyone remembers the Top Technology stocks during the Dot.Com craze dubbed the "Four Horseman" -- Intel, Cisco, Dell, and Microsoft. Intel and Cisco share prices have yet to reclaim their former grandeur. Dell has gone through numerous corporate changes. Michael Dell took the declining company private in 2013 through a $25 billion buyout with Silver Lake, then went public again in December 2018. Microsoft is one of the few old-line Tech names that has been successful in transitioning to the cloud. It will be interesting 20 years from now to see where today's FAANG stocks fit into the future technology stock landscape.

Inflationary Parallels: 1970s and Today

David Grimaldi, Foreign Exchange Sales Consultant

Americans under the age of 40 have never experienced the real-life impact of inflation, as inflation rates have remained relatively low following the runaway rates of the 1970s, that is until now. In the wake of the COVID-19 pandemic, the inflation rate is now the highest in 40 years.

According to a Gallup Poll taken in January, inflation is the number one problem facing this country today, with 79% of respondents expecting it to continue over the next six months.[1] Job growth surged in December, which is good news, although wages have not kept pace with inflation in real terms. President Biden called out critics who did not join in the celebration of the good jobs' numbers, referring to their comments as "malarky."[2] Inflation and its present-day causes are parallel to the "me" decade of 40 years ago.

The Federal Reserve policy on interest rates and the dollar, oil prices, American involvement overseas, and rising home and rental prices contributed to a decline in living standards during the 1970s. The same inflation experienced by the United States four decades ago is now encroaching on the American standard of living. The United States' approach to resolving these obstacles is critical. Will leaders learn from history and implement effective solutions to solve the United States' inflation

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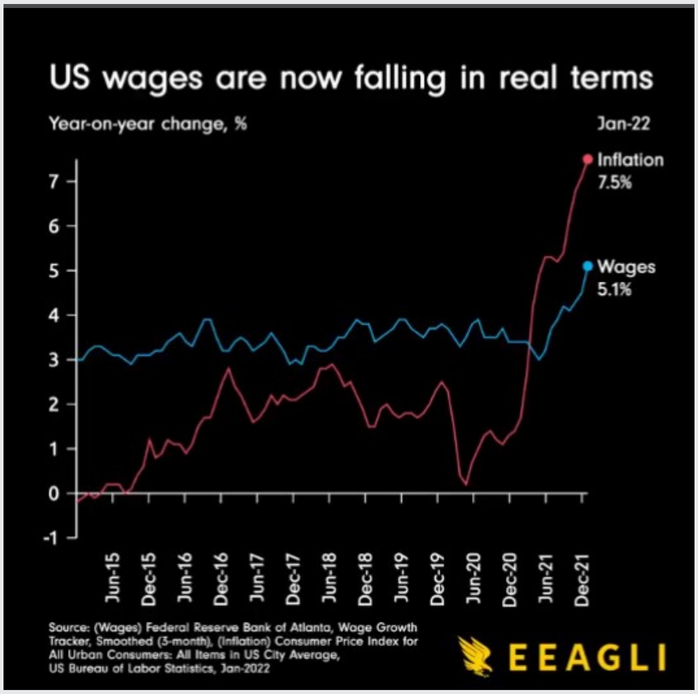
problems? Inflation is usually the cause of long-term instability, and if it persists, it can predetermine the demise of governments and nations.



Source: TradeView

The Federal Reserve

In 1979, Fed Chairman Arthur Burns argued that the inflation appeared to be the result of a plethora of forces: “the loose financing of the war in Vietnam .... the devaluations of the dollar in 1971 and 1973, the worldwide economic boom of 1972-73, the crop failures and resulting surge in world food prices in 1974-75, and the extraordinary increases in oil prices and the sharp deceleration of productivity.”[3] These same scenarios exist now, except in different form - replace crop failures with supply chain disruptions.

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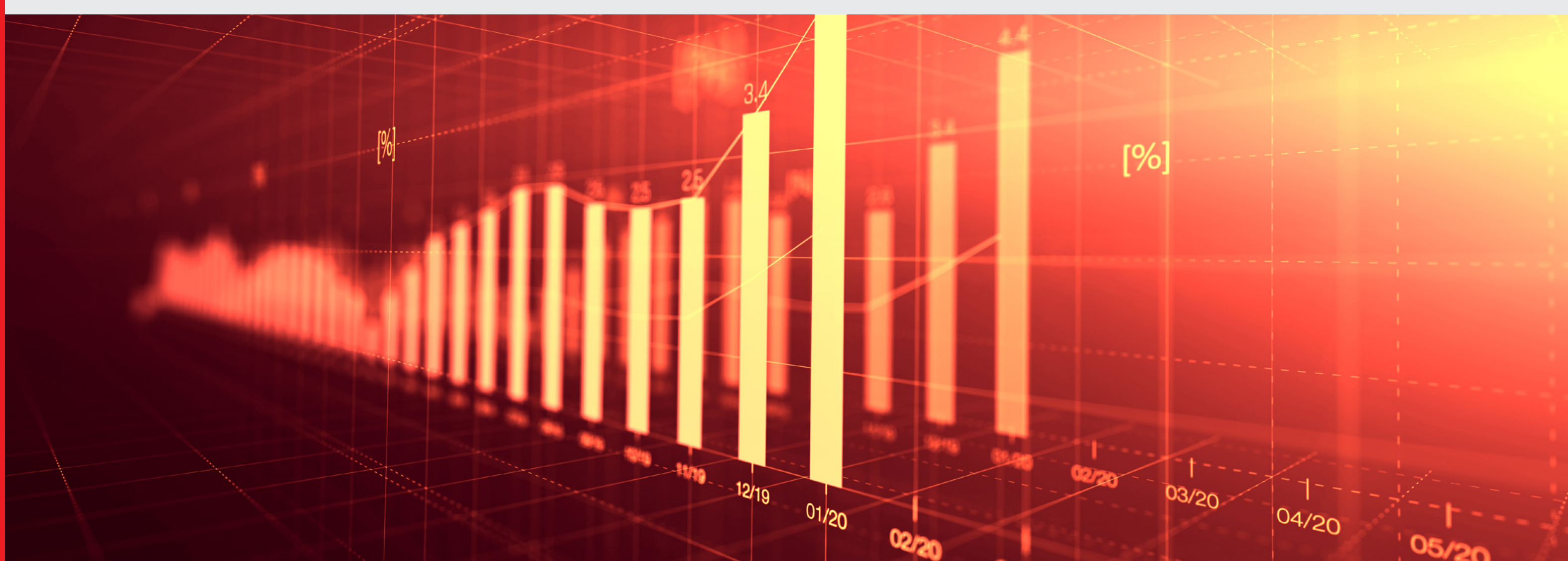
From 1973 into 1978, the Federal Open Market Committee (FOMC) maintained an aggressively accommodative stance on interest rates. The Federal Reserve focused on increasing employment as jobs began moving overseas for the first time in United States history while factories consequently began to close, crippling prosperous communities. While the United States government was paying for the long Vietnam War campaign, the country was also dealing with political turmoil in cities, a Presidential resignation, and oil prices controlled by an overseas conglomerate of countries. The U.S. Dollar entered the second Nixon White



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House term as a freely floating currency backed only by the full faith and credit of the United States. In 1971 the Smithsonian Agreement attempted to peg industrialized nations to the U.S. Dollar. The agreement failed, as the dollar was driven lower by the new currency market speculators created by removal from the gold standard. The U.S. Dollar continued to sink because of the increasing demand for overseas products and the budget demands of the unpopular Vietnam War. Consequently, the price of gold exploded due to a lack of faith in the U.S. dollar. One ounce of gold increased from $35 – a price artificially set by Franklin Roosevelt – to $455 an ounce!

By the middle of 1978, the Federal Reserve finally began taking steps to combat inflation, raising rates 3.1% to 10% overall, a decisive attempt to curb rising inflation. Modern economic historians now see the increases as timid and insufficient to stem a surge in inflationary pressure that had already become entrenched in the American psyche and economy.[4] These steps did not slow inflation as consumer prices topped 9%. In August 1979, President Carter installed Paul Volker as the head of the Federal Reserve with a clear mandate to fight inflation at any cost, including employment. Volker set about to raise rates from 11% to 19% in 1981.

Long lines of cars waiting to fill gas tanks and increased prices of food staples harmed Carter's popularity. Now, the populist would battle for the Democratic Presidential nomination against Massachusetts Senator Edward Kennedy. Carter did not win a second term, losing to California Governor Ronald Reagan, as inflation, the oil crisis, and the Iranian hostage situation doomed his election chances. Reagan, inheriting an economy in the worst recession since the 1930s, promised supply-driven economic policies vs. the familiar Keynesian demand model used since Franklin Delano Roosevelt. Reagan's tax cuts, in conjunction with Volker's Fed policy, eventually lowered the rate of twelve-month inflation from a peak of nearly 15% to 4% by the end of 1982.[5] The next period of economic growth and wages increases would be the most successful in modern United States history.

The Fed policy response following the 2001 attacks on the World Trade Center and the Pentagon, the 2008 Financial Crisis, and the COVID-19 pandemic has been the most accommodative in history. Since 2008, major central banks have pumped more than $25 trillion into the global economy with more than $9 trillion in response to COVID-19 alone.[6] The dollar had an average inflation rate of 1.92% per year between 2008 and today, producing a cumulative price increase of 30.58%. This means that today's prices are 1.31 times higher than average prices since 2008, according to the Bureau of Labor Statistics Consumer Price Index.[7] The parallels we now see are not only similar to the 1970s, but they could be worse, as debt soared past $30 trillion this year.

What will the tightening cycle look like in 2022?

Economists are in uncharted territory as supply chain disruptions and COVID-19 shocks hamper the ability of historical models to determine the pace and the extent to which the Fed must raise rates to fight inflation at a 40-year high. Expectations of three to four rate hikes in 2022 have jumped to four to five rate hikes, with another .50% rate hike in March and two to three additional rate hikes in 2023. However, the recent Russian invasion into Ukraine has tempered these expectations. The Federal Reserve expects to make its first hike in March to combat inflation that has been evident since mid-2021. During the same time last year, the administration used the word transitory to describe inflation and has now abandoned the word for systemic. "I am ready to retire the word transitory," Ms. Yellen, Chair of the Federal Reserve, said. "I can agree that that hasn't been an apt description of what we are dealing with."[8] The problem with raising rates is the inevitable bill the United States must pay for the interest rate on the national debt. The daily cost of interest is currently $1 billion each day at the current rates, which will certainly be much higher next year.[9]

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Oil Dependence and Inflation

The oil price increases, which contributed to inflationary pressures in 1973, are analogous to the challenges we face in 2022. In the 1960s, the Middle East was becoming a major foreign policy issue for the United States for the first time in history. In 1968, Palestinian-born Sirhan Sirhan murdered Senator Robert Kennedy, who was running for the Democratic Presidential nomination, at the Ambassador Hotel in California. Sirhan's justification for murder was Kennedy's support for Israel during the Six-Day War in 1967. Furthermore, the Yom Kippur War of 1973 and the United States' support of Israel brought a strong reaction from OPEC nations that had gained tremendous wealth from large gas-guzzling U.S. autos of the 1960s and 1970s. Fed up with supplying its nemesis, Arab nations tripled the price of oil.[10]

Until this point, America was still riding a high wave of prosperity, with oil driving all consumer activities. For the next decade, the United States would battle with stagflation, low economic growth coupled with high inflation. Nixon ultimately contributed to this decade-long dilemma by choosing a government manipulated currency over offering a large tax cut which would have increased United States investment and curbed the dollar's slide. [11]

The Iranian Revolution began in early 1978 and ended a year later when the royal reign of Shah Mohammad Reza Pahlavi collapsed, and Sheikh Khomeini took control as Grand Ayatollah of the Islamic Republic. In conjunction with the revolution, Iranian oil output declined by 4.8 million barrels per day (7% of world production at that time) by January 1979.[12] The culmination of the events resulted in Iranian terrorists seizing 52 American citizens and diplomats on Nov. 4, 1979. OPEC did not show sympathy for its largest client and raised oil prices to $20 a barrel in 1979. Oil prices would double between August 1979 and April 1980. United States oil dependence would last for the next 45 years, with the string finally broken briefly during President Donald Trump's time in office.

Oil Prices – COVID-19, Economic Shutdowns, and the Return to Oil Dependence

United States oil prices collapsed in 2020 as the world economy shut down due to COVID-19. Oil prices went contango, or below the prices of futures contracts. However, a shift occurred in January 2021 when newly elected President Biden shut down the Keystone pipeline between the United States and Canada. The Biden Administration's imposed environmental regulations reversed the United States oil independence causing the United States to revert to overseas supply. As oil prices began to spike, Biden reached out to OPEC to increase production to supply more oil to the U.S. OPEC, having suffered from increased United States energy production from fracking and shale, predictably said, to pump it yourself.[13]

Fossil fuel production has been an anathema to the Democratic base, and its elimination was a common platform during the debates in 2020.[14] In response, the government, in cooperation with private corporations, has

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targeted and directed hostility toward the fossil fuel industry. Private corporations are voluntarily moving away from fossil fuels and moving toward expensive renewable energy products. Companies are then passing the increased costs to the consumer. Similar to the oil crisis of the 1970s, the strangulation of supply has increased inflation. Claims of long-term environmental benefits cannot change the negative near-term economic impact these changes have had on the poor and working class. The price of oil has doubled into early 2022 to $93 a barrel. Oil dependence is the keystone to the current Ukrainian invasion by Russia. In May 2021, President Biden reversed the Trump administrations sanctions on the construction company building the Nord Stream II pipeline. The Trump administration argued Europe would become a hostage to Russia, with a disproportional dependence on their oil. Russia in turn could leverage oil dependence by tightening their grip on members within NATO.[15] Europe, for example, receives 40% of their natural gas from Russia, is reluctant to sanction Russia on the recent invasion into the Ukraine. Russia is second in the world only to the U.S., producing 10.1 million barrels per day vs. the U.S. at 11.3 million.[16] The Russians could get sanctioned by all cooperating nations, and still sell all their oil to uncooperating nations like China at a higher price, due to limited supply. President Vladimir Putin having calculated all of this, including the withdrawal in Afghanistan, chose an opportune time to risk that he would not be opposed.

Oil dependence is the keystone to the current Ukrainian invasion by Russia.

Cost of Global Conflicts

In 1976, dissatisfaction over the Vietnam conflict, Watergate, and the United States oil crisis resulted in the surprise election of Georgia businessman Governor Jimmy Carter. President Carter encountered the same problems as his predecessors Richard Nixon and Gerald Ford. Carter faced increasing global demand for oil that drove up prices, a deteriorating United States manufacturing base, escalating Middle East foreign policy issues, and a weakening dollar.[17] Most importantly, the cost of the Vietnam War was $168 billion, and after 1965 the United States was running budget deficits that ballooned from $1 billion to $74 billion in 1976.[18] The inflation impact appeared in a series of United States dollar slides that began in late 1977 when the markets began getting jittery about the failure of the United States to take economic actions they thought necessary. Although inflation was speeding up, the United States had no anti-inflation program. The Carter Administration's first steps toward combating inflation did not occur until the twentieth month of his Presidency.

Similar to the events during the 1970s, two significant conflicts have burdened the American public and the United States Treasury over the last 20 plus years. Notably, from 2002 to 2022 the United States debt has risen from $5.8 to $30 trillion, and debt to GDP ratio from 55% to 124% of GDP.[19] The cost of the Iraq and Afghanistan Wars is estimated at $2.2 trillion but could reach as high as $6.5 trillion due to interest.[20] The United States has pumped $6.55 trillion and $6.82 trillion consecutively into the economy to combat COVID-19 related job losses, running $3 trillion in deficits each year. Although the Biden Administration looked to add more spending, plans were halted by members of his party in the Senate, citing inflation numbers that touched 7%.

The Effect of Monetary Policy on Housing and Rental Prices

In the 1930s, President Franklin Roosevelt used monetary policy to increase the value of the largest asset in the United States, crops. Today, housing is the largest asset in the United States, and policymakers use quantitative easing to increase those assets in price. The actual cost of what our dollar can buy is depreciated. In the 1970s, when the price of rental housing became inflated, politicians stepped in by instituting rate controls. President Nixon first initiated wage and price controls in 1971, and large cities replicated the practice. As a result, renters would never leave rent-controlled apartments as property taxes increased and builders opted not to build new apartments for fear of not getting a return on investment. Rent control caused a dry-up of available

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supply and price increases for new buyers. "In many cases, rent control appears to be the most efficient technique presently known to destroy a city — except for bombing," wrote Swedish economist Assar Lindbeck, a Social Democrat.[21]

COVID-19 rent moratoriums have had a similar effect on housing. When the rent moratorium ended in December 2021, rent delinquencies doubled from rates seen during previous years. Furthermore, individual American investors and Real Estate Investment Trusts purchased properties in anticipation of the market reopening have drained the housing supply, and a supply reduction has allowed new landlords to demand higher than usual rents. Building material shortages have also added to new home building prices leading to a slowed supply. In the 50 largest United States metro areas, the median rent rose an astounding 19.3% from December 2020 to December 2021, according to a Realtor.com analysis of properties with two or fewer bedrooms. And nowhere was the jump bigger than in the Miami metro area, where the median rent exploded to $2,850 – 49.8% higher than the previous year.[22] Time will tell whether history will predictably repeat itself. Will rent control make its way back into the political discourse again?

Conclusions

Excessive monetary policy may be partially responsible for the more than 11 million job openings companies are having extreme difficulty filling. COVID-19 has changed the way Americans approach their work-life balance, which in historical terms means that Americans are working less, similar to the European model. Aging-out baby boomers are also creating job shortages, along with vaccination policies that lockout essential health care and government workers. The impressive jobs number of 447K in January and the revisions from December and November to 709K would typically be cause for celebration for the markets. However, the United States is still under the employment number pre-COVID-19 from March 2020. Accordingly, the positive employment number adds more evidence that the FOMC is too late in pursuing a policy that raises rates to combat inflation. Despite this, we can still learn from the lessons of the 1970s and early 1980s by implementing policies that improve future outcomes before we create further damage to the economic well-being of many struggling Americans.

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Source Footnotes:

[1]https://www.cnbc.com/2022/01/07/biden-touts-strong-december-wage-increases-brushes-off-weak-job-growth.html
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