Synovus Market Update

May 6, 2022
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The Federal Reserve hopes for a soft landing

Daniel Morgan, Senior Portfolio Manager

The March Consumer Price Index (CPI) posted the largest gain since 1981, increasing to 8.5% from a year ago. The prospect of a longer lasting inflationary period is now more likely. Thus, in our view the Federal Reserve will end the purchases of securities for their portfolio and begin aggressively raising the Federal Funds rate target through FY22.

Gross Domestic Product (GDP) growth for FY21 hit 5.7% year-over-year (YoY). However, excluding the Covid lockdown year of FY20, real GDP only rose 2.09% from FY19 to FY21. Going forward the comparisons are going to be much more difficult. For FY22, the consensus forecast for Real GDP growth is 3.3% YoY, while the Fed is projecting growth of 2.8% YoY. We expect personal consumption, which represents two-thirds of GDP growth, to be hampered by higher oil and food prices, that will result in Real GDP for FY22 to barely squeeze out a 2.0% YoY growth rate.

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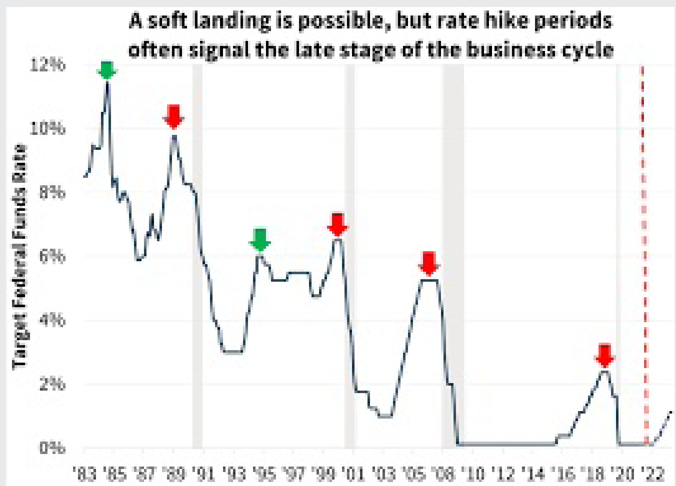
There are several risks built into this tightening cycle. The speed at which global supply chain disruptions are resolved will matter both for the near-term alleviation of supply bottlenecks as well as for longer term restructuring. The extent to which labor supply returns to the pre-COVID trend or remains short will impact wage costs and productivity. Based on the March Unemployment figures, there are approximately 3 million fewer workers today then in January 2020 (before the Covid shutdowns). Inflation continues to exceed previous expectations and appears not to be transitory as market pundits had originally predicted. Inflation would weigh more heavily on consumer spending, potentially retarding future economic growth. The Federal Reserve's choices will impact economic growth as well as housing and mortgage activity. Fiscal policy will most likely not play as a large of a role as in the past. The recently passed $550 billion infrastructure



Source: Fannie Mae

bill has a bulk of new spending not slated to occur until after FY23. Therefore, it will have a minimal positive impact for FY22. The larger $1.8 trillion fiscal package dubbed "Build Back Better" that is being worked on by the Democrats, is not included in the outlook due to the uncertainty over the actual details, and the probability of it actually being enacted.

While much remains uncertain, and assuming our 2022 forecast is reasonably accurate, by 2023 the economy will likely have entered the mature stage of the business cycle. By this we mean the level of GDP has recovered back to trend, the labor market is at "full employment," and the Federal Reserve is in the process of tightening monetary policy. At that point in the business cycle recession risk

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moves into focus, as there is no longer pent-up demand or excess production slack providing momentum. The economy is therefore more vulnerable to be knocked off its growth trend by any ensuing shocks. Additionally, imbalances or inefficiencies become more exposed in an environment of slower growth and tightening monetary policy. The probability of a recession in late FY23 now stands at 25%.

It may seem odd to be discussing the next potential recession so shortly after the 2020 downturn, but historically not all business cycles have been as long-lasting as we have become accustomed to over the past 30 years. From 1948 to 1960 there were four recessions despite the era being remembered as a period of post-war prosperity. Similarly, from 1970 to 1983 there were four downturns. During the 1970's the economy experienced a period of Stagflation. This refers to an economy that is experiencing a simultaneous increase in inflation, high oil prices with low or stagnate GDP output. While much has changed structurally with the economy since that time, we see parallels with the current period. Demand has rebounded sharply, unlike the drawn-out process following the 2008 financial crisis, inventory restocking is a more prominent driver of growth, and inflation pressures have started building quickly.

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While there have been a few historical instances of a "soft landing" being achieved, more typically once the Federal Reserve begins a regime of rate hiking, the next downturn occurs between one and three years later. The U.S. Treasury yield curve should provide clues to what investors think about how the expected Fed interest rate hikes will impact future expected GDP growth. A flattening of the U.S. Treasury yield curve would indicate that investors are predicting that current Fed tightening will lead to slower future economic growth. We will have to see if this formula plays out--hopefully, history will not repeat itself!

Q1 Corporate Earnings Reports

Wade Fowler, Senior Portfolio Manager

According to FactSet, the first quarter of 2022 will see growth in S&P 500 earnings of 6.6%. For the full calendar year 2022, earnings growth is expected to be 10.9% vs. 2021. At the time of writing, we are entering the busiest week of corporate earnings releases for large cap stocks followed next week by the busiest week of earnings for small cap

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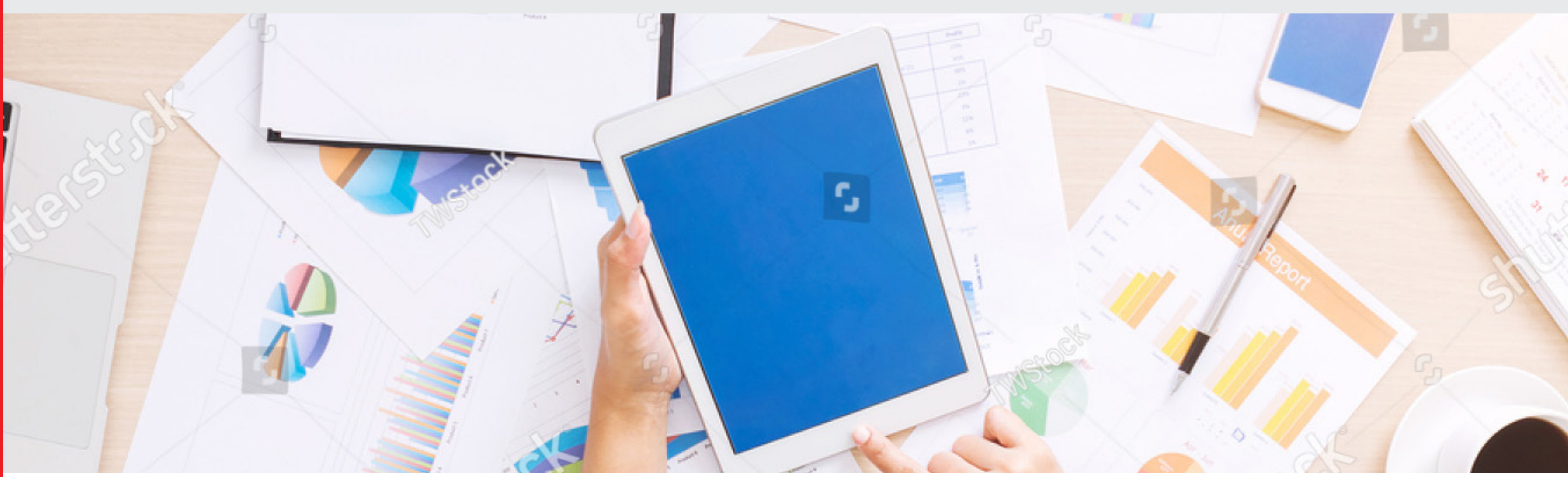

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stocks. While we still have the bulk of companies yet to report earnings, one trend emerging from the results is that large companies are reporting stronger results than smaller companies. If this trend continues, it will confirm the moderate weakness we are seeing in many of the economic leading indicators. While the U.S. economy is still growing, it is growing less strongly than in quarters past. Smaller companies tend to be more cyclical, or more impacted by general economic activity. It would make sense that smaller companies would find it more difficult to produce strong earnings when economic activity is slowing. Given the jump in oil and gas prices this year, it will likely not be a surprise to anyone that the energy sector is expected to report the largest earnings growth for the first quarter. The materials sector is second in line. These two commodity exposed sectors are producing strong earnings as higher inflation is causing a headwind for consumers and many other parts of the economy. Investors will be sorting through earnings reports and listening to company management teams provide guidance related to several key areas of concern. As mentioned, how companies are dealing with elevated inflation will be an area of focus. Also, ongoing supply chain problems, labor shortages, and the war in Ukraine are expected to be frequently cited factors affecting earnings during the quarter. Many of the issues facing corporate managers simply boil down to higher costs of doing business. When costs are rising and growth is slowing, we should expect to see profit margins decline. S&P 500 net profit margins for the first quarter are expected to be 12.3%. If the results match the expectations, this would be the third straight quarter of lower profit margins. Certainly, some of the volatility in the stock market so far in 2022 is directly related to this point. When companies find it more difficult to earn strong profits, investors tend to rethink how much they are willing to pay for the shares of those companies.

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Technology Corner: What do the FAANG stocks tell us about the true health of the Technology Sector?

Daniel Morgan, Senior Portfolio Manager

With the tech-laden S&P Information Technology Index down 16% year to date, while trading at a P/E ratio of just 27x trailing earnings, it is most likely a good time to revisit some of the investor concerns surrounding the Technology Sector and the pivotal FAANG/FAAMG (Facebook/Meta, Apple, Amazon, Netflix/Microsoft, and Alphabet) stocks. These stocks combined represent 25% of the S&P 500 Index market cap and 40% of the NASDAQ Composite market cap. Therefore, the overall health of these companies will dictate the general perception of the Technology Sector. Moving into the 1Q22 reporting season, there are more questions than answers surrounding the tech behemoths — Facebook/Meta, Apple, Amazon, Netflix, Microsoft, and Alphabet.

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Is Netflix's subscriber growth slowing due to market saturation? The first member to report 1Q22 results, Netflix, did not infuse much confidence in Tech Investors. Netflix reported a loss of 200,000 subscribers during the first quarter — its first decline in paid users in more than a decade — and warned of deepening trouble ahead. During the same period a year ago, Netflix added 3.98 million paid users. Netflix is forecasting a global paid subscriber loss of 2 million for the upcoming second quarter. The company said that the suspension of its service in Russia and the winding down of all Russian paid memberships resulted in a loss of 700,000 subscribers. Excluding that impact, the company said it would have seen 500,000 net additions during the most recent quarter. Netflix also cited growing competition from recent streaming launches by traditional entertainment companies, as well as rampant password sharing for the recent stall in paid subscriptions.

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Are investor concerns that slower economic growth will translate into a sluggish enterprise software environment warranted? Despite macro uncertainties, software budgets are expected to grow 4.8% in 2022, indicating that growth and fundamental demand trends remain strong into 2022. Microsoft's growth trajectory also appears to be stable despite the elevated market uncertainties. CIOs continue to focus on Microsoft as one the top share gainers of IT wallets as workloads move to the cloud. CIOs continue to prioritize, Cloud Computing, Security, Digital Transformation, and BI/Analytics. Microsoft looks to gain share in public cloud as enterprises ramp up the build out of modern applications, and the company is gaining share among those surveyed in the hybrid cloud space.

Can Microsoft's cloud engine Azure continue to drive 15%-20% top line growth? Microsoft's growth continues to benefit from its data-center cloud service Azure. Azure has become a formable player, running slightly behind in regard to market share to data center cloud leader AWS (Amazon). Azure revenue growth down ticked during the 2Q22 report as Azure posted revenue growth of 46% YoY. For the 3Q22, Azure revenue growth remained steady increasing by 46% YoY. Driven by steady existing consumption growth, layered in with some of the recent bookings strength. Three driving forces are still intact for Microsoft's cloud business, include:

1) accelerating commercial bookings growth to 32% YoY driven by expanding cloud commitments,

2) accelerating capital expenditure growth of 41% YoY,

3) positive management commentary on "very strong" cloud demand signals

Can YouTube continue to be one of Google's prime growth catalysts? In the 4Q19, Alphabet broke out the value of YouTube's advertising empire. While YouTube's ad revenue is just one-fifth that of Search, YouTube continues to stand out in both brand loyalty and its ability to capture a highly engaged audience that is typically difficult to reach. While YouTube has been complementary to TV, going forward expect more TV ad dollars to shift to YouTube given the streaming platform's massive scale at 2 billion plus Monthly Average Users (MAUs). Alphabet has shown to be less vulnerable to changes in iOS compared to social media competitors like Meta Platform's/Facebook, SNAP (which recently reported a 1Q22 revenue shortfall and warned of a more challenging operating environment ahead) and Pinterest. Google management has highlighted the social commerce opportunity: Samsung, Walmart & Verizon hosted shoppable live-stream events in the 4Q. New ad formats include a product feed, video action campaigns, and merging live commerce.

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Can Google Cloud (GCP) become profitable? For the 1Q22 the Google Cloud unit posted revenue of $5.82 Bn an increase of 44%. Despite posting strong revenue growth, GCP continues to post operating losses. Management highlighted three key trends shaping Google Cloud's growth that should drive the segment out of the red:

1) Strong customer momentum in the Data cloud

2) Large IT transformation deals with companies wanting a robust infrastructure cloud, and migrating data centers to Google Cloud

3) Innovations in enabling hybrid work with Google Workspace helping grow the number of seats and revenue per seat in 3Q21. The GCP sales force has grown 3x since 2019. New logos include LVMH, Albertson's, and Spotify.

Is AWS still a major catalyst in the Amazon growth story? AWS is teed-up to post record growth in the FY 2022, as demand in the IaaS cloud space appears to be strong. Management noted growth accelerated across a broad range of customers and benefited from easier comps with many companies focused on limiting spend during the pandemic. AWS is major part of the overall growth thesis for Amazon, along with advertising and Prime subscription revenue. Many Bears have pointed to the deaccelerating growth rate in AWS over the past quarters, however with the onslaught of Covid-19, this has caused more large non-tech enterprises to re-evaluate their on-premises data center architecture and accelerate their move to the public cloud. During the 1Q22, AWS revenue growth accelerated to $ 18.441 Bn, an increase of 37% YoY.

Could Amazon's burgeoning ad business be the next leg of growth? Another focus point will be how fast Amazon's advertising business will grow and can it take market share away from Facebook and Alphabet. Advertising is Amazon's other high-margin revenue stream and is now broken out separately on the Income Statement. For the 1Q22, advertising revenues were $7.877 Bn, an increase of 23%. Amazon's ad business benefits from the surge in online ad spend. After COVID-19 accelerated overall e-commerce penetration and the shift toward a digital economy, advertising has become an even more important opportunity for Amazon in terms of both revenue and margins. Alphabet and Meta continue to be clear leaders with a 65% plus market share of global online ad dollars, but Amazon's ad business has grown significantly from $1.80 billion in 2015 to an estimated $39.912 billion in 2022.

How will the Street's biggest worries – supply chain/ COVID/inflation – impact Apple's upcoming 2Q22? We are cautiously optimistic with regard to Apple's upcoming 2Q22 earning results. After beating estimates in the 1Q22, investors continue to be upbeat that this positive momentum will roll into 2Q22. The biggest reason for optimism surrounds recent upbeat forecast reports coming out of the companies in Apple's food chain that supply parts to manufacture the iPhone. Despite the shortages, recent earning results from Micron (PCs, servers, smart phones), Broadcom (smart phones, broadband) and TSMC (who produces 100% of Apple's processors) point to foundational strength in the Apple manufacturing chain. MU that makes the DRAM memory chips that go into smartphone, raised guidance for upcoming 3Q22/FY2022 after beating 2Q22 EPS/Revenue estimates. Broadcom that generates roughly 25% of its revenues from Apple, reported 1Q22 EPS $8.39/Sales $7.71 billion that beat estimates handily. TSMC recently stated that total sales soared 36% to NT$491.1 billion in the first quarter ended March, which was NT$20 billion higher than the average estimate. Despite, supply chain/Covid/inflationary concerns the combined results from Micron/TSMC/Broadcom show that demand for smartphone chips is strong giving me confidence that the upcoming 2Q22 for Apple should exceed expectations!

Do you think headwinds with the Apple's iPhone12 and iPhone 13 launches provide a probability that the 5G upgrade cycle could be extended? Total iPhone unit shipments for FY21 was 241 million (vs 190 million in FY20) an annual growth rate of 26% YoY. Going forward, the Street is expecting iPhone unit shipments to reach 250 million units by FY22, an annual growth rate of 4% YoY. But, that estimate maybe not taking into account that the iPhone cycle is not over just yet. Strong iPhone performance was notable in light of the supply constraints, as well as the lack of a form factor change on iPhone. Expect that those constraints helped push customers

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into higher-end models across many product lines (since Apple prioritized higher-priced products amid constrained supply), in addition to the more aggressive U.S. carrier incentives. While both iPhone 12 and iPhone 13 can now be considered a success, there have been headwinds for both cycles. In 2020 sales were constrained because of lockdowns, and in 2021 sales were affected by component shortages. For that reason, I expect there's a good chance the 5G upgrade cycle could get extended, since Apple wasn't able to reach the entire market. Coupled with what is likely to be a more significant iPhone form factor change next year is, we think, there is reason to stay constructive.

We will have to see how upcoming results from the FAANG/FAAMG stocks either refute or confirm current investor concerns surrounding the technology sector. Only time will tell!

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).**

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