Synovus Market Update

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GDP and Supply Chain Issues

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For the third consecutive quarter, U.S. GDP missed expectations, coming in at a dismal 2%. Businesses are faced with several operational challenges, including rising oil prices, inflation, supply chain issues, and labor shortages, which seem to be cutting into sales figures. COVID-19 and the resurgence of the Delta variant have added to the labor problem, along with Federal and employer-imposed vaccine mandates, resulting in over 10 million job openings. Additionally, a record 2.9% of the workforce, or 4.3 million people, quit their jobs in September. Oil prices have reached the highest levels they have seen in the past 7 years this month. The Biden administration seems to be saying this is the "new normal," which harkens back to President Carter in 1977 telling Americans to lower their future expectations on oil prices dropping, and to turn the thermostat down to 55 degrees at night and wear a sweater.[1] Equities have reached all-time highs, and online buying habits that people developed because of the COVID-19 pandemic seem to be here to stay, crushing small retail businesses. Although second quarter GDP at 6.8% was going to be hard to maintain, COVID-19 is not the only factor contributing to low GDP growth and problems going into year end.

Brent Crude reached a high of $85 a barrel in October, and with shortages in Europe and production picking up steam, we could see $105 by early 2022. President Biden's first act as incoming President was to cancel the Keystone XL pipeline project, which was a concession to climate activists. Since then, oil has surged 60%, which has had the effect of an imposed and crippling tax to low-income and middle-class workers who are just getting back to work after COVID-19 shutdowns. Energy independence, which had been achieved for the first time in 45 years during the Trump administration has been erased, as have most of the gains from the Obama administration from fracking, which had dropped prices from $107 to $28 a barrel. For a second time, Biden pleaded with OPEC to increase production at this weekend's G-20 meeting. Although oil is still flowing from Canada, it is no longer coming by pipeline, but rather via a more energy inefficient method – trucks and trains. Despite the Biden administration, corporations, and climate activists forcing out fossil fuels, 80% of all energy is still derived from these sources. Ultimately, limiting the supply has added to inflation pressures and reduced economic growth.

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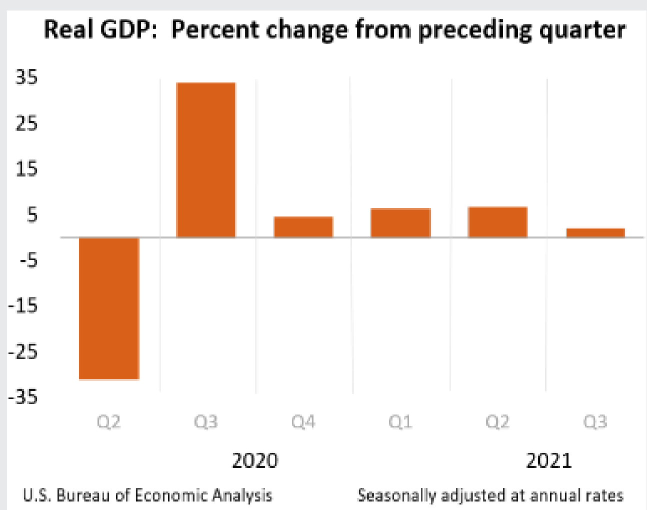
Supply chain issues are partially a result of suppressed demand from COVID-19 in 2020. Goldman Sachs is predicting port congestion to continue into the second half of 2022. Although many purchases were put off, overseas shutdowns have further delayed the production and delivery



https://nypost.com/2021/10/28/us-economy-grows-as-covid-recovery-cools-down/

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of goods. All U.S. ports are having record years, seeing a 120-130% increase in production just through October. California is reporting at least 100 ships waiting to get into port, and on the east coast, Savannah has 25 ships waiting to dock. Unfortunately, inland ports are not able to alleviate the coastal problem because empty shipping containers have become too valuable. Shippers do not want to risk the containers going inland for fear that they will not get them back, as the price of a shipping container has skyrocketed from $3,000 to $30,000 this year! Therefore, some ships are returning to China with empty containers, as wait times at ports are too long and containers are too valuable to leave behind. Moreover, there is also a shortage of a special truck chassis needed for shipping, as they are held up at congested warehouses and inland transit points. Consequently, large companies such as Home Depot, Amazon, Peloton, Walmart, and Ikea are chartering their own vessels or using airplanes to move goods, something that small businesses cannot afford to do.

To complicate matters, regulation is playing a major part in the way independent truckers and businesses will operate going forward. California AB5 went into effect on January 1, 2020. This law ushers in new tests for what constitutes an independent contractor. Under the new law, any worker completing tasks that are considered core to the hiring company's business will be deemed an employee. In the United States, 25% of all truckers are independent, but under the new law, these truckers could receive overtime pay and benefits from the companies they are contracted to drive for. Although California AB5 exempted truckers from this regulation, in April, the Ninth Circuit Court paved the way for them to be included. Many in the trucking industry are at a loss for how to comply with AB5, complaining the state has not provided any guidance, suggesting that the correct approach will ultimately be decided in court. In addition, four California state agencies confirmed they did not study the impact the law would have on freight capacity.

Likewise, on a national level, House Democrats in Congress passed the passed the Pro Act, aimed at impacting 27 right-to-work states in the United States. This bill, if passed, would affect independent contractors nationally, as it would require truckers to join a union, imposing union dues on truckers – whether or not they want to become union members. California trucking companies are subject to spillover fines that multiply based on the number of workers they employ. Companies cannot simply move out of state to avoid the long reach of the law because they will still be subject to AB5 if they continue to do business in California. Consequently, truckers and businesses are limiting activity because they are unable to exercise the freedom and flexibility needed to craft workplace agreements that respond to the unique needs of their workers.

Truckers who are employed as independent contractors may now find it much harder to work for themselves. Trucking companies would be forced to reconfigure routes that cross state lines or work with owner-operators to transfer their shipments to trucking companies who employ drivers. Moreover, regulations prevent individuals from driving a truck between the ages of 18-21, causing limitations on the work pool and discouraging training. Regulations require drivers to sit out 10 hours of a 24-hour workday. Since traffic around Los Angeles could take 2 hours each way from warehouse to port – and loading and unloading times have been up to 2.5 hours, the driver's ability to earn income is limited. Further complicating matters, truckers are not allowed to return containers to the ports. Instead, containers must be dropped offsite due to congestion, thus creating shortages. Consequently, Long Beach put a hold on a rule whereby containers could only be stacked 3 high, after containers were being left on residential streets blocking homeowner driveways. EPA rules are also having an impact, as operators are not allowed to drive trucks manufactured before 2010. Although about 96% of truckers are compliant, the new 2035 guideline for electric trucks – that don't yet exist – are keeping drivers from investing in new equipment.

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Supply chains are also being impacted by the difficult conditions of trucking, the age of the workforce, and the changes in quality of life after COVID-19. Trucking is a stressful business. Seventy-three percent of the trucking population is over the age of 40, with an average age of 47, and many drivers are stepping away after COVID-19. Smaller companies that were most affected by COVID-19 hire nearly 50% of all truckers. Trucker turnover is common as the rigors of the job are not for everyone. Accordingly, over 40% of truckers stay in the job for only one year, and that was before COVID-19. Furthermore, only 5% of all truckers drive beyond 11 years, with 77% of drivers leaving after 4 years. Starting salary is $45,000 with average salaries around $62,000, so wage growth in other sectors is limiting new drivers.[2] While trucking has been an attractive profession for ex-felons working as independent contractors, many may now be deemed unemployable if they are subjected to background checks required of large company employees. New and impending regulation is becoming a hindrance to finding new drivers, keeping older truckers, and it is leading to confusion in companies that hire truckers. These factors, in addition to record port business across the globe, are creating a long-term logistical nightmare at the ports.

Inflation is looking more permanent than transitory, as supply chain factors and escalating oil prices have increased the cost of most grocery store items. Annual inflation is accelerating at the fastest pace in 30 years. Personal Consumption Expenditure in September climbed by 4.4%, which is the highest level since 1991. Consumers are beginning to change their habits, according to the University of Michigan Consumer sentiment survey. Twenty percent of older and poorer households said inflation was leading to a declining living standard.[3] According to the Labor Department, rental cars have increased 42.9%, gas 42.1%, used cars 24.4%, and hotels 18%. Furniture has also seen a spike of 11.2%, and everyday items like meat, poultry, fish, and eggs are up over 10%. In contrast, wages in September grew only 4.6%, which is down year-over- year from an increase of 5.4% in 2020.[4]

Studies have shown that while an increase in GDP can lead to inflation, it can also lead to hyperinflation. Stagflation is a combination of stagnant growth like we saw in the third quarter, and high inflation. These times are beginning to be reminiscent of the oil shock we saw in the 1970s, as excessive government spending on the Vietnam War, dependence on exports from Germany and Japan (as their economies were on the upswing) occurred, while simultaneously created oil shortages leading to rising prices. We seem to be heading into a similar scenario with U.S. debt surpassing $28 trillion, while Congress is trying to negotiate for another $5 trillion. Furthermore, oil output is being intentionally restricted with self-imposed mandates by states and corporations mandating green initiatives, despite having an alternative

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cost-efficient renewable energy solution. Europe is also pushing demand as 90% of its natural gas is imported from outside the bloc, with Russia acting as the largest exporter.[5] Although the European Union is gradually cutting down on its long-time dependency on fossil fuels – renewables became the bloc's main source of electricity for the first time in 2020 – the shift has not been fast and widespread enough to contain fallout from the crunch.[6] Citizens in countries like Spain, Italy, France and Poland are now facing all-time-high energy bills that add to the economic woes caused by the pandemic, creating discontent with governments. Although there are ecological reasons for all of these decisions, in the short-term, fossil fuels are becoming more expensive for consumers, cutting into any wage increases they may have seen over the past year.

COVID-19 pandemic impacts have been unexpected and longer lasting than many had predicted.

These circumstances have also been combined with policies that are adding to supply chain problems, oil price increases, and inflationary pressures leading to a slowdown of economic growth. Warning signs are evident that a fourth quarter growth slowdown is imminent, as shortages and supply chain issues are forcing consumers to shop early for Christmas, or to put off big-ticket purchases due to price spikes and increased demand during the holiday shopping season. What is also becoming more evident is that some of these problems are policy driven. Consequently, one can conclude that if transitory inflation is endemic, is the "new normal" for consumers a declining living standard "malaise"?

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Technology Corner: Big Tech's Recent Earning Results are Mixed

Daniel Morgan, Senior Trust Portfolio Manager

With the lion's share of large-cap (well-known) technology companies – IBM, Facebook, Microsoft, Alphabet, Amazon, Apple and Intel – all reporting financial results recently, it may be a good time to pause and assess the current financial health of the sector. Chip shortages and Senate investigations into Big Tech are the subject of daily news headlines. However, that's just headline news. Let's take a deeper look at how these tech behemoths are performing – and at some of the headwinds going forward.

Top enterprise mainframe maker IBM kicked off the earning season with disappointing results for 3Q 2021. The company disclosed weak sales in their legacy IT management, and systems units outweighed robust demand for hybrid cloud computing. While IBM's revenue grew 3% year-over-year in the 3Q 2021, net income declined 33% year-over-year as the company's gross margin narrowed to 46.4% from 48% in the previous quarter. In early November, IBM expects to spin out the managed infrastructure part of Global Technology Services, under the name Kyndryl. IBM's emerging cloud business, Cloud & Cognitive Software, which includes Red Hat, produced $5.69 billion in revenue, but was up just 2.5% year-over-year.

There is no doubt that plankton in the hardware sector is the semiconductor chip. A global computer chip shortage has constrained worldwide production of goods, from iPhones to Sony PlayStations to Ford trucks. Recent channel check surveys point to a tightening supply chain, with increased instances of double ordering, expedited orders, and supply constraints, in addition to an extension in lead times. While shortages have proliferated throughout the entire industry, the automotive end market is seeing the most pronounced impact. Supply side indicators remain tight across all end markets, and lead times are stretched with some companies reporting lead times two times above normal levels (and in many cases into next year). Consequently, investors believe that these shortages for chips are actually getting worse. Given continued strong demand across all end markets, depleted channel inventory, extended lead times, and strong backlog, the current semiconductor up-cycle should extend well into fiscal year 2022.

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Despite shortages, I maintain a positive view on semiconductor companies exposed to cloud data center spending, 5G infrastructure, and gaming, and I see near-term weakness for companies exposed to auto/industrial/consumer and PC markets heading into fiscal year 2021 earnings. According to data reported by World Semiconductor Trade Statistics (WSTS) for the full year 2020, the semiconductor industry grew 7.3% (to $439 billion), up 5% excluding memory. The Semiconductor Industry Association reported overall revenue/growth of $440.18 billion (up 6.7%) in 2020, forecasting $548.5 billion (up 24.6%) in 2021.

Top chip maker Intel recently reported weaker-than-expected sales for 3Q 2021, and then blamed an industry-wide component shortage for its PC chip business. Intel also warned that its gross margin and free cash flow would decline to a lower level over the next two to three years as it invests in research and development and builds new chip factories. Intel's largest business, its client computing group, was down 2% year-over-year to $9.7 billion, which includes PC chip revenue. Intel said that PC sales were down primarily due to lower laptop volumes because of the chip shortage, and that its customers may have lacked other parts it needed to finish assembling computers.

During management's prepared remarks, top chip equipment maker Lam Research communicated that in the near term, they are not immune to the widely reported supply chain constraints and elevated costs that continue to create new challenges for their company and others across the industry. From a wafer fab equipment spending perspective, Lam now sees calendar year 2021 ending in the mid-$80 billion range. As chip makers build out capacity to increase output to meet current shortages, equipment makers see a long-term secular boost in demand.

In the social media space, many players such as Facebook, Snap and Twitter were impacted by the uncertainty faced in the fourth quarter in light of continued headwinds from Apple's iOS 14 privacy changes, macroeconomic, and COVID-19 related factors. Earlier this year, Apple introduced privacy changes by adding prompts allowing users to keep from being targeted with ads on apps. Snap shares plunged on its earnings report, and the company blamed the iOS changes for a disruption to its business. Despite the warning, Facebook still managed to post an astonishing $28.28 billion in advertising revenues for the 3Q 2021, an increase of 33% year-over-year. Alphabet appeared to be immune to the change in Apple's iOS privacy rules, posting strong growth during the 3Q 2021 with its YouTube advertising revenue coming in at $7.21 billion, growing from $5 billion a year ago. Alphabet's core advertising business – led by Search, Maps and YouTube – posted revenues topping $53.13 billion, a 43% year-over-year growth rate.

Top enterprise software company Microsoft reported their 1Q 2022 results, beating analyst estimates, providing evidence of healthy demand from IT managers for the latest cloud applications. The company also reported earnings of $1.82 per share, versus $1.54 per share as expected by analysts. Furthermore, revenues came in at $37.15 billion, versus an expected $35.72 billion. In 1Q 2022, Microsoft revenue grew 12% on an annualized basis, down from 13% growth in the prior quarter. Revenue for commercial PCs cratered 22%, months after support for Windows 7 ended and the coronavirus pandemic took hold. The category had surged last year, making outperformance this year more difficult. However, one of the fastest-growing parts of Microsoft, Azure (the public cloud for hosting applications and websites), grew 48% year-over-year, accelerating from 47% year-over-year in the prior quarter. Microsoft's Intelligent Cloud segment, featuring Azure, Enterprise Services, GitHub and server products such as SQL Server and Windows Server, contributed $12.99 billion in revenue, up 20% year-over-year.

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Amazon's 2Q 2021 results disappointed, as 24% of top-line growth came in at the midpoint of management's previous guidance. This occurred after Amazon exceeded high-end projections for six straight quarters in a row. Unfortunately, Amazon reported 3Q 2021 results that were weaker

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than expected, delivering disappointing guidance for the critical holiday period. Earnings came in at $6.12 versus an expected $8.92 per share, and revenue was $110.81 billion, up just 15% year-over-year versus being up 37% year-over-year a year ago. Amazon, the poster child for the "stay-at-home" internet shopper, is also reckoning with decelerating sales growth, as consumers go back to physical stores and the company faces supply chain challenges. Management commented that it expects to take on "several billion dollars" of extra costs in its consumer business in the fourth quarter because of labor shortages, higher employee costs, global supply chain constraints and increased freight and shipping costs. Despite weaknesses in Amazon's core on-line merchandise business, the company's IaaS cloud unit, Amazon Web Services (AWS), posted revenues that topped estimates, with sales jumping 39% year-over-year to $16.11 billion. Furthermore, AWS generated $4.88 billion in operating income in the period, while operating profit at the parent company was just $880 million.

One of the companies that was expected to be the hardest hit from the chip-component shortage was Apple, as most of its products – iPhones, Macs and iPads – rely on a healthy supply chain to meet production delivery targets. The focus on the iPhone 13 product cycle has shifted more toward supply constraints, led by the increasing likelihood of further disruption due to the resurgence of COVID-19 cases, in addition to more recent challenges to industrial production in China as a result of power usage restrictions. At this point, Apple's newest products - iPhone 13, iPad mini, 9th-generation iPad, Apple Watch Series 7 and MacBook Pro - won't be filled until November/December. The magnitude of these constraints are moderating at this time, and Apple has said that the company still expects to meet year-over-year revenue targets, and that it is well positioned for a strong "Holiday Season". However, Apple did report 4Q 2021 results that were below expectations, as all of Apple's core product categories, with the exception of the service unit, fell below expectations. iPhone revenue came in at $38.87 billion (up 47% year-over-year) versus an estimate of $41.51 billion. Services revenue was $18.28 billion versus $17.64 billion, up 25.6% year-over-year. On the hardware side, Mac revenue was $9.18 billion, up slightly, 1.6% year-over-year, while iPad revenue was $8.25 billion versus the estimate of $7.23 billion, up 21.4% year-over-year. All-in-all, it was a mixed quarter. However, management's confidence that it can meet delivery targets for its newest products in time for a strong "Holiday Season" was met with relief!

Given continued strong demand across all end markets, depleted channel inventory, extended lead times, and strong backlog, the current semiconductor up-cycle should extend well into fiscal year 2022.

In summary, with bellwether names like Uber, Qualcomm, Applied Materials, Cisco, HP, Salesforce and Micron

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Technologies still waiting on deck to report their results, the Tech earnings season is not over. However, I think we can make some conclusions from the evidence we have so far that there are the have-and-have-nots in the Tech Space. Companies like Intel and IBM, that are tied into mature growth areas like the PCs and mainframes, will continue to face headwinds. Although social media giants – Facebook, Alphabet, Twitter, and Snap – will most likely continue to face governmental scrutiny and changes in privacy rules, they should be able to sustain growth going forward. Companies with a strong reliance on the cloud – Microsoft's Azure and Amazon's AWS – should continue to see strong demand for their offerings, as IT departments shift away from traditional in-house data storage servers to more cost-efficient methods. Finally, movement towards 5G is still intact in the smartphone space, and despite component shortages, market leader Apple will find ways to overcome supply constraints and deliver on their product targets.

Amazon, the poster child for the "stay-at-home" internet shopper, is also reckoning with decelerating sales growth, as consumers go back to physical stores and the company faces supply chain challenges.

Source Footnotes:

[1]https://www.npr.org/2011/04/23/135640221/gas-prices-lessons-from-the-carter-years
[2]https://www.zippia.com/professional-truck-driver-jobs/demographics/
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