

# Synovus Market Update

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## Post War Global Monetary System

### Part 2: The Tale of Budget Deficits, Dollar Purchasing Power, and the Global Currency

David Grimaldi, Foreign Exchange Sales Consultant

Franklin Delano Roosevelt, having been elected President for a fourth time, had a mixed record of successes and failures in leading the United States and the world economy out of the Great Depression. Nevertheless, the American public was convinced of his leadership and his economic decision making, and elected him to a fourth presidential term, to drive the effort to supply the Allies with oil and munitions, and to fight the Axis powers. This military buildup put everyone in America back to work, either at home or overseas, and put an end to the Great Depression. Once the Allies began to anticipate a victorious conclusion to the war, they determined that important economic issues needed to be addressed, surrounding how the post war environment would look. The accumulation of debt to support the war had laid waste to the British Empire. However, although they were declared the winners by successfully defending their homeland from invasion, they had lost their vast colonial interests.

The Great Depression saw the largest economies remove themselves from a gold standard to print money, and countries devalued their currencies and created tariffs to protect trade and promote domestic employment. This beggar-thy-neighbor policy was defined as “any economic policy that seeks benefits for one country at the direct expense of another. In practice, it generally pertains to the process of competitive devaluation whereby a country depreciates its currency in the hope of increasing exports. Beggar-thy-neighbor adds nothing to global output in aggregate; instead, it attempts to reshuffle output”.<sup>1</sup> The Allies were also determined not to repeat the mistakes of

World War I, whereby winning nations punished the vanquished. Germany’s penalties for WWI resulted in repaying the debts of Allied nations, which created hyperinflation and planted the seeds leading to the rise of



Delegates at the Bretton Woods Conference, 1944  
(Source History Today) <https://www.historytoday.com/how-briton-created-almighty-dollar>

Adolph Hitler and invasion of Europe in WWII. The Allied remedy was to eventually enact The Marshall Plan to rebuild Europe and Japan with the United States, investing \$22 billion \$2.2 billion respectively from 1946 to 1952.<sup>2</sup> In order to proceed with these ground breaking measures, the post war recovery had to first address its currency dilemma.



In July of 1944, international leaders from 45 countries in the world met at Bretton Woods in New Hampshire to promote a stable post war international economic environment. The United States would spearhead this endeavor because, pursuant to FDR's gold initiative, it controlled three-fourths of the world's gold supply by the end of WWII.<sup>3</sup> Additionally, the industrial miracle the United States achieved in building the war effort supported reasoning behind having a leading role in the new arrangement. Thus, a new system was established, where international currencies were fixed, but adjustable, and backed by the U.S. Dollar (USD), which was fixed to gold at \$35 an ounce. This would be managed by the International Monetary Fund (IMF). These pegged rates could be adjusted only to correct a fundamental disequilibrium in the balance of payments, and only with the IMF's agreement. The Bretton Woods system could not have worked without the IMF, and member countries needed the IMF to bail them out if their currency became undervalued. Members would need a kind of global central bank they could borrow from if they needed to adjust their currencies value and did not have the funds themselves. Otherwise, they would just slap on trade barriers or raise interest rates.<sup>4</sup> Despite being problematic from the outset in 1958, this system remained in place until 1971.

Many of the post war goals of Bretton Woods were achieved, as Germany and Japan rebuilt and set the stage for how they would lead in global manufacturing at the end of the century. Countries that needed to cut ties from the gold standard were able to print currency to fund the cost of war. However, problems grew out of this arrangement, as the USD replaced gold as a reserve asset and established the United States with creditor status to other nations. Although foreign nations increasingly held U.S. Dollar reserves, this created a permanent balance of payments shortfall for the United States. The United States did not coerce countries to hold dollars—it was simply the most reliable for trade. Increased U.S. Dollar reserves held by foreign countries simultaneously increased the demand for dollars, while also increasing trade deficits for the United States. The United States was unable to fix this dilemma since they could not devalue their currency to increase imports. Eventually, the supply of dollar reserves held abroad exceeded the U.S. stock of gold, implying that the United States could not maintain complete convertibility at the existing price of gold—a fact that would not go

unnoticed by foreign governments and currency speculators.<sup>5</sup> These actions set United States on a new trajectory from a creditor to a debtor nation.

This balance of payments shortfall for the United States worsened into the 1960s, as President Kennedy cut taxes and increased U.S. overseas troop commitments in Europe and Asia. Additionally, the U.S. was becoming the banker to the world, especially when it came to international payments. Countries that were invoicing in USD-earned interest on the USD assets, leading them to hold surpluses. They also knew they could convert to gold at any time, and they didn't want to hold dollars at the guaranteed \$35-per-ounce rate.

Furthermore, President John F. Kennedy proposed cutting the top tax rate from 91 percent to 70 percent, which he argued would "raise revenues in the long run."<sup>6</sup> This was enacted after his death by the Johnson administration, and it created a burst of economic growth. President Kennedy, a fierce anti-communist, along with his brother Robert Kennedy, who served on Joseph McCarthy's Senate subcommittee to root out domestic communists, put the first 16,000 U.S. troops in Vietnam.<sup>7</sup> The War in Vietnam and these other factors would set the stage for an inflationary environment into the Johnson and Nixon administrations, a loss of faith in U.S. currency, and a run-on U.S. gold reserves by foreign nations.



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By 1970, President Nixon faced the possibility that the entire Bretton Woods System would collapse. The cost of the Vietnam War and U.S. troops stationed abroad were creating inflation, while simultaneously, the U.S. was beginning to see increased unemployment. Japan and Germany manufacturing had become a global success story, and their exports had become more competitive with the U.S.<sup>8</sup> The result of this competition reduced U.S. output, and made the large supply of U.S. Dollars abroad susceptible to a redemption back into gold by foreign nations. Nixon



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attempted to stem inflation with price controls and gradual increases in wages, to no avail. This marked the beginning of a loss in confidence in the U.S. Dollar, as funds began to move into large European and Japanese banks abroad, because of higher Eurodollar rates and speculation that the United States would devalue their currency. The United States had been able to stem outflows of gold up to this point with currency swaps between nations, but a system built on the assumption of a strong U.S. Dollar could not hold up when it was weak. In May 1971, Germany's minister for economic affairs, Karl Schiller, ordered that the Deutschmark should float temporarily due to the U.S. global selloff, thereby removing themselves from Bretton Woods.<sup>9</sup> Consequently, the Swiss redeemed \$50 Million in gold and France sent a warship to New York harbor in early August 1971, with instructions to bring back \$191 Million in gold from the New York Federal Reserve Bank. It was, after all, French President Charles de Gaulle who remained consistently skeptical about the U.S. dollar, saying at a press conference on February 4, 1965, that it was impossible for the dollar to be "an impartial and international trade medium . . . . It is in fact a credit instrument reserved for one state only."<sup>10</sup> Ultimately, the final trigger that ended the gold standard came from the British Ambassador.

In the second week of August 1971, the Rowland Baring appeared before the United States Treasury and asked that

\$3 billion be converted into gold to act as "cover" for all their dollar assets.<sup>11</sup> Paul Volker, who would soon become Federal Reserve Chairman, was heavily involved in Nixon's Camp David talks. He offered, "If the British, who had founded the system with us, and who had fought so hard to defend their own currency, were going to take gold for their dollars, it was clear the game was indeed over".<sup>12</sup>

Finally, on August 15, 1971, to stem a further drain of gold reserves from the United States, Nixon ended the dollars convertibility to gold. The request by the British would have drained 25% of the nation's gold reserves at Fort Knox and opened the door for similar drawdowns. Although there was a brief try at pegging currencies again in December with the Smithsonian Agreement, it proved unsuccessful after two years. After this, the dollar floated against other major currencies, a move praised by most nations which had no major long-term effect on international transactions. Additionally, attempting to turn the tide on inflation, Nixon once again forced wage and price controls on the United States. Except



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President Richard Nixon prepares to address the nation on removing the dollar from the gold standard  
(Source Richard Nixon Foundation)<https://www.nixonfoundation.org/2014/08/challenge-peace-nixons-new-economic-policy/>



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during periods of global crisis, this was the first time in history that most of the monies of the industrialized world were on an irredeemable paper money standard.<sup>13</sup> While these events proved challenging to U.S. businesses, a much more difficult future economy would lie ahead. The resignation of President Nixon, the loss of the Vietnam War, and exploding inflation exacerbated by the Arab Oil Embargo would change the economic landscape into the next decade.

## Corporate Earnings

Wade Fowler, Senior Trust Portfolio Manager

Earnings season is here again, and expectations for year-over-year corporate earnings growth continues into the third quarter. According to FactSet, the third quarter of 2021 will see growth in S&P500 earnings of 27%. For the full calendar year 2021, earnings growth is expected to be 42% vs. 2020. Looking further down the road, analysts expect to see growth in earnings continue in 2022, albeit at a slower pace. The forecast for 2022 S&P500 earnings growth is currently 9%. While booming corporate profits are certainly the headline, expectations continue to build for an earnings season that will see some companies negatively impacted by the ongoing supply chain issues and labor shortages we have come to see as pervasive throughout the economy. In fact, many companies negatively impacted by the ongoing supply chain issues and labor shortages we have come to see as pervasive throughout the economy. In fact, many companies have already preannounced a negative impact related to these factors. For example, the Pittsburgh-based paint and coatings giant, PPG Industries, recently lowered revenue expectations 6% for the quarter citing raw material

inflation, supply chain and transportation problems that prevented them from meeting customer demand. On the labor shortage front, FedEx reported disappointing quarterly earnings September 21. The company missed expectations largely due to a shortage of available labor and much higher costs associated with overtime pay for its workers. Congestion at ports and rail yards also contributed to the difficult quarter for the company. While PPG and FDX had disappointing quarters, both companies announced 5% to 6% pricing increases to offset some of the increased costs they are experiencing. This theme is likely to run through many industries as we hear from corporate America in the weeks ahead. Any information provided from management teams related to the topics of inflation, labor supply and troubled supply chains will be of particular interest to investors because these issues remain some of the biggest areas of U.S. economic uncertainty.



Analysts expect to see growth in earnings continue in 2022, albeit at a slower pace.

## Technology Corner: FAANG & Friends—Love Them or Hate Them, They Are Here to Stay

Daniel Morgan, Senior Trust Portfolio Manager

Some of the largest technology companies with the most dominate market share have collectively been given a nickname by Wall Street pundits: FAANG & Friends, which is an acronym for Facebook, Amazon, Apple, Netflix or Microsoft & Google.

	Forward P/E	FY21 EPS-GAAP	EPS GR %	\$Market Cap
Facebook	26x	\$14.015	44.2%	\$1.057 Tn
Apple	26x	\$5.572	69.8%	\$2.465 Tn
Amazon	66x	\$52.56	24.9%	\$1.762 Tn
Microsoft	34x	\$7.63	8.8%	\$2.290 Tn
Google	28x	\$100.67	84.9%	\$1.929 Tn
Netflix	55x	\$10.45	72.3%	\$258.4 Bn
S&P 500 Index	22x	\$199.00	57.3%	\$38.2 Tn

FAANG

Source: Bloomberg Based on Fiscal Year 2021 EPS Growth Estimate Table Data as of September 15, 2021

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The six FAANG & Friends are now collectively worth about \$9.76 trillion. These top-six tech companies (by market cap), represent approximately one quarter of the S&P 500 Index's market cap (FAANG & Friends combined Market Cap \$9.76 trillion/S&P 500 Index Market Cap \$38.2 trillion) and approximately 40% of the NASDAQ Composite's market cap.

It is interesting to compare the FAANG & Friends stocks of today to the hottest tech stocks before the dot.com bubble burst in the Summer of 2000. At that time, Microsoft Corporation, Intel Inc., Cisco Systems Inc., and Dell Computer accounted for nearly 14% of the S&P 500's capitalization, leading analysts to dub the companies the "Four Horsemen". Although those stocks eventually stopped climbing together, the S&P 500 still powered to new highs. When we look at the large number of profitable tech/internet companies today as compared to before the dot.com bubble burst, the tech sector does not feel like 1999.

Returns of FAANG & Friends shares have been unstoppable since these companies went public, offering mind-boggling returns to investors who purchased shares at the time of the actual IPO. How have FAANG & Friends have performed since the companies started trading publicly on the NASDAQ? Facebook is up 800% (2012 IPO). Apple is up 35,726% (1980 IPO). Amazon is up 224,759% (1997 IPO). Netflix is up 55,228% (2002 IPO). Microsoft is up 72,340% (1986 IPO). Alphabet – up 6,497% (2004 IPO).

The six household names are plays on some of the hottest technology trends, including cloud computing, streaming media, 5G smart homes and artificial intelligence. Facebook (FB) dominates in online social networking and social media. Amazon.com (AMZN) rules the markets for e-commerce and cloud-computing infrastructure. Apple is one of the largest smartphone producers. Netflix (NFLX) has taken a huge lead in subscription video on demand. Microsoft dominates the desktop computing area. Finally, Alphabet's (GOOGL) Google is the king of internet search.

Like the popular 1970s advertising slogan for the children's toy the Weebles, Facebook wobbles, but they don't fall down. Despite the Cambridge Analytics breach, celebrity

deletions, antitrust investigations, advertiser boycotts and, more recently, the censorship of former President Trump, Facebook keeps delivering. Facebook has a diversified advertising base, as its top 100 clients only represent 10% of its advertising revenues, which helps cushion the blow of any Fortune 500 customer boycott. Furthermore, the company's increasing number of international subscribers and emerging platforms such as Messenger, Instagram and What's App, permit Facebook to continue to grow its advertising revenues at a rate of 30 to 40% year-over-year, as advertisers ramp up spend rates following last spring's Covid-19 shutdown.

While Apple derives most of its revenue from hardware such as iPhone, iPad and Mac computers, one growth driver of late has been its internet cloud-based services, which represents about 20% of the company's total revenues, including the App Store, iCloud, Apple Pay, Apple Music, Apple TV+ and Apple Arcade. Analysts will continue to focus on the growth of Apple's recent iPhone 5G phone and the halo effect that has created positive momentum in iPad, Mac and Wearables. The iPhone 13 product launch and new model assembly,

which is expected to start in the third quarter, should add legs to this Apple growth story. The total estimated iPhone unit shipments for fiscal year 2021 now stands at 230 million (versus 190 million in fiscal year 2020), which is an annual growth rate of 21% year-over-year. iPhone shipments are projected to reach 237 million units by fiscal year 2022, which is an annual growth rate of 3% year-over-year. This expected strength in iPhone sales provides evidence for "Apple Bulls"—meaning another iPhone super cycle maybe in the cards. The last major iPhone super cycle occurred with the iPhone 6 back in 2014.



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Market research company eMarketer has estimated that Amazon's share of the U.S. online retail now stands at 40.4% for 2021. For context, this is more than five times higher than its next closest competitor, Wal-Mart, which controls an estimated 7.1% of online retail.

Admittedly, retail doesn't offer the best margins, and Amazon knows it. Therefore, the company has been pushing Prime memberships, which come with perks like free/expedited shipping, and access to Amazon's streaming platform. The second source of dominance comes from cloud-infrastructure services. In 2020, Amazon Web Services (AWS) registered full-year sales growth of 30%. AWS has entered its 10th year and is growing impressively with more than 1 million active users per month.

Indeed, AWS commands much higher margins than Amazon's core on-line retail business, accounting for 50.2% of the company's total operating income while only representing 20% of its total revenues. Microsoft has transformed itself from the dominant desktop operating software company (Windows & Office) to a major cloud player. Microsoft's Intelligent Cloud unit, which contains Azure, Windows Server, SQL Server, Visual Studio, GitHub and Enterprise Services, is running on all cylinders. Azure is Microsoft's premiere cloud-based data center service. Azure growth has been in the mid-40% year-over-year range in previous quarters. Microsoft has been intensifying its focus on cloud verticalization and a Microsoft 365 sales motion to support the seat-based/SaaS Azure workloads (EMS). Microsoft isn't hurting for cash. It has around \$137.9 billion in cash and short-term investments in addition to the projected \$200 billion in operating cash flow that should be generated

over the next three years. What it plans to do with all this cash is a subject of some speculation. Microsoft has many options to enhance its position as a trusted enabler of the digital enterprise beyond Azure, Office 365, LinkedIn and GitHub. Investors can expect to hear more about Microsoft's big vision.

After blowout results for 2020 (Netflix posted new subscriber growth of 36.6 million new users), 2021 has been a completely different story. Netflix posted disappointing new subscriber growth for the first quarter (3.98 million subscribers) and second quarter (1.5 million subscribers). This has prompted analysts to backload new subscriber estimates for the second half of 2021, with a consensus now calling for new subscribers of 3.8 million in the third quarter and 8.0 million in the fourth quarter.

Although management has not stated that competition may be hurting new subscriber growth, a more competitive landscape has formed in 2021. A slew of new streamers has come into the marketplace, including HBO Max, Peacock, Discovery Plus, and Paramount Plus, which are now available on Roku/Amazon Fire TV. These new streaming services join Apple TV and Amazon Prime in what is becoming a crowded family room. The most likely outcome will be that consumers will subscribe to multiple services —



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as the streaming market will not be a zero-sum game — and that Netflix, Disney, Amazon and others will be successful.

In October 2015, Google restructured and placed its legacy business under an umbrella corporation called Alphabet Inc. Alphabet is now the parent company of Google, and subsidiaries like Chronicle, Verily and Waymo. Alphabet should continue to gain momentum, thanks to the strength of its core businesses. Google Search unit is worth an estimated \$1 trillion on a standalone basis, while YouTube is valued at around \$400 billion. In the fourth quarter of 2019, Alphabet broke out the value of YouTube's advertising empire. The YouTube advertising segment has been posting revenue growth between 50% to 60% year-over-year, giving evidence that there is power underneath the hood beyond Alphabet's core search franchise. Google's new disclosure has gone a long way to showcase the earnings power of the core search/advertising franchise that is posting operating income growth of 41%.

In the past five years, FAANG & Friends have produced profits significantly above expectations. Amazon and Microsoft have delivered double what was asked, leading

their shares to jump 4x and 3x, respectively. Based on the full year 2021 EPS consensus, the forecast for each stock — if we exclude the higher multiple names like Netflix at 55x earnings and Amazon at 66x earnings — the average P/E ratio drops to just 29x earnings.

Therefore, based on these calculations, the group does not seem as overvalued as one might think. For example, at the peak of the dot.com craze, the S&P Information Technology Index traded as high as 70x earnings. Today, the S&P Information Technology Index multiple stands at just 35.3x earnings.

Love them or hate them, it appears that FAANG & Friends are here to stay.



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#### Source Footnotes:

<sup>1</sup><https://www.guggenheimpartners.com/perspectives/global-cio-outlook/the-return-of-beggar-thy-neighbor>

<sup>2</sup><https://www.usnews.com/opinion/blogs/world-report/2014/06/06/the-lessons-from-us-aid-after-world-war-ii>

<sup>3</sup><https://www.thebalance.com/bretton-woods-system-and-1944-agreement-3306133>

<sup>4</sup><https://www.thebalance.com/bretton-woods-system-and-1944-agreement-3306133>

<sup>5</sup><https://www.federalreservehistory.org/essays/great-inflation#:~:text=Eventually%2C%20the%20supply%20of%20dollar,foreign%20governments%20and%20currency%20speculators.>

<sup>6</sup><https://www.heritage.org/taxes/commentary/what-jfk-could-teach-modern-democrats-about-taxing-the-rich>

<sup>7</sup><https://www.jfklibrary.org/learn/education/teachers/curricular-resources/high-school-curricular-resources/jfk-and-vietnam-the-september-1963-tv-interviews#:~:text=In%20May%201961%2C%20JFK%20authorized,military%20advisors%20in%20South%20Vietnam.>

<sup>8</sup><https://www.federalreservehistory.org/essays/gold-convertibility-ends>

<sup>9</sup><https://www.bundesbank.de/en/tasks/topics/1973-the-end-of-bretton-woods-when-exchange-rates-learned-to-float->

<sup>10</sup>[https://www.huffpost.com/entry/august-15-1971\\_b\\_4284327](https://www.huffpost.com/entry/august-15-1971_b_4284327)

<sup>11</sup><https://www.bullionstar.com/blogs/ronan-manly/british-requests-for-3-billion-in-us-treasury-gold-the-trigger-that-closed-the-gold-window/>

<sup>12</sup><https://www.bullionstar.com/blogs/ronan-manly/british-requests-for-3-billion-in-us-treasury-gold-the-trigger-that-closed-the-gold-window/>

<sup>13</sup><https://www.federalreservehistory.org/essays/great-inflation#:~:text=Eventually%2C%20the%20supply%20of%20dollar,foreign%20governments%20and%20currency%20speculators.>

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