Synovus Market Update

Financial Markets Q&A

APRIL/MAY 2020
Opinions by Robert E. Nobles and Dan Morgan

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Robert:

Will there be a quick recovery for the unemployed when businesses reopen?

We anticipate the unemployment rate moving up to around 15% with the March report and working down to 8% by the end of the second quarter. Three variables will determine the speed at which people return to work: 1) business volume expected by the business owner; 2) confidence workers have in safety measures upon returning to worksites; and 3) how much government stimulus vs. pay the worker will receive. For these reasons, we think the labor market will recover gradually. At the same time, consumer income levels will trend up as demand stabilizes and settles into a new post-pandemic level. It's likely businesses and consumers will be cautious with spending plans for large purchases as they try to recover lost revenues and wages.

What are your thoughts on varying state plans to reopen for businesses?

Vast amounts of economic activity have come to a standstill. Pressure from citizens and businesses to end the lockdown has risen to a level where political leaders are weighing health risks versus continued economic turmoil. Our economy depends on consumer spending, and 68% is driven by consumption. Thirty million people work in industries comprised of transportation, hotels and tourism, entertainment, restaurants, and retail. These businesses depend on customer contact and found it impossible to operate under an environment of government shutdowns. Revenues from online sales and takeout orders have not been able to cover overhead expenses, and it is uncertain if reopening and operating at less than previous capacity will be profitable. The burden of developing and enforcing safety measures will fall on local businesses. We believe the recovery will begin gradually, progress unevenly, and be subject to fear of recurring COVID-19 cases. As a result, consumer confidence will take time to return to a level of normalcy.

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Economic data points are dismal, so which factors are you focusing on that point to an economic recovery?

We are closely tracking several leading data points that will lead us to a turn in the economy:

- Weekly unemployment claims trending down week after week, signaling fewer workers becoming newly unemployed
- Corporate earnings no longer being reduced and corporations being willing to provide limited guidance instead of no guidance on second quarter activity
- Fixed income market stability and the shape of the yield curve steepening instead of flattening
- Oil prices reaching a floor supported by production cuts and increased demand from increased economic activity
- A compilation of weekly data on passenger travels, restaurant reservations, transportation, mortgage applications and retail sales
- Reopening of schools, universities, camps, and day-care facilities.

Where is the focus on selecting investments for portfolios?

We are focusing on a company's strength to survive and prosper over the long term. Our analysis includes liquidity reserves, the level of debt and maturity dates, strength of the balance sheet, and whether the company has durable competitive advantages. The process of determining the impact on certain industries while they are awaiting governmental aid relief is difficult. Better companies will have pricing power flexibility, which leads to staying power as demand returns over time. We believe economic conditions will lead to a new normal business environment, and certain industries will be fundamentally altered going forward. Long-term investors have faced many challenges in the financial markets and, in time, moved beyond them to find new opportunities as they surface. We are comfortable that current challenges will reward disciplined investors with opportunities on the other side and consumers will be cautious with spending plans for large purchases as they try to recover lost revenues and wages.

What would you underscore for investors?

Be patient. A long-term investment approach is key, as the markets will continue to exhibit volatility to daily news on COVID-19. Unknowns still exist about the recovery's progress, how much economic damage has occurred, and whether COVID-19 will continue to spread globally or return to the U.S. in the fall. We think stimulus measures undertaken by the Federal Reserve and Congress will provide a floor for the economy, but not every business will survive the crisis. Early adapters – those who embraced technology and implemented increased safety measures to generate sales – will benefit the most. Eventually, businesses and consumers will adjust to lifestyle changes, and the economy will recover over several years. Staying with your long-term asset allocation will lead to better returns in volatile markets.

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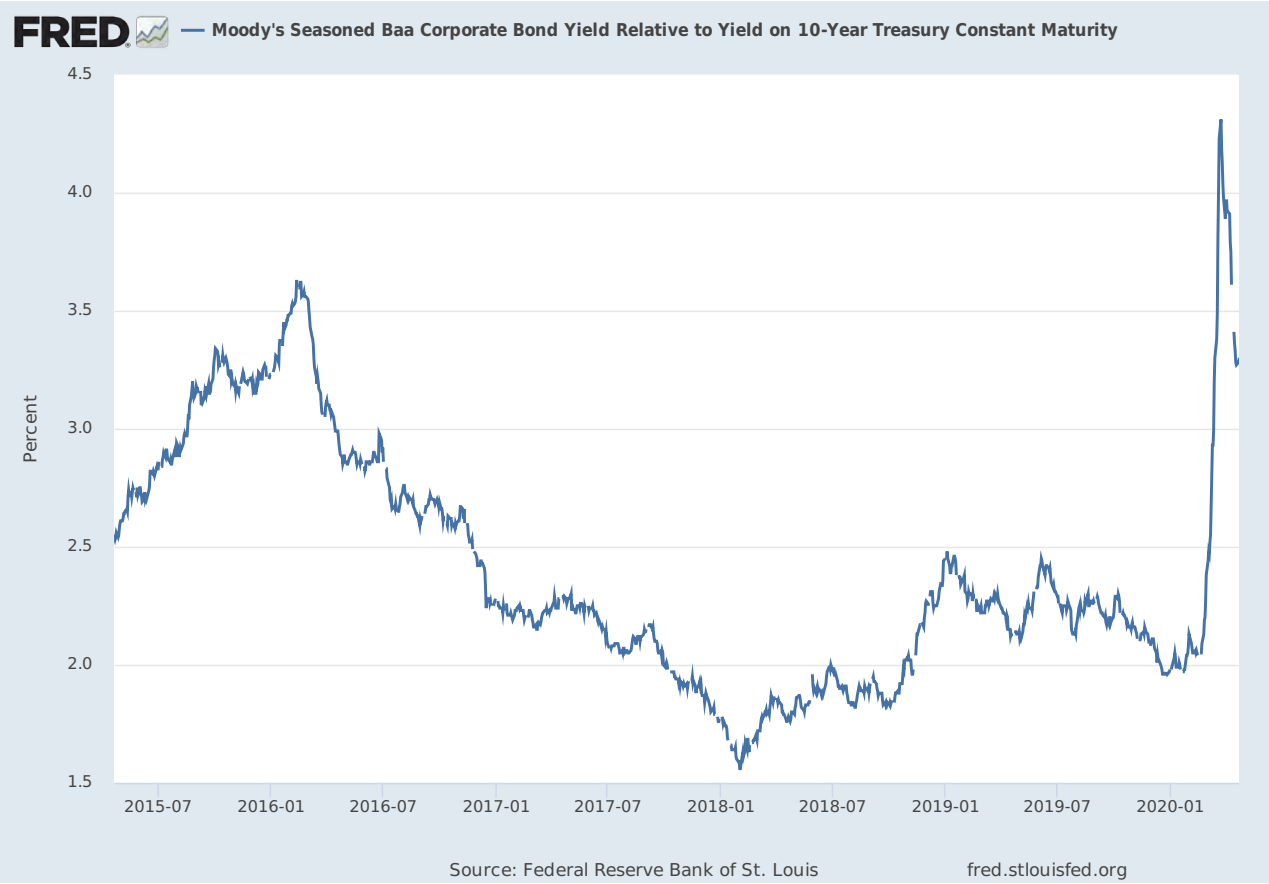
Dan:

What other market indicators are you closely following that can help Investors gauge when the current correction will end?

The market is looking for the number of COVID-19 cases to slow down. Studies from statisticians at Emory University say peak is late April. We're also looking at stocks bottoming as airlines, energy, and leisure sectors improve. Credit spreads have tightened to 329 basis points from over 400 basis points in March.



The small business community has been hit hard over the past month. What effect will the shutdown in business activity have on GDP for 2020 and into 2021?

Global GDP growth estimates have been slashed to -1.0%. We expect UE to move up to an 8.4% range, PCE to 1.0%, and fixed investments to go to -7.6%. Updated GDP estimates for first quarter are -3.1%. Second quarter is -26.0%, and third quarter is 9.0%. Fourth quarter should rebound around +6.4%. The U.S. Economy was in good shape when the virus began, increasing probability of a strong recovery in 2021 (we're estimating 3.8% growth).

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Is the stock market building a base for a solid recovery, or is this recent strength a blip on the screen?

Market recovery is expected to span coming quarters opposed to a V-shaped rebound. Based on current growth expectations, consensus estimate is that S&P 500 Index 2020 YOY EPS growth could drop by -16.75%, accompanied by an earnings trough in second quarter with S&P 500 Earnings dropping -31.74%, and followed by a sharp rebound of 22.65 YOY in 2021. Based on projected earnings of $160 times a 17.5 market multiple places the S&P 500 Index target at 2800.

With government stimuluses, do you expect this increase in deficit spending to cause future inflation, or even worse, stagflation?

The U.S. Treasury will be under pressure to finance the CARES Act of $2.2 trillion in deficit spending. The link between rising U.S. Treasury supply to fund deficits typically would cause rates to rise/inflation as more supply of UST bonds hits the markets and buyers require higher yields to compensate for more risk. However, the link between rising U.S. Treasury supply to fund deficits and rising rates is broken as foreign demand for USTs remains strong and international rates stay low.

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