

# Market & Economic Review Q1 2020

## Q4 2019 Review

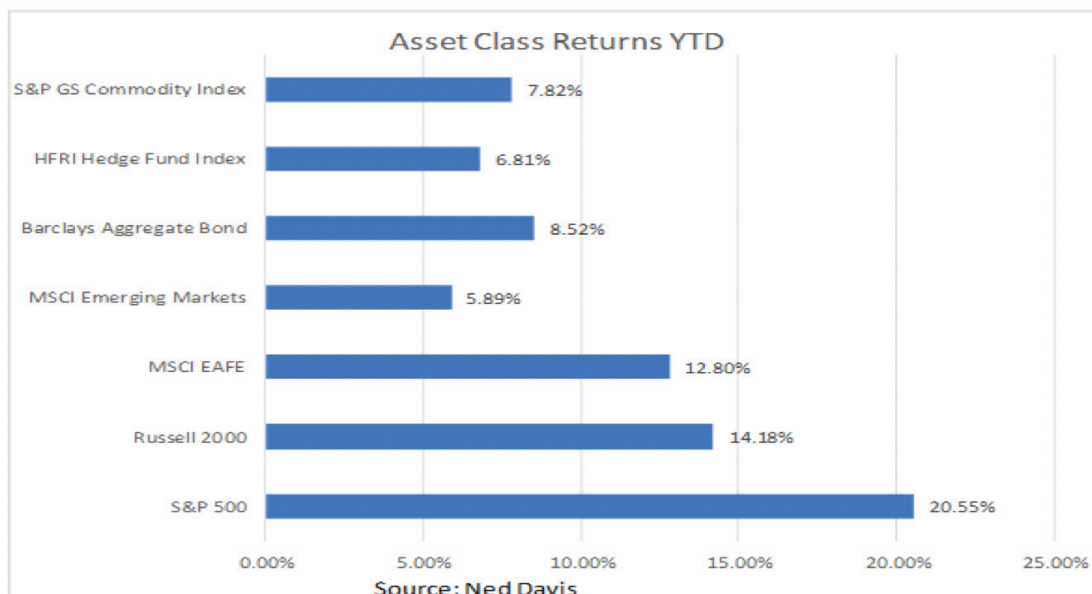
The year ended on a positive note as the negative sentiment of the previous quarter started to dissipate. While the manufacturing sector continued to stagnate with the previous uncertainty around trade, we did start to see a pickup in the non-manufacturing sectors of the economy. Continued strong employment and the increased likelihood of a trade deal with China increased risk taking as the S&P 500 returned over 9% during the quarter. The 10-year U.S. Treasury Bond finished the year at 1.92%, after bottoming out at 1.46% in October and the yield curve (10yr-2yr) started to re-steepen. Concerns of weakness in the global economy and a flight to safety by investors began to fade away as the Federal Reserve Bank likely reduced rates

enough to mitigate the uncertainty. With Central Banks back in easing mode, 2019 saw the broadest increase in asset classes in over 10 years (Source: Ned Davis Research). The S&P 500 led major markets with a gain of 31.4% and most bond indices were up 5% or more for the year. Even asset classes that have lagged over the past couple of years (Commodities and Hedge Funds) were up double digits.

## Economic Outlook

*"It's tough to make predictions, especially about the future."* - Yogi Berra

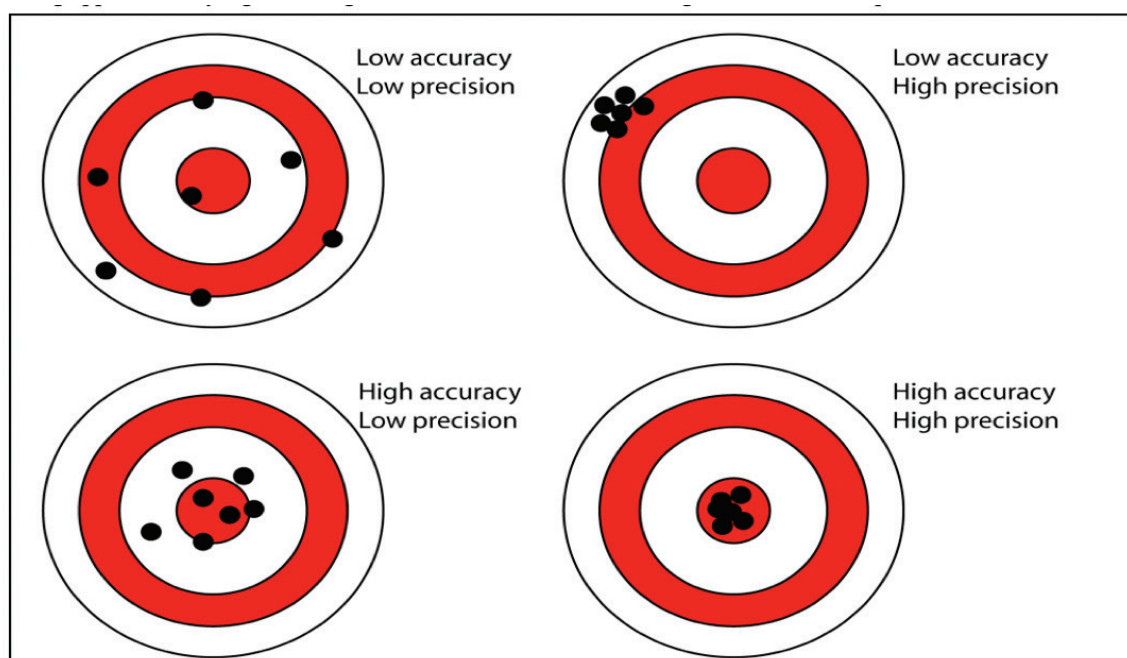
The time is upon us once again, where wall street strategists put out their forecasts for the



upcoming year. Some are entertaining, most are pretty boring and almost all will be wrong. According to research performed by The Economist magazine, GDP forecasts one year out are off by about .8%. If the current consensus for 2020 is for 1.8% GDP growth, then there is a good chance it could be 2.6% or 1%. The exception is a year before an actual recession, whereby estimates are off considerably more, as few actually predict a recession more than a year out. The accuracy of stock market forecasting is even worse. The New York Times references a study by Bespoke Investment Group that compared Wall Street consensus forecasts for the S&P 500 versus the actual level. The median forecast was off by 4.31 percentage points annually. The consensus averaged a 9.8% gain, while the market averaged a return of 5.5% between 2000 and 2019. Each year the consensus was for the S&P 500 to be higher, but it was actually lower in six of those years. If research proves that forecasts are not accurate,

how do we go about creating an economic outlook and for what purpose? To begin the answer to that question we offer another quote: *"It is better to be approximately right, than precisely wrong"* -Warren Buffet. We know that forecasts are precisely wrong, but we can benefit by being approximately right in the general direction or understanding how markets are priced based on consensus. (Source: <https://www.petewargent.com/2019/01/10/being-approximately-right-not-precisely-wrong/>)

In the chart below we see four bullseyes representing precision and accuracy. The top left would represent the unaware investor/forecaster who might be lucky every once in a while. The top right would be the experts who run complex models to arrive at a forecast that is precisely wrong. The bottom right represents a unicorn, that likely doesn't exist or is only accurate over a short period of time (maybe the guy in your golf group



Source: <https://www.petewargent.com/2019/01/10/being-approximately-right-not-precisely-wrong/>

that is always right). We would see this with world class marksmen or other areas where skill can be mastered, but not in the world of markets whereby hundreds or thousands of variables are always changing. The bottom left is where most would want to be. This target would represent getting the direction generally right, having good execution, and minimizing the miss. Our process ideally aligns with this.

The consensus for 2020 goes as follows: 1.) U.S.GDP growth around 1.8%, 2.) Inflation around 2%, 3.) 10-year U.S. Treasury yield around 2%, and 4.) S&P 500 up about 6%. We don't necessarily have a strong divergence from the consensus, but we do want to have an idea of what is priced in and how will markets react when new data is contrary to the consensus. For example, back in 2012 and 2013 after the 10-year hit 1.5% and then increased to 2.5%, the consensus was that rates were going to continue to move higher and owning a government bond at such a low rate was going to be a loser. Many investors moved out of those securities and into corporate bonds and high yield bonds. In 2018, even as the Fed was raising short term rates the consensus was that the 10-year would stay lower for longer and was worth buying at that same 2.5% yield. Being precise on the yield is not as important as being accurate on how investors will behave when the consensus starts to change.

Regardless of where the major economic/market statistics precisely fall, we think that the Fed will err on the side of leaving rates low and spurring some higher than expected inflation and asset valuation bubbles than erring on the side of cutting off growth by raising rates too quickly. We

see a consumer that remains strong, while small corporations continue to lever up and are more and more dependent on rates staying low. Global growth appears to be improving, but likely at a lower level than the past couple of years. Central banks globally are back to being in an easing mode, which tends to support growth and asset values. As we have mentioned previously, at some point the massive increase in debt worldwide won't translate into higher growth.

## Equities

We should have a stamp that reads "U.S. large cap stocks led". Once again U.S. large cap stocks led in 2019, while emerging markets outperformed during the quarter. With a total return of 31.5% the S&P 500 had it's best return since 2013 and second best return since 1999. Developed international markets outperformed emerging markets, which is unusual given that emerging markets tend to outperform in years when the S&P 500 is up double digits. The best sector in the S&P 500 was technology hardware (Apple... etc.) up 79%. The worst sector was Diversified Consumer Services (tax preparers and for profit education...etc.). Last quarter we pointed out the wide divergence between the best and worst sectors, and that spread continued to widen in the fourth quarter.

Many strategists are looking to add to international markets and specifically emerging markets coming into 2020. Compared to U.S equities and compared to their historical averages they look cheap. While they are cheap, they also don't have the same Return on Equity (ROE) as the more tech heavy U.S. markets. We are adding to emerging markets, but at the expense

of developed international exposure. We have been under-weight emerging market equities relative to developed international equities for some time and this move gets us more in line with our neutral position. Within our emerging market allocation, we prefer to be mostly active versus investing in the indices. As we mentioned in previous letters, emerging market indices are concentrated including exposure to China of around 33%. There are enough inefficiencies whereby a skillful manager can have a better chance of outperforming the benchmark. Looking at international markets versus U.S., we continue to see outperformance of U.S. markets led by a Federal Reserve who has indicated they are going to maintain loose monetary policy. We would want to see a clear change in momentum and relatively looser monetary policy by other Central Banks before we would make a meaningful move

toward international and away from U.S. equity exposure. We look to continue to push higher with active versus passive management as valuations continue to hit historical highs.

## Fixed Income

We saw a wild ride with interest rates in 2019. We started the year with Fed Funds at 2.5% and the 10-year U.S. Treasury at 2.68%. We ended the year with Fed Funds at 1.75%, and after touching a low of 1.5%, the 10-year ended the year at 1.92%. The Fed cut rates one more time in the fourth quarter and injected more liquidity into the system through Repo Operations. By year end the Fed had reversed the tightening environment of 2018 and has created an accommodative environment to keep asset levels from falling dramatically.

During the middle of 2019 there was concern that negative interest rate policies in Europe and

**2019 Top and Bottom Performing S&P 500 Industries**

S&P 500 Industry	2019 Return (%)	Sector
Technology Hardware, Storage & Peripherals	79.09	Information Technology
Personal Products	61.45	Consumer Staples
Construction Materials	53.39	Materials
Real Estate Management & Development	53.07	Real Estate
Semiconductors & Semiconductor Equipment	48.18	Information Technology
Software	45.64	Information Technology
Building Products	45.40	Industrials
Health Care Technology	39.95	Health Care
Auto Components	38.94	Consumer Discretionary
IT Services	<b>Top 10</b> 38.93	Information Technology
Automobiles	<b>Bottom 10</b> 14.02	Consumer Discretionary
Pharmaceuticals	11.99	Health Care
Diversified Financial Services	11.08	Financials
Communications Equipment	10.65	Information Technology
Airlines	10.19	Industrials
Air Freight & Logistics	9.30	Industrials
Oil, Gas & Consumable Fuels	7.80	Energy
Energy Equipment & Services	5.60	Energy
Wireless Telecommunication Services	-1.30	Communication Services
Diversified Consumer Services	-7.45	Consumer Discretionary
Cap-weighted, price only. Sources: NDR Multi-Cap Institutional (Universe), S&P Capital IQ and MSCI, Inc. (GICS)		
Ned Davis Research		T_BF20_01.2

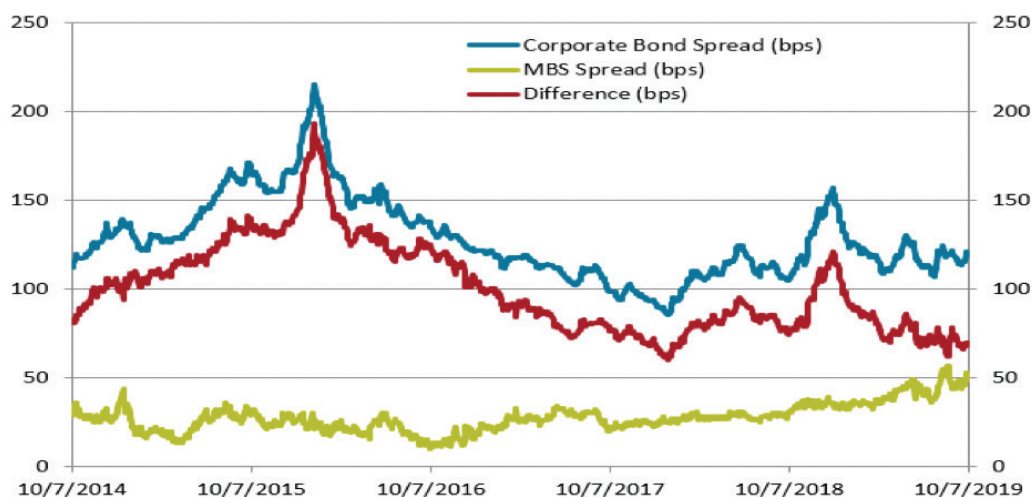
Japan were a possibility for the U.S. By year end even European Central Bankers were starting to question the long term viability of a negative interest rate environment. After briefly inverting, the yield between 3mo. and 10-yr. Treasuries resumed to a normal steepening. It is likely that the Fed has learned from Europe and Japan the structural damage of negative interest rates and won't go down that road. Interest rates in the U.S. are likely to stay low for the foreseeable future with stretches of volatility.

In the current low interest rate environment we continue to see the search for yield and its effect on riskier fixed income markets. The investment grade corporate and high yield bond markets have seen record low yields and spreads to Treasuries that are near historical lows. We have been buyers of shorter term quality corporate bonds and intermediate to longer term Municipal bonds. With the rally in short term corporates we have made the decision to look at mortgage backed securities (MBS) and TIPS (Treasury Inflation Protected Securities)

to complement our Municipal bond purchases. These two areas have not seen the purchasing flows that corporate bonds have and are at an attractive relative yield. Spreads between mortgage backed and corporate bonds have been at historically narrow levels while the underlying composition of investment grade corporate bonds has gotten riskier.

## Alternatives

In a year like 2019 it is easy to question exposure to alternative investments. Global stocks were up over 20% and bonds were up anywhere from 5%-8% on average. Hedge funds were up around 10%, while private equity was likely up low to mid-teens on an IRR basis. In a straight up equity bull market, alternatives will lag. In the past decade the best decision would have been just to invest in the S&P 500 and maybe some bond exposure to help reduce volatility. In today's environment we are in the later stages of a bull market and valuations on many metrics are significantly over valued. A concern we have with a traditional equity and fixed income



Source: JanusHenderson

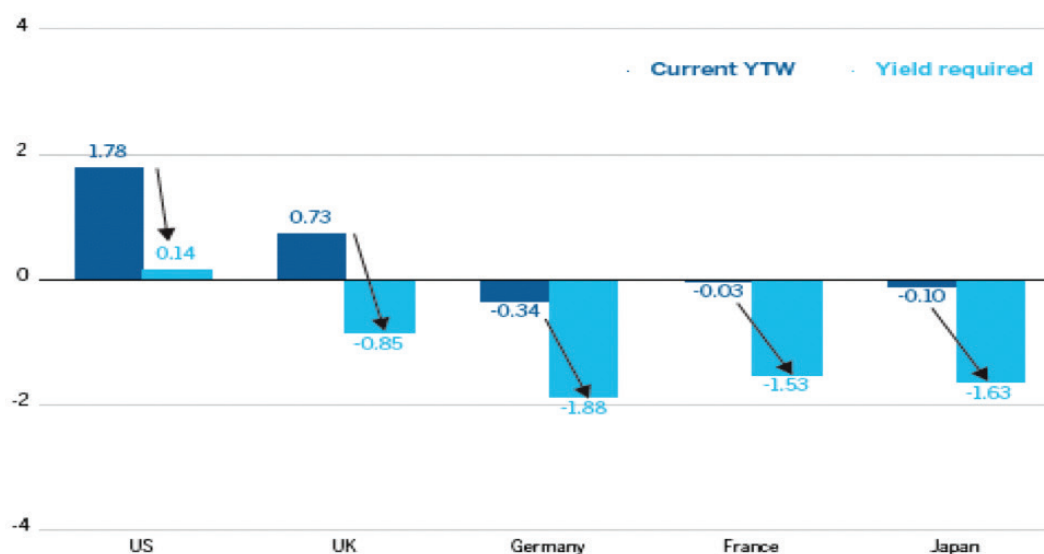


portfolio is, at these extreme valuations for both, there is likely going to be a bigger drawdown and more volatility during a market correction. The chart below shows what level interest rates on a 10-year government bond would need to go to in order to offset a 10% market correction.

In today's environment, on a conservative 60% equity and 40% bond portfolio, yields on the U.S. 10-year Treasury would need to fall to .14% to offset a 10% decline in the S&P 500 index. It is very likely that bonds won't rally like they would at higher yields. What seems like a conservative portfolio by historical standards is likely to decline more than investors are expecting. If bonds aren't providing the cushion that they did in the past, what is? We are looking to add to long/short equity and absolute return hedge fund exposure. In the later stages of the economic cycle long/short tends to outperform

long only equity indices and can hold up better in a major selloff. Absolute return strategies can compliment bond and stock allocations, but we seek not to make the mistake of classifying them as bond replacements. An increase in long/short exposure would come entirely from long only exposure while an increase to absolute return would come about 70% from equity and 30% from bond exposure. We continue to see new investors entering private equity and direct lending funds. While we see private equity as a good long-term investment, we have concerns with valuations in certain areas and that is where the new money is investing. As we have mentioned previously, we are staying away from direct lending except for those managers who have long-term experience and skill in working through a distressed cycle. Unfortunately, 90% of the managers raising capital in this space don't meet those qualifications.

The yield needed to offset a -10% equity drawdown in a hypothetical 60/40 portfolio (%)



Source: Wellington Management

## Current Positioning

- **Equity:** Favor Large Cap and U.S.
  - Favor Quality and GARP (Growth At a Reasonable Price) managers
  - Adding exposure to Emerging Markets away from Developed International
- **Fixed Income:** Quality bonds with average duration around 5 years
  - Shifting exposure from short term corporate to mortgage backed and TIPS
- **Alternatives:** Environment for Hedge Funds is improving we are slowly adding exposure
  - Private Equity exposure is increasing with focus on small-mid buyout funds and co-investments with small to mid-size funds
  - Adding to long/short exposure rebalancing from equities

## **The Family Office at Synovus Team**

Michael S. Sluder, Chief Investment Officer & Sr. Portfolio Manager  
Scott Bowen, Director of Portfolio Management  
Andrea R. Parker, Senior Portfolio Manager  
Zachary D. Farmer, Senior Portfolio Manager  
Comments and questions can be directed to [michaelsluder@synovus.com](mailto:michaelsluder@synovus.com)

## **Disclosures**

This report has been prepared from sources and data believed to be reliable but not guaranteed to or by Synovus Trust Company, N.A. (STC).

Opinions expressed are subject to change without notice. Synovus Trust Company, N.A. has prepared and presented this report for the sole usage of its clients as information and is neither an offer to sell nor a solicitation of an offer to buy any security.

Trust services for Synovus are provided by Synovus Trust Company, N.A. Synovus Family Office is a division of Synovus Trust Company, N.A. Investment products and services are not FDIC insured, are not deposits of or obligations of Synovus Bank, are not guaranteed by Synovus Bank, and involve investment risk, including possible loss of principal invested. Synovus Trust Company, N.A., its affiliates and its officers, directors and employees may from time to time acquire, hold, or sell securities, funds or asset classes that may be referenced herein.