The Family Office at Synovus

Market & Economic Review Q3 2020

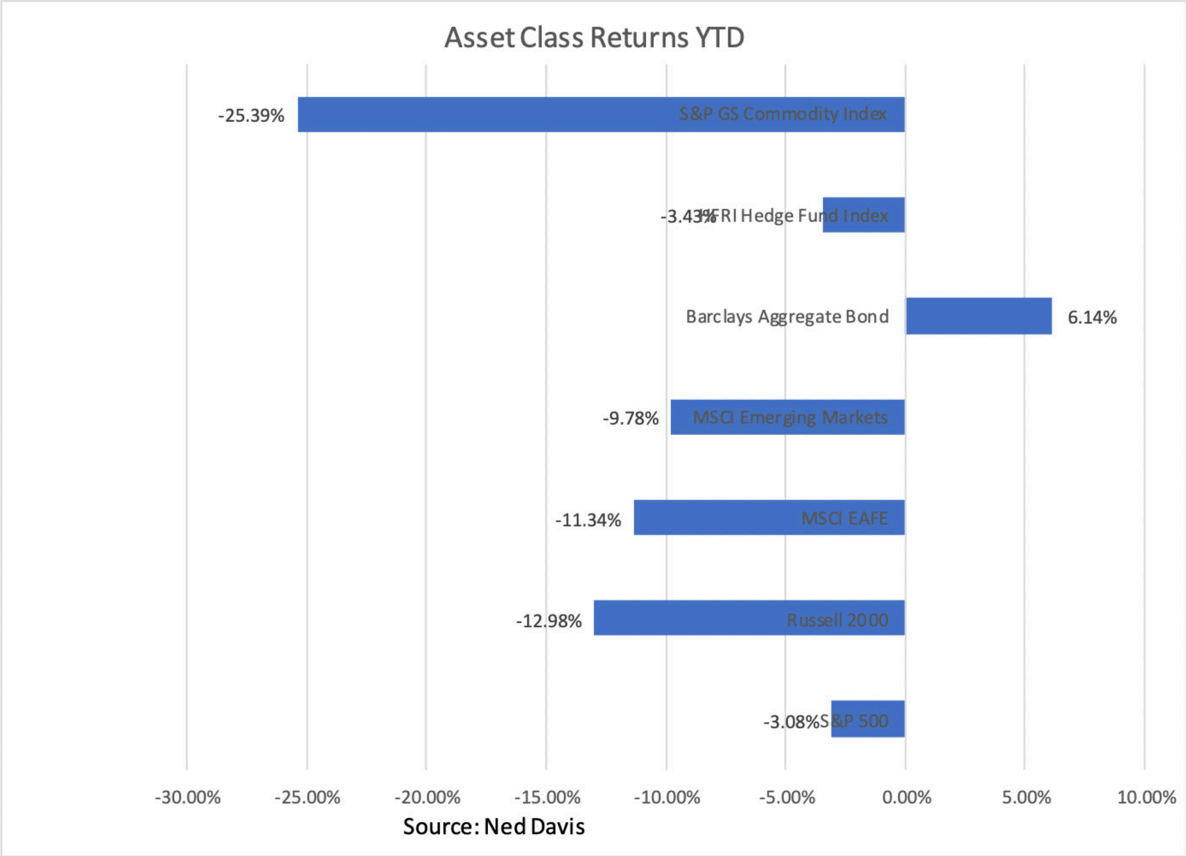
Q2 2020 Review

The 2nd quarter saw significant gains across major asset classes. The S&P 500 index rallied over 20% to make up most of the loss from the first quarter. While economic indicators were pointing to high unemployment and a 30% annualized decline in GDP, markets were pricing in improved treatment and possible vaccines for the COVID virus. Most of the gain in the quarter came in April and May. By June, the virus was starting to pickup in the Sunbelt states and re-opening of the economy began to slow down.

For the most part, Fiscal and Monetary policy worked well during the quarter. The CARES Act was able to provide generous unemployment benefits to laid off workers and PPP (Payment Protection Plan) bought some time for businesses to recover. Government benefits were high enough to prevent a major decline in overall consumer spending and to help with rent payments for a short period of time. Consumer staples and ecommerce held up well, while discretionary spending on travel, leisure, and big-ticket items took a major hit. Due to people being forced to stay home, the savings rate jumped to over 25% in the 2nd quarter. Policy seemed to be working regarding bridging the gap for when things would return to normal.

We wrote in last quarter's newsletter that dealing with the virus and the effects of social distancing would be vital to a return to normal. Unfortunately, the situation has not improved as much as many anticipated. The virus continues to spread and many businesses that were able to access PPP funds are running out of money. Expanded unemployment benefits run out at the end of July and no plan has been put in place to extend or modify going forward. While the perverse incentive of workers collecting more on unemployment than their job was a factor, it is not as big of a factor as benefits getting dramatically cut due to the economy not reopening fully. Transfer payments in the form of unemployment benefits are a good short-term tool, but it does not add to economic growth; it only keeps the contraction from being worse. In fact, it doesn't show up in how GDP is directly calculated.

The market's reaction to news has tended to be focused on the future with the possibility of a vaccine by year-end and better treatment pushing the fatality rate lower. Bad economic data in the 2nd quarter is a given and markets have looked through it. The most amazing trend we saw in the quarter was the shifting forward of revenue driven by online sales and technology. Many themes that



were thought to play out over 3-5 years have played out quickly in real time. Work from home has its own ecosystem of services that have benefited, as most items can be ordered online with the click of a mouse. Tech stocks continue to dominate a trend that has gone on longer than expected.

2nd half outlook

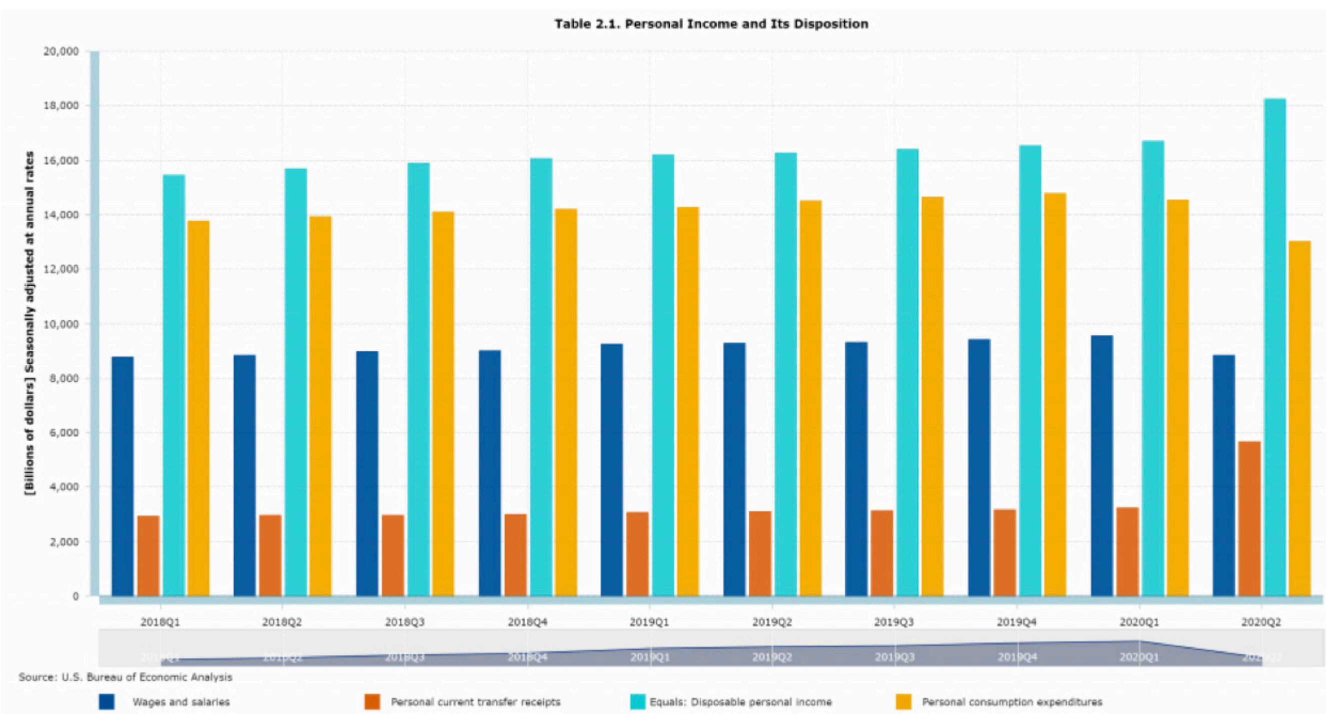
The massive amount of stimulus implemented in the first half of the year has helped to mitigate a major recession, by supplying liquidity to capital markets and offsetting lost wages from the shutdown. The primary goal of the plan was to bridge the gap from shutting down the economy to "Flatten the Curve" on the COVID outbreak. Expectations were that a short and sharp shutdown in the economy would be followed by a strong bounce back in the second half of the year. Unfortunately, the reopening of the economy has been affected by an increase in infections. The economic acceleration that was expected in the third quarter will likely be delayed as restaurants and the hospitality and travel industries continue to operate at 0% to 50% of pre-covid levels. The U.S. has yet to get virus transmission down to levels that would sustain a return to normal. The best case for a return to normal is a viable vaccine being available by year-end.

A key component of the stimulus package that was effective but is set to end at the end of July, was the expansion of unemployment insurance to $600 per week and the Payment Protection Plan (PPP) that helped small businesses to stay afloat as revenue fell off. As indicated in the chart below, the extra unemployment benefits (represented as personal transfer receipts) were more than enough to offset the loss in wages. While unemployment reached 11.2% at quarter-end (after touching 14.8% in April), the stimulus package was able to offset a dramatic economic contraction that we would normally see. Consumer staple sales were supported and rent payments were temporarily postponed and deferred. The big issue with the Great Financial Crisis (GFC) of 2008/2009 was the drying up of liquidity and dramatic increase in defaults. The Financial system is in much better shape coming into this crisis and the Federal Reserve has provided significant liquidity on the front-end.

At the end of July, the extra unemployment benefit comes to an end. As of late July, a deal to extend or modify has not been reached. The reopening of the economy has been delayed due to the continued spread of Covid. Some type of extension of unemployment benefits is still needed to bridge the now wider gap. Without a new plan, income will fall 2% below February levels by the end of August compared to being currently about 5% higher. We see the rebound in the economy being extended out further as full re-opening gets pushed out with increased flare ups in the Covid virus. A rebound in GDP in the 3rd quarter is likely to come in lower than previous estimates, and 4th quarter growth will be dependent on how well the virus can be slowed and how the new school year plays out. If schools are unable to have in class instruction on a wide scale, then that will trickle into slower economic growth.

Equities

Technology stocks led the quarter as the Nasdaq hit a new record in late June. Small cap and mid cap stocks outperformed large cap stocks



during the quarter, but still lag considerably for the year. Growth continues to dominate as it outperformed value by the largest margin on record for the first half of the year. U.S. stocks continued to lead international with emerging markets gaining momentum in June. Technology and Consumer Discretionary(mostly ecommerce stocks like Amazon) led the quarter and remain in positive territory for the year. We have continued to see divergences between the winners and the losers. Larger well capitalized companies that are innovative are thriving, while smaller companies with leveraged balance sheets continue to lag behind. Technology and consumer discretionary are broad sector descriptions, but the themes driving their strong performance is pretty narrow. COVID19 has been an accelerator in regards to market adoption of work from home/anywhere and ecommerce. With that comes an ecosystem of companies to facilitate the delivery of those services. For example, the ability to work from home/anywhere takes multiple services in the background to safely access a company's system. Here are a few examples: 1.) Security: Okta, Crowdstrike 2.) Virtual Desktop: Citrix, Twilio 3.)Virtual meetings: Zoom, Webex, and 4.) Collaboration: Slack, Dropbox. The pickup in ecommerce from physical retail has benefited companies as well: Amazon, Shopify, GrubHub, Ebay, etc. On the other end of the spectrum we continue to see bankruptcy filings by established brands with a physical presence such as: JCPenney, Neiman Marcus, JCrew, Brooks Brothers, Pier 1, and Chuck E. Cheese (every parent's favorite). The first set of companies are asset light and plow most of their cash flow back into growth and innovation. The second set of companies have more tangible assets and a large physical footprint. While COVID helped push them into bankruptcy, most were already on their way. This list also represents the dynamic of growth versus value. The technology names don't fit into the traditional core or value equity managers portfolio due to having much in the way of tangible assets or in many cases profitability. Companies with traditional margins of safety (Assets, Real Estate, Earnings) have not been immune to avoiding secular declines. The challenge today is deciding whether to own a company's stock that will likely not be profitable for many years, but has significant growth potential, or those that have been left behind that have flat to slow growth but looks cheap based on historical metrics. We tend to think that you have to buy both, but selectively.

Our active managers as a whole continue to do well in this environment especially our growth and small/mid cap managers. Large cap core has been a struggle due to a value tilt, but not too far off of the benchmark. Within emerging markets we have seen significant outperformance with our growth manager and slight underperformance from our value oriented manager. All in, our equity models are ahead of the global benchmark year-to-date. Going forward we are looking to add to international growth including emerging markets. While growth in developed markets is not likely to be faster than in the U.S., valuations are cheaper and money is starting to flow into those markets.

Fixed Income

After considerable volatility in the first quarter, fixed income markets were down right boring. The 10-Year U.S. Government bond started the quarter around .65% and ended just below that level. The massive amount of stimulus and Federal Reserve action significantly reduced risk and increased liquidity. With that, we get low volatility. The chart below shows the MOVE Index (Merrill Lynch Option Volatility Estimate) which is the bond market equivalent of the VIX. We saw an extreme pickup in volatility in March as corporations began to search for liquidity in anticipation of the economy getting hit from COVID. The MOVE Index went from around 60 to over 160. As the Fed intervened, the index moved back down to the same level as in February. By the end of the quarter the index was at its lowest level of the year. We continued to see corporate and high yield bond spreads narrow for most of the quarter as risk assets were supported by Fed action. While rates are likely to stay low for the rest of the year, there is more talk around inflation and the massive amount of debt that has been taken on in the U.S. We continue to keep our bond allocations around 4-6 years, trying to balance yield and interest rate risk.

Alternatives

As we mentioned in the last newsletter, hedge funds have provided nice diversification benefits reducing volatility in our investment portfolios. With volatility around earnings and dispersion amongst industries, our managers are seeing the best opportunity to provide alpha in a very long time. Within private equity we have mostly seen positive to neutral marks during Covid. Those that are stable to growing tend to be in the technology or ecommerce space. A few investments related to hospitality and energy are being marked down. Our co-investment opportunities continue to pickup and we have a great pipeline of managers that we have identified for our next private equity vehicle.

Current Positioning

- **Equity:** Favor Large Cap and U.S. Favor Quality and GARP (Growth At a Reasonable Price) managers
  - Adding to active management within our small/mid and international exposure

- **Fixed Income:** Quality bonds with average duration around 5 years
  - Core municipal and investment grade corporate bond allocation

- **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. Looking at secondaries and distressed
  - Adding to long/short exposure rebalancing from equities

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