SYNOVUS® FAMILY ASSET MANAGEMENT

MARKET COMMENTARY

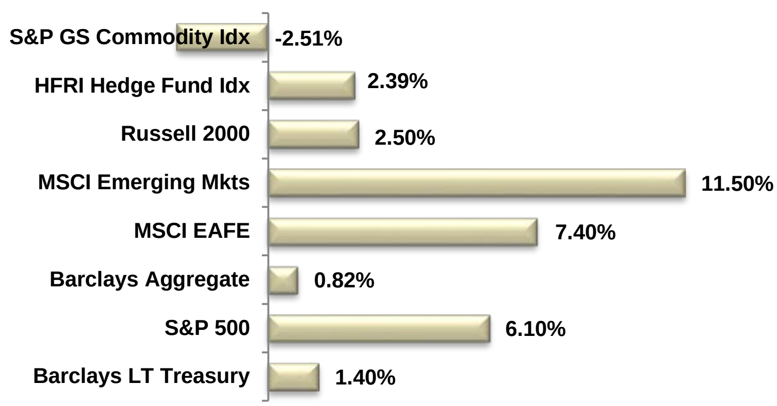
MARKET & ECONOMIC REVIEW

Second Quarter 2017

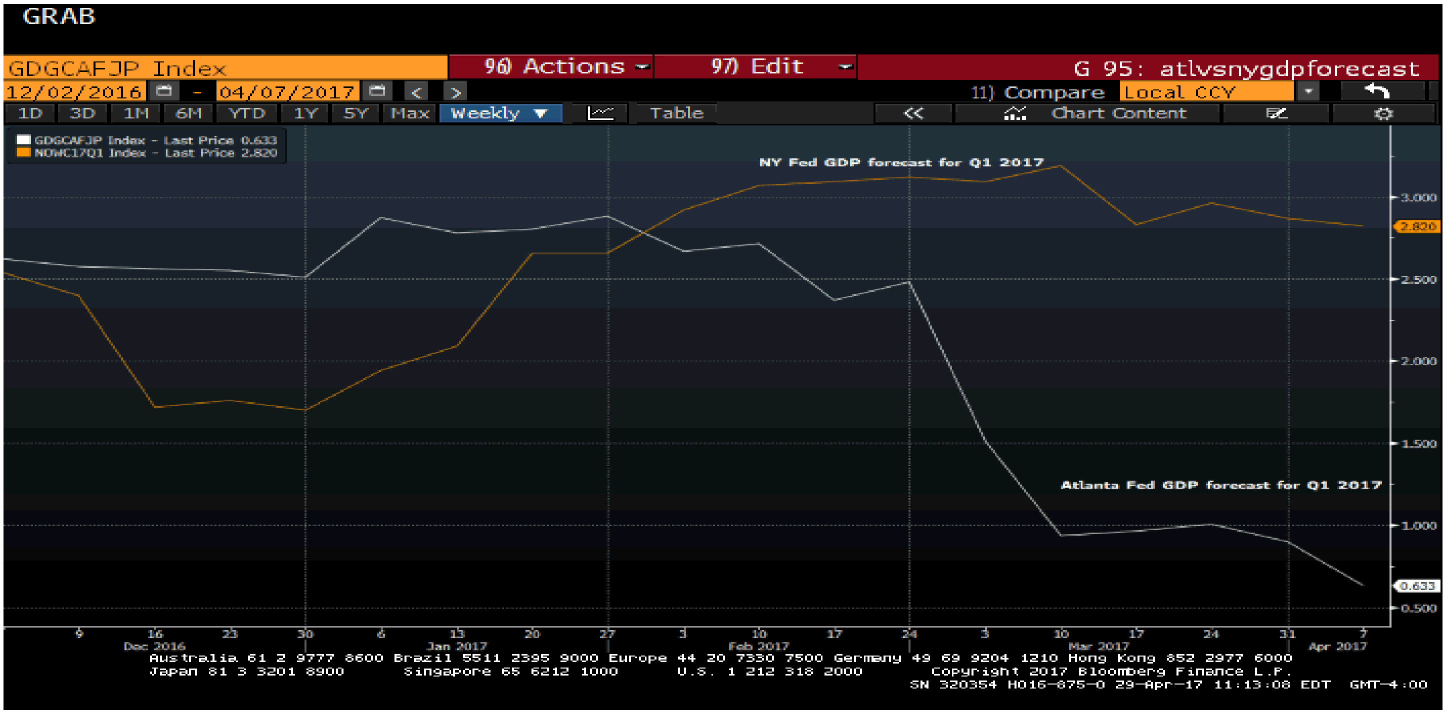
Q1 2017 Review

During the first quarter we saw continual strength in sentiment from the election of President Trump, but we have yet to see that sentiment translate into strong economic data. The equity markets continued to rally through February, but began to stall as policy implementation looked harder to achieve. The promise to repeal and replace Obamacare proved more difficult to pass. Without the tax savings involved in Obamacare repeal, the tax cut proposal also got postponed. The markets slowly began to discount in less optimism, but were still buoyed by likely roll backs in regulation and a push to help U.S. based manufacturers compete better with those overseas. We are currently seeing a very large divergence in what has been termed “soft” economic data versus “hard” data. Soft data is primarily composed of sentiment indicators such as the University of Michigan Consumer Confidence survey and the NFIB Small Business survey. Across the board, small business owners and even larger manufacturers are as upbeat as they have been since 2010. The hard data, which would include GDP and Retail Sales, have not participated as of yet in the enthusiasm. Another interesting statistic where we see the divergence is in the Atlanta and New York Fed real time forecast for GDP(Chart below). The Atlanta Fed forecast is more heavily weighted to hard data while the New York Fed is weighted more towards soft data. The Atlanta forecast for first quarter GDP is .6% while the New York forecast is 2.8%. It remains to be seen if sentiment can translate into actual economic growth. What we have seen in the past, is that sentiment can turn very quickly if the growth doesn’t show up. We are likely to see a reversion back to a level of improved economic growth and a pull back in sentiment, as the real life policies out of Washington begin to take shape.

Asset Class Returns, Q1 2017



Source: NDR



Source: Bloomberg

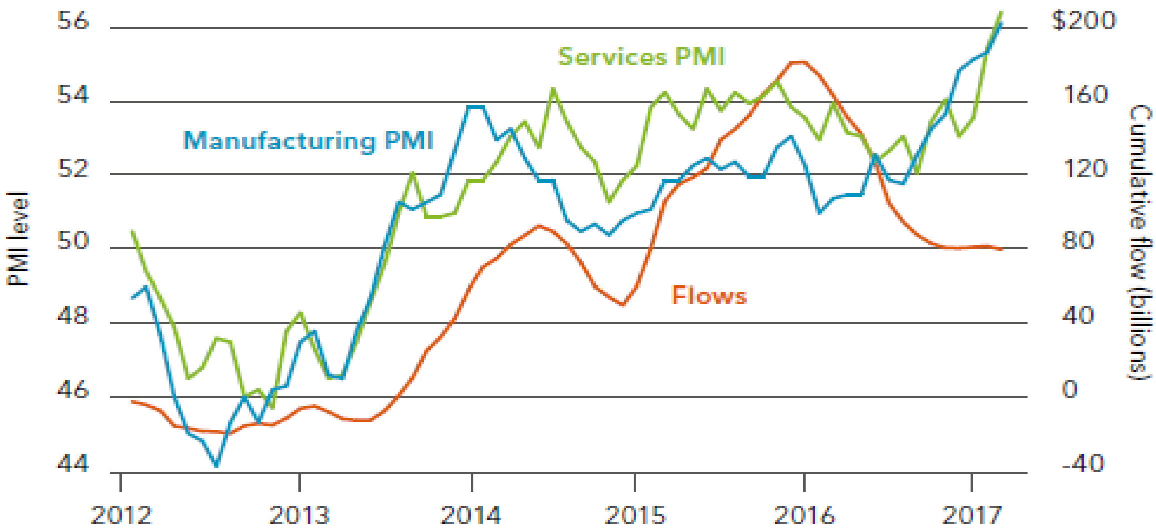
Equities

The first quarter was one of the best quarters for the S&P 500 in the past 15 years, finishing up with a total return of 6.1%. We also saw the end of one of the least volatile periods for the index, as there was no day down over 1% for 109 consecutive days(longest in over 20 years). The quarter saw a switch in leadership from 2016, as growth came back into favor and large caps outperformed small caps. The overseas markets produced better returns as developed markets were up 7.4% while emerging markets were up 11.5%. Much of this was a catch up from the fourth quarter and the tempering of fears that President Trump's policies would hurt free trade. The dollar was weaker, which translates into better returns for U.S. investors investing overseas. Within the U.S., Technology stocks were the big winner, while Energy stocks declined the most. We also saw Financials underperform while Health Care bounced back. This switch is likely due to the belief of continued scarcity in growth. In a strong cyclical up market, value stocks would continue to outperform, while in a tepid economic environment investors are willing to pay up for growth. In 2016, value started to make a run (especially after the election) but has stalled as the economic data has yet to pick up.

We have started to add additional exposure to international markets, as the fundamentals look to be improving and the valuations are not as extreme as in the U.S. In Europe, we have not seen the massive amount of capital inflows as in the U.S.(chart below), as cumulative flows in the past year are down while growth indicators have picked up. We saw a continuation of active management start to come back into favor early in the quarter, but as value began to underperform value the trend started to slow down. We will continue to monitor the environment and wait until conditions are favorable to add to active relative to passive.

European disconnect

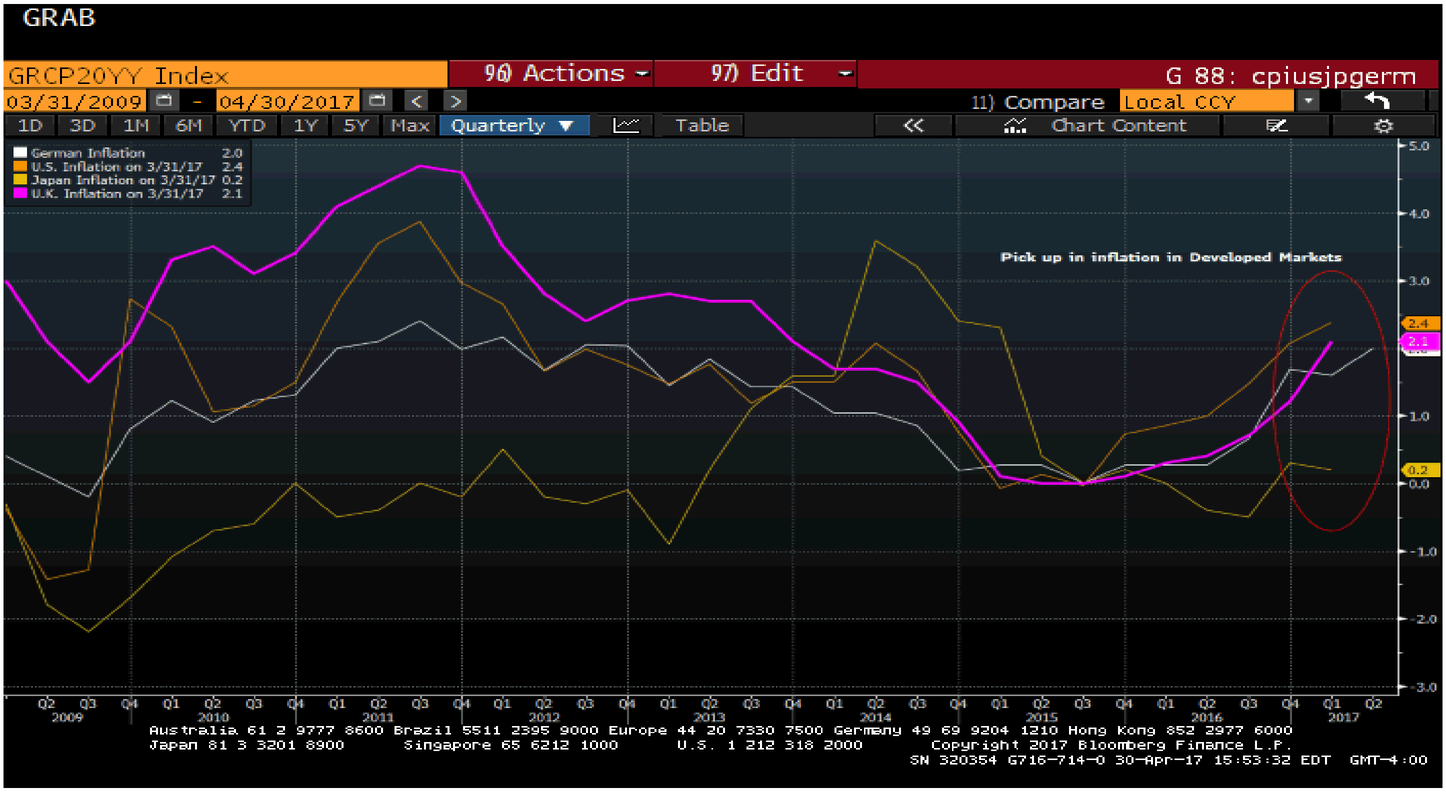
Eurozone PMIs and Europe ex-UK equity flows, 2012-2017



Sources: BlackRock Investment Institute, Markit and EPFR, March 2017.
Notes: PMI stands for purchasing managers' index. A level above 50 indicates expansion. Flows are cumulative net investments into equity funds.

Fixed Income

While the Fed raised rates in mid December and March for a combined 50 b.p.'s, the 10 year Treasury finished the quarter about where it started the year at 2.4%. The result was a flattening of the yield curve as expectations had begun to taper off after the President took office. We began to see the U.S. and Europe post inflation numbers in the 2% range, while Japan turned slightly positive. While the U.S. seems to be growing at a rate slower than expected, Europe is growing a bit faster than expected. Where rates were negative in Germany and Japan for much of 2016, today the 10 year for each country has a positive yield. The Fed has indicated that they are looking to target inflation over 2%, so just reaching that target will not lead them to tighten too quickly. We believe we will likely see only one more rate hike for the year and the longer end of the curve will start to move slowly higher. It is not quite time yet for the economy to be able to support normalized interest rates. On the Credit side we prefer quality oriented investment grade bonds. As we wrote in the last letter, there is a risk that a new tax proposal would eliminate the deduction of interest expense for corporations, which would punish low quality higher levered companies. We maintain our less than benchmark duration on bond portfolios, but see less likelihood of rates spiking dramatically anytime soon.



Source: Bloomberg

Alternatives

During the quarter continued to see flows out of hedge funds as the preliminary numbers show about $5bn of negative flows. What has changed is that smaller funds are doing a better job of attracting capital than large funds. With Equities and Bonds in the overvalued range, hedge fund strategies with lower correlations can provide good diversification within a portfolio. We continue to evaluate these types of strategies and will add them to our hedge fund portfolios. The two areas within private equity we have focused on include Mezzanine and Secondaries. Mezzanine is attractive as middle market companies should benefit from the easing of regulation and tax cuts that will likely target businesses. We want to be higher up in the cap structure, as equity is at historically high valuations and the risk reward is better. Within Secondaries there is opportunity with continued hedge fund redemption and private equity funds that are beyond their stated life. Both present opportunity to buy in at significant discounts.

Conclusion

Markets have continued to trade up on the positive expectations of President Trump's policy announcements, but eventually we need to see some execution to justify current values. The Fed will likely raise rates one additional time this year and then determine if the economy is vital enough to take additional normalization in interest rates. In Europe, it appears the populist wave has slowed, and stability should allow for markets to catch back up relative to the U.S. We continue to see the need to be more diversified as Central Bank policies have begun to diverge and winners will be sorted out from the losers.

SYNOVUS® FAMILY ASSET MANAGEMENT

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