SYNOVUS®

Family Asset Management

MARKET COMMENTARY

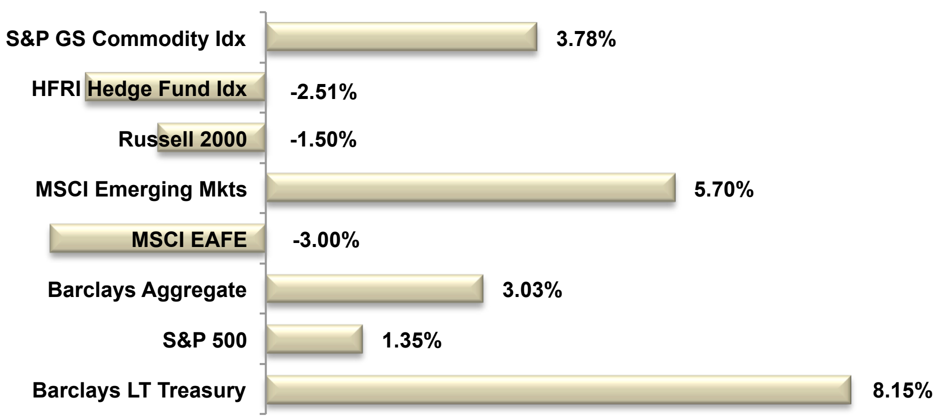
Market & Economic Review

Second Quarter 2016

First Quarter Review

The S&P 500 ended the quarter up 1.35% while experiencing significant volatility. The market experienced the worst January in the history of the index, bottoming out with a 10.3% drawdown by February 11th and then rallying significantly until quarter end. The volatility in energy prices and the talk of negative interest rates were the key drivers. Bonds rallied as the belief that the Fed was actually going to raise rates four times during the year began to quickly fade; markets began to price in the likelihood that it will only be increased one or two more times in 2016.

Asset Class Returns, 1Q 2016



Source: NDR

Coming into the year many investors continued being long the dollar and short the yen and euro. It made logical sense considering that the U.S. began to raise rates while Japan and the EU were maintaining a more loose policy. What most failed to take into account was the continued shortage of dollars and some unusual distortions in the currency and fixed income markets. The Bank of Japan set a rate of negative -0.1% on excess bank reserves on January 28th. This was intended to get banks to lend money out rather than sit on it. What followed was a quick rally in short term Japanese government bonds to yield close to the -0.1% rate as banks sought to pay the lowest penalty on their reserves.

An anomaly has also arisen whereby a U.S. investor can swap dollars for Yen and receive a premium which would be 80 bps better than buying a 5-Year Treasury. In fact, Japan has had the most foreign purchases of JGB's in over 15 years, despite negative yields. On March 10th, the ECB unveiled a package of policy measures which included the purchases of corporate bonds. The Euro just like the Yen did the opposite of what most would expect and strengthened over 4% in the following days. Both events are of extreme importance because it is becoming apparent that central banks are having a more difficult time getting the result they want.

Source: Bloomberg

Equities

In the first quarter value, defensive, and high yield equities significantly outperformed growth and momentum. There was a big shift in market leadership as the high-flying FANG's were off -4% while defensive equity was up 6.7%. Dispersion increased within the S&P 500 with 8 out of 10 major sectors ahead of the benchmark overall. Telecom and Utilities led; up 16.6% and 15.5% while Financials and Healthcare were down -5% and -5.5% for the quarter. Globally Emerging Markets led while Europe and Japan lagged behind. A weakening dollar and a bounce back in commodity prices were a tailwind for emerging markets, while Europe and Japan suffered due to skepticism on how much further monetary policy can continue to push markets.

The market has begun to become more attractive for active management because dispersion has widened and correlation between stocks has gone down. A good stock picker should have better odds in this environment as the market is not being led by just a few names (as it was in 2015). Oddly enough Bank of America came out with research showing that just 19% of equity funds beat the S&P 500 in the first quarter. This is the lowest number since 1998. Our experience was much different as we had the best quarter of relative performance in about 5 years. The managers that were ahead were well ahead, and the others were within basis points of their respective benchmark. Coming into the year we were positioned for value and quality names to outperform, which hurt us in 2015. Going forward if we see energy and financials move higher we will start overweighting value relative to growth. In early March we made the decision to add exposure to emerging markets and developed international markets. We are beginning to become concerned with valuations in high dividend paying stocks. The low interest rate environment has made it a very popular place to be, but valuations and the prospect of higher rates down the road make us cautious. We still prefer the dividend growers, who have consistently increased their dividend, but are not the highest yielders.

Source: Bloomberg

Fixed Income

With sustained lower rates overseas, U.S. Treasuries continued to rally. Long-term U.S. Treasuries returned over 8% for the quarter, and corporate and high yield were both up around 3.3%. Municipals were up modestly but could not keep up with the liquidity pouring into government debt. As stated earlier, Japan and Europe have implemented negative interest rate policies, which have kept U.S. rates low. We continue to be cautious in purchasing bonds, as the risks continue to increase. For example, nearly one-third of global government bonds are trading with negative yields, and investors have pushed corporate bonds to record low yields.

Our concern is that holders of debt are completely different than in the past as governments and central banks are not buying for investment reasons, but for monetary policy reasons. We worry that in the future there could be very significant volatility for what most believe is a low-risk investment. For example, the duration on global bond indices has increased from 6 to 8 years within past 10 years, and the average corporate bond yield in Europe is around 1%. A quick return to what were considered low rates just 5 years ago could result in a 20% mark-to-market loss in a bond portfolio. We seek to mitigate the risk by investing in individual, high quality corporate and municipal bonds as a core strategy while maintaining a duration slightly below the index. We also invest tactically in structured credit, floating rate securities, and other diversifiers. We aren't advocating that rates will rise dramatically anytime soon, but that the odds of it happening are much higher than investors have priced in, and we want to diversify away some of the risk.

Alternatives

Within Absolute Return strategies, managers came into the year long the dollar and short commodities. It took them awhile to adjust and most did not manage to earn a positive return in the first quarter as the HFRI FOF index was down -2.5%. Long/Short held up relatively well especially during January but was down -1.2% for the quarter. Our managers did a little bit better job during the quarter, and most of our Long/Short managers completely recovered losses from January and February. In March and thus far in April, managers have had better performance as value and small cap stocks have begun to rally. In Private Equity we have found good opportunities to invest in distressed strategies focusing on European bank loans, commercial mortgage backed securities, and energy. We believe this is an area where we can provide good value and better relative returns.

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Disclosures