WHERE WE STAND

FEDERAL RESERVE ANNOUNCES TAPER

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TOM WALD, CFA®

Chief Investment Officer, Transamerica Asset Management, Inc.

The Federal Reserve formally signaled the end of its peak accommodation cycle when, following its November meeting, it announced a reduction in open market asset purchases at an initial monthly pace of $15 billion. This asset purchase taper was widely expected and with its official implementation slated for later this month, markets have begun focusing on when actual rate hikes might occur.

With this in mind, we believe investors should take into account the following:

- Since March of 2020 the Fed has been purchasing Treasury bonds and agency mortgage-backed securities at a combined monthly pace of $120 billion. Assuming the Fed's monthly reductions continue to increase at $15 billion monthly, this will reduce its bond buying to zero by mid-year 2022.
- Following the expected conclusion of tapering in July 2022, we believe the Fed is likely to begin raising the target range on the federal funds rate, which is currently at 0%–0.25%. In our judgment, the probabilities are high we could see two rate hikes by the Fed in 2H 2022, concluding the year with a new target range of 0.50%–0.75%.
- In our opinion, it will be necessary for the Fed to sufficiently combat inflation with rate hikes in the year ahead. With indexes such as the consumer price index and personal consumption expenditures price index reflecting annualized rates of inflation not seen in more than 30 years, the Fed will likely find raising rates necessary to sufficiently control inflation that could remain persistent through the first half of 2022.
- We believe in the year ahead markets will likely look for the Fed to shift emphasis away from accommodation and toward more aggressive inflation-fighting policy. For this reason, we do not see the Fed's tapering of asset purchases or potential rate hikes as necessarily being a threat to the markets.
- Long-term interest rates are likely to continue rising, as we see the 10-year Treasury bond yield challenging 2% by the early months of 2022. Although this rate level on the 10-year bond would represent a meaningful increase from last year's record-low yields, we would still view it as potentially favorable for the markets based on long-term historical comparisons.
- The November 5 nonfarms payrolls report exceeded expectations, adding 531,000 jobs to the economy for the month of October as well as substantial positive revisions of 235,000 for August and September. While recent job reports have been volatile and inconsistent, an established trend of this magnitude would increase the probability of 2H 2022 Fed rate hikes.

While the historically unprecedented accommodative monetary policy of the past 20 months will soon be in the rearview mirror, we would still view more inflation-focused Fed policy over the upcoming year to likely remain basically market friendly by historical standards, particularly in the event corporate earnings growth for equities remains strong.

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THOMAS R. WALD, CFA®

CHIEF INVESTMENT OFFICER
TRANSAMERICA ASSET MANAGEMENT, INC.

Tom oversees investment and mutual fund development and the sub-adviser selection process. He heads Transamerica's investment thought leadership with advisors, clients, and media. Tom has more than 30 years of investment experience and has managed large mutual funds and sub-advised separate account portfolios. Tom holds a bachelor's degree in political science from Tulane University and an MBA in finance from the Wharton School at the University of Pennsylvania.

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1801 California Street, Suite 5200, Denver, CO 80202, USA

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