



WHERE WE STAND

CURRENT MARKET
UNCERTAINTIES

FEBRUARY 7, 2022

TOM WALD, CFA®

Chief Investment Officer,
Transamerica Asset
Management, Inc.

So far this year, markets have already seen a full-fledged, double-digit correction for almost all major stock indexes, and we expect volatility to continue throughout 1H22 as various investor concerns and market uncertainties play out in the months ahead. These uncertainties have included inflation, COVID-19, Federal Reserve policy, macroeconomic trends, corporate earnings growth, and concerns of a Russian invasion of Ukraine.

Our perspectives on these uncertainties and their potential market impacts include:

Inflation: The consumer price index and personal consumption expenditures price index have reached annual rates of increase representing their highest levels since 1982. While we expect inflation reports throughout 1H22 to remain running hot, these rates could begin to mitigate in 2H 2022, perhaps subsiding to more manageable levels in the 3% range, as supply chain challenges begin to ease and we reach the one-year anniversary of last year's initial surge in consumer prices.

COVID-19: The initial onslaught of the Omicron variant now appears to have peaked in mid-January at a seven-day average of more than 800,000, as this statistic has since fallen to fewer than 250,000 (Worldometer, February 7). In the months ahead, the markets and society at large will be watching these trends anxiously to see if an Omicron burnout might infer further and substantial declines in virus trends. In our judgment there is a realistic probability COVID cases continue to trend downward and that by year-end 2022 the virus could shift from pandemic to endemic status.

Fed policy and interest rates: The Federal Reserve stands ready to begin raising rates in March and reducing its nearly \$9 trillion balance sheet shortly thereafter. Since late 2021, market expectations as to how many quarter-point federal funds rate hikes will be implemented in 2022 and how fast the Fed will begin reducing its existing bond holdings have increased at a fast and furious pace. We believe the Federal Reserve is likely to raise the federal funds rate by an even 1% in CY 2022, concluding the year with a target range of 1.00%-1.25%. It is also likely the Fed begins reducing its balance sheet at a pace of close to \$1 trillion annually, thereby lowering its bond holdings by about \$3 trillion over the next three years. We see a realistic range on the 10-year Treasury yield of 2.25%-2.50% by year-end 2022.

Economic growth: Amid a current environment with seemingly conflicting economic data pertaining to COVID trends, expected 1Q gross domestic product growth, and the labor market, we continue to believe the U.S. economy can achieve 3% economic growth in CY 2022 providing for a favorable backdrop for equity and credit investors. Inflation stands a good chance to slow into the 3% range as supply chain constraints and worker shortages improve in 2H 2022 and COVID-19 trends move the virus closer to an endemic rather than pandemic status. This could potentially unleash pent-up consumer demand into 2H22 and CY 2023.



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Corporate earnings: Following blistering hot profits growth in CY 2021 likely to come in north of 45% on S&P 500 net operating earnings, current estimates seem to be coalescing in the 8%-10% range for CY 2022 (FactSet Earnings Insight, Feb 4). While this is still a favorable rate of growth, the markets may need to absorb this slower pace as companies complete their 4Q21 earnings reports and provide updated guidance for CY 2022. We believe given a potentially stronger pace of earnings growth in 2H 2022 and what could be accelerating comparisons in CY 2023 — as COVID-19 and inflationary trends subside to some extent amid 3% or better economic growth — that equity investors could be well rewarded for staying the course over these next few months. We continue to see a strong probability overall stock total returns through 2023 will be in line with realized earnings growth.

Russia and Ukraine: In the event of a Russian invasion of Ukraine, it is likely markets could initially react with more inflationary concerns and a rotation away from equities and credit-oriented fixed income and toward safe harbor type assets such as gold and U.S. Treasury bonds. We caution such an immediate reaction would likely be short term in nature as history has typically shown markets to recover shortly after selling induced by geopolitical or military events.

In summary, investors will likely be facing a wider array of uncertainties and short-term market volatility throughout 1H22. However, we believe potential trends within and resolutions to these uncertainties favor a continuing longer-term upward trend for stocks and a favorable fundamental environment for the credit markets.



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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