WHERE WE STAND

THE FED AND INFLATION

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The Federal Reserve's June Meeting created a bit of a stir as the market reacted to three principal developments. These were an increase in the committee's inflation forecasts in 2021 (from 2.4% to 3.4%), recognition that it had begun discussions on tapering open market asset purchases, and an incremental move in the dot plot survey, presumably shortening the time frame on a rate hike(s) as more likely to occur in 2023. Taking all of this into consideration, we believe the following points are important to investors.

- We see the Federal Reserve holding its target on the fed funds rate at 0–0.25% into 2023 and maintaining its present level of $120 billion in monthly open market bond purchases into 2022. We view this scenario as a favorable monetary policy backdrop for the markets.
- We are prone to agree with the Fed's perspective that recently rising inflation rates will likely prove to be transitory in nature and have a strong probability of reverting back toward their longer-term 2% target by the early months of 2022.
- Our rationale for this judgment includes the base effects comparisons of recent higher monthly inflation reports versus suppressed inflation during last year's pandemic-related economic contraction. A large bulk of the price increases in recent reports appear to be concentrated within a handful of business areas most sensitive to reopenings, such as car rentals, used cars, hotels, airfares, and restaurants.
- That said, we do expect inflation to continue running hot and noticeably above the Fed's long-term target for the remainder of 2021 as the monthly year-over-year comparisons will continue to look challenging and inflation-sensitive businesses work through reopening amid short-term supplier bottlenecks.
- We believe the Fed will be patient and deliberate in regard to any policy actions specifically related to inflation and will remain consistent with last year's "Statement on Longer-Run Goals and Monetary Policy Strategy."
- Another key factor in our opinion as to why the Fed will likely not raise rates until 2023 surrounds its emphasis on the term, "substantial further progress," in the economy, which we interpret as a lagging recovery in the labor market, where the total number of jobs remain 7.6 million below the pre-pandemic peak in February of 2020.
- We see the Fed soon signaling to the markets it will begin official discussions on tapering the pace of open market bond purchases, and we believe it will provide adequate notice before such tapering begins, hence sufficiently preparing the markets for the eventual wind down.
- We see a V-shape recovery in terms of real aggregate gross domestic product and S&P 500® underlying company operating earnings being achieved by year-end 2021. We also believe expected Federal Reserve policy in the year ahead will continue to provide a favorable backdrop for these improving trends.

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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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