WHERE WE STAND

THE MARKET RALLY

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The equity and credit markets have staged an impressive and unexpected rally since late March. After the fastest 35% drop in its history between February 19 and March 23, the S&P 500® is now close to fully recovering its entire decline. High-yield and investment-grade credit spreads have also narrowed considerably. This market activity has occurred against a backdrop of the worst short-term economic contraction since the Great Depression of the 1930s.

- We continue to believe current equity levels represent meaningful long-term opportunities. The market is the great discounter of future events and as the economy moves past the worst of the COVID-19-induced shock, asset prices could potentially continue to rise.
- The May Employment Report released on June 4 has thrown cold water on the bearish argument that the markets' strong performance in recent months is "disconnected" from economic reality. With 2.5 million jobs added to the economy in May versus expectations of 8.5 million job losses, there is now clearly a case to be made for faster than previously anticipated economic improvement.
- We are now solidly entrenched in a lower interest rate environment that is likely to be beneficial not only for corporate profitability but also equity and credit market valuations.
- Equity valuations are more than reasonable in our opinion when looking at them from the perspectives of both revised dividend and earnings yields in comparisons to long-term Treasury bond rates.
- We believe there are four primary catalysts that have driven the markets higher in recent months and will continue to do so. These catalysts are:

    1. Record fiscal economic stimulus passed by Congress — the CARES Act — of approximately $2.7 trillion and the potential of more to follow in the months ahead
    2. Unprecedented monetary stimulus being implemented by the Federal Reserve not only in taking short-term interest rates to zero but also applying large-scale asset purchases also in the trillions of dollars
    3. Improving medical data and trends in the COVID-19 virus itself displaying stable fatality rates and rising recovery rates
    4. Continued safe re-opening of the economy on a national basis

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- We believe there is a strong probability that the historic fiscal and monetary economic stimulus put forth in recent months by Congress and the Federal Reserve will likely remain in effect well into an economic recovery, therefore transitioning from a bridge to a tailwind for the markets.
- All considered, we see potential upside over the next 12 months on the S&P 500 of approximately 10%, and total returns on high-yield bonds in the high-single digits and for investment-grade bonds in the mid-single digits.

Given this strong move in the markets, investors should remain prepared for short-term volatility on a daily or weekly basis. As we have said before, this is still not an environment for faint hearts or short time horizons.

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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 25 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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