WHERE WE STAND

ECONOMY IN SECOND QUARTER WILL BE ROUGH

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TOM WALD, CFA®

Chief Investment Officer, Transamerica Asset Management, Inc.

The new world COVID-19 has created will have direct and negative impacts on the U.S. and global economies for at least the next three to six months. Since so much of the widespread shutdowns and cancellations occurred during recent weeks and at such a rapid pace, the magnitude of these negative effects are only just now being fully estimated and they are turning out to look far worse than expected even just a few weeks ago. However, while this pending economic air pocket is to a large extent stunning and sobering, there are several unique circumstances investors should take into account regarding this first medically related economic recession in more than a century.

Second quarter U.S. gross domestic product (GDP) now appears to be on the verge of the worst single quarter of economic contraction since GDP first began to be measured on a quarterly basis in 1948. In a flurry of downward revisions over just a few days, the latest round of forecasts for second quarter economic growth now range from about negative 8% to negative 15%. Should reality between now and June reflect the midpoint of that range, only those who personally experienced the great depression of the 1930s will be able to say they have lived through a steeper three-month decline in the economy.

The markets have to some degree already discounted the second quarter contraction and are likely now more focused on the duration of the slowdown rather than the depth. Should we see more of a "U-shaped" economic recovery driven perhaps by containment or successful treatment options for COVID-19, we could potentially see positive growth in 2H20, which we believe, given the recent dramatic decline in asset prices, could result in a sharp reversal for stocks and the credit markets.

The Federal Reserve has stepped up in historic fashion by reducing short term-rates to zero and reinstituting large-scale asset purchases in an open-ended manner. The Fed has taken unprecedented action by announcing an unlimited commitment to purchasing assets in the open market, which will now include not just Treasury bonds and agency mortgage-backed securities, but also corporate bonds, municipal bonds, and commercial mortgage-backed securities. In addition, the Fed will be providing a Main Street Business Lending Program to support small- and mid-sized businesses. As we have said previously, actions by the Fed in this environment will not address the root cause of the coronavirus-induced economic contraction. However, these aggressive measures will allow greater financial assistance for adversely impacted businesses and a higher degree of liquidity for investors.

Fiscal stimulus awaits and it could come in large dollar amounts. The White House and Congress appear to be in the final stages of drafting a fiscal stimulus package potentially totaling $2 trillion. It's believed to consist of a combination of direct payments and tax relief to individuals, small business loans, and financial assistance or investment into distressed industries such as airlines, hotels, and other transportation- or leisure-related businesses. Should the pending legislation actually represent this dollar amount, it would approximate 10% of the total U.S. economy. Like the Fed's monetary actions, this fiscal policy response may not address the root cause of the upcoming economic contraction, but it will provide much-needed financial assistance to struggling companies and sectors of the economy. In addition, at the point of a future recovery, it could also provide a meaningful tailwind.

The markets and the world are watching infection, fatality, and recovery rates on a country-by-country basis. We believe a vital statistic to be watching is total recoveries/total cases and ironically China, where the virus began in late 2019, currently is the only nation where recoveries constitute a majority of the reported cases. While this is currently a major challenge globally, if in the months ahead the U.S. and other highly impacted nations such as Italy, South Korea, Iran, France, Germany, and Spain can reach a recovery profile close to China's it could go a long way toward not only reducing the overall fatality rates of the virus but also alleviating fears throughout the world community.

We would like to remind investors that calling a bottom in this market is challenging and instead it is likely more rational to determine long-term entry points. It is also important to remember the end of prior modern day recessions in 1982, 1991, 2002, and 2009 were followed by meaningful upward moves in the markets during the years to follow. This is worth noting in our opinion, particularly in the event the expected economic contraction proves to be relatively short lived and the effects of current and pending monetary and fiscal policy remain in place afterward.

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 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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1801 California Street, Denver, CO, 80202, USA

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