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TRANSAMERICA Market Trends

2013 OCTOBER EDITION

ECONOMIC & MARKET RECAP

In September, speculation that the Federal Reserve would not reduce bond purchases boosted equity and bond markets leading up to the September 17th announcement. On the announcement of "no tapering," bonds rallied further with the yield on the 10-year U.S. Treasury ending the month at 2.6%, down from nearly 3% in early September. Then, despite an equity sell-off leading up to the federal government shut-down, U.S. equities managed to hold onto gains with the S&P 500® finishing up 3.1% for the month.

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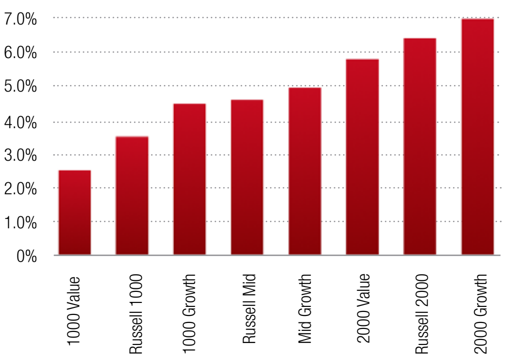
U.S. equity markets were also boosted in September by economic reports which indicated that U.S. personal income and personal spending in August strengthened and beat street estimates. Also beating estimates, new home sales in August increased 7.9% from the prior month, although sales failed to recapture June's highs likely due to higher mortgage rates. Finally, the September Institute for Supply Management (I.S.M.) surveys of both manufacturing and service businesses continued to signal stronger growth. In addition, reports released in September indicated that industrial production, durable goods, retail sales and non-farm jobs increased in August. However, all three were below market expectations.

The apparent diplomatic solution to Syria along with Angela Merkel's reelection to a third term helped remove some political uncertainty in Europe. These events, along with the Fed news, helped drive the MSCI EAFE index up 7.4% in September. The MSCI Emerging Market Index was up by 6.5% in September based on cash injections from Chinese and Indian central banks.

U.S. CORPORATE PROFITS: THIRD QUARTER AND BEYOND

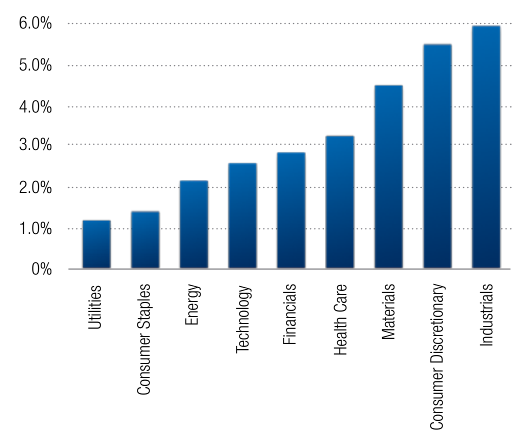
The U.S. government reports the income of the nation's companies based on a sample of corporate tax returns. However, income for federal tax returns is defined differently from income reported to investors. Income reported to investors is defined by a set of rules known as Generally Accepted Accounting Principles (GAAP).

CHART 1:
Russell Style Indexes September 2013 Returns



Source: Bloomberg, as of 10/1/2013

CHART 2:
S&P Global Sector Indexes
September 2013 Returns

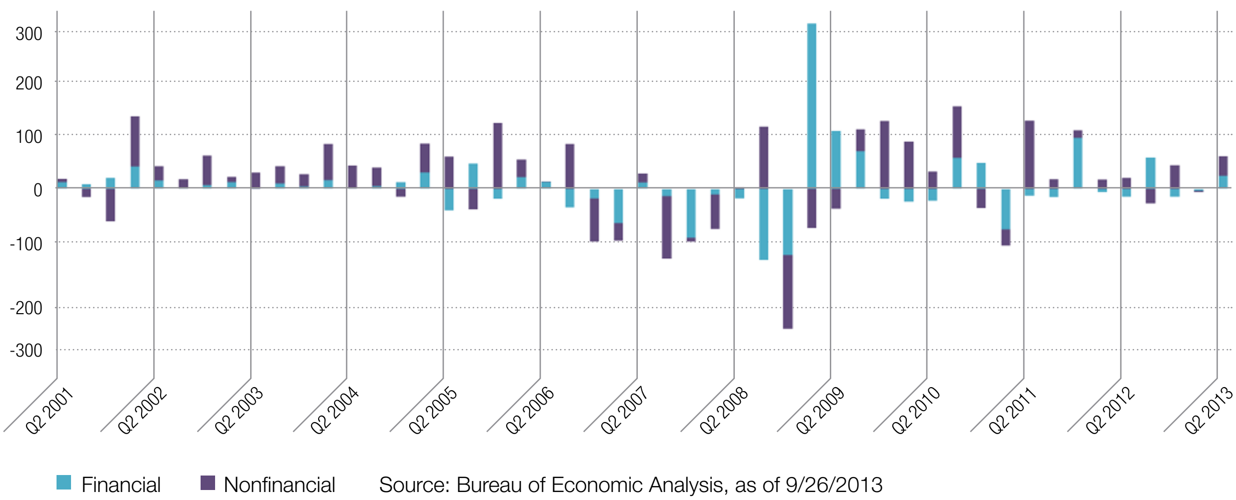


Source: Bloomberg, as of 10/1/2013

Federal taxable income is more rigidly defined as compared to GAAP earnings, which allows management to make subjective decisions which affect income. As a result, near the top of earning cycles, income from federal taxable income tends to decline before GAAP income, which can continue to grow via management decision making. At the bottom of economic cycles, companies can use more write-downs and one-time charges against GAAP income than against federal income. The result is that federal income tends to rebound earlier than GAAP income near the bottom of the earnings cycle. Historically, federal taxable income has changed direction two to three quarters earlier than GAAP earnings.

The most recent estimate of corporate profits from these federal tax returns showed a return to growth of 3% in the second quarter 2013 from a 0.4% contraction in the first quarter. If historical relationships remain consistent, that suggests GAAP income for the third quarter (reported in October) could be weak but may be followed by a strong bounce in the fourth quarter (reported in January 2014). This bounce would be consistent with the surge in capital goods investment that businesses have made over the last six months.

CHART 3: Change in Corporate Profits in Billions of $, seasonally adjusted at annualized rate



Source: Bureau of Economic Analysis, as of 9/26/2013

THE BOTTOM LINE

Although third quarter earnings reported in October could be weak, multiple signs indicate that a strong earnings bounce may follow in the following quarters.

INCREDIBLE INDIA

A lack of productivity gains combined with an insufficient infrastructure has worked to keep the cost of manufacturing goods in India high. As a result, inflation has remained high even as economic growth slowed since early 2010 (see chart 4). High domestic manufacturing cost and high inflation made imported goods more competitive with each passing day. Since 2007, the current account deficit has grown by 1,025% from $8 billion to $90 billion (Morgan Stanley, August 27th, 2013).

High inflation combined with a large current account deficit set the stage for the currency, the rupee, to weaken. When growth began slowing, foreign investors pulled money out, which pushed the rupee down. Persistent inflation also caused gold imports to increase, which drove the rupee down even further. To stop the spiral and attract capital into the currency, the central bank hiked rates a full 2% in July. In addition, they implemented controls which limit capital flowing out. As a result, the rupee has recently stabilized near a four-year low.

Unfortunately, the July rate hikes have brought financing and real estate development to a halt (Bradsher, September) and could negatively affect earnings growth in other industries as well. To compound the problem, many Indian companies had, over the last few years, incurred debt denominated in foreign currencies. When the rupee recently weakened, the amount needed to make those debt payments went up. Even worse, much of the debt is short-term debt. In fact, debt due in the next 12 months is equal to one-third of all foreign currency reserves held by the central bank (Ministry of Finance, 2013). Repayment of this debt could further challenge earnings and push the rupee down further.

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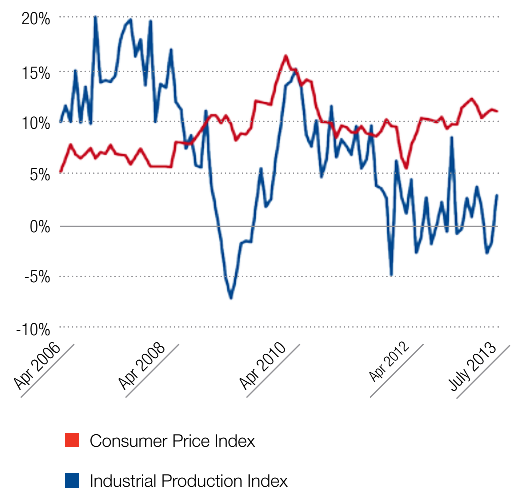
The long-term benefit of a weak rupee is that it will make Indian exports cheaper to foreigners and should help the trade deficit. In addition, high rates have made Indian bonds interesting. According to Bloomberg, a five-year, highly rated corporate bond in India is paying yields between 9% and 10% compared to 5% for a similar security in China (Patil, 2013). However, we prefer sovereign bonds to corporate bonds due to the foreign debt issue. If the recent rate hikes and capital controls are able to bring inflation down, then rates can be lowered, which would push bond prices up. However, rates could be pushed higher near-term if inflation proves stubborn.

THE BOTTOM LINE

Indian sovereign bonds could be attractive at current yields if inflation and rates come down. However, selected industries and companies will struggle with foreign debt and slowing growth. In India, security selection and active management, as in all emerging markets, is the key to success.

CHART 4:
India: High inflation despite slowing growth
YoY % Change



Source: Indian Labour Bureau, Indian Ministry of Statistics, as of 9/27/2013

SELECT MARKET PERFORMANCE (as of 9/30/2013)

		TOTAL RETURN	
Equities - Global	**Closing Price**	**1 Month**	**Year-to-Date**
MSCI ACWI	$382.07	5.2%	12.46%
MSCI EAFE	$1,818.23	7.4%	13.36%
MSCI EM	$987.46	6.5%	-6.42%
Equities - The Americas			
Brazil - Bovespa	$52,338.19	11.9%	-14.1%
Canada - S&P/TSX Composite	$12,787.19	3.7%	2.84%
Mexico - IPC	$40,185.23	3.2%	-8.06%
US - Russell 2000®	$1,073.79	6.4%	26.42%
US - S&P 500®	$1,681.55	3.1%	17.91%
US - NASDAQ Comp	$3,771.48	5.1%	24.90%
US - DJIA	$15,129.67	2.3%	15.46%
Equities - Europe			
France - CAC 40	$4,143.44	8.1%	14.61%
Germany - DAX	$8,594.40	8.7%	13.45%
UK - FTSE 100	$6,462.22	5.5%	9.22%
Spain - IBEX	$9,186.10	13.7%	13.42%
Italy - FTSE MIB	$17,434.86	7.6%	8.13%
Equities - Asia Pacific			
Australia - S&P ASX 200	$5,218.88	7.4%	12.00%
China - Shenzhen A Index	$2,174.67	3.9%	-4.16%
India - SENSEX	$19,379.77	10.8%	0.47%
Japan - Nikkei 225	$14,455.80	8.5%	39.34%
South Korea - KOSPI	$1,996.96	7.0%	0.09%
Singapore - FTSE Str Times	$3,167.87	6.3%	0.46%
Commodities			
DJ UBS Commodity Index	$127.11	-2.6%	-9.31%
WTI Crude ($/bl)	$102.33	-5.4%	10.90%
Natural Gas ($/mcf)	$3.56	0.4%	7.31%
Copper ($/lb)	$3.32	1.1%	-10.77%
Silver ($/oz)	$21.71	-10.6%	-30.48%
Gold ($/oz)	$1,326.50	-7.2%	-22.72%

		TOTAL RETURN	
Barclays Global Bond Indexes	**Yield**	**1 Month**	**Year-to-Date**
AsiaPac ex-Japan Corporate Index	5.59%	5.24%	8.74%
AsiaPac ex-Japan Sovereign Index	4.02%	4.45%	10.00%
Pan-European HY Corporate Index	6.64%	1.48%	5.68%
Pan-European IG Corporate Index	3.84%	0.67%	1.40%
Pan-European Sovereign	3.43%	0.76%	1.04%
US HY Corporate	7.29%	0.99%	3.73%
US IG Corporate	4.41%	0.69%	-2.62%
US Treasury Aggregate	2.07%	0.70%	-2.01%

Source: Bloomberg, Barclays Capital Global Family of Indices. Copyright © 2013.

Key

bl	barrel
mcf	metric cubic feet
lb	pound
oz	ounce
IG	Investment Grade
HY	High Yield

SELECT ECONOMIC RESULTS

Country	Indicator	Period	Value	Comments	As of Date
Australia	PMI-Mfg	Sep 2013	51.70		10/1/2013
Australia	Retail Sales	Aug 2013	0.40%	m/m, sa	10/1/2013
Brazil	Industrial Prod.	July 2013	2.00%	y/y	9/3/2013
Brazil	Retail Sales	July 2013	6.00%	y/y	9/12/2013
Brazil	PMI-Services	Aug 2013	49.70		9/5/2013
Canada	PMI-Mfg	Aug 2013	52.1	RBC/Markit	9/3/2013
Canada	Retail Sales	July 2013	0.60%	m/m	9/24/2013
China	Industrial Prod.	Aug 2013	10.40%	y/y	9/10/2013
China	PMI-Services	August-13	52.8	HSBC/Markit	9/5/2013
China	PMI-Mfg	Sep 2013	50.2	HSBC/Markit	9/30/2013
China	Retail Sales	Aug 2013	13.4%	y/y	9/10/2013
France	Industrial Prod.	July 2013	-0.6%	m/m	9/10/2013
France	PMI-Mfg	Sep 2013	49.8		10/1/2013
France	PMI-Services	Aug 2013	48.9		9/5/2013
Germany	Industrial Prod.	July 2013	-1.70%	m/m, sa	9/6/2013
Germany	PMI-Mfg	Sep 2013	51.1		10/1/2013
Germany	Retail Sales	Aug 2013	0.30%	y/y	9/30/2013
India	Industrial Prod.	July 2013	2.60%	y/y	9/12/2013
India	PMI-Mfg	Sep 2013	49.60		10/1/2013
India	PMI-Services	Aug 2013	47.60		9/5/2013
Italy	Industrial Prod.	July 2013	-1.1%	m/m,sa	9/12/2013
Italy	PMI-Mfg	Sep 2013	50.80		10/1/2013
Italy	PMI-Services	Aug 2013	48.8		9/5/2013
Italy	Retail Sales	July 2013	-0.30%	m/m, sa	9/26/2013
Japan	Industrial Prod.	Aug 2013	-0.70%	m/m,sa	9/30/2013
Japan	Personal Spending	July 2013	-1.60%	y/y, real	9/30/2013
Japan	PMI-Mfg	Sep 2013	52.5		9/30/2013
Japan	PMI-Services	Aug 2013	51.2		9/4/2013
Japan	Retail Sales	Aug 2013	1.10%	y/y, nsa	9/30/2013
Mexico	Industrial Prod.	July 2013	-0.5%	y/y	9/11/2013
Mexico	Retail Sales	July 2013	1.30%	y/y	9/23/2013
South Korea	PMI-Mfg	Sep 2013	49.70		10/1/2013
South Korea	Industrial Prod.	Aug 2013	3.30%	y/y	9/30/2013
Spain	Industrial Prod.	July 2013	-1.40%	y/y, wda	9/6/2013
Spain	PMI-Mfg	Sep 2013	50.7		10/1/2013
Spain	PMI-Services	Aug 2013	50.4		9/5/2013
Spain	Retail Sales	Aug 2013	-4.50%	y/y	9/27/2013
Switzerland	PMI-Mfg	Sep 2013	55.3		10/1/2013
Switzerland	Retail Sales	July 2013	0.80%	y/y, real	9/9/2013
United Kingdom	Industrial Prod.	July 2013	-1.60%	y/y	9/6/2013
United Kingdom	PMI-Mfg	Sep 2013	56.7		10/1/2013
United Kingdom	PMI-Services	Aug 2013	60.5		9/5/2013
United Kingdom	Retail Sales	Aug 2013	-0.9%	m/m, w/fuel	9/18/2013
United States	Durable Goods	Aug 2013	0.1%	m/m, sa	9/25/2013
United States	Industrial Prod.	Aug 2013	0.4%	m/m, sa	9/17/2013
United States	Non-Farm Payrolls Prod.	Aug 2013	177,000	sa	9/9/2013
United States	Personal Income	Aug 2013	0.4%	m/m, sa	9/30/2013
United States	ISM-Manufacturing	Sep 2013	56.2		9/30/2013
United States	ISM-Services	Aug 2013	58.6		9/9/2013
United States	Retail Sales	Aug 2013	0.2%	m/m, sa	9/17/2013

Source: Respective National Statistics Agencies, Markit, HSBC Markit

Comments Key

ar	annualized rate
m/m	month-over-month
q/q	quarter-over-quarter
y/y	year-over-year
real	adjusted for inflation
sa	seasonally adjusted
saar	seasonally adjusted and annualized rate
wda	work day adjusted

TERMS AND DEFINITIONS

Bureau of Economic Analysis: The Bureau of Economic Analysis (BEA) is an agency of the U.S. Department of Commerce and is responsible for the analysis and reporting of economic data.

Current account deficit (or surplus): A measure of the net money flowing out of (or into) a country which includes money related to investment capital as well as money flows due to trade in goods and services.

Durable goods: Physical goods or equipment that is not consumable and has a usable life of several years.

Federal Reserve: The central bank of the U.S. which serves as both a regulator and a banker to U.S. banks. The Federal Reserve is composed of a central government agency (the Board of Governors) and 12 regional Federal Reserve Banks.

Generally Accepted Accounting Principles (GAAP): A set of accounting rules whose use by public corporations is mandated by U.S. securities law. These rules are managed and published by the Financial Accounting Standards board.

Industrial production: A measure of the output from the manufacturing, mining, electric and gas industries.

Inflation: A rate that measures the rise in the general level of prices for goods and services.

ISM: Survey of businesses by Institute for Supply Management which measures business conditions. A value above 50 indicates business expansion. Below 50 indicates business contraction.

MSCI EAFE Index: A market-cap weighted and free float-adjusted index which measures the equity market performance of international equity markets in 22 developed economies in Europe, Australasia and the Far East.

MSCI Emerging Market Index: A market-cap weighted and free float-adjusted index which measures the performance of international equity market indexes in 21 emerging economies from all regions of the globe.

Non-farm payrolls: A broad measure used to represent the total number of U.S. workers in the economy.

Standard & Poor's (S&P) 500® Index: An index that consists of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500® is designed to be a leading indicator of U.S. stocks and is meant to reflect the risk and return characteristics of the large-cap universe.

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