Voya Multi-Asset Perspectives

Macro Themes: Watching the Central Banks

October proved to be another solid month for equities globally. Most regions we invest in delivered positive returns led by Japan up 4.6%; the emerging markets up 3.5%; and the United States up 2.3%. Europe excluding the UK ended up as the laggard yet still gained 0.4%. Within the U.S. large caps outpaced small caps and cyclical sectors (e.g. consumer discretionary industrials and information technology) well outpaced defensive sectors (telecommunications and consumer staples). We are now past the historically weakest part of the year. During the month fixed Income did very little: most segments such as 10-year U.S. Treasurys, high yield and senior loans were flat.

Economic data fully supported the strength of equities during October. Purchasing managers across the globe remained in an upward trend. In the U.S., cyclical activity such as construction spending and durable goods were reported better than expected. Retail sales and the employment report were affected by the hurricanes. Inflation readings were at least turning from their relative downward trend. Core personal consumption expenditures were a little bit better but well below the Federal Reserve target.

In our view, policy will drive markets going forward. Monetary policy in the U.S., UK and Europe will be marginally tightened over the course of the next 12 months at varying paces. We don't think this necessarily represents a challenging growth-policy trade-off phase yet, since the economic data are solid and corporate earnings are powering ahead. Central bank speeches and nuanced statements will serve as good guideposts.

Currency markets are on our mind as well. The U.S. dollar continued September's trend and appreciated in October but at a slower pace. The dollar strengthened against the euro and yen and broadly against the emerging markets. The upside of dollar strength is that it will help keep inflation, low which should keep the Fed from having to tighten monetary policy abruptly.

Tactical Indicators

Economic Growth (Good):
Recent U.S. economic data indicate strength in the sustainability of economic growth (Figure 1)

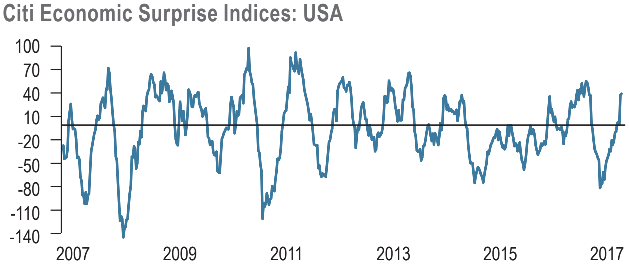
Fundamentals (Good):
Strong corporate earnings signal healthy and sustainable markets

Valuations (Stable):
Double-digit earnings growth expected over the next 12 months (Figure 2)

Sentiment (Neutral):
Sentiment toward Japanese equities being lifted by strong earnings and easing geopolitical tensions (Figure 3)

Figure 1. Economic Growth Looks More Sustainable

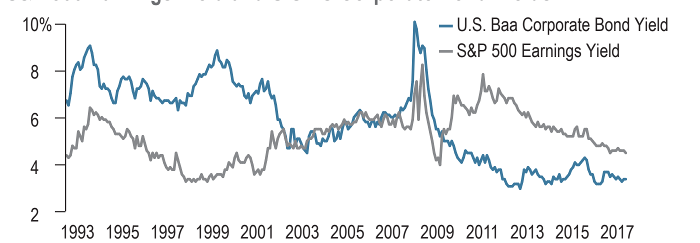
Citi Economic Surprise Indices: USA



Source: Bloomberg, Voya Investment Management.

Figure 2. Earnings Yield is More Attractive Than Bond Yields

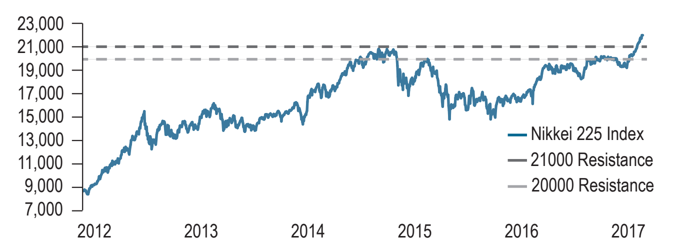
S&P 500 Earnings Yield and U.S. IG Corporate Bond Yields



Source: Bloomberg, Voya Investment Management.

Figure 3. Japanese Stocks Appear Poised for Further Upside

Nikkei 225



Source: Bloomberg, Voya Investment Management.

Portfolio Positioning

Equities	●	
U.S. Large Cap	○○●	Stronger 2H17 growth and better corporate profits are positive
U.S. Mid Cap	○●○	Valuations look somewhat expensive, but should benefit from strong earnings prospects
U.S. Small Cap	○○●	May benefit from the Trump administration's legislative agenda and U.S. dollar strength
International Equities	○●○	Rising global activity, lower political risks and attractive valuations make us positive, especially in Japan
Emerging Market Equities	○○●	Easy financial conditions, solid global growth and attractive valuations are supportive
REITS	○●○	Relatively good yields, but full valuations and mature real estate cycle have us neutral
Commodities	○●○	Crude oil making first sustained rise over $50/barrel since May, on increased demand forecasts and some threats to supply
Fixed Income	●	
U.S. Core Fixed Income	●○○	U.S. Treasury yields at middle of post-election trading range, buoyed by increased risk appetite after sluggish August and renewed hopes for tax plan
Non-Investment Grade	○○●	High yield spreads near cycle tights, offer less value in the face of rising rates. Income potential and floating rate coupon still make loans attractive
International Fixed Income	●○○	Persistent deflationary pressures and low yields lead us to favor U.S. bonds

Underweight ● Neutral ● Overweight ●

Investment Outlook

This is the first year since 2010 where a meaningful contributor to returns can be explained by strong earnings delivery versus price/earnings multiple expansion. We see this as a sign of health for the equity market. Earnings revisions are another sign of an equity market rally on firm footing. The three-month global earnings revision ratio climbed to a seven-year high in October, with every major region except the U.S. witnessing improvement. While we don't dismiss lightly the U.S. lack of improvement, we note the strength within the U.S. is with foreign-exposed stocks. Management guidance has remained positive through Q3 earnings season and we see that corporations are planning to spend more on capital expenditures, which is corroborated by the Philadelphia Fed Survey of Capex Intentions. Our Voya U.S. Earnings Indicator is pointing to just over 10% earnings growth for the next 12 months.

The fixed income market is broadly positive for equities as well. Real yields — U.S. Treasury yields minus inflation — are very low and financial conditions are easy. It is a far more challenging position for equities when real yields are climbing and financial conditions are tightening. With unemployment at 16-year lows and real rates also low, we see an environment that is favorable for equities but possibly not for bonds. Therefore, we maintain our negative view on duration. Within credit, we like the flexibility that leveraged loans give the portfolio against rising short-term interest rates. Credit spreads in the broader high yield market look expensive to us.

Our strategy is to focus on asset classes and parts of the market that are cyclically geared to growth. In our view that goes squarely to global equities. While outright price/earnings multiples are stretched, not all measures give the same signal. If we look at the earnings yield (which is the inverse of the P/E multiple) or free cash flow yield, they well outpace what is currently available in fixed income. We are maintaining our positions in the emerging markets and U.S. small caps. During October we continued to rotate our equity position toward Japan, while hedging the currency back into U.S. dollars. Prime Minister Abe had a decisive win in the election and it is clear that monetary policy will continue to be highly accommodative. The equity market has agreed, and the Nikkei index has finally broken through 22,000, which has not happened since 1996. There are a number of positives, but we continually look for potential pitfalls to financial markets. The transition to a new Federal Reserve chairman next year is top of mind, as is the view that inflation can stay low indefinitely, despite tightening of the labor markets. We are holding our high quality fixed income assets as a buttress against either of those potential pitfalls.

Past performance does not guarantee future results.

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