February 2018

Voya Multi-Asset Perspectives

Records Are Made to Be Broken

After 2017 proved a banner year for global equity markets, many investors wondered if markets could deliver similar returns in 2018. Global equity markets started the year off stronger than any year in the past two decades. Emerging market equities led the rally, delivering 8.6% followed by U.S. equities with 5.7% and international developed equities with 5.1%. There have only been four years when the S&P 500 has had a better start than in 2018, with each of those years posting double-digit gains in the first month.

Robust earnings, an improving global economic outlook and a weakening U.S. dollar have been driving global equity markets. Based on the 50% of S&P 500 companies that have already reported 4Q17 earnings, over 75% are beating both sales and earnings estimates. Consensus earnings estimates for 2018 have increased across all regions of the world, led by the emerging markets and the United States (Figure 1).

Further supporting the strength in emerging market equities and large-cap U.S. equities has been the decline in the dollar measured by the narrow U.S. Dollar index, which has fallen by 13% since early 2017 with a 3% decline just in January. The majority of the recent dollar weakness is attributed to the sudden strength in the euro. Capital flows into Europe largely explain the recent appreciation in the euro given higher than expected growth in the euro area. Furthermore, the widening U.S. fiscal and current-account deficits act as headwinds to dollar appreciation. All this continues to reinforce our long-term dollar depreciation view as the dollar exits from its previous seven-year bull market.

The durable nature of this global economic recovery has re-stoked inflation expectations, bringing 10-year U.S. Treasury yields to a three-year high of 2.73% (Figure 2). Although bond market investors were stubborn for most of 2017, pinning yields to a range of 2.0–2.6%, the breakout to 2.7% and above shows that the bond market is starting to agree with the equity markets that global economies are likely to finally grow above trend. We expect yields to continue to drift higher.

Tactical Indicators

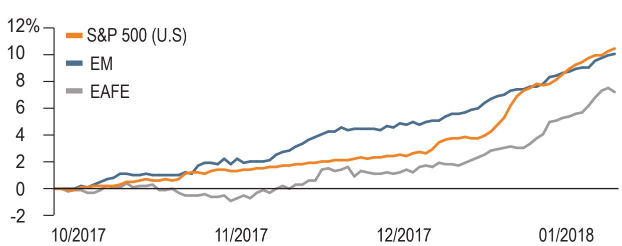
Economic Growth (Good):
Broad based strength across the developed and emerging markets

Fundamentals (Good):
Global estimates for 2018 earnings have increased by 10% since 3Q17

Valuations (Stable):
Forward PEs for U.S. equities have remained constant even after the index rose over 6% this month

Sentiment (Good):
U.S. stock investors continue to avoid excessive margin risk while remaining bullish (Figure 3)

Figure 1. 2018 Global Earnings Estimates Improve, Led by Emerging Markets and U.S. Equities

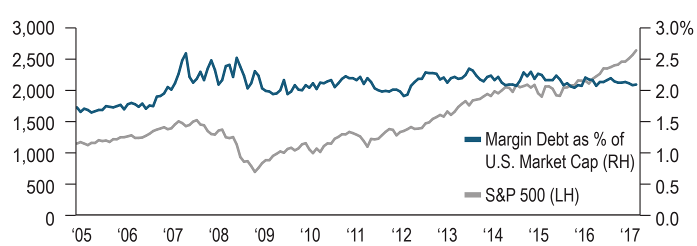


Source: Bloomberg, data as of 01/31/2018.

Figure 2. 10-Year U.S. Treasury Yields are Rising with Increasing Market Based Inflation Rates

Source: Bloomberg, data as of 01/31/2018.

Figure 3. Margin Levels for U.S. Stock Investors are Not Extended



Source: Bloomberg, data as of 1/31/2018.

Portfolio Positioning

	Positioning	
Equities	Overweight	
U.S. Large Cap	Underweight	Stronger 2H17 growth and better corporate profits are positive
U.S. Mid Cap	Overweight	Valuations look somewhat expensive, but should benefit from strong earnings prospects
U.S. Small Cap	Overweight	Should benefit from the decline in corporate tax rates
International Equities	Neutral	Rising global activity, lower political risks and attractive valuations make us positive, especially in Japan
Emerging Market Equities	Overweight	Easy financial conditions, solid global growth and attractive valuations are supportive
REITS	Underweight	Relatively good yields, but full valuations and mature real estate cycle have us underweight
Commodities	Neutral	Crude oil making a sustained rise over $60/barrel looks durable
Fixed Income	Underweight	
U.S. Core Fixed Income	Underweight	U.S. Treasury yields at top end of their trading range, looks sustainable with faster growth and larger budget deficits
Non-Investment Grade	Overweight	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	Underweight	Low yields lead us to favor U.S. bonds

Underweight Neutral Overweight

Investment Outlook

The logical question after such a heady start to the year on top of already strong gains in 2017 is, what type of upside is left or are the equity markets vulnerable to a correction? We answer that question with our investment process framework of valuations, fundamentals and sentiment.

Valuation is high on most measures such as the Shiller PE, price/book and price/earnings ratios and can act as a headwind to forward equity returns over long-term investment horizons such as ten years. In the intermediate term of one to two years, valuations tend to be a fickle if not poor indicator for forward looking returns. In the world of multi-asset investing, however, equities are clearly more attractive than bonds; bond yields are far too low given the economic outlook. The sharp move higher in bond yields has begun to leave investors questioning at what point it will begin to impact equity valuations. Although it's difficult to point to a critical level, it is important to note that the move higher has been driven mostly by the continued momentum in global growth, which is a positive for equities.

Fundamentals — which incorporate monetary policy rates, earnings, business investment and consumption — are strong and improving. Global activity remains supportive, with upward revisions to growth estimates across regions. The same can be said for earnings revisions as the trend remains higher across the majority of the markets we track, while higher commodity prices and a weaker U.S. dollar should continue to be tailwinds for earnings in the near term.

Sentiment across a number of our indicators is fairly extended, as we have seen record inflows into equities to begin the year. While we are mindful that these conditions leave the market vulnerable to a shock, using these indicators to time the onset of a correction has proven less effective.

In summary, we are mindful of risks on the horizon given the current state of our sentiment indicators. Nevertheless, we are comfortable with a positive bias towards equities, given the relative valuations of equities versus bonds and the fundamental underpinning of a strong global growth environment.

Past performance does not guarantee future results.

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Voya Investment Management's Multi-Asset Strategies and Solutions (MASS) team manages the firm's suite of multi-asset solutions designed to help investors achieve their long term objectives. The team consists of 25 investment professionals who have deep expertise in asset allocation, manager selection and research, quantitative research, portfolio implementation and actuarial sciences. Within MASS, the Asset Allocation team, led by Barbara Reinhard, is responsible for constructing strategic asset allocations based on its long-term views. The team also employs a tactical asset allocation approach, driven by market fundamentals, valuation and sentiment, which is designed to capture market anomalies and reduce portfolio risk.

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