March 2018

# Voya Multi-Asset Perspectives

## Tough Month for Equities

February proved to be a difficult month for investors: the MSCI All Country World Index, the proxy for global stocks, weakened, losing 4.2%; and U.S. fixed income, as measured by the Bloomberg U.S. Aggregate Bond Index, fell 0.9%. The United States, with a return of -3.7%, was the safe haven, but only in terms of losing less than the rest of the world. Developed international equities returned -4.5% and emerging market equities -4.6%. Within fixed income, U.S. high yield returned -0.8%, whereas leveraged loans posted gains of 0.2%.

The equity pullback kicked off in late January, when lopsided bullish positioning and frothy expectations for growth and U.S. corporate earnings had left equities vulnerable to disappointment. The pullback was a bona fide correction, with a 10% peak-to-trough decline over nine trading days from January 26 to February 8. A recovery of about 7.7% followed, which was being retested by month-end. We think the pullback may need to retest the previous lows. As seen in Figure 1, this current episode fits the historical context in terms of magnitude, but probably needs more time; on average, these wobbles in equities take between 20–36 days to exhaust themselves.

The broad, trade-weighted dollar rallied over the course of February. Generally, when markets see loose fiscal policy and tightening monetary policy, it is positive for the currency; thus, one might expect the dollar rally to have some momentum. However, the current U.S. situation is more complex because of the twin deficit problem. As we have noted before, the U.S. is implementing fiscal stimulus with its economy already at full employment, a current account deficit at 2.6% of GDP and a federal budget deficit forecast to rise to 5.5% of GDP in 2019. Though it may proceed in fits and starts, we think the U.S. dollar will trend lower over the medium term.

## Tactical Indicators

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

**Fundamentals (neutral):**
Good economic growth is supportive of global corporate profits

**Valuations (negative):**
Broadly, equities are overvalued relative to their history, but attractive versus competing asset classes such as high yield or U.S. Treasurys

**Sentiment (Good):**
Elevated sentiment self-corrected in the February sell-off in equities

### Figure 1. The Recent Drawdown Seems About Average in Price but Not in Time Measures

S&P 500 5%+ Drawdowns since the 2009 Global Financial Crisis

| Start | End | No. of Trading Days | Price Return |
|---|---|---|---|
| 05/02/2011 | 10/03/2011 | 108 | -19.4% |
| 04/26/2010 | 07/02/2010 | 49 | -16.0% |
| 05/22/2015 | 02/11/2016 | 183 | -14.2% |
| 01/26/2018 | 02/08/2016 | 9 | -10.2% |
| 04/03/2012 | 06/10/2012 | 42 | -9.9% |
| 01/20/2010 | 02/08/2010 | 14 | -8.1% |
| 09/17/2012 | 11/15/2012 | 42 | -7.7% |
| 09/19/2017 | 10/15/2014 | 19 | -7.4% |
| 06/15/2009 | 07/10/2009 | 19 | -7.1% |
| 02/22/2011 | 03/16/2011 | 17 | -6.4% |
| 01/02/2014 | 02/03/2014 | 22 | -5.8% |
| 05/22/2013 | 06/24/2013 | 23 | -5.8% |
| 10/20/2009 | 10/30/2009 | 9 | -5.6% |
| 03/27/2009 | 03/30/2009 | 2 | -5.4% |
| 05/11/2009 | 05/15/2009 | 5 | -5.0% |
| 12/08/2014 | 12/16/2014 | 7 | -5.0% |
| **Average** | | **36** | **-8.7%** |
| **Median** | | **19** | **-7.3%** |

Source: Bloomberg, Voya Investment Management, data as of 02/28/2018.

## Portfolio Positioning

| | | |
|---|---|---|
| **Equities** | ● | |
| U.S. Large Cap | ●○○ | Strong 2018 growth and corporate profits are positive, but opportunities outside the U.S. are more compelling |
| U.S. Mid Cap | ○○● | Beneficiaries of U.S. corporate tax reform |
| U.S. Small Cap | ○○● | Should benefit from lower corporate tax rates |
| International Equities | ○●○ | Rising global activity, lower political risks and attractive valuations make us positive, with a focus on Japan |
| Emerging Market Equities | ○○● | Supported by solid current account positioning and good growth |
| REITS | ●○○ | Relatively good yields, but full valuations and mature real estate cycle have us underweight |
| Commodities | ○●○ | Crude oil making a sustained rise over $60/barrel looks durable |
| **Fixed Income** | ● | |
| U.S. Core Fixed Income | ●○○ | Closer to fair value, but forthcoming U.S. Treasury issuance could dampen price potential |
| 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 | ●○○ | Low yields lead us to favor U.S. bonds |

Underweight ● Neutral ● Overweight ●

## Investment Outlook

The financial backdrop has shifted over the past month with the arrival of signs of inflation "green shoots" and a big dose of U.S. fiscal easing. Those are important changes at the margin for financial assets. Today, the concerns about inflation stem from tight labor markets in the U.S. and wage growth edging toward 3%. Tight labor markets will not by themselves cause inflation and academic work shows the relationship between wages and inflation is very loose, but rising wages could have a knock-on effect of denting profit margins if companies find they cannot pass higher prices on to consumers. In our work, it appears that companies have enough of a revenue boost to absorb current and slightly higher wage gains. Our view remains that the Federal Reserve will raise rates three times over 2018; even if it were to raise four times, it still would not be a restrictive Fed. The yield curve has plenty of room before it becomes flat, which would be a sign that a recession is closer to the horizon.

We think the equity market is likely to be able to withstand a peak in near-term economic activity indexes as earnings are still strong and stock buybacks are running at a record pace. Even with stronger inflation data, we are not facing runaway inflation. Our work shows that equity price/earnings multiples do not historically start to contract until inflation starts running above 4% — twice the Fed's 2% target. Therefore, we maintain our positive equity stance, noting the current strength in earnings is a positive fundamental factor to buttress any downside or volatility.

Within fixed income, we maintain our below-benchmark duration, which has helped portfolios benefit from rising bond yields. In our view, bonds have come a long way toward fair value and are looking a bit more attractive, at least on a short-term basis. As we look ahead to the third quarter, however, we are a bit concerned about the amount of U.S. Treasury issuance the market will need to absorb.

The recent escalation of global trade tensions should not be underestimated and may continue to contribute to the fragile mood in markets. Nonetheless, we see the strength from earnings and the low probability of recession as two factors that will carry the day. From a multi-asset perspective, we still see equities as able to outpace bonds and are positioning portfolios accordingly.

**Past performance does not guarantee future results.**

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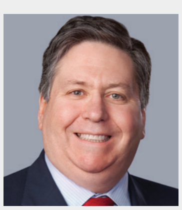
## Multi-Asset Strategies and Solutions Team



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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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