May 2019

Voya Multi-Asset Perspectives

A Strong Month, a Persistent Cycle

April proved to be another good month for global equities. The United States led the way with gains of 4.0% for the S&P 500 index, followed by international developed markets at 2.8% and emerging markets at 2.1%. Within fixed income, U.S. 10-Year Treasurys fell 0.6%; credit-related indexes fared well, with high yield gaining 1.4% and senior loans 1.7%.

We continue to believe the equity market is in a late-cycle environment, which becomes harder to navigate as concerns of recession start to rise. What leads us to believe it is late cycle? Three important factors are the decline in the unemployment rate (Figure 1), bubbling wage growth and peak profit margins; but the two missing ingredients for a classic, late-cycle environment are rising inflation and financial market excesses. The absence of those last two factors is particularly important, because they are the ones central banks tend to lean into when tightening monetary policy. Notwithstanding a pick-up in those factors, we think the cycle can persist into late 2020.

We rotated our portfolios a bit more toward U.S. large caps during April.

We believe small- and mid-cap companies are feeling the pinch of rising wages. Rising wages are not an intrinsically negative development, but because we are seeing more wage growth in the small- and mid-cap segments, and because these companies carry higher levels of leverage, they are more susceptible to increasing cost pressures. Holding higher allocations to large caps is a theme we expect to maintain in portfolios over the next year as the cycle continues to age.

Despite the broad-based rally in financial assets that has unfolded over the course of this year, investors have been steadily buying bonds and selling equities. We think this is largely a reflection of skittish sentiment, having just been through a gut-wrenching sell-off in late 2018. In spite of poor flows, we find comfort in data points such as global earnings revisions (Figure 2). Over the past two months they have stopped declining and shown much needed stabilization; the U.S. and emerging markets have seen the strongest revisions. We maintain our positive risk position toward the U.S. and emerging markets where we have the most visibility on monetary policy and earnings.

Tactical Indicators

Economic Growth (neutral):
U.S. growth slowdown is a necessary part of the convergence toward trend

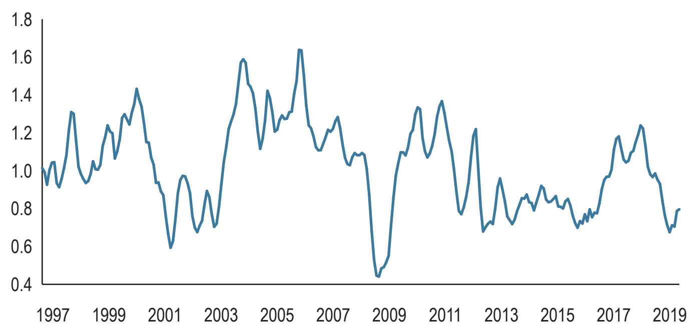
Fundamentals (improving):
Global earnings revisions have stabilized

Valuations (positive):
Stocks continue to look more attractive than bonds

Sentiment (neutral):
The majority of our preferred sentiment indicators are fluctuating in neutral territory

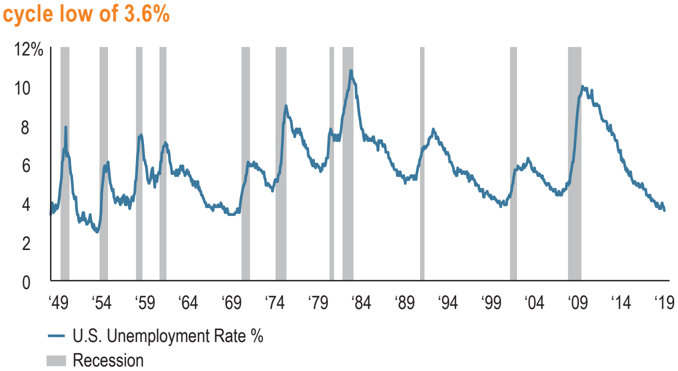
Figure 2. Global earnings expectations have improved

MSCI ACWI 3-Month Earnings Revision Ratio



Source: Bloomberg and Voya Investment Management, data as of 5/3/2019.

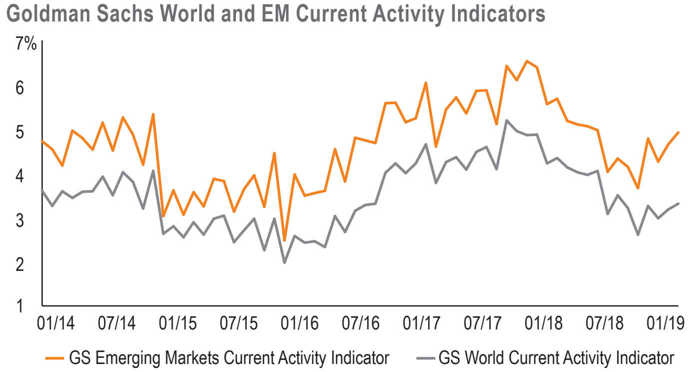
Figure 1. The U.S. unemployment rate has declined to a cycle low of 3.6%



Source: Bloomberg and Voya Investment Management, data as of 5/7/2019.

Figure 3. Current activity indicators are looking up, led by emerging markets

Goldman Sachs World and EM Current Activity Indicators



Source: Bloomberg and Voya Investment Management, data as of 4/30/2019.

Portfolio Positioning

Equities		
U.S. Large Cap	○○●	Reasonable valuations and earnings yields create relative attractiveness versus fixed income
U.S. Mid Cap	○●○	Tax reform is fully incorporated into prices from an after-tax profit standpoint
U.S. Small Cap	●○○	Susceptible to increasing operating costs because of high leverage
International Equities	○●○	We expect a stable dollar, continued weak activity in the Eurozone and accommodative monetary policy both there and in Japan
Emerging Market Equities	○○●	With less EM currency volatility and more policy support, we expect the growth outlook to brighten and equity performance to begin converging to DM
REITS	○●○	May act as a buttress due to their yield attractiveness during high levels of volatility
Fixed Income		
U.S. Core Fixed Income	○○●	We favor quality investment grade bonds over high yield as downgrade risk of BBBs could weigh on spreads
Non-Investment Grade	●○○	Senior loans are recovering in the wake of a weak 4Q18
International Fixed Income	●○○	Low absolute and relative yields lead us to favor U.S. bonds

Underweight ● Neutral ● Overweight ●

Investment Outlook

The April readings of our indicators show global growth continuing to slow as the benefits of U.S. fiscal policy diminish over the course of 2019. But we see fading benefits in the U.S. as part of a necessary process to slow U.S. GDP down to trend growth after a blistering 3% growth rate last year. Engineering a soft landing is a tricky thing to do: trying to slow the economy raises the risk of overdoing the tightening and tipping the U.S. into a recession. In this case, the Federal Reserve already has made progress toward renormalizing monetary policy by tightening in 2017 and 2018; those actions have raised short-term interest rates away from zero and closer to the neighborhood of neutral.

The Fed now has some room to wait to see if its policy of snugging up interest rates has worked. At the heart of the issue is whether the policy tightening can steady the meaningful decline in the unemployment rate. Despite the latest drop in the unemployment rate to 3.6%, wage growth is not broadly spiraling out of control. We continue to watch closely to see if our soft-landing scenario unfolds over this year and into 2020. In our view, a soft landing would support risk assets broadly.

Outside the U.S., we are looking for an upturn in economic data after the weakness of last year (Figure 3). The Chinese data in March were better, but we did not get a follow-through improvement in April. We see that there are a number of easing policy steps already in place, and think they likely point to economic stabilization after last year's surprise slowdown. Europe has been stuck in the economic doldrums. The European Central Bank is conveying a dovish message similar to those of other monetary authorities around the world. According to our data, domestic demand is holding up but the export sector is still suffering.

Past performance does not guarantee future results.

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