Voya Multi-Asset Perspectives

Moving the Goal Posts on Interest Rates

At the September Federal Open Market Committee (FOMC) meeting, policymakers raised their 2018 forecast for real GDP growth to 3.1%, up from 2.1% a year ago. They also raised the target range of the Fed funds rate to 2.00–2.25%, as expected. The Fed's dot plot and the Fed funds futures market imply one more rate hike this year and three hikes in 2019. Some voting members justify continuous rate increases as appropriate given that the Fed funds rate is below what is viewed as the "neutral" rate (r*), i.e., the rate which neither stimulates nor cools the economy.

Notably missing from Chairman Jay Powell's commentary was "the stance of monetary policy remains accommodative." Its removal could suggest that the Fed would be slower to hike rates in 2019, as the target rate gets closer to its 2.6% estimation of the neutral rate. On the other hand, New York Fed President John Williams, a staunch proponent of r*, said that it would no longer be the sole guide of monetary policy. Williams says policy will instead depend on data. This revelation gives investors more to consider when forecasting the direction of monetary policy. Currently, we view policy as equity market friendly. Unless something changes, it is likely to become less accommodative in 2019.

The United States has repeatedly overcome obstacles to remain the world's strongest economy, and U.S. asset values have flourished as a result. Foreign ownership of U.S. securities recently reached a record high of $18.3 trillion. The nation boasts a supportive business environment and is home to many of the world's most innovative companies. What's more, it has become an energy superpower: the Energy Information Agency estimates that the U.S. currently is the largest oil producer in the world. Despite the ramp-up in output, OPEC production cuts and Venezuelan supply disruptions have pushed oil prices to their highest levels since 2014. As a result, revenue and earnings growth in the energy sector have been remarkable and contributed to S&P 500 earnings growth in excess of 20% for the second straight quarter.

Tactical Indicators

Economic Growth (positive):
U.S. current activity signals continued above trend growth (Figure 1)

Fundamentals (positive):
Forecasts for U.S. earnings growth remain strong

Valuations (neutral):
Strong U.S. economic growth indicates higher long-end yields going forward

Sentiment (neutral):
Global risk appetite has bounced off panic levels (Figure 2)

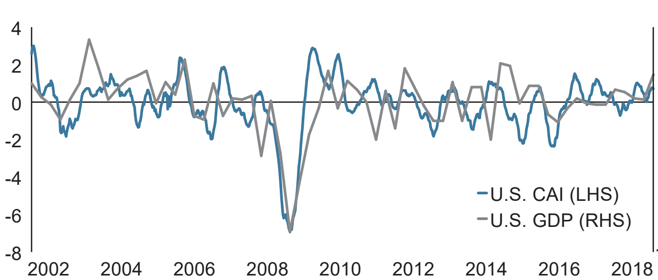
Figure 2. Market Sentiment is Improving

Credit Suisse Global Risk Appetite

Source: Credit Suisse, as of 09/30/18

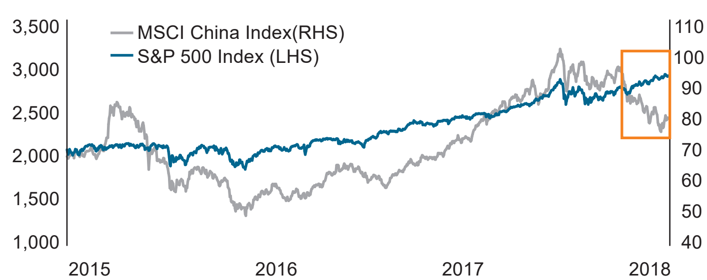
Figure 1. Economic Activity Remains on a Positive Trend

Voya U.S. Current Activity Indicator



Source: CFTC, Bloomberg, Voya Investment Management, as of 09/28/18

Figure 3. U.S. Equities Dramatically Outperformed Chinese Equities in the Third Quarter



Source: Bloomberg, Voya Investment Management, as of 09/30/18. **Past performance is no guarantee of future results. Investors cannot invest directly in an index.**

Portfolio Positioning

Equities		
U.S. Large Cap		Recent contraction in multiples and robust earnings 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		Small-cap's relative performance reversal accelerated in September as financial conditions tighten
International Equities		Labor market slack and low inflation, coupled with stabilization in European growth and bullish Japanese fundamentals, should support equities
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		Rising interest rates, full valuations and mature real estate cycle have us underweight
Commodities		Positive global growth, still accommodative global monetary policy and increases in inflation should support commodity prices over the medium term
Fixed Income		
U.S. Core Fixed Income		Tighter Fed policy and stronger economic growth will push yields higher
Non-Investment Grade		Tight spreads offer little value in the face of rising rates. Income potential and floating rate coupons still make senior loans attractive
International Fixed Income		Low absolute and relative yields lead us to favor U.S. bonds

Underweight Neutral Overweight

Investment Outlook

A stable economic backdrop, well-communicated plan for monetary policy and increasing earnings keep us favoring stocks over bonds. U.S. stock returns were mixed in September as small caps gave back more of their year-to-date outperformance versus large caps. The size trade reversal coincided with a pullback of small-cap earnings growth. With tax benefits fully priced in and trade concerns already front of mind for most investors, we believe small caps will continue to lag large caps through year-end.

U.S. equities have dramatically outperformed other markets year-to-date, which reflects the U.S.'s ability to withstand the effects of ongoing trade disputes. Trade tensions in North America have eased with the recent news that NAFTA essentially could be preserved, and tensions with Europe have eased, but strains between the U.S. and China show no signs of abating. So far, the stock market says the U.S. is winning (Figure 3). Although we believe U.S. corporate earnings should make another strong showing in the third quarter, the performance gap between the U.S. and other regions of the world is likely to narrow.

Japan was the best performing regional equity market in September. Reflationary policies have flowed through to consumers and businesses, pushing nominal growth high enough that the Bank of Japan has trimmed its long-term bond purchases. Japanese yields jumped, U.S. dollar gains paused and local markets appear poised to gain momentum. Grumblings over the Italian populist movement and setbacks in Brexit negotiations have held back European stocks. The U.K. officially exits the European Union on March 29, 2019, but there remain disagreements over the terms of withdrawal that could drag the process out longer than expected. Nevertheless, the systemic impact likely will be more muted than initially feared when the referendum took place in 2016; most of the fallout should be confined to the U.K.

Emerging markets seem to be stabilizing. U.S. dollar strength has abated, trade pressures are old news and China policy support is in the early stages of filtering through to its own and other economies. We anticipate that as effects of U.S. fiscal stimulus fade, emerging countries' growth will pick up and asset prices will bounce back from their generally depressed levels.

With the projected path for both short and long rates higher, and mostly healthy corporate balance sheets, investment grade and high yield credit look more attractive to us than U.S. Treasurys. Yet, with spreads tightening to new lows, we do not see compelling opportunities in high yield. Instead, we are tactically overweight senior loans. We are watching credit conditions, earnings growth and housing starts for signs of stress that would change our preference for equities over bonds.

Past performance does not guarantee future results.

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