

Rates are in the driver's seat

US markets have not taken kindly to the Fed's renewed course of monetary tightening, but the effects of the Fed's actions are stretching far beyond US shores.

Tactical indicators



Economic growth (negative)

After two quarters in a row of negative GDP growth, we expect 3Q to register positive growth before heading into year-end.



Fundamentals (neutral)

US earnings expectations have adjusted down and as of the beginning of the reporting season, have generally been in line with forecasts.



Valuations (positive)

Earnings multiples on US equities have compressed by roughly 30% since the start of the year. Small caps have given back all of their stimulus-driven gains, sitting at levels last seen in early 2020, now at forward P/E ratios materially lower than those of large caps.



Sentiment (neutral)

Markets are oversold according to a host of technical indicators, including the AAll Index, put/call ratios and various moving-average measures, suggesting cyclical assets could be poised for a counter-trend rally.

US interest rates are calling the shots

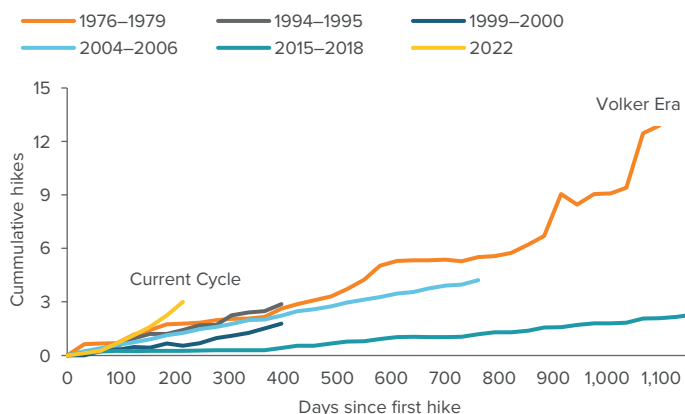
Amid ongoing market volatility, Treasury yields across the curve have been rising dramatically, up more than 1% since early August. The less accommodative policies of the Federal Reserve, including substantial rate hikes and reduction of its vast Treasury and mortgage bond holdings, are set to continue for some time, leading to stress in markets, domestically and abroad. We highlight the lead role of US interest rates across asset classes, and how we are positioning ourselves to take advantage of the resulting opportunities.

The Fed is committed to quashing inflation no matter the cost. With a string of 75 basis-point (bp) rate hikes behind it, the Fed is likely to continue its aggressive stance into early next year at least. We believe inflation is peaking and will decline markedly into next year, giving the Fed breathing room to pause. In the meantime, the ripple effects of the Fed's actions to date are spanning the globe.

Hawkish Fed action is likely to result in a shallow but potentially prolonged recession. The drastic tightening of financial conditions driven by short rates is rising at historically extreme velocity (Figure 1). Conditions are on course to worsen before they get better. Labor markets remain strong despite a decline in job openings, with demand for workers continuing to surpass supply, providing a key buffer to economic weakness. Nonetheless, given stresses in other areas of the economy, we are holding our neutral equity position with a generally defensive tilt.

Figure 1: The Fed is raising rates at the fastest pace in modern times

Major Fed funds rate hike cycles



As of 09/30/22. Sources: Voya Investment Management and Bloomberg.

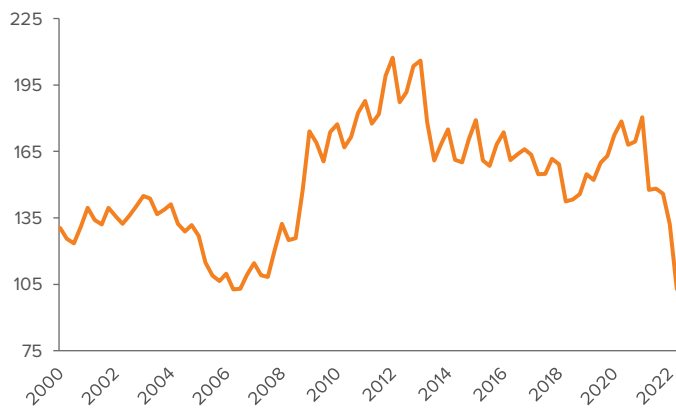
Portfolio positioning

Equities	Neutral	
U.S. large cap		Bigger US firms are better positioned to withstand prolonged inflationary pressures and have more durable earnings streams than companies of other regions or sizes.
U.S. small cap		Small caps have retraced all their stimulus driven gains and now trade at a discount to large caps. We believe severely oversold conditions could unwind and small caps would disproportionately benefit from the bounce.
International equity		Europe is likely to enter a recession as it contends with energy supply issues and heightened geopolitical risks. Japan's efforts to stem currency weakness are at odds with yield curve control, a program it may need to end to meaningfully impact exchange rates.
Emerging market equity		Outlook mixed by region. Covid driven lockdowns across China have disrupted economic activity. China and EM Europe are adversely exposed to Russia-Ukraine conflict.
REITs		REITs remain expensive; we see other income investments as better alternatives.
Fixed income	Neutral	
U.S. core		Favor high quality credit given yield pickup over sovereign bonds, generally healthy corporate balance sheets. We have extended duration as we think growth will slow faster than expected and drag down long dated yields.
Inflation (TIPS)		Breakevens are meaningfully cheaper, but actual inflation likely has peaked and could fall quickly.
Non-investment grade		High yield spreads have widened but do not provide sufficient compensation for likely rise in defaults that will accompany looming recession.
International debt		Low relative yields and scope for stronger US dollar keep us favoring US bonds.

Underweight Neutral Overweight

Rising rates are taking their toll on housing following several years of extremely strong home demand and price increases. This newfound weakness in housing should flow through to the “shelter” component of the CPI, tugging down inflation. Since the start of the year, the average US 30-year mortgage rate has more than doubled and now sits near 7%, decreasing home affordability to the lowest levels since 2006 (Figure 2). In response, home builder sentiment and new and existing home sales have plummeted. This has resulted in a decline of the closely watched Case-Shiller home price index for the first time since 2019, breaking three years of continuous price increases. Another sign of weakening housing demand is the price of lumber, now lower than prior to the pandemic.

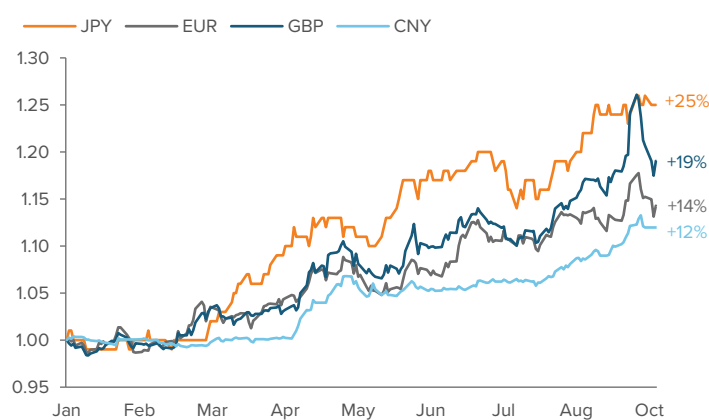
Figure 2: U.S. home affordability dropped sharply to levels last seen in 2006



As of 09/30/22. Source: Bloomberg.

A stronger dollar is complicating the global economic picture as the US central bank has been far more hawkish than those of other developed countries (Figure 3). The dollar has become a high-yielding currency. We expect it to remain strong, though see it is overbought on some technical measure and could be due for a short-term correction. Meanwhile, the ECB is plotting a less aggressive course, Japan has stood by its extremely accommodative policies, and the BoE recently announced it would buy “unlimited” Gilts to maintain low rates, a policy of the newly installed UK administration. US dollar strength is evidence of the relative safety and stability of the greenback and serves as one of the reasons we continue to prefer the US over other regions during this period of heightened volatility.

Figure 3: Since bottoming mid-2021, the U.S. dollar has risen substantially against other developed market currencies



As of 10/05/22. Source: Bloomberg. Past performance is no guarantee of future results.

Despite the BOJ's unlimited bond purchases, bond yields are testing the 0.25% ceiling. While other global bond market yields have risen, Japan's has so far been static at the BOJ's chosen rate peg. As a result, the yen has weakened considerably. The BOJ has (for now) chosen to intervene in currency markets, dipping into its dollar reserves to prop up the yen. We're skeptical of the BOJ's ability to defend the yen while maintaining yield curve control. We cut our exposure to Japan and are closely monitoring signals from authorities that indicate they are more committed to supporting their currency than current actions and history suggest.

With US interest rates rising alongside the dollar, we think inflation will fall faster and farther than the consensus. We believe declining energy and core goods prices, reduced shelter costs, softening labor market, and decreased domestic demand will pull inflation down to the 4–5% range by the middle of next year. The necessary drop in nominal GDP or expectation thereof should weigh heavily on long dated yields. As a result, we have extended duration in fixed income portfolios and maintain our preference for high-quality credit bonds.



Paul Zemsky, CFA
Chief Investment Officer,
Multi-Asset Strategies



Barbara Reinhard, CFA
Head of Asset Allocation,
Multi-Asset Strategies

Multi-asset strategies and solutions team

Voya Investment Management's Multi-Asset Strategies and Solutions (MASS) team, led by Chief Investment Officer Paul Zemsky, 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/or reduce portfolio risk.

Past performance does not guarantee future results.

This market insight has been prepared by Voya Investment Management for informational purposes. Nothing contained herein should be construed as (i) an offer to sell or solicitation of an offer to buy any security or (ii) a recommendation as to the advisability of investing in, purchasing or selling any security. Any opinions expressed herein reflect our judgment and are subject to change. Certain of the statements contained herein are statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (1) general economic conditions, (2) performance of financial markets, (3) interest rate levels, (4) increasing levels of loan defaults, (5) changes in laws and regulations and (6) changes in the policies of governments and/or regulatory authorities.

The opinions, views and information expressed in this commentary regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Fund holdings are fluid and are subject to daily change based on market conditions and other factors.

The distribution in the United Kingdom of this Market Insight and any other marketing materials relating to portfolio management services of the investment vehicle is being addressed to, or directed at, only the following persons: (i) persons having professional experience in matters relating to investments, who are "Investment Professionals" as defined in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Financial Promotion Order"); (ii) persons falling within any of the categories of persons described in Article 49 ("High net worth companies, unincorporated associations etc.") of the Financial Promotion Order; and (iii) any other person to whom it may otherwise lawfully be distributed in accordance with the Financial Promotion Order. The investment opportunities described in this Market Insight are available only to such persons; persons of any other description in the United Kingdom should not act or rely on the information in this Market Insight.

In addition, please be advised that Voya Investment Management is a non-Canadian company. We are not registered as a dealer or adviser under Canadian securities legislation. We operate in the Provinces of Nova Scotia, Ontario and Manitoba based on the international adviser registration exemption provided in National Instrument 31-103. As such, investors will have more limited rights and recourse than if the investment manager were registered under applicable Canadian securities laws.

The Capital Markets Authority and all other Regulatory Bodies in Kuwait assume no responsibility whatsoever for the contents of this Market Insight and do not approve the contents thereof or verify their validity and accuracy. The Capital Markets Authority and all other Regulatory Bodies in Kuwait assume no responsibility whatsoever for any damages that may result from relying on the contents of this Market Insight either wholly or partially. It is recommended to seek the advice of an Investment Advisor.

Voya Investment Management does not carry on a business in a regulated activity in Hong Kong and is not licensed by the Securities and Futures Commission. This Market Insight is issued for informational purposes only. It is not to be construed as an offer or solicitation for the purchase or sale of any financial instruments. It has not been reviewed by the Securities and Futures Commission.

Voya Investment Management accepts no liability whatsoever for any direct, indirect or consequential loss arising from or in connection with any use of, or reliance on, this insight, which does not have any regard to the particular needs of any person. Voya Investment Management takes no responsibility whatsoever for any use, reliance or reference by persons other than the intended recipient of this insight. Any prices referred to herein are indicative only and dependent upon market conditions. Past performance is not indicative of future results. Unless otherwise specified, investments are not bank deposits or other obligations of a bank, and the repayment of principal is not insured or guaranteed. They are subject to investment risks, including the possibility that the value of any investment (and income derived thereof, if any) can increase, decrease or in some cases be entirely lost, and investors may not get back the amount originally invested. The contents of this insight have not been reviewed by any regulatory authority in the countries in which it is distributed. The opinions and views herein do not take into account your individual circumstances, objectives, or needs and are not intended to be recommendations of particular financial instruments or strategies to you. This insight does not identify all the risks (direct or indirect) or other considerations which might be material to you when entering any financial transaction. You are advised to exercise caution in relation to any information in this document. If you are in doubt about any of the contents of this insight, you should seek independent professional advice.

This material may not be reproduced in whole or in part, in any form whatsoever, without the prior written permission of Voya Investment Management.

©2022 Voya Investments Distributor, LLC • 230 Park Ave, New York, NY 10169 • All rights reserved.

IM2527407 • CMMC-MAP-1120 • 103124 • 102622