September 2017

Voya Multi-Asset Perspectives

Macro Themes

Domestic risk assets cooled off in August. The S&P 500 index eked out a slight gain of 0.31%; small cap equities, as measured by the Russell 2000 index, were down 1.27%. Internationally, MSCI EAFE was virtually flat for the month, with MSCI EM the lone bright spot, gaining 2.23%. U.S. 10-year Treasury yields sat at 2.12%, after starting the month at 2.29%, reflecting the broadly "risk-off" environment.

Economic data in July were mostly upbeat as "hard" measures finally appeared to converge with positive survey-based measures. Retail sales beat expectations, rising 0.6% month-over-month (MoM) and 4.2% year-over-year (YoY). U.S. Industrial production rose to 2.2% YoY, the best reading since late 2014. Markit Manufacturing PMI dipped to 52.5 for the month but still signaled expansion. The Philadelphia Fed Business Outlook, University of Michigan Sentiment Index, Richmond Fed Manufacturing Index and Kansas City Fed Manufacturing Index all registered gains, reaffirming positive sentiment both for consumers and businesses. Finally, second quarter GDP growth was revised to 3%, rather than 2.6% reported initially; and corporate profits rose 1.3% quarter over quarter, after falling 2.1% during Q1. (See Figures 1 and 2.)

Domestic small cap equities were one of the worst performing risk asset classes for the second month in a row. After surging post-election on the prospect of corporate tax reform, small caps have managed only a 4.42% gain year-to-date. The S&P 500 has gained 11.93% year-to-date, as prospects of tax reform this year have dwindled and the weaker U.S. dollar has helped larger companies with more exposure to overseas revenues. On the other hand, emerging market equities remain the darling of risk assets, buoyed by the weaker dollar, dovish Federal Reserve, accelerating global economic growth and easier financial conditions. Ten-year U.S. Treasury yields closed August at the lowest level since last November, as they reacted to renewed geopolitical tensions with North Korea and to the impact of Hurricane Harvey. Yields remain at the very low end of their post-election trading range.

Tactical Indicators

Economic Growth (Good):
2Q GDP growth revised up to 3.0%, led by increases in consumer spending and business investment

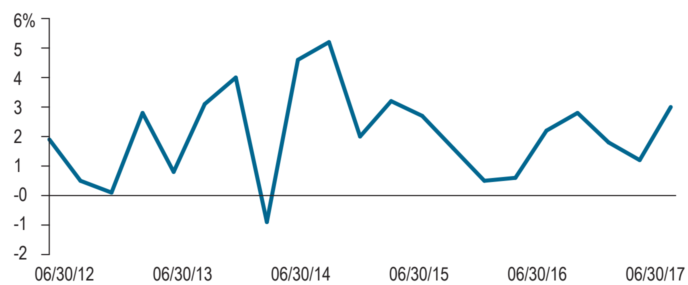
Fundamentals (Good):
Corporate profits rebounded in Q2, a positive sign for the business cycle

Valuations (Stable):
With earning season almost finished, Q2 S&P 500 earnings are tracking almost 10% YoY growth, with two thirds of companies beating expectations

Sentiment (Neutral):
Risk off environment in August has pushed sentiment further into neutral territory, after hovering close to overbought earlier this summer

Figure 1. Quarterly GDP Growth has been Uneven but Upward-Trending

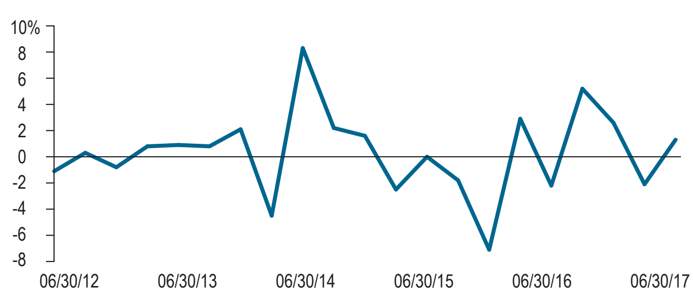
GDP QoQ Growth



Source: Bloomberg

Figure 2. Though Volatile, Corporate Profits also are Rising

Corporate Profit Growth QoQ



Source: Bloomberg

Portfolio Positioning

Equities	●	
U.S. Large Cap	○○●	Stronger 2H 2017 growth and better corporate profits positive; subdued U.S. dollar should benefit multi-nationals
U.S. Mid Cap	○●○	Valuations look somewhat expensive, but should benefit from strong economic activity
U.S. Small Cap	○○●	Underperforming large caps as the current administration's growth agenda stalls and the U.S. dollar continues to weaken
International Equities	○●○	Rising global activity, lower political risks and attractive valuations are positive though a stronger euro is a headwind
Emerging Market Equities	○○●	Easy financial conditions, solid global growth and attractive valuations are supportive
REITS	○●○	Relatively attractive yields, but full valuations and mature real estate cycle have us neutral
Commodities	○●○	Crude oil is off its lows, but recent trend is not encouraging. Industrial metals hampered by tightening conditions in China
Fixed Income	○	
U.S. Core Fixed Income	●○○	U.S. Treasury yields at bottom of post-election trading range, anchored by benign inflation and geopolitical tensions
Non-Investment Grade	○○●	Spreads have widened recently, led by energy, but still near cycle tights. Income potential and floating rate coupon still make senior loans attractive
International Fixed Income	●○○	Persistent deflationary pressures and low yields lead us to favor U.S. bonds

Underweight ○ Neutral ● Overweight ●

Investment Outlook

Currency markets have been top of mind for investors this summer as the broad based weakness in the U.S. dollar has been a major influence on cross-asset performance. We first take a look at what has been driving the recent weakness and what we would expect going forward, then look into the implications for regional equities.

The much anticipated Jackson Hole symposium was expected to be influential for currency markets, as both Federal Reserve Chair Janet Yellen and European Central Bank President Mario Draghi were scheduled to speak. Both had an impact on their respective currencies; not for what they said, but for what they didn't say. Yellen neglected to mention any policy related impacts from the recent easing of financial conditions and Draghi did not address the potential impact the recent rally in the euro would have on future policy decisions. This pushed the euro–U.S. dollar exchange rate to fresh year-to-date highs and continued the divergent trends of the dollar and real interest rate differentials that we have seen for much of 2017. Looking at an average of the euro, yen and pound, which account for roughly 80% of the DXY index, two-year real rate differentials versus the dollar have moved lower by about 50 basis points (bp) since the start of the year while the dollar has fallen approximately 9% versus those currencies. We will be closely monitoring the dollar to see if it can mount a sustained move higher. Additionally, we will be paying close attention to inflation data and various U.S. political issues, most notably, raising the debt ceiling.

European equities have felt the brunt of U.S. dollar weakness, with earnings revisions seeing downgrades and the equity indexes giving up nearly all of their gains since the French elections. Emerging markets have been a beneficiary as Voya's market-cap weighted emerging market policy rate metric has eased nearly 50 bp since the beginning of the year, along with a broader easing of financial conditions. Japan has been interesting. Investors would expect the recent yen strength to coincide with weakness in the equity market, but the TOPIX index has been fairly range-bound during the quarter after grinding higher earlier in the year. Earnings continue to reach new highs thanks to improving profit margins as companies remain focused on corporate governance measures. As the political discord surrounding Prime Minister Abe has subsided, as evidenced by recent upticks in his approval rating, the TOPIX is trading nearly three points below its peak multiples this cycle.

Past performance does not guarantee future results.

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