Portfolio Manager Quarterly Commentary | June 30, 2017

VY® Clarion Global Real Estate Strategy

> Worldwide Location Means Real Diversification

Many investment goals—growth potential, income and diversification— may be realized with global real estate investment trusts (REITs).

- **Historically strong growth potential, income and diversification—**REITs combine historically strong return potential with distribution income—and offer low historic correlation to stocks and bonds.
- **One of the world's largest real estate investment companies—**CBRE Clarion, one of the world's largest real estate investment companies, has been 100% dedicated to real estate securities since 1984.
- **Strong long-term historical returns—**Research analysts identify attractive investment opportunities around the world, backed by solid real estate fundamentals.

Key Takeaways

- For the quarter, the Strategy modestly outperformed its benchmark, the FTSE/EPRA NAREIT Developed Index – Net.
- Global real estate stocks moved modestly higher during the quarter, up +2.7%, and are positive year-to-date, up +4.8%
- We believe real estate stocks remain attractively priced, trading at a 7% discount to our estimate of the inherent value of the underlying real estate held by these companies

Market Review

Global property stocks delivered a positive total return for the quarter, up +2.7%, as returns were positive in all markets except Australia. The European region delivered the strongest performance, while property companies in the Americas and Asia-Pacific regions were modestly positive for the quarter. Continental European real estate stocks moved higher, catalyzed by a favorable French election outcome, and supported by continued evidence of improving economic and property fundamentals. Hong Kong and Singapore property stocks also moved higher, maintaining their status as the best performing geographies year-to-date as property fundamentals showed marginal improvement. North American REITs were modestly positive despite woes in the retail and net lease sectors, which weighed on overall total return earlier in the quarter. Mall stocks in particular rebounded in June, but were negative for the quarter, as were shopping centers. A number of the other U.S. property sectors outperformed, including technology, industrial, residential and healthcare. By the end of June, interest rates were moving steadily higher but still finished lower than three months prior. The yield on the U.S. 10-year Treasury finished June at 2.30% versus 2.39% at March 31st. The USD generally weakened versus other major currencies, with the exception of the JPY, thus continuing a year-to-date trend of general weakening.

The prospects for renewed and improved economic growth as the result of potential stimulus in the U.S. and economic growth globally should prove positive for tenant demand. We believe that real GDP growth in the U.S. in 2017 will improve to the 2.0% range and that the yield on the U.S. 10-year Treasury will trend gradually higher. Monetary policy will tighten in the U.S. but remain relatively more accommodative elsewhere. The U.S. Federal Reserve Bank will likely raise the Fed Funds rate one to two additional times (25 basis points each) during 2017 after having raised twice this year, to the current target rate between 1.0% and 1.25%. Central banks elsewhere including the ECB and BOJ will remain relatively more accommodative given sluggish economic conditions in these geographies, although "tapering" is nearer with the ECB. Bond yields by the end of the quarter were steadily rising as a result of the above. Real estate stocks are performing well despite near-term headwinds from expected higher interest rates, particularly in the U.S. With real estate companies trading at an approximate 7% discount to our estimate of inherent real estate value of net asset value (NAV), and an implied capitalization rate approaching 6% globally, we believe real estate stocks remain attractively priced.

Portfolio Review

On a gross of fee basis, the Strategy outperformed during the quarter as stock selection and asset allocation decisions added value. Stock selection in the U.S. was the largest contributor to relative performance, which was as much the result of risk mitigation by avoiding underperformers as it was investing in outperformers. This was particularly true in the troubled sectors of malls, shopping centers and net lease, all of which had a difficult quarter given the continued negative headlines surrounding retailers and trends in on-line shopping. By sticking with quality companies and being underweight a number of underperforming sectors, including net lease and shopping centers, we generated positive relative performance. Stock selection in Australia and Hong Kong also added relative value. Favorable stock selection in Australia was generated by an overweight position in outperforming industrial companies as well as avoiding underperforming companies in the retail sector. In Hong Kong, stock selection was superior among both landlord-oriented companies as well as the developers during the quarter. From an asset allocation standpoint, positioning decisions in the Americas and the Asia-Pacific region benefited relative performance during the quarter, while European positioning detracted slightly from relative performance despite strong absolute performance, as London office stocks underperformed.

Outlook and Current Strategy

In North America, we remain positive on property fundamentals in the U.S. We are overweight sectors and stocks where we are positive on the fundamentals and valuations seem reasonable to cheap; we are underweight where fundamentals are weak and valuations are not cheap to justify poor fundamentals. We prefer attractively valued stocks that offer visible earnings growth, conservative balance sheets and modest development pipelines. In the U.S., we favor class-A mall companies, technology, and select residential and industrial companies; we are more selective in the storage, healthcare, net lease, office, shopping center and hotel sectors. Within residential, we like manufactured housing, single family home-for-rent companies and select coastal apartment REITs. Class-A mall stocks have been weak on on-line shopping concerns and we believe offer attractive value at these levels. We remain selective on the more bond-like sectors that offer modest growth and trade less attractively relative to our estimate of underlying private market real estate value. We favor companies which offer growth in an economic environment which will see fiscal stimulus, increased consumer spending and higher rates of inflation. In Canada, we prefer companies with solid balance sheets, stable earnings growth and above average dividend yield.

In the Asia-Pacific region, we like Hong Kong and Japan, but remain cautious on Singapore and Australia. We have become more positive on Hong Kong this year as valuations remain attractive relative to property fundamentals which are showing moderate signs of improvement off of sluggish levels. In Japan, we prefer companies with exposure to the Tokyo office market, which continues to experience improved rental growth as vacancies have fallen below the 4% threshold at which landlords enjoy increasing pricing power, particularly with a modest increase in inflation expectations. We also like J-REITs with access to robust acquisition pipelines from their sponsors. Australian investments are benefiting from an attractive combination of yield and growth but are reaching valuations levels which give us some pause, particularly in the residential market. Elevated housing policy risk remains a constant in the Asia-Pacific region, which otherwise is a region that should benefit from improving global economic growth.

We are more positive on Europe given indications of renewed economic growth and stable property fundamentals; macro-economic risk remains elevated. Given continued uncertainty surrounding the future economic and political relationship between the U.K. and E.U., and issues surrounding where we are in the economic and real estate cycles, we believe cautious positioning is appropriate in the U.K., although have become somewhat more positive given valuations. Caution is particularly warranted in the office sector, where any future impact of Brexit would be particularly felt. This is despite tenant demand and investor demand which has exceeded expectations immediately following the Brexit referendum vote which occurred a year ago. U.K. property shares will continue to be volatile and subject to the political vagaries of this political process, despite arguably “pricing in” much of this risk. On the Continent, economic releases reflect improving economic conditions off a low base against a backdrop of attractive financing and macro political risk that may be diminishing. We have become more positive on markets with dependable growth, including Germany, and those with attractive valuations, including a number of the French-based shopping center/mall companies as well as property companies in Spain.

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The **FTSE EPRA/NAREIT Developed Index** is designed to track the performance of listed real estate companies and real-estate investment trusts (REITS) worldwide. Relevant activities are defined as the ownership, disposal and development of income-producing real estate. Constituents are classified into distinct property sectors based on gross invested book assets, as disclosed in the latest published financial statement. Index constituents are free-float adjusted, liquidity, size and revenue screened. The Index does not reflect fees, brokerage commissions or other expenses of investing. **Investors cannot invest directly in an index.**

The **Bloomberg Barclays U.S. Aggregate Bond Index** is an unmanaged index composed of securities from the Bloomberg Barclays Capital/Government/ Corporate Bond Index, Mortgage-Backed Securities Index, and the Asset-Backed Securities Index including securities that are of investment grade quality or better and have at least one year to maturity. The Index does not reflect fees, brokerage commissions, taxes or other expenses of investing. **Investors cannot invest directly in an index.**

Principal Risks: All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield. **Foreign Investing** poses special risks including currency fluctuation, economic and political risks not found in investments that are solely domestic. **Emerging Market** stocks may be especially volatile. Investing in stocks of **Small- and Mid-Sized Companies** may entail greater volatility and less liquidity than larger companies. **Concentration** of investments in one or more real estate industries may subject the Fund to greater volatility than a portfolio that is less concentrated. **Price Volatility**, liquidity and other risks accompany an investment in **Global Real Estate Equities**. The risks of REITs are similar to those associated with direct ownership of **Real Estate**, such as changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand and the management skill and creditworthiness of the issuer. Other risks of the Portfolio include but are not limited to: **Company Risks, Currency Risks, Convertible Securities Risks, Rule 144A Securities Risks, Initial Public Offerings Risks, Investment By Other Funds Risks, Market Risks, Issuer Non- Diversification Risks, Other Investment Companies' Risks, Liquidity Risks and Securities Lending Risks. Investors should consult the Portfolio's Prospectus and Statement of Additional Information for a more detailed discussion of the Portfolio's risks. An investment in the Portfolio is not a bank deposit and is not insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.**

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