April 2018

Voya Multi-Asset Perspectives

Risk-Off Mood Persists

March was another risk-off month for global equities with the broadest measure, the MSCI All Country World Index, down 2.2%. Japan and the United States fared the worst, shedding 2.8% and 2.5%, respectively, while emerging markets lost 2.0%. Within the U.S., value outperformed growth; small caps and mid-caps were able to make modest gains of 1.3% and 0.1%, respectively. Because of the decline in equities, fixed income indexes posted gains: the Bloomberg U.S. Aggregate rose 0.6%, the Bloomberg Global Aggregate Bond gained 1.1% and the longer-duration 10-year U.S. Treasury climbed 1.3%. Within credit-related fixed income, U.S. senior loans rose 0.3% and high yield fell 0.6%.

As we have written previously, the equity market weakness earlier this year was prone to a re-test of the lows reached on February 8, in part because the initial move was so swift over a relatively short period. That re-test appears to be the path the equity markets have been working through in March and early April.

So far, the return of forgotten volatility has produced some knock-on effects. Most of the sentiment indicators we look at have reversed their high levels of optimism that were prevalent in late January (Figure 1). What's more, we have seen two straight months of inflows into Treasurys and about one-quarter of the massive inflows into equities year-to-date have reversed. These data points are telling us that the excessive exuberance in equities has been wrung out of financial market participants. While it seems to have distressed some, we see it as a return to more normal levels of volatility, which is a much healthier footing for equities to stand on going forward.

Tactical Indicators

Economic Growth (positive):
Growth is not likely downshifting but cooling from its above-trend boil

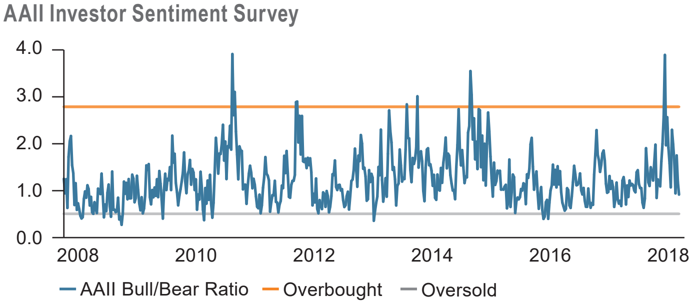
Fundamentals (neutral):
Good economic growth is supportive of global corporate profits

Valuations (neutral):
Equity valuations look more normal, still more attractive than fixed income

Sentiment (neutral):
Elevated sentiment self-corrected in the February sell-off in equities, continues to decline

Figure 1. Market Sentiment has Reversed from the Optimism that Prevailed in January

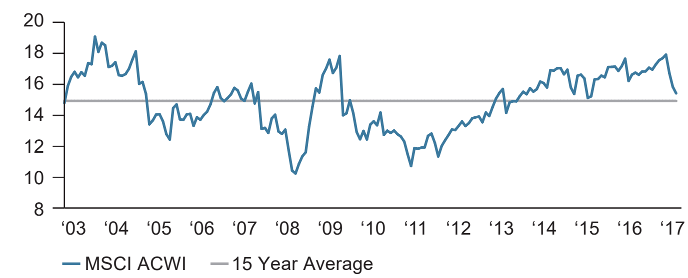
AAII Investor Sentiment Survey



Source: Bloomberg and Voya Investment Management, data as of 03/31/2018.

Figure 2. The Recent Pullback has Reduced Equities to Levels that are Closer to Long-Term Averages

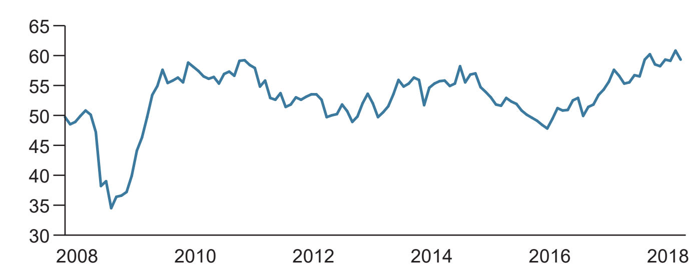
MSCI ACWI Forward P/E Ratio



Source: Bloomberg and Voya Investment Management, data as of 03/31/2018.

Figure 3. Purchasing Manager Activity is Moderating from High Levels Due to Trade Uncertainty

U.S. ISM Manufacturing PMI



Source: Bloomberg and Voya Investment Management, data as of 03/31/2018.

Portfolio Positioning

Equities		
U.S. Large Cap		Strong 2018 growth and corporate profits are positive, but opportunities outside the U.S. are more compelling
U.S. Mid Cap		Beneficiaries of U.S. corporate tax reform
U.S. Small Cap		Should benefit from lower corporate tax rates
International Equities		Rising global activity, lower political risks and attractive valuations make us positive
Emerging Market Equities		Supported by solid current account positioning and good growth
REITS		Relatively good yields, but full valuations and mature real estate cycle have us underweight
Commodities		Crude oil making a sustained rise over $60/barrel looks durable
Fixed Income		
U.S. Core Fixed Income		Closer to fair value, but forthcoming U.S. Treasury issuance could dampen price potential
Non-Investment Grade		High yield spreads near cycle tights, offer less value in the face of rising rates. Income potential and floating rate coupon still make loans attractive
International Fixed Income		Low yields lead us to favor U.S. bonds

Underweight Neutral Overweight

Investment Outlook

This ongoing corrective phase has not modified our medium-term view that the risk-reward between equities and fixed income still favors equities. On a valuation basis, the recent pullback has reduced equities to levels that are more normal. On a global view, the MSCI All Country World Index forward price/earnings multiple at 15.3x is now back around its 15-year average (Figure 2). In terms of fundamentals, we think the complacency of the growth outlook appears to be correcting as purchasing managers are moderating from high levels and trade uncertainty dominating the narrative (Figure 3).

Our forward-looking indicators do not signal a meaningful downshift of growth, but more likely point to coming off the boil from well above trend levels. Over the next quarter or two, we will likely experience a moderation of growth rather than something akin to the growth scare of 2015. Corporate earnings are an area of fundamental support for equity prices. Most of the excessive, euphoric sentiment in January (a contrarian indicator) has ameliorated. Although our sentiment indicators did not get to a capitulation-oversold reading similar to what we saw in February 2016, the swamping of excessive ebullience can help focus the equity market on the positive fundamental earnings picture.

We think the return to more volatile markets will be a hallmark of equities going forward. This is in part due to the late stage of the cycle: labor markets are tightening, wages are rising and monetary policy is tightening, which is boosting funding costs for both the public and private sector. Our models and qualitative work tell us that, even with a late-stage environment, equities can outperform fixed income this year.

Bond yields look to be trading in a range of 2.75–3.00%. There may be intermittent movements to touch the top and bottom of the range, but without an inflation overshoot, yields over 3% look just a bit out of reach. We have been maintaining our long held position in floating rate debt to give our portfolios the potential to reap higher coupons as funding rates move up this year. The high yield market does not score as attractively on most of our metrics.

We see near-term risks for emerging market equities to feel the brunt of trade war worries, but with underlying fundamentals — such as current account balances and financing needs — in positions of strength to weather the news flow over the medium term. Weakness in emerging markets is a buying opportunity in our view. Our expectation is for the U.S. dollar to remain on its back foot the rest of the year, moving lower in fits and starts — which should be a propellant for non-U.S. developed international markets.

Past performance does not guarantee future results.

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Multi-Asset Strategies and Solutions Team

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

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

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