Voya Global Perspectives

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Executive Summary

- In the first half of 2019 our market theme, "The Storm before the Calm," has unfolded as we predicted
- We originally anticipated a rising rate environment, however, this outlook has changed and is allowing for a rebound in fundamentals
- Markets have been soaring, with the S&P 500 posting its best half-year gain since 1997
- Corporate earnings may be the best indicator to follow as they continue to beat all-time highs
- An apt metaphor for investors may be to take advantage of the blowing wind and go "full sail"

Midyear Update: May Showers Bring June Flowers

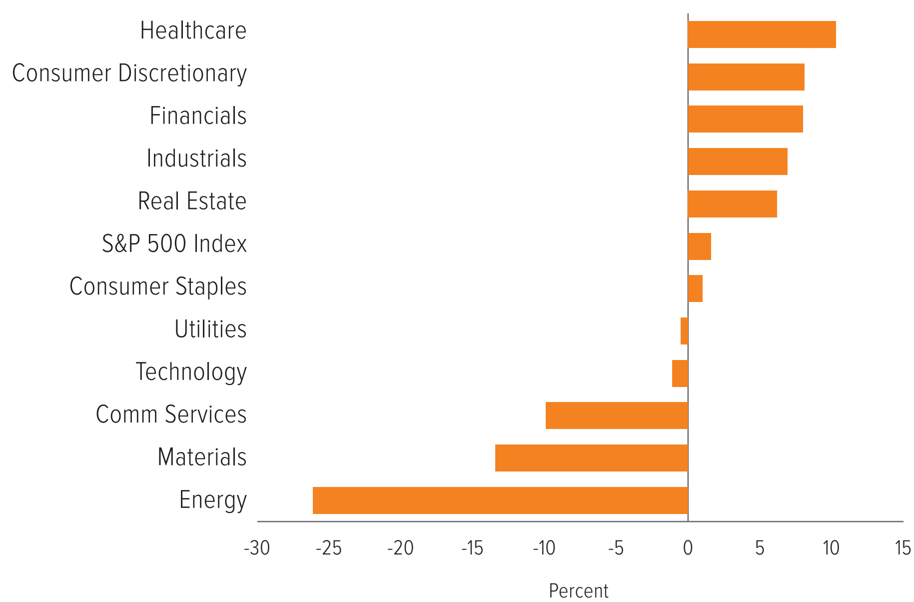
We unabashedly tout our 2019 theme, "The Storm before the Calm," as it accurately unfolded in the markets in the first half. The storm in December was followed by a calm from January through April, which sent markets to near record highs. Since then another pop-up thunderstorm ensued in May, only to be followed by additional calm in June. This season the old saying is off by a month but is apt nonetheless: "May showers bring June flowers."

The fear is palpable since the sell-off in the fourth quarter last year. Investors were frightened — of rising rates until interest rates plummeted; of negative corporate earnings growth in the first quarter, until they reached all-time record highs; of U.S.–China trade wars until the G20 meetings at the end of June. The examples are numerous, but the concern is for those investors in particular who have hunkered down in such defensive positions that they are missing these extraordinary 2019 returns. This is called upside risk. Upside risk differs from downside risk in that investors miss capturing positive returns that build wealth.

The Head Fake and Bear Traps

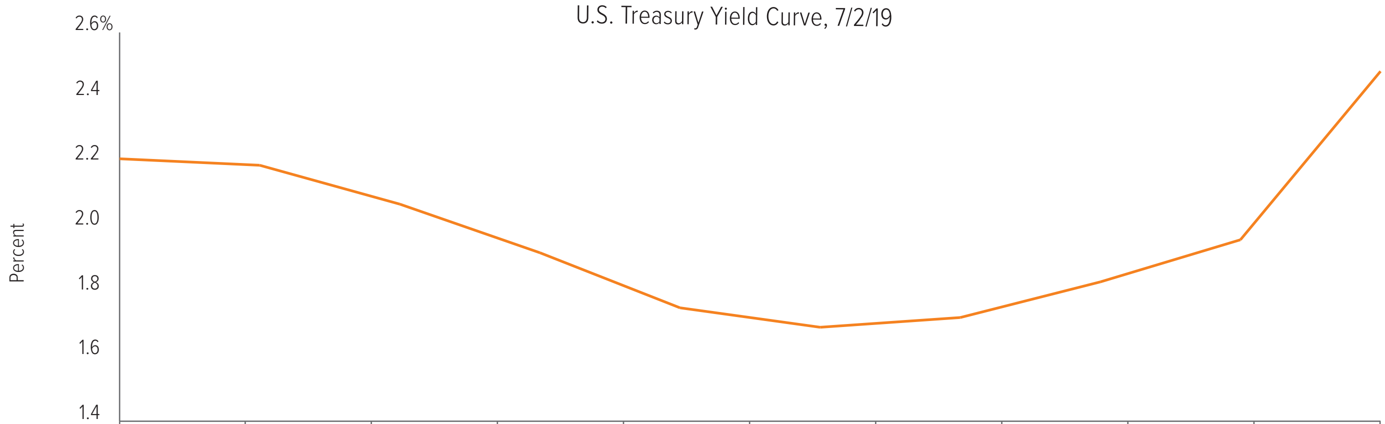
Investors may have it wrong yet again. This time it is similar concerns regarding second-quarter earnings that are about to be reported. Note a recent glaring headline from CNBC regarding the 2Q19 earnings season, "Companies are warning that corporate earnings results are going to be brutal." Really? Companies are doing that? Shocking. Companies have been talking down their quarterly earnings and miraculously "beating by a penny" since Methuselah. No, he is not an equity analyst, he was just around for a really long time.

Figure 1. S&P 500, Index and Sector Earnings Growth Rates, 1Q19



Source: Refinitiv

Figure 2. Inverted Yield Curve Indicates Expectations of Slowdown



Maturity	1M	3M	6M	1Y	2Y	3Y	5Y	7Y	10Y	30Y
Yield	2.21	2.19	2.07	1.92	1.75	1.69	1.72	1.83	1.96	2.48

Source: FactSet

Are there risks? Of course, in the real world there are always risks. Against this market backdrop, there has been a meaningful reduction in downside risk and an increase in upside risk. The Federal Reserve is now front and center as the pillar of upside risk contribution; this is appropriate, since the Fed originated the downside risk last year. Yes, this means that the Fed made a policy error that needlessly disrupted the markets and business sentiment.

One only has to look at the "mis-shaped" yield curve to understand the market thinks the Fed has it all wrong. The Fed controls the short end of the curve and right now it doesn't look like it has control of anything. A normal yield curve has an increasing slope as the maturities increase, which indicates that investors predict normal growth and normal inflation. A negative, or inverted yield curve has short-term maturities with yields higher than longer-term maturities, and is indicative of expectations for sluggish growth and low inflation. After its June meeting, the Federal Open Market Committee all but indicated this would be corrected at its July meeting with a fed funds rate cut. Looking at the inverted curve above (see Figure 2) and with the 10-year U.S. Treasury yield below two percent, a 50 basis point fed funds cut may be in the cards.

The "Double-Header" Market

Readers may have missed the Global Perspectives forecast two years ago, calling this market a "double-header" — a baseball analogy for you cricket players. Yet, here we are with the market hitting all-time record highs and corporate earnings we forecast will post positive growth in the second quarter. In fact, a number of fundamental economic data improved right before the double-header began some time after 1Q16. In 1Q16, S&P 500 corporate earnings were $117 per share. In 2019, we estimate corporate earnings per share will reach $178, an all-time high, up more than 50% since 1Q16. Price, in contrast, has not kept up, gaining only 44%. Let's take a stroll down memory lane.

Figure 3. Economic Statistical Advances, 2016–2019

Date	1Q16	1Q19
Industrial Production Index	101.4	109.7
Retail Sales ($ billions)	$451.0	$514.3
Consumer Confidence Index	96.1	124.2
S&P Earnings per Share	$117.00	$178.00
Unemployment Rate	5.0%	3.7%
Private Fixed Investment ($ billions)	$2,410	$2,891
Household Wealth ($ trillions)	$90.50	$108.64
Productivity Growth	0.5%	3.6%
Average Hourly Wage	$25.46	$27.71

Source: FactSet

Manufacturing has been facing the headwinds of a slowdown in China, weakness in the global economy, Brexit and trade war uncertainty, and malaise in Europe; yet since 1Q16 the global economic landscape has undergone significant change:

- Industrial production is up 8% despite tariffs and supply chain upheavals
- Consumer confidence has soared almost 30% and consumer retail spending has climbed significantly higher, from $451 billion to $514 billion per month
- The unemployment rate plunged to 3.7%, near 50 year lows

- Household wealth now exceeds $108 trillion, a 20% increase
- U.S. GDP has jumped from $17.4 trillion to $18.9 trillion in 2019; outside the United States, international GDP levels are now $10 trillion higher

Market Review 2Q19

After rough seas in May, the S&P 500 turned around in June, posting a 4.3% gain for the quarter and the best first half since 1997, with an impressive 18.5% total return. The market is now hovering near all-time highs. Investors who followed the adage, "sell in May and walk away," may be wishing they had stayed in. Despite the trade tariff impasse and continued admonitions of a global slowdown, both U.S. and international markets notched positive returns in 2Q19. While U.S. large caps were the leaders, EAFE stocks were not far behind and followed by U.S. midcaps. Global real estate investment trusts were only up 0.2% in the quarter but have returned 15.1% so far this year. Even beleaguered emerging markets had a positive second quarter, and were up double digits for the year as the U.S. dollar weakened in 2Q19 and China ramped up ongoing stimulus efforts.

The field of green didn't end with equities. Bonds also posted stellar returns as the Fed not only called time out, but added the prospect of rate cuts onto the menu. Long U.S. Treasurys appreciated another 6.1%, now up 11.1% YTD; corporate bonds were up 4.5% to post 9.9% YTD. High yield added another 2.5% in the quarter and global bonds provided diversification and quarterly returns of 3.3%.

Figure 4. Global Asset Class Diversification Generally Offers Attractive Return Potential

Index	Jun-19	2Q19	1H19
Equity			
S&P 500	7.0	4.3	18.5
S&P Midcap	7.6	3.0	18.0
S&P Smallcap	7.4	1.9	13.7
Global REITs	1.7	0.2	15.1
EAFE	6.0	4.0	14.5
Emerging Markets	6.3	0.7	10.8
Average	6.0	2.4	15.1
Fixed Income			
Corporate	2.4	4.5	9.9
U.S. Treasury 20+	1.3	6.1	11.1
Global Aggregate	2.2	3.3	5.6
High Yield	2.3	2.5	9.9
Average	2.1	4.1	9.1

Source: FactSet

Conclusion

The global and U.S. economy may be slowing from our original optimistic projections, but policies are being adjusted as well. Our original interest rate forecast anticipated a rising rate environment, however, this outlook has changed and is allowing for a rebound in fundamentals. Additionally, the markets are soaring, with the S&P 500 posting its best half-year gain since 1997. In our view, this may be the most hated bull market ever as investors continue to hunker down needlessly. Corporate earnings may be the best indicator to follow as they continue to beat all-time highs. In this summer sailing season an apt metaphor for investors may be to take advantage of the blowing wind and go "full sail."

Diversification does not guarantee a profit or ensure against loss

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