Voya Global Perspectives

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Executive Summary

- Good domestic economic data on top of more accommodative Fed policy served as a double-whammy boost for markets, driving a risk asset rebound after a dismal January.
- Given the global economic weakness, the Fed seems to believe there is greater risk to being early in normalizing rates than there is to being late.
- With nearly half of S&P 500 revenue derived from overseas, weakness in the global economy is showing up in U.S. corporate earnings and is likely to result in a fourth consecutive quarter of negative growth.

Markets Have Stormed Back From a Bleak January

Index	March 2016	YTD 2016
Equity		
S&P 500	6.8	1.3
S&P MidCap 400	8.5	3.8
S&P SmallCap 600	8.2	2.7
Global REITs	9.6	5.4
EAFE	6.6	-2.9
Emerging Markets	13.3	5.8
Fixed Income		
Corporate	2.8	4.0
U.S. Treasury 20+	0.0	8.5
Global Aggregate	2.7	5.9
High Yield	4.4	3.4
Senior Loans	2.5	1.6

Data as of 03/31/2016
Source: FactSet, FTSE NAREIT, Voya Investment Management

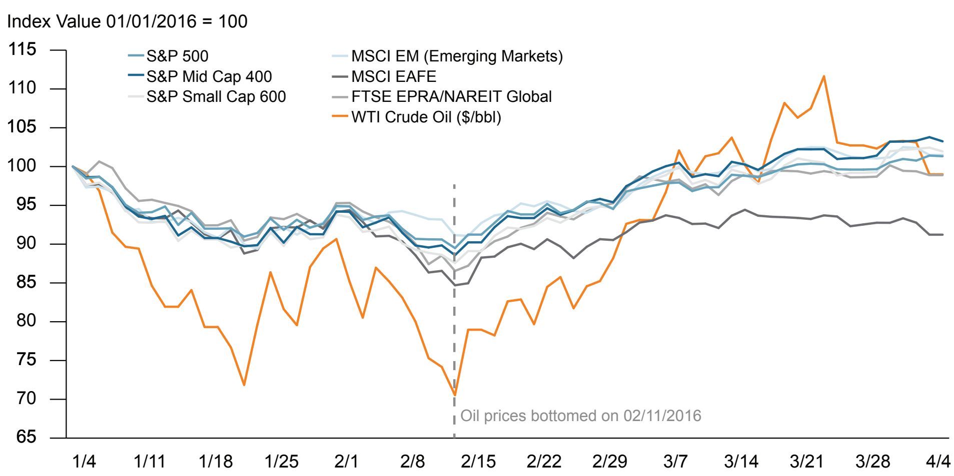
Dovish Fed Inspires Global Markets

The market was ahead of us in predicting an exceptionally accommodating Federal Reserve. Fed Chair Yellen had investors spooked after signaling four 2016 rate increases at December's policy meeting as other global central banks were embarking on an even more accommodative path. Apparently considering the successful navigation of such massive global central bank divergence a task on par with solving a Rubik's Cube with your feet, the market revolted. And it looks like the market won; the Fed backed off near-term rate hikes, inspiring an incredible rebound in global markets.

After sniffing out a turning point in Fed sentiment at Yellen's mid-February testimony to Congress, the market hasn't looked back. The March FOMC meeting provided even more emphatic evidence, as the central bank formally lowered its 2016 rate-hike expectations to two. But it was in an end-quarter speech at the New York Economics Club — at which Yellen used such phrases as "proceed with caution," "gradual increases in fed funds rate" and "pace of global growth a concern, influenced by developments in China" — that likely pushed the next rate hike until September and set off a broad-based surge in commodities, foreign currencies, bond prices (i.e., falling yields) and global equities in the face of a weakening dollar.

Does this mean that the FOMC is backing off its plan to bring rates back up to more normal levels? No, this is merely a pause in the long process of normalization driven by concerns about global economic weakness beyond the Fed's mandate; a true capitulation by the central bank likely would have had severe negative repercussions. In fact, the U.S. economy continues to deliver. The March jobs report was strong, manufacturing climbed back to expansion, and the core PCE price index — the Fed's preferred inflation metric — surged to 1.7% annualized, nearing its 2% target. Maybe the Fed was simply trying to avoid the mistake of declaring victory too soon by raising rates and potentially torpedoing the global economy and markets .

The Rebound in Oil Prices Has Driven Improved Sentiment for Risk Assets



Source: FactSet

First Quarter 2016: Volatile but Solid Across Asset Classes

Equity markets started the first quarter with a global rout. The prospect of rising rates pushing the dollar ever higher combined with tepid economic data, uncertainty in global markets (especially China), plunging oil prices and most important a corporate earnings recession to result in an unfavorable mix for risk assets. Accordingly, those assets perceived as most risky — such as emerging markets, international equities and domestic small caps — were hit hardest, though even large-cap domestic stocks were down more than 10% at one point to officially enter a correction. However, markets in mid-February staged a dramatic turnaround as it appeared the price of oil had bottomed, the dollar had stabilized and global central banks — including the U.S. Fed — delivered dovish messaging on monetary policy.

In fact, performance across equity and fixed income asset classes was largely positive in the first quarter. While U.S. equity indexes turned in decent performances, global REITs and emerging market equities were the big winners; the reversal in emerging markets was particularly noteworthy, as the asset class shook off a -6% January to end the quarter up nearly 6%. International developed market stocks lagged, as the MSCI EAFE Index was down nearly 3% for the quarter.

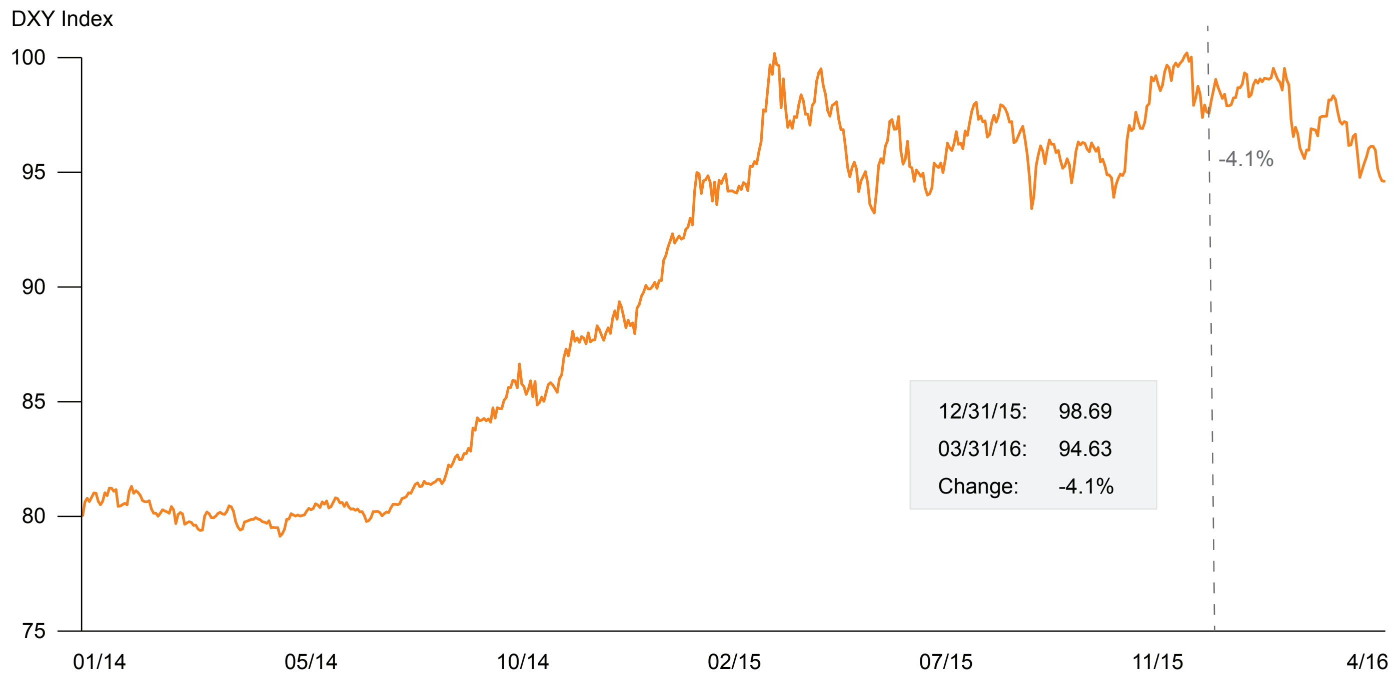
Fixed income contributed its traditional risk control function amid the uncertainty. Bond yields declined globally over the quarter as Fed hike expectations eased and the U.S. dollar weakened. In addition, better credit conditions — improved domestic economic indicators as well as stimulus measures in Japan, Europe and China — has driven bond spreads tighter. Long U.S. Treasury bonds, the most sensitive to changes in interest rates, basked in the glory of declining rates, returning more than 8.5%. Even global bonds and high yield bonds — fourth quarter 2015's fall guys — impressed in the first stanza of 2016, with 5.9% and 3.4% respective returns.

Though U.S. Improves, Global Economic Outlook Remains Sluggish

A lot of optimism in the U.S. has been spurred by continued progress in consumer spending, jobs, housing and the first expansion of ISM manufacturing in six months suggesting that the end of the petro-recession may be at hand. Arguably, the U.S. could have withstood a Fed rate hike, as the central bank is within shouting distance of its two mandates: full employment is near, and the latest inflation data fell only slightly short of target. In fact, good economic data on top of policy easing was a double-whammy boost for the markets.

But global growth and global inflation seems to be the cautionary tale that may come back to hit the U.S. markets. The European Central Bank's March stimulus was a bazooka, but as we have seen with our domestic QE efforts, the impact is temporary without true pro-growth economic policies — namely, reform in labor, capital, regulation and trade — supporting it. While China's confusing monetary and fiscal policy strategy is a conundrum that suggests all is not well with the world's second-largest economy, we are hesitant to count it out. Japan's Abenomics seems to be a failure, as fourth quarter GDP

A More Dovish Fed Has Capped the Dollar Rally



Source: FactSet

growth was -0.3% and inflation was a meager 0.3%. But frontier markets such as the ASEAN-5 in Southeast Asia are proving to be a positive regional counterbalance to Japan's struggles. For example, Indonesia is the fourth most populous country in the world with a population of 250 million, has an investment grade rating and is expected to grow 5.9% in 2016.

Given that nearly half the S&P 500's revenue is derived from overseas, weakness in the global economy is showing up in U.S. corporate earnings. We have had three straight quarters of negative growth, and the consensus is that first quarter 2016 will represent a fourth, a string not seen since 2009. There is light at the end of the tunnel, but the fact is that the global economy is more interdependent than ever.

Conclusion

U.S. markets have applauded both the improving domestic economy and the ongoing — and likely unnecessary at this point — monetary accommodation coming from the Fed. While the central bank has bounced around in terms of its level of concern over the impact of global weakness on the domestic economy, it now seems quite fearful, and the general agreement appears to be that there is much greater danger in being early to normalize rates than in being late. Market participants have implied pejoratively that the Fed is now the world's central bank; while this may be partially true, it also may be the most prudent path under the circumstances.

In light of the astounding moves across asset classes this quarter, we have no reason to deviate from our usual recommendation to focus on broad global diversification to withstand volatile, fast-changing markets.

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