Voya Global Perspectives

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Executive Summary

- A stealth bull market has frustrated the Bears as both stocks and bonds relentlessly rise in price in unison sending bond yields to historic lows
- Britain, true to its motto, “Keep Calm and Carry On” has removed a lot of uncertainty as Theresa May takes the mantle of Prime Minister
- Global Central Banks expected to ratchet up monetary accommodation
- Despite the headwinds from negative corporate earnings the consumer remains resilient

Stealth Bull Market Across Stocks and Bonds

Index	2Q16	June 2016	YTD 2016
Equity			
S&P 500	2.5	0.2	3.8
S&P MidCap 400	4.0	0.5	7.9
S&P SmallCap 600	3.5	0.9	6.2
Global REITs	3.7	3.8	9.4
EAFE	-2.9	-3.4	-4.0
Emerging Markets	5.8	4.0	6.6
Fixed Income			
Corporate	3.6	2.3	7.7
U.S. Treasury 20+	6.8	6.7	15.8
Global Aggregate	2.9	2.7	9.0
High Yield	5.5	1.1	9.1
Senior Loans	2.1	0.0	3.8

Data as of 06/30/2016

Source: FactSet, FTSE NAREIT, Voya Investment Management

2016 Mid-Year Update on the Road to Normal

Global Perspectives	Forecast 2016	Mid-Year Update
S&P 500 Price	2250	affirmed
S&P 500 Earnings per Share	$120	changed from 126
S&P P/E	18.5x	changed from 17.9
Crude Oil (NYM)	$48/barrel	affirmed
Euro/U.S. Dollar	$1.05	affirmed
Gold (NYM)	$999/troy oz	affirmed
U.S. Ten-Year Treasury Yield	1.50%	changed from 2.6%
U.S. Unemployment Rate	4.75%	affirmed
U.S. GDP Growth	2.25%	affirmed
Euro Zone GDP Growth	1.75%	affirmed
Japan GDP Growth	0.50%	affirmed
Global GDP Growth	3.00%	affirmed

Source: Voya Investment Management

2016 Mid-Year Update — A Stealth Bull Market Surprises Investors

So far 2016 is reminiscent of past stealth bull markets, climbing a wall of worry despite obstacles in its way. The year started off with a crash in commodities, but staged a sharp recovery bringing the markets along with it. All seemed to be progressing smoothly until the June 23 British European referendum or “Brexit,” which pummeled the global markets when Britain surprisingly voted to “leave” the European Union (EU). Within a week the equity markets had broadly recovered but bond yields remain near record lows on the expectation of continued monetary accommodation by the world’s central banks. Stealth bull markets are commonly marked by a distinct lack of euphoria and more often than not fear as well as disbelief. There is certainly enough to be fearful of as Brexit has heightened confusion and uncertainty but fallout may be both positive and negative.

- Japan’s currency appreciation accelerated post Brexit, putting additional pressure on its economy
- The Brexit has exposed weakness in the EU economy and its banks, especially Italian banks
- China and emerging markets ironically are beneficiaries of Brexit, as the probability of a U.S. Federal Reserve rate rise has diminished

Q2 and First Half Market Review

Major U.S. indexes such as the Dow Jones Industrial Average and the S&P 500 finished with gains for the month, second quarter and first half. Stocks in Europe were mostly down but surprisingly British equities represented by the FTSE 100 were up for the month, quarter and year to date in sterling terms; emerging markets had the best equity performance for the month and quarter and were only beaten by U.S. midcaps which placed first in the first half of 2016 and global REITS which placed second. Fixed income of all stripes beat equities handily for the quarter and first half as long U.S. Treasury securities led the way followed by high yield and global bonds. Going into 2016 the notion that fixed income would beat equity during an expected rising interest rate environment was enormously contrarian.

With this economic and market backdrop we update our ten themes that we introduced at the start of 2016.

Theme #1 Mid-Year Update: Low Commodity Prices Continue to Roil Markets

Low commodities roiled markets during the first quarter; they have since returned to relatively normal but still low levels. Due to a combination of growing energy demand, a weakening U.S. dollar and falling oil supplies, crude oil prices have surged from their February low of the mid-twenties to hover around $48 U.S. a barrel. The recovery was felt in U.S. manufacturing, which improved during the second quarter after steadily contracting early in the year. The rebound in oil has also had a ripple effect throughout the global economy, as many emerging markets are invested in natural resources. For the rest of 2016, slowing China growth and a strong dollar remain factors that might put downward pressure on commodity prices. Entering into the second half of 2016, we maintain our original price forecast for oil.

Theme #2 Mid-Year Update: Global Central Bank Coordination

The U.S. Federal Reserve (Fed) has backed off from an initial consensus of four rate increases down to our revised forecast of no further rate increases due to uncertainties surrounding global growth. While the Fed's "road to normal" agenda for the time being is "under construction," it will focus on maintaining a tight labor market and a stable dollar. The latter is particularly important, as a surging greenback would be extremely disruptive to currencies, commodities, corporate profits and dollar-denominated international debt. Meanwhile, major central banks elsewhere — particularly the Bank of England, European Central Bank, People's Bank of China and Bank of Japan — continue with the prospect of further accommodative monetary policies.

S&P 500 Earnings for 1Q2016 are negative for the fourth quarter in a row.

Sector	Earnings Growth		
	Percent	Positive	Negative
Consumer Discretionary	19.7	55	26
Telecommunication Services	16.6	4	1
Health Care	7.1	41	16
Consumer Staples	1.0	19	15
Utilities	-2.9	8	19
Industrials	-5.3	32	32
Information Technology	-6.8	38	27
Financials	-12.3	45	44
Materials	-14.5	10	14
Energy	-107.2	3	27
S&P 500	**-6.7**	**255**	**221**

Source: FactSet
Note: Earnings Growth is the percentage change in the cumulative share-weighted EPS earnings from that of a year ago. Earnings Surprise Percent is the shareweighted average of the ratio of actual company earnings vs. the consensus estimates.

Theme #3 Mid-Year Update: Rates and Inflation Stay Low

We believe that U.S. Fed Chair Janet Yellen will likely hold off tightening the key policy rate through the rest of 2016, as the U.K.'s vote to leave the European Union has sparked questions about worsening a global slowdown. The yield on the 10-year U.S. Treasury has fallen from 2.24% at the start of the year to less than 1.50% in response to a dovish Federal Reserve, subdued U.S. growth expectations and preponderance of negative yields in developed market sovereign debt. Inflation abroad remains essentially nonexistent; euro zone inflation edged up meagerly to 0.1% in June from -0.1% the previous month and May Japanese core CPI fell further into deflation for the third straight month, reaching -0.4%. Here in the United States inflation too is on unsolid ground; headline and core CPI figures hover around 1.0% and 2.2% respectively while the year-over-year PCE Price Index, Janet Yellen's preferred gauge of inflation, remains well below the Fed's 2% goal. PCE reaching its 2% target in 2016 is out of the cards; look for this key index to hover around the 1% mark and, if anything, to backslide. We expect the U.S. Treasury yield to end 2016 at 1.50%.

Theme #4 Mid-Year Update: The Strong Dollar Stabilizes

The Fed on hold to raising its benchmark rate will stabilize the dollar near its current level of 96.0 (DXY Index – USD vs. a basket of trade weighted currencies). It will also assist U.S. corporate earnings and exports as well as take pressure off of emerging market currencies, especially China's Yuan.

Theme #5 Mid-Year Update: Markets Climb a Wall of Worry of Volatility and Fear

The biggest fear going into 2016 was the potential for aggressive Fed rate increases — four times to a range of 1.00–1.25%. While the market has been hit hard by several bouts of volatility, the benefit of these market swings has been to diminish the probability of Fed action and thus most of the fear that this induced.

Theme #6 Mid-Year Update: U.S. Corporate Earnings Struggling with Global Challenges

Fundamentals continue to be challenged as second quarter earnings are estimated to show negative growth rates. If it should happen this would mark the first time since 2009 we have seen five consecutive quarters of year-over-year declines. Given that nearly half of the S&P 500's revenues are generated outside the U.S., growth expectations suggest the global slowdown is playing a big role in these negative forecasts. There are signs for optimism though as Q2 forecasts may be too pessimistic due to the strengthening oil prices and a more accommodating Fed that are expected to benefit the second half with higher earnings and revenue. We downgrade our earnings target to $120 while maintaining our price target of 2250.

Theme #7 Mid-Year Update: The Strong U.S. Consumer Keeps the Economy Growing

The blockbuster 287K nonfarm figure from the June jobs report boosted U.S. consumer confidence and calmed fears due to the simple fact that a consumer with a secure job is a happy spender. The positive forces from low energy prices, home price appreciation, solid wage growth couple with this tightening labor market have resulted in a virtuous cycle for the consumer that will likely remain a driver of U.S. growth throughout the rest of the year — as long as the job market remains robust.

Theme #8 Mid-Year Update: Emerging Markets are Down but Not Out

China has been a disruptor for the markets in the past year due to excessive state and private sector debt levels, slowing exports and imports, a generally slowing economy and political uncertainty. This may seem to resemble a "hard landing," but the Chinese will have none of it, as they intend to meet their economic goals even if a touch of economic chicanery is required. No doubt they have observed the developed markets in Japan and Europe experimenting with negative yields. On the other hand, Russia and Brazil are in recession, and emerging economies are not out of the woods. There are opportunities, but investors must choose wisely and brace for volatility.

Theme #9 Mid-Year Update: Washington D.C. and the Presidential Elections

We now know that the Republican and Democrat nominees have been whittled down to Donald Trump and Hillary Clinton. They have a few things in common in that they have high negative sentiment, tend toward protectionist policies, and are near or at seventy years old. This last point on age will put pressure on both to select a younger vice presidential candidate to their ticket that can of course garner more votes and hopefully balance the candidates' weaknesses. We expect the race to the Whitehouse to heighten volatility until the inaugural ceremonies.

Theme #10 Mid-Year Update: Diversification Smooths the Bumps in the Road

By casting a wide net investors can capture a broader set of investment opportunities and spread their risk exposures, potentially boosting expected returns and reducing volatility. Diversification enables investors to pursue a thoughtful, considered investment policy that replaces unintended bets with prudent investment discipline. Chasing performance, trying to predict which sector of the market will outperform in any given time period, essentially "gaming diversification," is a futile task in the long run. Instead, we believe that portfolios should be globally diversified across many asset classes, regions and risk exposures.

Through mid-year the consensus forecasts were astonishingly inaccurate about the markets. In fact, long-term bonds were expected to be clobbered, but instead long U.S. government bonds returned nearly sixteen percent in the first half of the year. And within equities, unpopular emerging markets handily beat U.S. large caps by a factor of two for the second quarter and almost 3% YTD.

Conclusion

The markets have braved challenges and benefited from opportunities in a world of anemic growth, strengthening consumers, the prospect of better corporate earnings ahead and an expectation of continued global central bank monetary and governmental fiscal stimulus. We recommend in the second half of 2016 that investors position their portfolios to benefit from a continued stealth bull market marked by periods of volatility. We believe the best approach is a broadly globally diversified portfolio of equity and fixed income.

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