Voya Global Perspectives

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Executive Summary

- Central banks continue to supply extraordinary levels of stimulus, to the delight of stock markets.
- While earnings growth may decline for a second consecutive quarter, corporate America has been remarkably resilient given the headwinds.
- While markets are paradoxically paying up for declining earnings, valuations remain reasonable.
- The recent rally's sustainability depends on how the private economy can turn exogenous support into earnings growth.

Equity Markets Worldwide Surged

Index	Oct. 2015	YTD
Equity		
S&P 500	8.4	2.7
S&P MidCap 400	5.6	0.7
S&P SmallCap 600	6.1	0.3
Global REITs	5.7	1.3
EAFE	7.8	2.5
Emerging Markets	7.1	-9.2
Fixed Income		
Corporate	0.4	0.3
U.S. Treasury 20+	-0.5	-0.7
Global Aggregate	0.2	-2.0
High Yield	2.7	0.2
Senior Loans	-0.1	2.4

Data as of 10/31/2015

Source: FactSet, FTSE NAREIT, Voya Investment Management

Synchronized Central Bank Stimulus Sets off Global Market Rally

We have seen this all before: as fundamentals deteriorate, central banks act. It happened in third quarter 2012. With earnings growth expectations negative, the Federal Reserve stepped in with a third round of quantitative easing supplemented by Operation Twist for an unprecedented $1 trillion of stimulus per year. U.S. markets opened 2013 strong and never looked back. And now it's happening across the globe. The Fed set the tone by holding steady on rates following both its September and October meetings, and the European Central Bank declared its intention to stimulate big. But it was the People's Bank of China that upped the ante with two significant rate cuts in recent weeks, sparking a surge in global markets.

This central bank-hosted party is most definitely not a celebration of economic prosperity; inflation, GDP and corporate profit expectations continue to be cut by Wall Street analysts, the International Monetary Fund and the World Trade Organization. Should the old adage "don't fight the Fed" be expanded to "don't fight the global central banks"? It sure looks that way given the latest explosive equity rally in the face of slowing global growth.

TRED With a Global Perspective

Under normal circumstances, central banks should not be such a profound influence in a free market; these are not quite normal times, however. Fortunately, we have a method of integrating these and other exogenous factors into our Global Perspectives forecasts to provide greater insight into the markets. We initiated our approach to this deeper research this year for our 2015 forecast ("Sustainable Global Expansion Driven by Tectonic Shifts"), introducing the multi-faceted "TRED" framework to provide an integrated view of global economies, financial markets and investment strategy.

- **Tectonic Shifts** are both catalysts for growth and long-term risks in the real economy that bear careful watching. They move markets in ways that defy conventional forecasting, often revealing themselves in extraordinary, trend-reversing price shifts.
- **Rates** provide a window into the overall economic health of countries, regions and the world as a whole. Their impact can be seen in inflation levels, sovereign yields, currencies and the unconventional central bank policies that have been the norm since the financial crisis.
- **Earnings** deliver an unbiased view of the strength or weakness of a cross-section of global and domestic corporate profitability, reflecting the health of the global economy.
- **Diversification** encourages investors to abandon the "folly of gaming diversification" and instead pursue a thoughtful, considered investment philosophy that replaces unintended bets with prudent investment discipline.

TRED: Rates

As discussed in the opening, central bank activity is dominating markets currently. In fact, throughout this nearly seven-year bull market, central banks have been successful in opening the spigots when all seemed lost. And as they say: History doesn't repeat itself, but it does rhyme. For example, China's latest monetary stimulus sparked a global market rally and sent the laggard Emerging Markets surging over 7%. The interest rate cuts came on the heels of August's surprise devaluation of the yuan that heightened concerns about Chinese and thus global economic growth. And with nearly $3.6 trillion in reserves, there are more arrows in China's quiver.

The extent of the concerted actions by global central banks certainly has been a surprise to the markets. As recently as this summer the Fed seemed to be nearing the end of its stimulative ways; the start of a tightening cycle was widely anticipated for September before China's devaluation sent markets into a swoon. With the dollar as the global reserve currency, the Fed tends to set the tone for global monetary policy — but apparently not when central banks feel the need to defend their own economies and markets.

TRED: Earnings

S&P 500 earnings have consistently grown with this bull market for 22 of the last 24 quarters to stand at all-time record highs. However, while it's still early in the third quarter reporting season, it doesn't look good for the top and bottom lines; both revenue and earnings growth are on track to be negative for the second quarter in a row, a trend not seen since 2009. Collapsing energy prices are a big reason. We have detailed previously the impact of the Tectonic Shift in energy; not only does the decline in energy prices deliver enormous benefits to consumer and business users, it serves as an enormous detriment to energy producers and associated sectors. Cheaper energy also impacts the economic growth prospects of the countries that import it and export it — in fact, this is true not just for oil but all commodities given the pall over the complex. For now, at least, it seems like the pain for exporters is much more severe than the benefit to importers, conspiring to reduce global growth.

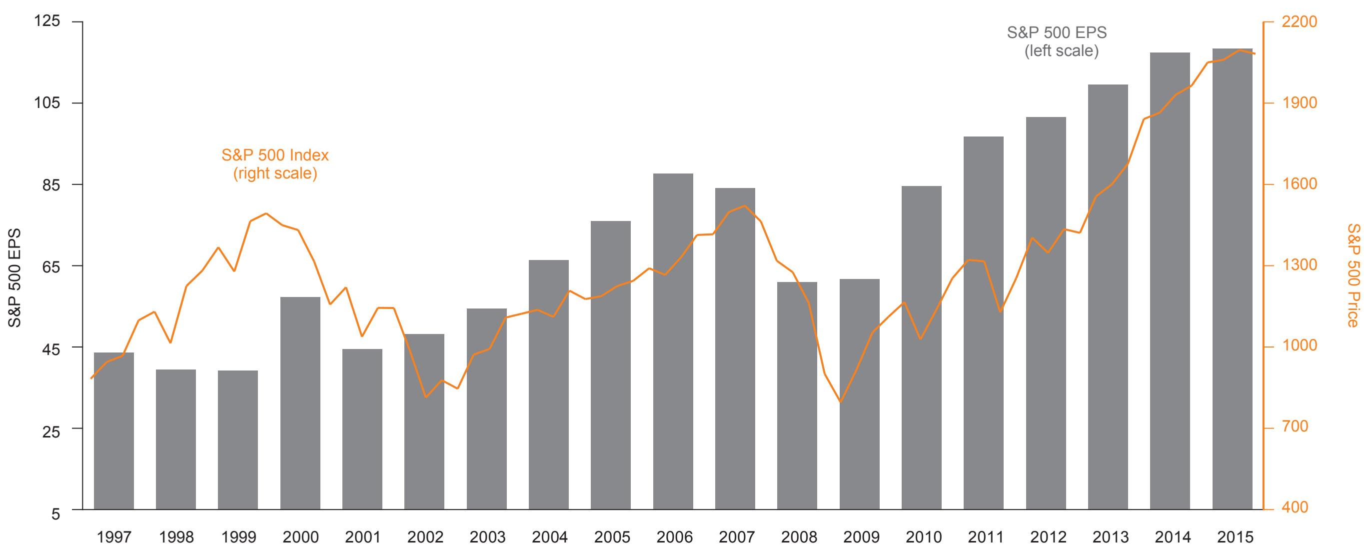
Markets certainly have delivered of late, but is the rally sustainable? Lower earnings on rising prices — courtesy of central bank stimulus — stretches valuations. But while markets are paradoxically paying up for declining earnings, we are nowhere near an extreme overbought situation. Currently, the S&P 500 is trading at 17.5 times 2015 earnings, rich for recent times but not near historical excesses. On 2016 earnings, markets are even more reasonably valued.

When the private economy adapts and reinvents itself, it's positive for future growth. One thing for sure is that recent central bank stimulus seemed to revitalize M&A and put 2015 volume back on track to beat the 2007 record high. Here are some highlights of how the private economy has adapted to low growth during the first nine months of 2015, courtesy of Dealogic:

- Global M&A deals in excess of $10 billion are at the highest level on record in terms of both volume and number.
- U.S.-targeted M&A deals are at record highs in volume and number.
- China-targeted M&A is more than seven times larger than Japan-targeted M&A.

This bull market is nothing if not resilient, overcoming many obstacles to get where it is today. Its gravity-defying October is a testament to this.

Corporate Profits Tend to Do Well During Periods of Central Bank Accommodation



Source: FactSet

Market Sustainability and Resilience

The good news for this reporting season is that earnings tend to beat expectations by 3–4% historically. This has held true for the first two quarters of 2015, as corporate America defied extreme pessimism to finish nearly flat, and it may continue into the third. While sectors such as the consumer and manufacturing have benefitted greatly from collapsing energy prices, seemingly unrelated sectors such as healthcare and financials are forging ahead. The U.S. economy is not just an energy story, and its diversification provides resilience.

What is different this time is that earnings have been bouncing around zero growth for several quarters, offering no clear trend. This is a unique time in earnings history, and the lack of clarity makes forecasting a challenge. Our multi-faceted TRED framework is well suited to capture a broader view of the market, critical in times like these.

The U.S. consumer, the biggest slice of the GDP pie, is undoubtedly helping the markets' resilience. Retail sales are at their highest level ever. Jobs are the most plentiful in 15 years, and housing prices are rising faster than inflation. Household wealth is at an all-time high. Low oil prices are undoubtedly helping auto sales and consumer confidence. Corporations are doing their part as well. Given emerging market turmoil, strong dollar hurdles and the recent soft economic data points, the fact that earnings growth is flattish instead of severely negative is a testament to the skill and tenacity of U.S. businesses. According to a study highlighted last year in *The Economist*, U.S. companies are the best managed in the world.

Ninety years ago Calvin Coolidge stated that the chief business of the American people is business. That is as true today as it was then.

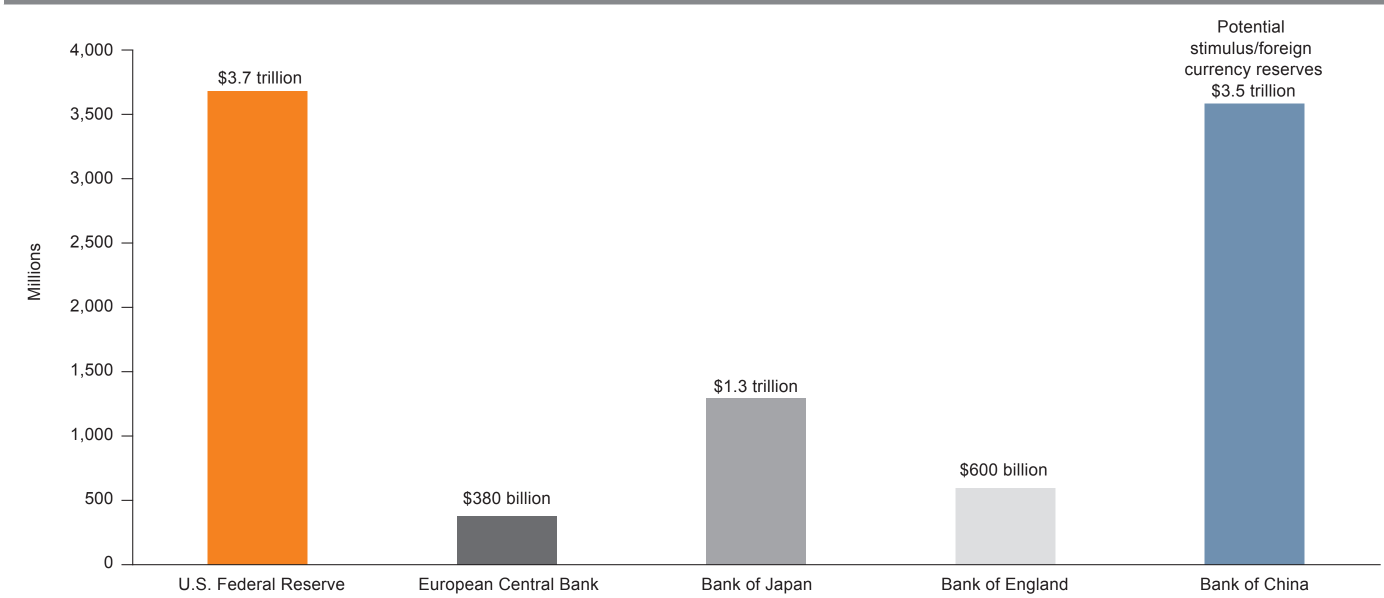
While a dark horse compared to manufacturing, the emerging market consumer is surprising on the upside. China's services sector is expanding robustly, as the country moves from a manufacturing economy to a consumer-driven one, and retail sales have been increasing at a double-digit rate. This emerging consumerism was highlighted by several bellwether U.S. technology and consumer discretionary stocks in their quarterly earnings reports. China's "Singles Day" — the world's biggest online shopping extravaganza, coming soon on November 11 — was an enormous success last year, beating our own Cyber Monday by a landslide to suggest the Chinese consumer is far stronger than understood.

Conclusion

The recently departed Yogi Berra said "it is tough to make predictions, especially about the future". We agree, especially when such an important barometer as corporate earnings bounces around zero and signifies no clear trend. By integrating central bank interest rate policies and Tectonic Shifts in the real economy into our analysis, however, we gain added dimensions that are supportive of global growth. Whether the recent global rally is sustainable depends on how the private economy can turn this exogenous support into earnings growth. As always, however, effective global diversification is the key to building and protecting wealth.

Central Banks Have Gone to Extraordinary Lengths to Stimulate Economies

Monetary Easing Since 2008



Source: Voya Investment Management/Global Perspectives, Evercore ISI

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