Market Update | November 2016

Voya Global Perspectives

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Executive Summary

- The October surprise was not in the presidential election — it was in the bond market
- Despite uncertainty, slowly rising yields signal economic growth and a path to normal
- Earnings appear on track for a positive third quarter
- Markets will need to transition from a yield-driven to an earnings-driven foundation

Rising Yields Depressed Markets

Index	October 2016	2016 YTD
Equity		
S&P 500	-1.80	5.90
S&P Midcap	-2.70	9.40
S&P Smallcap	-4.50	8.80
Global REITs	-5.70	4.70
EAFE	-2.00	0.10
Emerging Markets	0.20	16.60
Fixed Income		
Corporate	-0.80	8.30
U.S. Treasury 20+	-4.30	10.50
Global Aggregate	-2.80	6.80
High Yield	0.40	15.60
Senior Loans	0.73	7.28

Data as of 10/31/2016

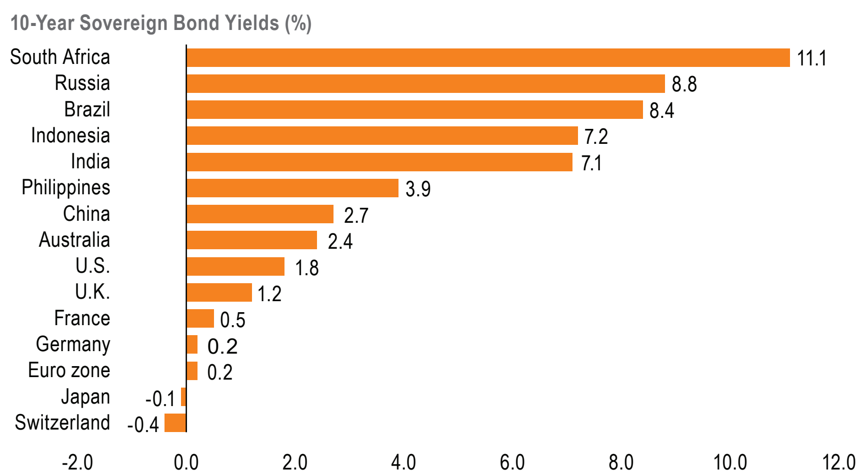
Source: FactSet, FTSE NAREIT, Voya Investment Management

The October Surprise

Investors were bracing for the infamous October surprise that often occurs in a presidential election year. Then it happened. A damaging video sent Donald Trump's polls plummeting; but wait, an equally damaging letter from FBI Director James Comey pulled Hillary Clinton's poll numbers back to earth. The net effect appeared to be a deadlocked race to the finish for the most important political office in the world. While these events were a media boon, from an investment perspective the real October surprise was rising yields.

How are rising yields an October surprise? Utterly boring, right? Absolutely not: rising yields have presented a conundrum for every major central banker since onset of the great financial crisis. It may be the most positive news to hit the markets in eight years. Rising yields are a sign of economic growth; although yields are clearly not soaring, the recent trend has been ticking up. The greatest danger to prospects for the global economy is declining yields, the antithesis of growth.

Developing Market Sovereign Bonds Currently Offer More Attractive Yields Than Developed Markets



Sources: Bloomberg, FactSet

The European barometer of yields, the ten-year German Bund, has made a dramatic move from negative to positive. Concurrently, European manufacturing has picked up; the euro zone economy is now growing at a stable pace, and even Britain looks like it will avoid a recession after Brexit.

In the United States, GDP growth surged in the third quarter to nearly three percent, and all-important manufacturing and services also are on upward trajectories. But as we know, fundamentals drive markets. After a five-quarter drought, third quarter corporate earnings look decidedly positive with two thirds of companies reporting. Rising corporate profits, rising economic growth, rising commodities and rising inflation are the essential coincident indicators for an expanding global economy.

Yes indeed, rising yields are the October surprise, but contrary to the usual pejorative implication, this time it's cause for a little revelry.

Market Review

This yield-driven market will have to transition to a more sustainable earnings-driven foundation. Markets have discounted low yields as far as the eye can see, so there have been and will be more disruptions as the transition occurs, although it is likely that yields will rise very slowly, mitigating the pain.

In this context equity markets sold off in October and the higher interest rate-sensitive and longer duration assets such as REITs, small-cap equity and U.S. Treasury bonds were hit the hardest. Emerging markets though, bucked the trend, shrugging off rising yields and a stronger dollar to eke out gains and adding to their domination of other asset classes in 2016. High yield bonds also gained; investors apparently saw the sun through the passing clouds as credit spreads narrowed in a nod to better economic prospects.

Among sectors, financials were the best performers, whereas healthcare was slammed. Could the healthcare sell-off be a function of the tightening of the presidential race? We'll soon see.

Investors have been reluctant to participate in the perceived riskier areas of the markets, including equities. Yet we advise broad global diversification in the face of broadening economic growth and rising yields.

Conclusion

This contentious election may bring considerable mental anguish to American voters on one side or the other. Markets may experience sharp volatility in the coming days as investors weigh prospective policy impacts to sectors, asset classes and global constituents. But markets crave certainty, and the end of the election cycle will be one step in the right direction. Although tail risks persist in both developed and emerging markets, overall risk remains subdued and rising yields are the surest sign of economic growth and the best path to prosperity for the fully invested and diversified investor.

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