Voya Global Perspectives

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2017 Forecast

A New Path: The Growth and Reflation Trade

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Executive Summary

- A surprise outcome in the U.S. elections ushered in a new path forward, and markets worldwide celebrated the promise of pro-growth economic policies with rising asset prices and rising bond yields
- In effect, the markets took the reins from the central banks, clarifying the likely path toward rate normalization — reflation — and away from unconventional monetary stimulus
- The prospect of business-friendly policies also supported a corporate earnings turnaround — potentially higher growth, increased pricing power and higher after-tax net income — a boon to global business
- The paradigm shift will provide unexpected returns — and risks — that may create both positive and negative extremes, making a case for broad global diversification

Global Perspectives Outlook for Markets and Rates

Rate/Sector/Metric	2017 Forecast
S&P 500	2400
S&P 500 EPS	133
Crude Oil (NYM)	58
Euro/USD	1.05
Gold	999
10 Year U.S. Treasury Yield	3.00%
U.S. Unemployment Rate	4.50%
U.S. GDP Growth	2.50%
Eurozone GDP Growth	1.75%
Japan GDP Growth	1.00%
Global GDP Growth	3.50%

Source: Voya Investment Management

A New Path: The Growth and Reflation Trade

The U.S. elections ushered in a new path forward with a populist uprising that surprised pundits and stunned the pollsters. In response, markets worldwide celebrated the promise of pro-growth economic policies with rising asset prices and rising bond yields. It was just the spark the markets needed to light a nascent global economic upturn. Assuming continuation, these conditions will assist the Fed's path to normalization by allowing it to scale back its unconventional monetary policies — which constitute the old path. The essence of the new path forward is classical economic policies that promote free market capitalism through tax and regulatory reform.

Of course, substantial risks and uncertainties remain: Trump's seemingly anti-trade protectionist policies; a distaste for pro-growth structural reforms in Europe; a possible U.S. dollar surge wreaking havoc with commodity nations; and an unexpected China growth scare. Nevertheless, there is evidence that pent-up animal spirits have been sparked by the election, and we expect bolstered growth and reflation in 2017. Here are the areas that will be pivotal:

- The Trump tax plan for individuals, corporations and small businesses, if and when enacted, will be highly stimulative — the strongest possible positive fiscal stimulus
- A path to central bank normalization — reflation — driven by pro-growth economic policies and away from unconventional monetary stimulus, is a U.S. dollar positive-move that carries its own risks
- Resurgence of business investment in manufacturing and energy, abetted by Trump's expressed intention to cut regulation and bureaucracy; and by pro-growth policies, which should increase consumption and production
- Corporate earnings turnaround — potentially higher growth, increased pricing power and higher after-tax net income — a boon to global business in response to prospects of business-friendly policies that may spread beyond the United States
- The consumer as game-changer in the U.S. — and globally — remains in a virtuous cycle of positive employment trends, low interest rates and rising asset prices
- The paradigm shift will provide unexpected returns — and risks — that may create both positive and negative extremes, making a case for broad global diversification

Our base case is an uplift in economic growth, strong equity markets, rising interest rates and rotation out of defensive positions and into more cyclical assets

Therefore, our base case for 2017 is a shift upwards in economic growth, continued strength in equity markets and rising interest rates, inspiring a rotation out of defensive positions and into cyclical sectors and asset classes. If growth can be sustained near 3% for a couple of years (the average of the past five years is just 2%), that will enable companies to expand sales and, among other things, create jobs. Expansion of top line revenues can prompt more business investment as well as a response from the consumer through increased wages and employment. Permanent tax cuts make possible the increases in both business investment and consumption.

The U.S. dollar will rise along with bond yields which will likely temper inflation and prevent the economy from overheating. The key event driving our growth and reflationary forecast is tax reform for multi-national corporations, small businesses and individuals, bolstering the world's largest economy where recovery was already underway and confidence was increasing.

In the Voya Global Perspectives forecast we explore these themes.

Trumponomics

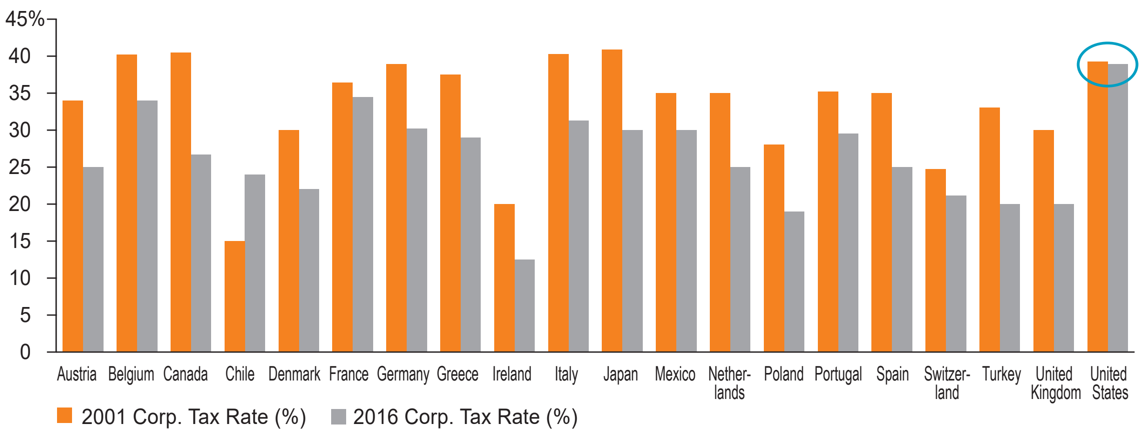
The new administration's economic policies have yet to be realized. At this point "Trumponomics" is a media-inspired word to describe the positions that President-elect Trump advocated during the campaign. As stated, they would represent the first move by a major economy to enact "structural" reforms that have a track record of accelerating and sustaining economic growth. It is the elixir that central banks have sought from politicians to support their increasingly unconventional methods, but that, until now, was taken halfheartedly or not at all.

Without credible plans to cut spending...tax cuts alone may be discounted by the market as a temporary benefit unlikely to spur capital investment

The key policy that will spur economic growth is tax reform. While the U.S. consumer has benefited from a virtuous cycle of rising employment and housing rates, and low interest rates and energy prices, the other major source of growth – business investment – has languished. Lowering the corporate tax burden in the U.S. is imperative to spur business investment, but it is not enough to unilaterally cut taxes without also cutting spending. The much ballyhooed infrastructure spending is intended to be deficit-neutral according to the Trump doctrine, although that remains to be seen. Without a credible complementary plan to cut spending or at least change the trajectory of future entitlements, unilateral tax cuts may be discounted by the market as a temporary benefit and will be unlikely to inspire long-term capital investment.

U.S. corporate taxes are the highest of all G20 economies and third highest in the world; while all the Trump target tax rates may not survive the legislative process, even a compromise to reduce corporate rates from their current levels could have a significant impact on corporate growth and earnings — especially since U.S. corporate tax rates have lagged behind changes in other nations, which have reduced their marginal rates around the world over the past 15 years.

Figure 1. U.S. Corporate Tax Rate Remains the Highest among Developed Nations



Source: OECD.stat. Graph shows combined central and sub-central government tax rates.

Is it any surprise that Ireland's 12.5% corporate tax rate economy is among the fastest growing in the world? Could British Prime Minister Theresa May's proposed 17% corporate tax rate be a sign of pro-growth policy contagion?

The Central Bank Manages the Economy — Not Anymore

We are now experiencing reflation, a return to normalization or "good inflation" that started right before the election. The market is in effect taking over the reins from the Fed, which, faced with little choice but to keep up. As of the release of this forecast, federal funds rates are between 0.50% and 0.75%, but we expect three additional rate hikes in 2017. However, low global growth, high debt levels and slack in global labor markets will keep a lid on inflation and hence rates. Our fair value model based on expected inflation, employment and term premiums pegs the 10-Year U.S. Treasury rate at 2.75%, and we expect the actual market rate to finally converge toward fair value, though it may be a bumpy ride. Still, the Fed's commitment to remain accommodative and move cautiously is a positive for risky assets.

Business Revival Spurs Capital Investment

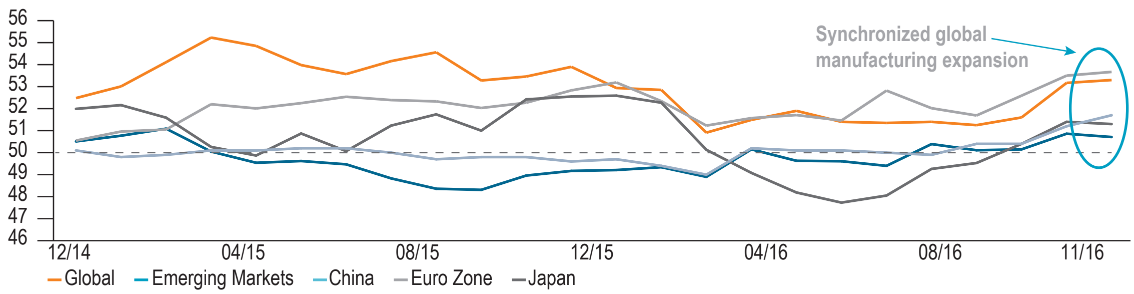
Lack of business investment, burdensome regulations and the highest corporate income tax rates in the developed world have been among the most common explanations for a slow growth economy. The proposed business tax reform will provide the single most important change needed to ignite the U.S. economy. Moreover, any reduction in the existing banking regulations that tend to obstruct lending will rocket small business growth forward. Finally, a taxation scheme that accommodates repatriation of overseas profits will increase shareholder wealth and stimulate further investment. Some, any or all of these measures would be profoundly business friendly.

- According to the U.S. Small Business Administration, small businesses create two-thirds of all new jobs and are responsible for more than half of the private work force; however, lending to small businesses from big banks, although improving, has one of the lowest approval rates, estimated at 23.5%, according to Small Business Trends, 11/21/16

Business friendly policies will not bring back all of the manufacturing jobs that have been lost since America's heyday. But unless shipping costs and tariffs are zero it generally behooves companies to manufacture goods where they sell them, and the U.S. is the number one global consumer market. Conventional wisdom holds that manufacturing industries account for about 12.5% of the U.S. economy, but this number is misleading. Small business's significant demand for goods and services in other areas of the economy such as energy, software, construction and even accounting is not entirely reflected; according to the Bureau of Economic Analysis, manufacturing actually accounts for more than 35% of gross domestic output.

- U.S. manufacturing has been moving up after a mid-year lull that lasted several months. But even before the election, a series of strong global PMI reports created a wave of optimism. China's official PMI rose to 51.2 in October, the highest level since July 2014, and the euro zone, Japan and emerging markets are all above 50, the level cited as the threshold indicative of expansion. It's a rare but welcome development to have most manufacturing metrics moving up at the same time

Figure 2. Global Manufacturing Reports Uniformly Indicate Expansion



Sources: FactSet as of 11/30/16.

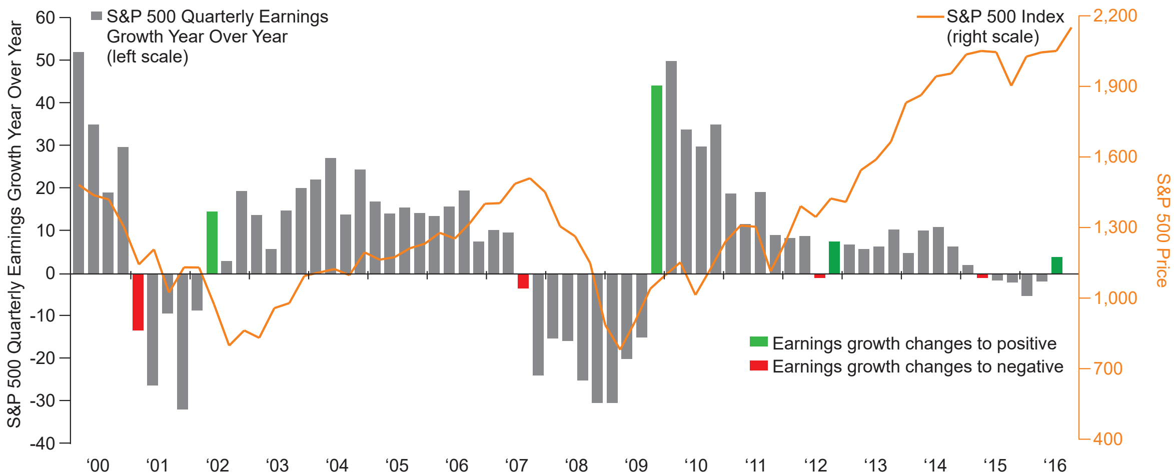
Corporate Earnings Turnaround

Corporate earnings are the fundamental drivers of markets. They also offer an unbiased glimpse into the inner workings of the global economy. After five quarters of profit recession, companies recovered in the third quarter of 2016 and are now growing their year-over-year earnings. The recovery was well underway before the election. The U.S. economy has been steadily improving, and the confluence of market headwinds at the beginning of the year — rock bottom commodity prices, instability in China, a strengthening U.S. dollar and global growth fears — has moderated. A continuation of the recent surge in the dollar is the most likely hurdle in 2017, but a rising tide of growth may temper its ascent. Much of 2016's equity market gains were predicated on a lack of other viable investment alternatives. But the market will be earnings-driven in 2017. Even the energy sector is joining the party. The potential for pro-growth policies will likely trump the headwinds that could hold the market back. But remember that actual policy change takes time, and bottom line improvement based on modifications to the tax code and or regulations cannot realistically be expected to manifest itself until the second half of the year.

Much of 2016's equity market gains were predicated on a lack of other viable investment alternatives, but in 2017 the market will be earnings-driven

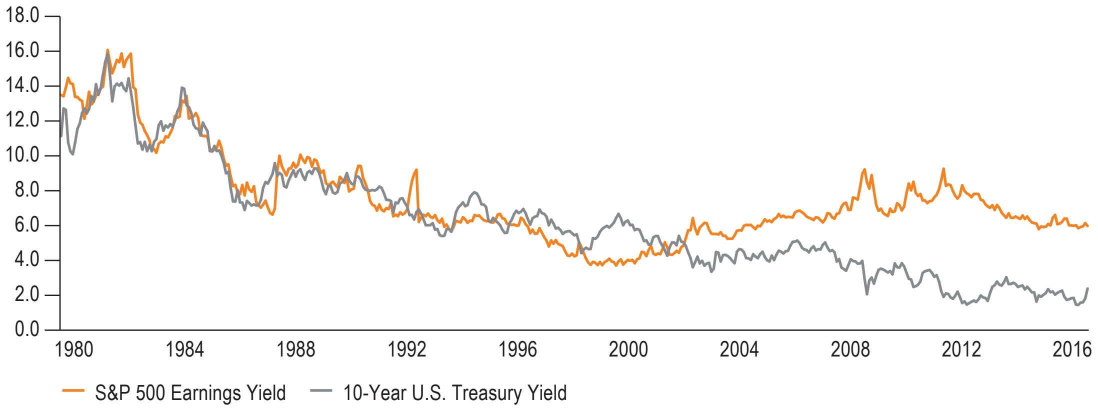
Global Perspectives 2017 Forecast for S&P 500: 2,400 based on $133 earnings per share and an earnings multiple of 18x. While the average multiple over time is around 15, bear in mind that the historical time period includes interest rate periods when bank certificates of deposit paid double-digit returns with very little risk. In an ultra-low interest rate environment, the market could be regarded as comparatively inexpensive. In addition, multiple expansion may be able to extend its impressive run because of the simple fact that flows into equity funds have been negative most of the year. If we see renewed enthusiasm for equity investing, more money will come in from the sidelines, potentially generating more upside

Figure 3. Corporate Earnings Growth is a Barometer for the Health of the Global Economy



Sources: FactSet, Voya Investment Management.

Figure 4. Stocks Still Look Historically Attractive Compared to 10-Year U.S. Treasuries



Sources: Standard & Poor's, First Call, Reuters, Bloomberg, FactSet. Note: Earnings yield is the inverse of the P/E ratio and is calculated as the sum of the reported next twelve months' earnings estimates divided by market capitalization. The 10-year U.S. Treasury yield is used for bonds. **Past performance is no guarantee of future results.**

Consider the effect of previous U.S. tax cuts on equity performance and interest rate changes: on average, the impact on equities is positive over both a one- and three-year horizon. Interest rates, on the other hand, move up in response to higher growth and inflation and the increased debt issuance associated with lower tax revenue and greater deficit spending.

Figure 5. Impact of U.S. Tax Cuts on Equity Returns and Interest Rates Since World War II

	S&P 500 Performance	Long-Term Interest Rates
Tax Cut Periods from 1944-2014	Average Total Return	Average Percent Change
1 Year Following Tax Cuts	8.7%	1.6%
3 Years Following Tax Cuts	24.5%	4.9%

Source: Voya Investment Management

A Strong Consumer Beefs Up

The consumer has been doing the heavy lifting, keeping the U.S. economy chugging along. All-time highs in retail sales, auto sales, Black Friday sales, Cyber Monday sales, online sales; you name it, they are buying it. A strong jobs market, cheap gas prices and steady home price appreciation in excess of 5% is icing on the consumer cake. It is no surprise that the latest consumer confidence figures surged to their highest levels since before the recession.

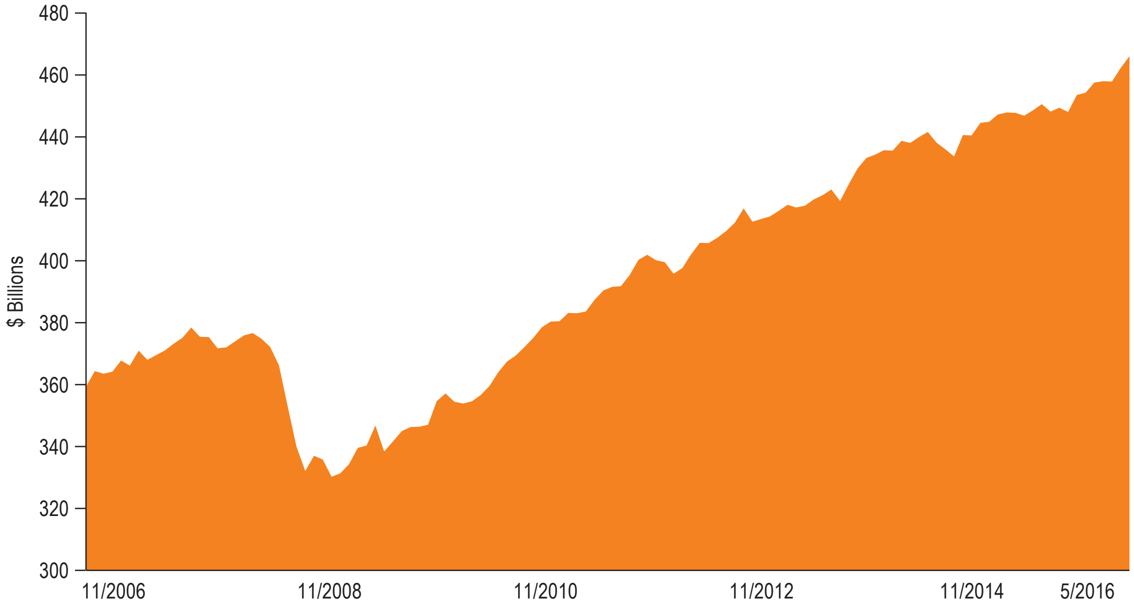
Productivity gains have averaged below 1% for the last several years — a sustained lift in GDP will not be possible without a boost in productivity

Housing is one area, in particular, that has been burning bright and will continue to light the way despite modestly higher interest rates.

- Every 250,000 in new homes built adds about 0.75% to GDP growth. While housing starts are still about 40% off peak, home prices have been increasing about 5% per year, faster than the rate of inflation, helping to boost household wealth to an all-time high of $90.2 trillion
- Higher prices and inventory shortages will continue to induce new construction; new home permits are running 5% higher than last year

The proposed income tax cuts could be the catalysts that make a strong consumer even stronger. More disposable income, more economic growth opportunities, growing household wealth, increased confidence — all bode well for the U.S. consumer. If there is any downside to the consumer, it is that job creation has been trending lower in 2016 than in 2015, and inevitably will go lower in 2017 because we are close to full employment. Other negative notes: the lion's share of job creation has been in lower paying services jobs — especially retail trade, hospitality and leisure — not in manufacturing. What's more, labor participation is near record lows, wage growth has been meager and — most importantly — productivity gains have averaged below 1% over the last several years. A sustained lift in GDP will not be possible without a boost in productivity, which will require the private sector to increase capital spending and business investment.

Figure 6. The U.S. Consumer Remains the Game Changer in Leading Economic Growth Forward



Source: FactSet. All data as of 10/31/16.

Tail Risks Can Rain on the Parade

- **Trumponomics Execution Risk:** A unified-party government doesn't necessarily make it easier when that party is the party of fiscal conservatism. Trump's policy initiatives could meet major opposition in Congress, with resulting bills passing only as watered down versions of his original proposals. It could turn out that the political will required for big-time fiscal stimulus is stiffened only after a stock market correction frightens everyone
- **Global Trade War:** While Trump may kill the Trans-Pacific Partnership (TPP), the area around tariff and trade is grey. An escalating trade war cannot be ruled out. Higher import tariffs and restrictions on free trade may temporarily boost U.S. growth, but any short-term positives could be swamped by a subsequent global recession. China in particular is the wild card when it comes to trade. Trump was a vocal critic of China during his campaign. If he holds true to his rhetoric, labels China a currency manipulator, and succeeds in enacting higher import tariffs, China may retaliate, starting a tit-for-tat trade war
- **European Union Instability:** Europe has its own wave of populism driven by stagnant economic growth, years of austerity and resistance to rising immigration. Further cracks in the European union are possible, which could produce a negative economic shock, hurting investors' appetite for risky assets. France, Germany, the Netherlands and Italy have elections next year, with populist politicians and policies gaining increasing support. If U.S. pro-growth reforms and Brexit appear to have been successful, will more European nations follow?
- **Overshoot of Inflation:** Since the financial crisis, inflation has remained stubbornly low despite central banks' accommodative monetary policies. After eight years of expansion, reflationary efforts (infrastructure spending, additional debt issuance, higher deficits) will increase potential for monetary policy mistakes and economic overheating — potentially leading to inflation spikes. The Fed may lose credibility if it falls too far behind-the-curve, which could cause it to raise rates more quickly as a catch-up maneuver
- **Runaway Rise in the U.S. Dollar:** A strong dollar was one factor contributing to the US corporate earnings recession in 2015 – 2016. While a rise in the U.S. dollar has a deflationary effect for the domestic US economy, larger multi-national corporations are hurt as international sales translate to U.S. dollar earnings at a lower exchange rate. Additionally, emerging-market nations and companies that have borrowed dollar-denominated debt, with over $3 trillion worth of dollar-dominated debt outstanding as of Q1 2016, will come under increasing pressure as debt service costs rise

A New Path Leads to a Tried and True Answer: Broad Global Diversification

By casting a wide net, investors can capture a broader set of investment opportunities and spread around their risk exposures, boosting the expected return and reducing the volatility of their portfolios. Diversification enables investors to pursue a thoughtful, considered investment philosophy that replaces unintended bets with prudent investment discipline. Chasing performance or trying to predict which sector of the market will outperform in any given time period — which we call "gaming diversification" — is a futile effort over the long run. Broad global diversification protects against the consequences of getting it wrong. In times of uncertainty, equal-weighting provides style-, sector- and market-agnostic diversification — most likely a safer way to channel your enthusiasm.

Chasing performance or trying to predict which sector of the market will outperform — called "gaming diversification" — is a futile effort over the long run

Figure 7. Global Markets Face Potential Positives and Negatives in 2017

Global Markets	Potential Positives	Potential Negatives
U.K.	Weak pound continues to boost economy, domestic spending surprisingly strong	Brexit effects kick in
Europe	End of ECB bond buying program and rise of populism motivates policy makers to implement more pro-growth fiscal reforms	U.K. exit from EU encourages other countries to renegotiate their arrangements
	Weaker euro supports export growth and eases pressure on PIGS, their goods and labor become more competitive globally	Breakup of EU and/or euro bloc. French right-wing candidate Marine Le Pen has argued for Frances's exit from euro zone
Japan	Weaker yen supports export growth	Aging population limits potential growth rate
	BOJ monetary policy keeps interest rates low	Inflation remains stubbornly low to negative from failure of unconventional policy
China	Economic growth is picking up as retail sales and producer prices increase	Foreign capital reserves continue to decline, indicating capital outflow
	Government is trying to manage economic risks, remains committed to supporting growth through central and local intervention	Credit growth has outpaced economic growth for years; any decline in asset prices may be destabilizing
Emerging Markets	Higher commodity prices and weaker currencies support export-oriented economies	All other things equal, a stronger U.S. dollar increases debt servicing costs
	Recent declines in economic growth may be turning the corner as policy makers fight corruption and implement pro-growth fiscal reforms	Lower returns, higher defaults and weaker currencies could lead to large capital outflows and balance of payments crises

Source: Voya Investment Management

Investors recently have been rotating towards risk including emerging markets and U.S. small-cap equity and on the sector side includes financials, energy, healthcare and technology. But we find ourselves at a major inflection point, where relationships between styles, sectors and cap sizes have become unclear. This lack of clarity argues for broad global diversification and in particular we would highlight the following areas of the markets in 2017.

Equity

- **Small- and Mid-Cap Stocks:** Regulations and high U.S. corporate taxes disproportionately affect smaller companies. As a result, small- and mid-cap stocks have the most to gain from an upward shift in economic growth
- **EAFE Developed Market Equities:** We believe the underperformer in 2016 is poised for a turnaround on the back of rising corporate profits and growth

Fixed Income

- **Senior Loans:** Minimal duration; a floating-rate structure to hedge against rising rates and attractive pricing make bank loans a top income pick
- **Intermediate-Term Bonds:** Intermediate bonds are in demand worldwide for risk control benefits and potential spread compression

Figure 8. Effective Diversification Protects against Unexpected Risks

Index	November 2016	2016 YTD	3 years	5 years	10 years	15 years
Equity						
S&P 500	3.7	9.8	9.1	14.4	6.9	6.6
S&P Midcap	8.0	18.2	9.4	14.7	8.9	9.9
S&P Smallcap	12.5	22.4	8.8	16.1	8.7	10.4
Global REITs	-2.7	1.9	5.8	9.9	2.2	9.8
EAFE	-2.0	-1.9	-1.8	6.1	1.2	5.6
Emerging Mkts	-4.6	11.3	-2.8	1.3	2.6	10.4
Average	2.5	10.3	4.7	10.4	5.1	8.8
Fixed Income						
Corporate	-2.7	5.4	3.9	4.4	5.3	5.5
U.S. Treasury 20+	-7.7	2.0	7.8	3.3	6.5	6.8
Global Aggregate	-4.0	2.6	-0.2	0.4	3.2	4.7
High Yield	-0.5	15.0	4.2	7.5	7.4	8.2
Average	-3.7	6.2	3.9	3.9	5.6	6.3
Overall Average	0.0	8.7	4.4	7.8	5.3	7.8

Sources: FactSet, FTSE NAREIT, Voya Investment Management. The overall average model allocation includes ten asset classes, equally weighted: S&P 500, S&P 400 Midcap, S&P 600 Smallcap, MSCI U.S. REIT Index/FTSE EPRA REIT Index, MSCI EAFE Index, MSCI BRIC Index, Bloomberg Barclays U.S. Corporate Bonds, Bloomberg Barclays U.S. Treasury Bonds, Bloomberg Barclays Global Aggregate Bonds and Bloomberg Barclays U.S. High Yield Bonds. Returns are annualized for periods longer than one year. **Past performance is no guarantee of future results.**

Summary and Conclusion: The Growth and Reflation Trade

"Insanity is doing the same thing over and over again and expecting different results," a quote widely attributed to Albert Einstein. The logic applies to economic policy as well. While zero/negative interest rates and quantitative easing have supported economic activity and asset prices since 2008, monetary policy has reached its limits. Even central bank leaders admit more of the same will only cause greater economic distortions. Now is the time for pro-growth fiscal policy.

The focus on pro-growth policies over perpetual monetary stimulus marks a turning point for economic policy and a new path forward — one focused on business and consumer friendly policies that encourage investment and spending. Markets in turn have responded, pushing up stocks, yields and commodities to new highs. The animal spirits have awakened and — for the moment — are not looking back.

Therefore, we are forecasting a continuation of recent trends, with a shift upwards in economic growth and earnings propelling both equity markets and yields higher. However, the new path forward is not without risks. Political uncertainty and the imminent end of unconventional monetary policy will also increase volatility. Investors should remain vigilant. True to our disciplined investment approach, we continue to believe a globally diversified portfolio provides the best way to achieve attractive risk-adjusted returns and navigate the changing landscape of 2017.

General Investment Risks:

All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield inherent in investing. All security transactions involve substantial risk of loss.

Domestic Equity: Exposure to financial and market risks that accompany investments in equities. Markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market or economic developments. Small cap stocks may be more volatile and less liquid than stocks of larger more established companies.

Fixed Income: Exposure to financial, market, prepayment, credit and interest rate risks. The value of an investment in a fund is not guaranteed and will fluctuate. Higher yielding bonds are subject to greater volatility and credit risks. A fund may invest in securities guaranteed by the U.S. Government as to timely payments of interest and principal, but a fund's shares are not insured or guaranteed. Bonds have fixed principal and return if held to maturity, but may fluctuate in the interim. Generally, when interest rates rise, bond prices fall. Bonds with longer maturities tend to be more sensitive to changes in interest rates.

International: In addition to the general risks of investing in equities and fixed income securities, investing in foreign securities poses special risks, including currency fluctuation, economic and political risks not found in investments that are solely domestic. Risks of foreign investing are generally intensified for investments in emerging markets.

REITS: Real Estate Investment Trusts may be sensitive to factors such as changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand, and the management skill and credit-worthiness of the issuer. REITs may also be affected by tax and regulatory requirements.

Non-Diversified Strategies: Due to the concentrated nature of non-diversified and sector funds, they may experience greater volatility than funds with a broader investment selection/strategy.

Diversification does not guarantee a profit or ensure against loss. **Past performance is no guarantee of future results.**

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