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Wall of Worry Punishes Market in January

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2015 started out as a bust for U.S. equities, as January's decline cemented the first two-month losing streak for the S&P 500 since 2012. There has been no shortage of risks to roil investors here in the new year — including a new low-oil regime, a strong dollar, rising interest rates and slowing global growth — and in classic "what have you done for me lately?" fashion, sellers once again lined up to bet against the astounding resilience of this five-year bull run.

So will the most hated bull market in history finally be kind to the bears? It's possible, but we give it about the same probability as bets against Tom Brady.

Many Concerns, All Manageable

Investors have been worried about interest rates since 2010, reasoning that record liquidity injections from the Fed should result in hyperinflation and multiple rate hikes to battle soaring prices. Neither of these materialized, as the velocity of money — how often money changes hands within an economic system — plummeted, suggesting the vast increase in liquidity did not filter through to the general economy. Last year, investors assumed a strong U.S. economy would finally push rates higher; wrong again, as an abysmal first quarter GDP print and even lower global interest rates pushed Treasury yields lower and kept the Federal Reserve cautious. Given this history and the fact that any rise in Treasury yields will likely be the result of domestic economic strength, and not hyperinflationary conditions, let's resolve to not focus too much on interest rates in 2015.

Waning global growth is another biggie in the market's basket of overblown worries. While growth around 3% has investors sulking, that rate amounts to an expansion of more than $2 trillion per year when applied to the world GDP pie of $77 trillion. Central banks, meanwhile, are doing their part to juice growth beyond this level. The European Central Bank, for example, in January announced a mammoth €1 trillion asset-purchase program designed to stoke economic growth and inflation, and more recently China lowered a key lending rate, effectively freeing up more than $100 billion for its banks to lend. These stimulus efforts — to which markets responded positively — suggest that global liquidity will not be drying up anytime soon despite the Fed's intention to slowly normalize policy. So let's also resolve to not dwell unduly on global growth in 2015.

A strong U.S. dollar troubles investors concerned that the appreciation of our currency will hurt the sales of U.S. companies with international exposure, as U.S. goods are now more expensive to overseas buyers. To gauge the impact of the stronger dollar, it makes sense to check in with the tech sector, as 50% of its sales come from abroad, more than any other sector including energy's 44%. Tech sector earnings for fourth quarter 2014 are surprising on the upside so far, boasting year-over-year growth of 9.2% with more than half the companies reporting. The message here is that U.S. corporations are skilled at navigating international market scenarios; although the speedy rise of the dollar may have slowed them down a bit

Executive Summary

- While there's been no shortage of risks to roil investors here in the new year, it's more important to focus on ever-growing corporate earnings and adequate diversification.
- Any increase in interest rates during 2015 will be the result of domestic economic strength — which is a good thing.
- The overall net effect of lower oil prices is positive and should help support global economic growth as central banks step up their stimulus efforts.
- If tech sector earnings are any indication, corporate America should be able to navigate around the challenges of a strong dollar.

Domestic Equities' Struggles Continued Into January

Index	Jan-15
Equity	
S&P 500	-3.0
S&P MidCap 400	-1.1
S&P SmallCap 600	-3.5
Global REITs	4.9
EAFE	0.5
Emerging Markets	0.6
Fixed Income	
Corporate	3.0
U.S. Treasury 20+	9.3
Global Aggregate	-0.2
High Yield	0.7
Senior Loans	0.4

Source: FactSet, FTSE NAREIT, Voya Investment Management initially, it is just a speed bump. So let's add dollar strength to the list of things we will not be obsessing over in 2015.

Finally, low oil prices have been blamed for the recent market selloff. But low oil is good (for the most part). It is good for consumers, who drive 70% of the U.S. economy. It is good for corporations — not just transportation companies, but any firm that uses energy (i.e., all of them). It is good for countries that are net importers of oil, including most of the emerging markets; emerging market equities actually rebounded in January, up 0.6% for the month. Of course, low oil is not good for economies whose budgets are predicated on $100/barrel oil. It is also not good for energy companies in general; we've already seen these firms scale back on some of their marginal projects, which does not bode well for capital expenditures. But in the final accounting, the overall net effect of lower oil prices is positive; the International Monetary Fund estimates that each 10% drop in the price of oil lifts global GDP by 0.2%. So the 50% drop in oil prices since June should have contributed a 1% boost to global GDP. But we already resolved to not dwell on global growth.

Focus on Fundamentals

So what should we dwell on? As always, investors should focus on the fundamental driver of markets: corporate earnings. So far, fourth quarter earnings season is exceeding admittedly diminished expectations; with about 50% of the S&P 500 having reported results, year-over-year earnings growth currently stands at about 3.5%, relative to a FactSet consensus estimate of 1.7% as of December 31. And even though analysts have slashed their forecasts for 2015, earnings are expected to grow to the highest level ever next year, which should bolster the markets' resolve. (See our 2015 Forecast for our specific expectations.)

Investors also should be concerned about the job market and its impact on inflation. While nearly 3 million jobs were added in 2014 (the best such figure since 1999) and the unemployment rate stands at a below-target 5.6%, the lack of upward pressure on wages is keeping a lid on inflation and making it difficult for the Fed to consider its mission fully accomplished. In fact, the threat of deflation is more consequential than any of the other perceived perils we discussed earlier.

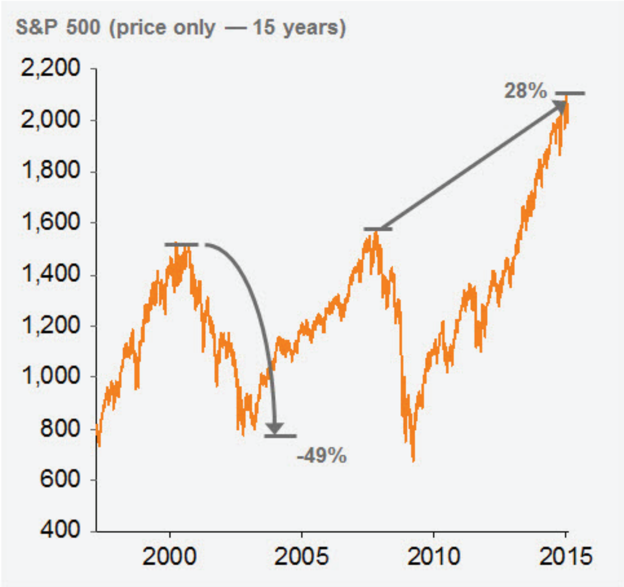
Resolve to Diversify

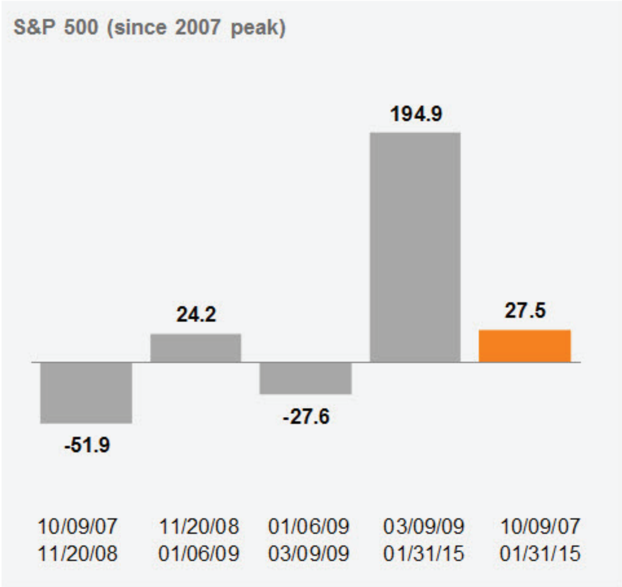
Among other challenges, the market is contending with a generational shift in energy prices that is meting out carnage and fortune in its wake. These extreme outcomes — or "fat tails" to statisticians — are long from being resolved and contribute to the steepness in the "wall of worry" that continually tests but has yet to derail markets. Investors would be well advised to resolve to focus on the fundamentals, with diversification as a means of insulating against the fluctuations of normal markets.

The U.S. Dollar Has Surged on the Relative Strength of the Domestic Economy

Source: FactSet

After Two Bull and Two Bear Market Cycles, the S&P 500 Is Now 28% Above Its 2007 Peak





Source: FactSet, Voya Investment Management
Past performance is not a guarantee of future results. Investors cannot invest directly in an index.

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