Voya Global Perspectives

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Executive Summary

- Domestic large cap indexes have lagged as oil prices and dollar strength weigh on giant multinationals.
- The negative impact of normalization has outpaced the expected benefits, a trend likely to be evident in first quarter earnings.
- Earnings in the energy sector are expected to drop precipitously, and the abandonment of new projects could impede future growth.
- Tighter U.S. policy combined with rampant easy money globally may be a game changer for asset allocation strategies.

Global Diversification Leads in Q1

Index	March 2015	YTD
Equity		
S&P 500	-1.6	1.0
S&P MidCap 400	1.3	5.3
S&P SmallCap 600	1.6	4.0
Global REITs	-0.2	4.2
EAFE	-1.4	5.0
Emerging Markets	-1.4	2.3
Fixed Income		
Corporate	0.3	2.3
U.S. Treasury 20+	1.2	4.2
Global Aggregate	-1.0	-1.9
High Yield	-0.5	2.5
Senior Loans	0.6	2.3

Source: FactSet, FTSE NAREIT, Voya Investment Management
Data as of 03/31/2015

Global Diversification Roars Like a Lion in the First Quarter

We have been advising — even warning — investors crowded into U.S. large caps that they are “gaming diversification”. The S&P 500 has been a go-to asset class for the duration of this bull market, and rightfully so given the double-digit returns delivered by the index in five of the past six years thanks to the relatively strong domestic economy and low unemployment. But all good things must come to an end; while this stumble may not represent the finish line for domestic large-cap equities, other markets have elbowed their way to the front of the pack. With the first quarter in the books, strong performances by indexes in Europe and Asia as well as domestic small and mid-cap names have left U.S. large caps in the unfamiliar position of last place.

Normalization Drives Markets in First Quarter

The first quarter was punctuated by massive global central bank stimulus, as the European Central Bank finally stepped up to the quantitative easing plate while the U.S. Federal Reserve’s likely rate-hike path appeared to grow more benign. The rising U.S. dollar and collapsing energy prices took a toll on many of the mega-capitalization companies found in domestic large-cap bourses like the DJIA and S&P 500, though smaller-cap domestic equity markets surged, as did Europe, China, Japan and select emerging markets. Europe, for example, was fueled by the 20% drop in the euro/U.S. dollar exchange rate, which instantly boosted the global competitiveness of the region’s manufacturers (especially those in Germany, a country whose opposition to QE has been well documented over the past several years). Central bank activity also sent bond prices and returns skyward, resulting in low-to-negative real yields in the U.S. and Europe, to the delight of business and consumer borrowers.

Despite the handwringing over the pronounced movements in currency and energy markets during the first quarter, the trends are suggestive of simple normalization. FX activity has pushed the dollar toward its pre-2001 average while pulling the euro down close to its level at issuance in 1999. And though oil prices are off sharply from the high levels to which we’ve grown accustomed in recent years, the black gold now is trading close to its 30-year average. Normalization is not being welcomed in all corners; both corporate profits and certain national economies have felt an immediate detrimental impact from currency and energy trends. Those who stand to benefit from these new levels, on the other hand, are seeing a slower transmission of the spoils, a timing mismatch likely to show up in first quarter corporate profits.

Meanwhile, the trend toward broad normalization has bypassed interest rates, inflation and volatility, all of which remain near historical lows as investors continue to brace for an uptick that never seems to happen.

Earnings Season to Provide Insight Into Dollar, Energy Impacts

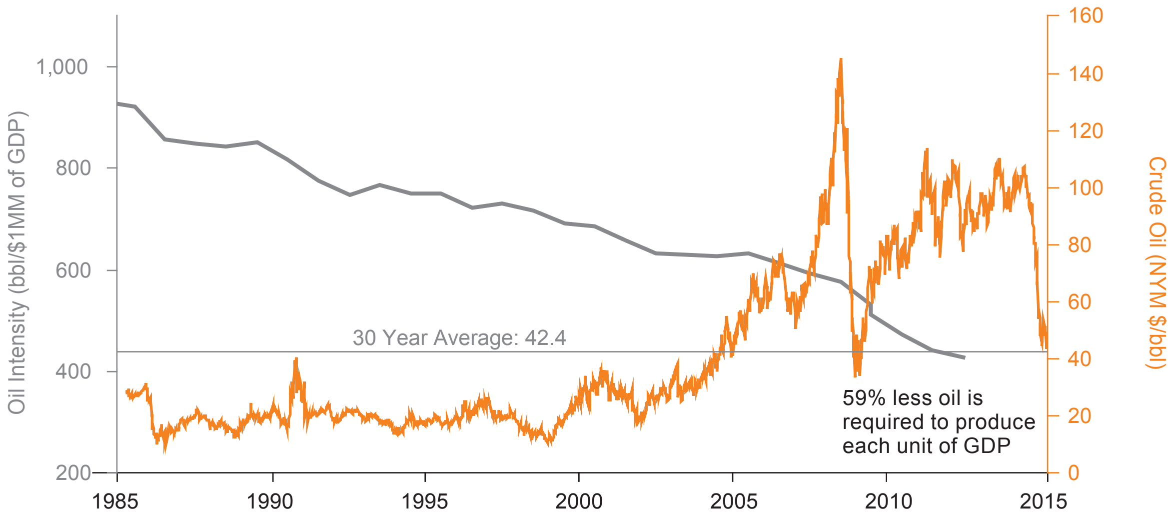
With first quarter earnings season getting underway, we’ll soon get a read on the impact “normal” is having on corporate America. Analysts currently predict that first quarter profits will decline 4.8% year over year. However, resilience and sustainability have characterized corporate earnings in the current bull market, so we’ll wait and see if corporate America can pull another rabbit out of the hat; actual earnings tend to beat expectations by 4–6% given the tendency of analysts to overshoot on the side of pessimism. But it would be an ominous sign indeed were the S&P 500 to report its first year-over-year decline in earnings since third quarter 2012.

Analysts expect the technology sector — which typically contributes about 20% of the S&P 500's earnings — to post slightly negative growth as these companies navigate the stronger-dollar global landscape. Technology posted the biggest positive surprise in fourth quarter 2014, and a repeat performance could nudge the index into another quarter of positive growth. Such an upside surprise is less likely from energy, where earnings are forecast to decline more than 60% compared to first quarter 2014. Already, numerous capital expenditures in the sector have been shelved, which could impede future economic growth; a Saudi oil executive was quoted by Reuters saying that the oil and gas industry was poised to cancel or delay $1 trillion in capital products due to the price environment. Evidence of this pullback can be seen domestically in the latest nonfarm payrolls report, which showed a disappointing 126,000 jobs added to the U.S. economy in March, breaking the 12-month streak of 200,000-plus adds per month; the mining industry (which includes oil drilling) has lost 30,000 jobs so far this year. While the 40% year-to-date drop in rig count may signal a bottom for oil, the supply/demand dynamics of that market are never easy to predict, let alone time.

Meanwhile, other economic statistics have been decidedly mixed of late.

- The U.S. has been slightly weaker than expected on ISM manufacturing, retail sales and jobs but stronger on overall consumer spending, ISM services and new-home sales. The net result is that first quarter GDP estimates have been ratcheted down considerably, to 1.6%.
- Europe's economy is responding positively to the ECB's introduction of QE, with a flurry of positive data on credit growth, economic sentiment, French business confidence and German retail sales. As a result, analysts now expect first quarter GDP growth of 0.4% by the currency bloc.
- Asia continues to grow, and in a noteworthy surprise India's GDP is expected to expand 7.2% this year — faster than China's.

Oil Prices Have Collapsed in Recent Months, While Oil Intensity Has Been in Decline for Decades



Source: U.S. Department of Energy, FactSet

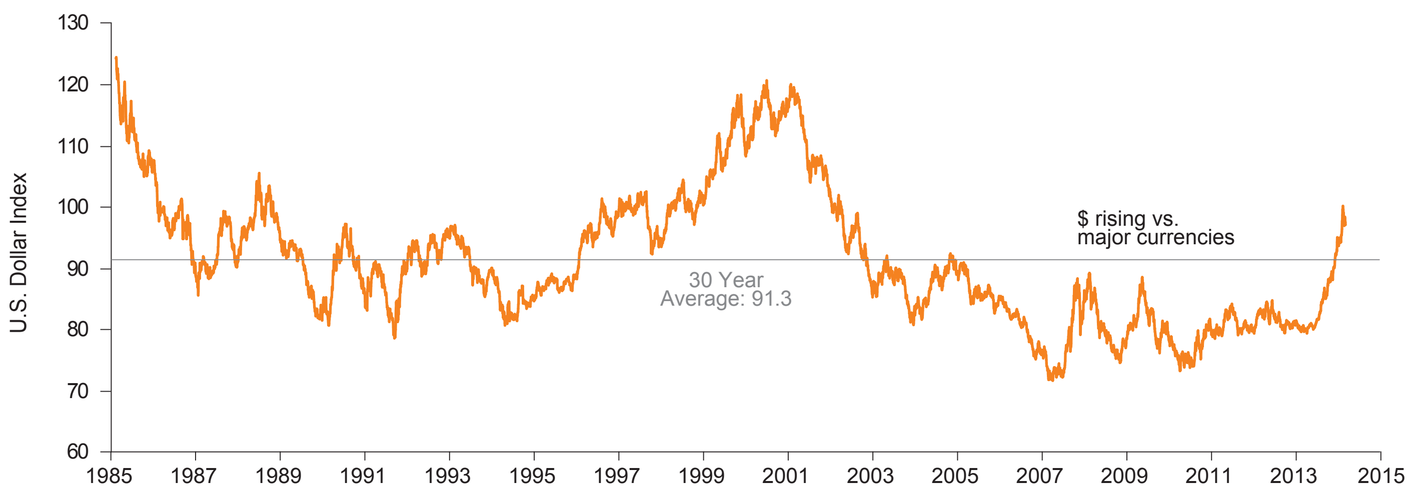
Note: Oil Prices are West Texas Intermediate light crude spot price (NYMEX). Oil intensity as of 12/31/12; crude oil as of 03/31/15.

Normalization of Markets Has Led to Volatility

It is clear that central banks have tended to act as a market force of last resort; their ongoing liquidity efforts — and the low interest rates and risk taking that resulted — have effectively established a "put" (or floor) on the markets, pushing asset prices higher and dampening volatility. After years of lagging the U.S., European markets this year have been celebrating a put of their own, rallying on the ECB's introduction of quantitative easing. But the Federal Reserve is the 800-pound gorilla, and Chair Yellen — a hawk in dove's clothing — has been highly skilled in nudging the markets on a path toward normalization (aka, rate tightening) even as her global compatriots grow more accommodative.

Tighter policy in the U.S. and rampant easy money globally may be a game changer for asset allocation strategies. However, investors continue to pile into U.S. large caps in the seventh year of the bull market despite a rising dollar and the prospect of weaker corporate profits. Those unwilling to break free from the herd and diversify beyond our country's borders may find their portfolios exposed to the dual risk of lower returns and higher volatility.

After a Decade of Weakness, Dollar Returns to Strength



Source: FactSet
Data as of 03/31/2015

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