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Voya Global Perspectives

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Executive Summary

- Developed markets have demonstrated awe-inspiring resilience in the face of emerging market struggles.
- Emerging market currencies are plunging. U.S. monetary policy is partly to blame but the true culprit is China.
- U.S. interest rate hikes are likely to be gradual. Investors who exit bonds may miss income opportunities.
- Energy sector problems cloud the Q2 earnings season. It could be the first quarter of negative growth since Q3 2012.
- Despite China's recent selloff, keep in mind that volatility may be rewarded.

Developed and Emerging Market Diverge

Index	July 2015	YTD
Equity		
S&P 500	2.1	3.4
S&P MidCap 400	0.1	4.3
S&P SmallCap 600	-0.8	3.3
Global REITs	3.5	0.6
EAFE	2.1	8.1
Emerging Markets	-6.9	-4.0
Fixed Income		
Corporate	0.7	-0.3
U.S. Treasury 20+	3.7	-1.7
Global Aggregate	0.2	-2.9
High Yield	-0.6	1.9
Senior Loans	0.4	3.5

Data as of 07/31/2015

Source: FactSet, FTSE NAREIT, Voya Investment Management

Developed Markets Resilient as Emerging Markets Struggle

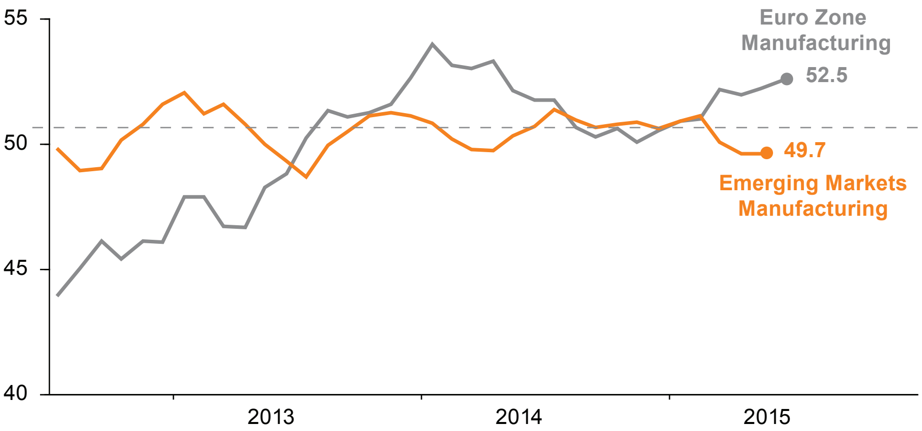
Investor fear headed east in July from Greece to China. As Greece's avoidance of Grexit for now faded from the spotlight, markets instead focused on the steep sell-off in Chinese equities. Major Chinese indices are still up double digits year to date but that fact didn't stop investors from fearing the worst – a hard economic landing. When the Chinese markets were on fire, reaching new highs, there was nary an investor predicting a speed-up in the economy. Yet now that equities have come back to earth it of course must spell doom. Not really. China has been slowing down for quite some time as it tries to thread the needle of taming excesses while sidestepping a crash. When it comes to emerging markets, volatility is a given and should be expected.

Developed Markets on Cruise Control

Developed markets have demonstrated awe-inspiring resilience in the face of struggles in China, Brazil, Puerto Rico and Greece. The U.S. economy and markets continue to march forward at a measured pace. The housing sector in particular is showing vigorous improvement, with existing home sales the fastest in eight years and rising to the highest median price on record. The employment front is also looking healthy; jobless claims have fallen to the lowest number since November 1973 and consistently have been below 300,000 since March. Enthusiasm was curbed, however, by a drop in consumer spending; retail sales unexpectedly fell 0.3%, the first decline in four months. An anticipated surge in consumer spending, which was predicated on low oil prices, is taking time to work through the economy. Manufacturing, despite the carnage in the capital-intensive oil industry, expanded for the 31st consecutive month led by an increase in new orders.

The latest U.S. and euro manufacturing reports indicate expansion while emerging markets are contracting slightly.

Global Manufacturing PMIs



Source: Institute of Supply Management, FactSet

European and Japanese markets also demonstrated resilience, holding on to their strong gains year to date driven by expanding manufacturing and positive GDP. Their currencies also have stabilized relative to the U.S. dollar after sharp adjustments due to monetary stimulus from their respective central banks. As intensive energy exporters both regions are benefiting from lower energy prices, which are providing are a healthy dividend for consumers and businesses.

Emerging Markets, Currency and Commodity Woes

Developed countries are practically an oasis in the desert of the global economy. Emerging market currencies are plunging, especially Asian currencies such as the Malaysia ringgit, Indonesia rupiah, Thai baht and South Korean won; but also the currencies of commodity-intensive exporters such as Brazil, Canada, Australia and South Africa. Certainly the U.S. Federal Reserve (Fed) is creating some of these waves as result of ending its quantitative easing program and the likelihood of a near-term interest-rate hike, but the true culprit is China.

China's historic growth drove the commodity super cycle, and now its slowing growth is ending the super cycle through adverse impacts on Chinese exports, imports and investment spending. The world economy is struggling with a slowing China, but last year China was the biggest contributor to global growth, exceeding the United States. Its economy is the second largest in the world and nearly as big as all of Europe. It has four times the population of the United States. This may be why nearly every global firm is falling over itself, seeking to drive growth by locating and building in China.

China's government has clearly demonstrated that the nation is not ready to be a prime time market participant. Recent government interventions in the stock markets have done more to destroy China's future growth prospects than a summer sell-off would ever do. MSCI recently rejected China's A shares for inclusion into its MSCI Emerging Markets index, fortunately right before the July sell-off. The International Monetary Fund recently rejected China's yuan currency to be included for special drawing rights (SDR) – an exclusive collection of global currencies that form a special reserve asset. The SDR currently includes the U.S. dollar, euro, yen and pound sterling. China's aggressive intervention into its markets likely delays indefinitely these two important market-opening catalysts. These are minor but important examples of why the second largest economy in the world is still considered "emerging."

Fed Rate Hike

On the fixed income side, looming Fed interest rate hikes are keeping markets on edge too. A hike seems likely soon based on U.S. inflation and employment data, but this expectation assumes Fed Chair Janet

Developed markets are resilient while emerging markets struggle in the near term

Index	Currency	July 2015	YTD	1 year	3 years	5 years	10 years
Global Markets							
International	*USD*	2.1	8.1	0.1	12.8	8.5	5.5
	local	3.5	13.0	16.4	19.4	11.5	5.9
Emerging Market	*USD*	-6.9	-4.0	-13.1	1.0	0.9	7.0
	local	-4.3	1.3	-1.0	6.8	5.1	8.9
Regions							
Euro x-UK	*USD*	3.8	9.3	1.9	16.0	9.0	6.0
	local	*5.3*	*16.7*	*20.3*	*19.8*	*11.7*	*6.2*
UK	*USD*	1.7	3.8	-5.4	9.3	8.6	4.8
	local	*2.5*	*3.7*	*2.3*	*9.5*	*8.7*	*6.1*
Pac x-Japan	*USD*	-1.1	-0.5	-11.1	5.0	6.5	7.8
	local	*1.7*	*6.6*	*4.0*	*13.5*	*9.1*	*7.7*
Japan	*USD*	0.5	14.3	8.5	14.7	8.4	4.3
	local	*1.7*	*18.1*	*30.7*	*33.7*	*16.4*	*5.4*
China	*USD*	-10.8	2.5	3.1	10.4	4.4	12.1
	local	*-10.8*	*2.5*	*3.1*	*10.4*	*4.4*	*12.1*
S&P 500		2.1	3.4	11.2	17.6	16.2	7.7

Source: FactSet. Returns for periods greater than one year are annualized. All returns reflect total return including dividends expressed as a percentage.

Yellen is impervious to problems overseas. While investors seem overly fixated on when the Fed will make its first move, we believe the more important considerations involve the pace and magnitude of Fed policy change which are likely to ensue. The level and pace of the Fed's hikes will likely be gradual and slower than previous tightening cycles. In light of expectations for a patient Fed, we expect long-term rates to stay lower due to external demand and a flatter yield curve. Many sectors and classes of bonds potentially can do well under such conditions; in our view, investors who bail out of bonds may miss attractive income opportunities.

Energy and Earnings

Low oil sank lower in July, posting its worst monthly performance this year precipitated by oversupply, a strong dollar and sluggish global growth. The energy sector continues to get battered, which raises warning flags for the Q2 earnings season. Earnings growth is the fundamental driver of markets and sure enough, markets have been moving sideways more than up because of earnings concerns. Company earnings on the S&P 500 grew about 1% in aggregate in the first quarter, primarily because of energy companies; Q2 does not look significantly better. Expectations are for a nearly 60% drop in energy sector earnings and an overall drop of about 1%. If earnings growth is negative it would be the first quarter of negative growth since Q3 2012.

Conclusion

The good news always seems to be overwhelmed by the bad news, which is why the adage "the market climbs a wall of worry" is so appropriate. Investing is relative and we recommend that the problems in China be evaluated in the context of other emerging markets, which might just be normal albeit disruptive. China desperately wants to shed its pejorative "emerging" status and attempting to game investing in this market is, well, folly. By contrast, developed markets are a bright spot and are providing ballast to an overall portfolio. Nonetheless, investors must keep in mind that volatility potentially may be rewarded. And though there can be no guarantee that diversification can prevent a loss, a portfolio globally diversified across stocks and bonds potentially builds resilience such as we have witnessed in this bull market.

Returns for a globally diversified strategy over the last 10 years refute the notion of a "lost decade."

Index	Wgt	July 2015	YTD	2014	2013	2012	2011	2010	2009	2008	3 Years	5 Years	10 Years	15 Years
Equity														
S&P 500	10%	2.1	3.4	13.7	32.4	16.0	2.1	15.1	26.5	-37.0	17.6	16.2	7.7	4.5
S&P MidCap 400	10%	0.1	4.3	9.8	33.5	17.9	-1.7	26.6	37.4	-36.2	18.7	16.3	9.2	9.3
S&P SmallCap 600	10%	-0.8	3.3	5.8	41.3	16.3	1.0	26.3	25.6	-31.1	18.8	16.8	8.5	9.6
Global REITs	10%	3.5	0.6	15.9	4.4	28.7	-5.8	20.4	38.3	-47.7	9.4	11.1	6.0	10.1
EAFE	10%	2.1	8.1	-4.5	23.3	17.9	-11.7	8.2	32.5	-43.1	12.8	8.5	5.5	3.8
Emerging Markets	10%	-6.9	-4.0	-1.8	-2.3	18.6	-18.2	19.2	79.0	-53.2	1.0	0.9	7.0	7.7
Average		0.0	2.6	6.5	22.1	19.2	-5.7	19.3	39.9	-41.4	13.0	11.1	8.9	8.1
Fixed Income														
Corporate	10%	0.7	-0.3	7.5	-1.5	9.8	8.1	9.0	18.7	-4.9	2.5	4.8	5.4	6.3
U.S. Treasury 20+	10%	3.7	-1.7	27.5	-13.9	3.4	33.8	9.4	-21.4	33.7	1.0	7.4	6.8	7.8
Global Aggregate	10%	0.2	-2.9	0.6	-2.6	4.3	5.6	5.5	6.9	4.8	-1.1	1.4	3.6	5.0
High Yield	10%	-0.6	1.9	2.5	7.4	15.8	5.0	15.1	58.2	-26.2	5.9	7.7	7.6	7.7
Average		1.0	-0.7	9.5	-2.6	8.3	13.2	9.8	15.6	1.9	4.4	6.9	5.5	7.2
Overall Average		**0.4**	**1.3**	**7.6**	**11.1**	**15.1**	**1.8**	**16.1**	**28.8**	**-26.6**	**9.6**	**10.7**	**7.3**	**7.5**

Sources: FactSet, FTSE NAREIT and Voya Investment Management. The overall average model allocation includes 10 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, Barclays U.S. Corporate Bonds, Barclays U.S. Treasury Bonds, Barclays Global Aggregate Bonds and Barclays U.S. High Yield Bonds. Returns are annualized for periods longer than one year.

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