Market Update | July 1, 2015

Voya Global Perspectives

Markets. Insights. Opportunities.®

Douglas Coté, CFA
Chief Market Strategist

Executive Summary

- In the first half of 2015, the long-running bull market continued to overcome a variety of potential stumbling blocks.
- With ECB stimulus blazing, Europe has been a pleasant surprise this year.
- While the mechanics of policy normalization can test near-term resolve, investors must remain focused on their long-term goals.
- If the bull market that arose out of the Great Recession taught us anything it's that waiting on the sidelines for a precise entry point is pure — and costly — folly.

Investors Sought Risk Assets in 1H15

Index	June 2015	2Q15	YTD
Equity			
S&P 500	-1.9	0.3	1.2
S&P MidCap 400	-1.3	-1.1	4.2
S&P SmallCap 600	1.0	0.2	4.2
Global REITs	-3.9	-6.7	-2.8
EAFE	-2.8	0.8	5.9
Emerging Markets	-2.5	0.8	3.1
Fixed Income			
Corporate	-1.8	-3.2	-0.9
U.S. Treasury 20+	-4.1	-9.1	-5.3
Global Aggregate	-0.4	-1.2	-3.1
High Yield	-1.5	0.0	2.5
Senior Loans	-0.2	0.7	3.0

Data as of 06/30/2015

Source: FactSet, FTSE NAREIT, Voya Investment Management

2015 Midyear Update

In our 2015 forecast (published December 2014) we opined that "though periods of volatility may challenge investor resolve over the course of 2015, resilience will prevail". We feel pretty good about that prediction so far, as in the first half of the year we watched the long-running bull market continue to deliver gains despite the emergence of such potential stumbling blocks as collapsing oil prices, a surging dollar and periodic flareups in the perpetual Greek drama. Investors who capitulated into the periodic chop that some of these events inspired missed out on what proved to be a truly resilient bull market, both here and abroad.

As bleak as first quarter U.S. GDP growth was, many (including the Federal Reserve) were comfortable writing the weakness off as merely a byproduct of transitory occurrences — relevant or not — like the West Coast port strike and dismal winter weather. Meanwhile, markets cheered positive first quarter corporate earnings growth, as corporate America defied bearish expectations that S&P 500 profits would be dragged down by a decimated energy sector.

Another welcome surprise in the first half of the year was Europe. We warned in our 2015 forecast that without some strong medicine from the European Central Bank, the continent faced the prospect of slipping into deflation and recession. Fortunately, the ECB came through big time in the form of a €1.1 trillion asset-purchase program announced in March, surprising markets not so much with its existence but with its magnitude. And the ECB was not the only central bank with its eye on stimulus, as fears of rising U.S. rates were mitigated by rampant global central bank activity that included multiple fine-tunings by China, spurring asset prices sharply higher (and in recent weeks, sharply lower).

With that as our backdrop, let's take a look at the second quarter and our expectations for the balance of 2015.

Second Quarter Market Review

Global equity markets trended higher in the second quarter on improved economic data worldwide, including positive euro zone economic growth and employment; robust U.S. manufacturing, housing and employment numbers; and Japan's strong first quarter GDP report. Positive year-over-year earnings growth for U.S. corporations was also a pleasant surprise given the consensus estimate for a significant contraction.

Equity markets in the second quarter extended their year-to-date lead over fixed income. In terms of developed markets, EAFE equities led the way thanks to Japan and the U.K., as well as positive contributions from Switzerland and France. Domestic equities were paced by small-cap names, a performance that brought this capitalization cohort close to par with the strong year-to-date performance of mid-caps stocks. Global REITs, spooked by the specter of rising interest rates, were one of the few equity asset classes in the red for the second quarter.

Fixed income was predominately negative in the second quarter, as investors fled safe havens like U.S. treasuries for riskier climes; high yield bonds, for example, managed to avoid a downturn during the quarter given their exposure to an improving economy and a rebound in oil prices. After many years of inflows, bond assets finally reversed course in June and investors fled from fixed income and into global equities. This increased risk appetite was bolstered by the aforementioned concerted global central bank stimulus, broad-based improvements in economic data during the second quarter and M&A deal activity that is challenging 2007's all-time record high.

Normalization in Markets Lowers Risk

As we enter the second half of the year, investors must resolve to not let the mechanics of policy normalization obstruct their long-term wealth-building plans. In fact, we'd argue that for the first time in a long time, good news really is good news. For example:

- **Interest rates.** There's no downside to the Fed raising its federal funds target rate now; in fact, beginning to normalize the policy rate would actually bolster confidence in the economy and the markets and allow us to once and for all leave the Great Recession behind.
- **Currencies.** The strong dollar has indeed been a headwind for U.S. companies that export goods and services abroad. On the other hand, it also has assisted the cross-border M&A binge that is seeing U.S. companies buy overseas concerns at an FX-assisted discount.
- **Energy.** While low crude oil prices are a negative for energy company earnings and capital spending on new energy-related projects, they provide an unequivocal boost for consumers both here and abroad. While the virtuous cycle of plummeting gas prices, perpetually low interest rates, stable-to-rising home values and a rapidly improving jobs market has been somewhat slow to transmit to the broader economy, we are beginning to see some positive momentum in consumer spending patterns, which bodes well for near-term growth.
- **Global growth.** As the Fed continues to ease off the accelerator, most global central banks are keeping the pedal to the medal to bolster growth. And despite only minimal structural reforms, global growth is moving closer to the range of normal thanks to the ongoing stimulus.
- **Greece.** Admittedly, the ongoing saga in Greece is anything but normal — and anything but good news. However, history suggests an 11th hour agreement is the most likely outcome here, allowing the country to meet its obligations and hopefully providing some stability to a euro zone that is already showing signs of life.

Midyear Update in Forecasts

While we continue to believe that equity markets will continue to exhibit resilience in the face of myriad challenges during the second half of 2015, we are lowering our expectations for several key fundamental metrics given the very sluggish winter economy.

- **S&P 500 earnings:** lowered to $124 per share from $130 per share. Our original EPS estimate was based off a calendar year 2014 result of $121, though the final came in at $118.29. And given drastic reductions in expectations for energy sector earnings, we have lowered our growth rate forecast for the index to 5% from 7.5%. The bottom line: 5% growth applied to final 2014 EPS of around $118 gives us $124 for 2015.
- **S&P 500 price target:** affirmed at 2200. Given our lowered earnings expectations, this price target now suggests a forecast P/E ratio of 17.7, up from our previous estimate of 16.9. A variation of plus/minus 1 to the P/E ratio falls within our tolerance range.
- **U.S GDP:** lowered to 3% from 3.5%. While the first quarter's surprise contraction left us with no choice but to lower our full-year expectations, we expect strong, consumer-driven growth over the balance of 2015.

First Quarter Earnings Growth Surprised Analysts Calling for a Contraction

Sector	Reported		Earnings Growth			Earnings Surprise		
	Actual	Total	Percent	Positive	Negative	Percent	Positive	Negative
Health Care	55	55	23.6	45	8	10	44	7
Financials	86	86	15.9	54	30	7	61	19
Industrials	65	65	7.5	39	25	4	40	19
Consumer Discretionary	84	84	6.5	45	37	1	54	25
Utilities	30	30	3.4	18	10	6	22	7
Information Technology	67	67	3.2	36	31	5	45	16
Consumer Staples	37	37	2.6	24	14	6	27	7
Telecommunication Services	6	6	-0.6	2	4	5	4	1
Materials	29	29	-1.3	17	9	7	17	10
Energy	41	41	-56.6	7	34	27	29	9
S&P 500	**500**	**500**	**1.0**	**287**	**203**	**6**	**343**	**120**

Source: Bloomberg, Standard & Poor's, FactSet

Note: Earnings Growth is the percentage change in the cumulative share-weighted EPS earnings from that of a year ago. Earnings Surprise Percent is the share-weighted average of the ratio of actual company earnings vs. the consensus estimates.

- **Euro zone GDP:** raised to 1.5% from 0.5%. This is one of the biggest positive surprises of 2015. With blockbuster ECB stimulus, a significantly weaker euro and plummeting energy prices, the euro zone has backed away from the precipice of another recession and deflation.
- **Global GDP:** lowered to 3.3% from 4%. The U.S. being forced to dig its way out of a first quarter hole and a slowing China are providing a drag to global growth.
- We affirm all of our other forecasts, including:
  - Crude oil at $68 per barrel
  - U.S. ten year treasury yield at 2.60%
  - Gold at $999 per troy ounce
  - Euro/U.S. dollar exchange rate at 1.16
  - U.S. unemployment rate at 5%

Beyond our specific forecasts, our broad themes for 2015 remain intact:

- Global growth will be buoyed by tectonic shifts in the real economy.
- Global central banks will remain supportive.
- Conditions for global trade will improve thanks to accords like the Trans-Pacific Partnership.
- Regionalized scarcity has water is on its way to achieving "oil-like" status.
- Global M&A gunning to top 2007's record high.
- Consistent S&P 500 earnings growth is a positive sign for both U.S. and global economies.

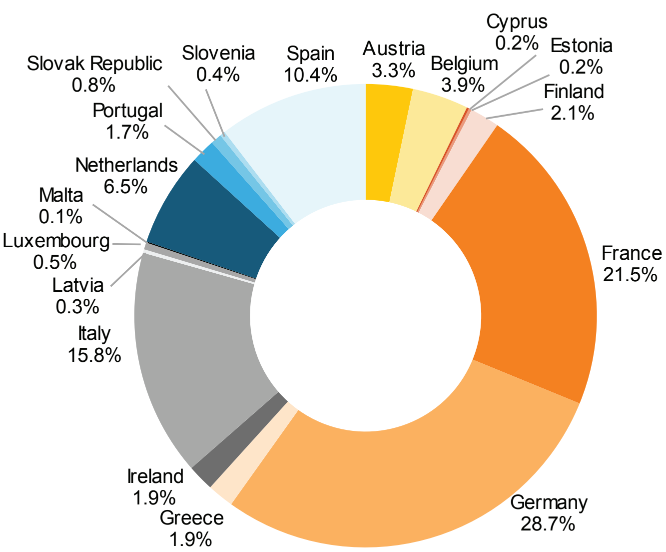
Conclusion

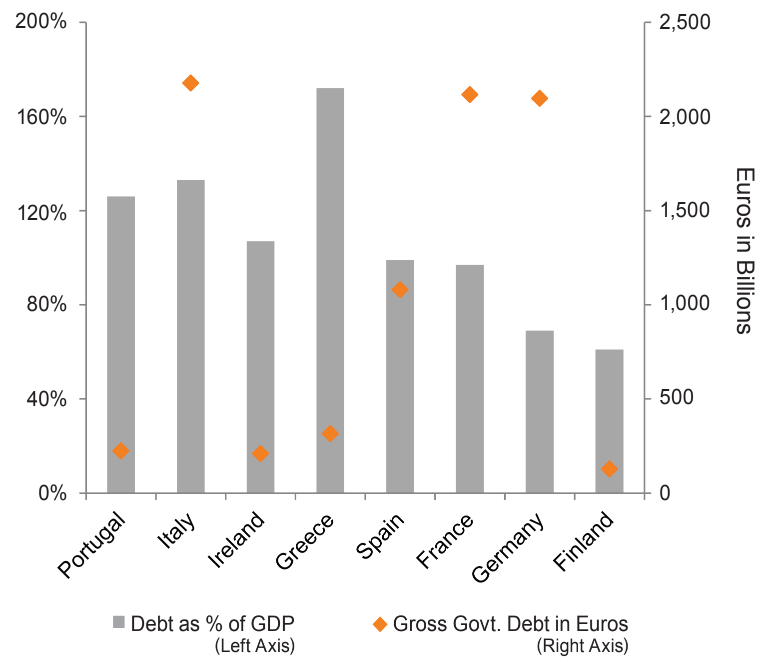
The fear mongers have successfully kept countless investors on the sidelines since we emerged from financial crisis, denying them an opportunity to build substantial wealth during what has been a six-year (and counting) bull market. Markets indeed move fast, but global diversification can counter these often-unpredictable swings in sentiment, to the benefit of investors who take a thoughtful approach to asset allocation.

For example, while Europe was a global darling for the first half of 2015, trouncing the S&P 500, the outcome of its ongoing game of chicken with Greece may suggest a far different outcome for the second half of the year. By casting a wide net, however, investors can capture attractive return opportunities as they arise while reducing overall portfolio risk. Just as important, of course, is being fully invested in the markets; if the aftermath of the Great Recession taught us anything it's that waiting on the sidelines for a precise entry point is pure — and costly — folly.

Europe Has Begun to Improve Despite Headwind from the Periphery

Euro Area 2014 GDP by Country





Source: International Monetary Fund

BBGP-MIDYEAR 070115 • IM-0715-15166-0716 • CN-0715-15177-0817 • **170428**