Voya Global Perspectives

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Executive Summary

- Beginning to normalize the policy rate should actually bolster confidence in the economy and the markets and allow us to once and for all leave the Great Recession behind.
- M&A activity has been red hot in 2015, suggesting confidence in executive boardrooms.
- Earnings surprised mightily to the upside in 1Q, but 2Q expectations remain dim.
- While the math of rising rates discounts financial assets, the growth that prompts the rate hikes should be far more important in sustaining this bull market in the long run.

Domestic Equities Hold Up in May

Index	May 2015	YTD
Equity		
S&P 500	1.3	3.2
S&P MidCap 400	1.8	5.6
S&P SmallCap 600	1.5	3.1
Global REITs	-1.4	1.1
EAFE	-0.4	8.9
Emerging Markets	-4.0	5.8
Fixed Income		
Corporate	-0.7	0.9
U.S. Treasury 20+	-1.8	-1.2
Global Aggregate	1.8	-2.7
High Yield	0.3	4.1
Senior Loans	0.2	3.2

Data as of 05/31/2015

Source: FactSet, FTSE NAREIT, Voya Investment Management

Central Bankers Keep the Pedal to the Metal in May

Even though a June rate hike was a long shot, the markets were nonetheless relieved when the May 20 release of the latest FOMC minutes clearly showed that it was off the table. This was a gift; we expect Chair Janet "Hawk in Dove's Clothing" Yellen to introduce the first fed funds rate increase in September. And why would the Fed do that even as the International Monetary Fund offers their unsolicited advice to hold off? There's no downside to the Fed acting now; in fact, we think 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.

Even as the Fed prepares to tighten, central bankers in 2015 have had the pedal to the metal with a generous show of liquidity marked by 40 rate easings and aggressive asset purchases. The European Central Bank is gleeful at the quick turnaround in the euro zone economy since the extremely bold implementation of QE. In fact, the ECB's efforts have been so impressive that the People's Bank of China joined the party; while the explosion in Chinese markets may appear a bit reckless, we wouldn't bet against the country given its volume of dry powder (perhaps not coincidentally, the Chinese invented gun powder). In Japan, not only does the Bank of Japan have an aggressive quantitative easing effort in place, several public pension plans — including the $1.1 trillion Government Pension Investment Fund — are engaging in a bit of stock market speculation of their own.

Central Banks Spur M&A Deals

Mergers and acquisitions (M&A) activity has skyrocketed on both solid global growth and cheap, abundant money and is a catalyst for sustaining these financial markets. Year to date through May, U.S. M&A targeted at companies worth $10 billion-plus has more than doubled over the same period last year to reach the highest level ever, according to Dealogic; U.S. M&A activity in May alone also set a new monthly record, exceeding the previous high-water mark established in May 2007. Dealogic also reports that U.S. acquisitions into Europe, Middle East and Africa year to date through May are the highest on record. And while the U.S. is the most active cross-border acquirer, it is not the only one — global cross-border M&A volume is up 49% year on year to reach the second highest level ever. All of this activity not only suggests CEO confidence in the future of global markets but also represents a number of strategic deals the will bolster both top-line and bottom-line results.

First Quarter Earnings Defy Negative Expectations

A funny thing happened on the way to first quarter earnings season. In December, consensus expectations for year-over-year earnings growth stood at about 4%. By mid-April, this number had reversed course to -4%. However, with all of the S&P 500 having reported first quarter results, we have positive growth of about 1%. Investors may be scratching their heads at this series of events. But you'll recall that the energy sector was the villain in the negative scenario all along. As the price of oil plummeted from more than $100/barrel in mid-2014 to $45/barrel in mid-January, alarm bells sounded and economists jumped on the

bandwagon en masse in calling for $20/barrel oil. Energy earnings were expected to drop a horrific 65%.

Oil prices have a profound effect on everything. The recent sharp downward adjustment in oil prices, however, was not signaling a precipitous drop in global demand but rather a tale from the supply side. For years new supply has been coming on board faster than demand has been growing thanks to fracking and fuel conservation; finally, normalization was occurring. The average price of oil over the last 30 years has been about $40/barrel, not $100. And is $100/barrel really appropriate given the tectonic shift in energy thanks to a U.S. shale oil boom?

While earnings projections for the second quarter are also negative, we get the feeling we have seen this movie before. Again the energy sector is cast as the bad guy; after reaching a trough in March, the price of oil has rebounded to above $60/barrel — low, but not low enough to cause undue concern. Investors will have to wait and see if the earnings forecast pendulum has swung too far for the second quarter in a row.

Now that earnings season is all but wrapped up, investors need something to hold their focus. Luckily we have the Fed and the epic debate on when interest rates will finally move. The economic data that the Fed has been depending on to guide the way has taken a turn for the better. Jobs, housing, auto sales, manufacturing — all are on track. The improvement in the latest euro zone PMI report suggests there's a good chance of the euro area enjoying GDP growth of 2% in 2015, which should help large-cap companies with international exposure. Housing has been starting to simmer, if not boil, in some markets. Every three houses built in the U.S. creates one new job, which will further help an employment market that is at its best in 15 years. U.S. auto sales absolutely crushed expectations in May, rising to a seasonally adjusted annualized rate of 17.79 million. At this point, the first quarter negative GDP print is so far in the rear view mirror it seems senseless to dwell on it. After all, our experience in 2014 and 2015 has conditioned us to weak first quarter economic growth only for the economy to accelerate in subsequent quarters.

When Will the Fed Take the Punch Bowl Away?

May nonfarm payrolls beat expectations handily — 280,000 jobs were added last month and previous months were restated higher by another 32,000 jobs — and put the Fed's rate hike back in the news. The kneejerk reaction is to sell bonds and high-cash-flow asset classes like REITs, even though such a strategy has not worked out well for investors in recent years. Even if the Fed does begin to raise rates later in 2015, we advise investors to "measure twice and cut once" before making meaningful changes to their strategy.

A recent CBRE Clarion Securities report titled "Why Rising Interest Rates Are Actually Good for Global Real Estate Stocks" points out the following:

- Increases in bond yields are generally associated with improving economic conditions, which tend to boost tenant demand, revenue and profits for owners and operators of commercial properties.
- REIT shares have generated positive total returns during periods of rising interest rates over the past 20 years.

First Quarter Earnings Defy Expectations 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	36	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	22	13	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**	**1.1**	**285**	**200**	**7**	**343**	**120**

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.

Source: Bloomberg, Standard & Poor's, FactSet

REITs Have Performed Well in Rising-Interest-Rate Environments												
	YTD	2014	2013	2012	2011	2010	2009	2008	1 Year	3 Year	5 Year	10 Year
S&P 500	3.2	13.7	32.4	16.0	2.1	15.1	26.4	-37.0	11.8	19.7	16.5	8.1
U.S. REITs	-2.9	25.3	-1.4	13.6	4.7	23.5	21.0	-41.5	6.1	8.3	9.9	3.4
Global REITs	1.1	15.9	4.4	28.7	-5.8	20.4	38.3	-47.7	5.9	13.3	12.8	7.0

Data as of 05/31/2015

Source: FactSet, FTSE NAREIT, Voya Investment Management

- REIT shares should not be confused with bonds, whose prices fall when rates risk; the performance pattern of bonds and REIT stocks are markedly different.

The consensus is not always accurate, and the notion that "good news is bad news" because a strengthening economy means rising rates overlooks the underlying economic growth that should be supportive of global REITs. In fact, for risk assets "good news is always good news" is a more accurate aphorism as it suggests pricing power and improved top-line growth.

Conclusion

June is notoriously a tough month for stocks. Investors are worried — will this be a June swoon or a summer sizzle? The flow of funds out of equities seems to indicate a swoon. I think we've seen this movie, too; it was playing as a double feature with "sell in May and go away". The markets have been celebrating accommodative central banks but are increasingly concerned about the impact of the Fed going in a different direction. While the math of rising rates discounts financial assets, the growth that prompts the rate hikes should be far more important in sustaining this bull market in the long run.

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