Voya Global Perspectives™ | Market Update

Markets. Insights. Opportunities.

Market Whipsaw Sheared Bears Like Sheep in February

Douglas Coté, CFA
Chief Market Strategist

February may have ushered in the Lunar New Year of the Sheep[1], but it was the market bears — many of whom were calling the end of the bull run based on the weakness that had gripped stocks to end 2014 and begin 2015 — that were shorn during the month. Domestic equity markets staged an astounding reversal, bringing major indexes comfortably into positive territory for the year to date and whipsawing those who sold into the softness. Meanwhile, international markets have continued to outperform, suggesting to us that 2015 might be particularly painful for those blind to the "folly of gaming diversification."

Let's take a look at the recent behavior of this now 2,170-day-old bull market (the fourth-longest in history). The S&P 500 Index returned 13.7% in 2014 after posting returns of 32.4% and 16.0% in the two years prior. With this track record, it's hard to argue that the S&P 500 is not the place to be — until the time comes when it isn't the place to be. As you can see in the performance table to the right, year to date the S&P 500 is decidedly in the lower end of the equity pack while the EAFE (Europe, Australasia and Far East) Index leads. Yes, the same index that lost more than 4% last year thanks in large part to its 50%-plus exposure to Europe, which has been the source of considerably hand-wringing among investors for more than five years now but has started to show some green shoots thanks to a cheaper currency and highly accommodative central bank.

[1] Or possibly the goat or the ram, depending upon whom you ask.

Corporate America Maintains Momentum in the Fourth Quarter Despite Oil Collapse

Fourth quarter earnings season, now almost completely in the books, handily beat diminished expectations. With 95% of the S&P 500 having reported results, year-over-year earnings growth stands at 4.4%, not too shabby considering that expectations had been slashed from 8.4% on September 30 to 1.7% at the onset of the reporting cycle. Driven by the collapse of oil prices, the magnitude and pace of the adjustment was unusual and — as it turned out — overdone, as fretful analysts were unable to appreciate the resilience of the capitalist model.

While the fourth quarter delivered a welcome upside surprise, first quarter 2015 could give the bulls pause when earnings announcements begin in April. The consensus estimate calls for year-over-year earnings growth of negative 4.6%, as energy sector earnings, down 22% in the fourth quarter, are expected to plunge 60% in the first. Even the tech sector, which posted year-over-year growth of almost 10% in the fourth quarter to account for 24% of the index's dollar earnings, is expected to post slightly negative growth. Can the consumer discretionary sector make up for other areas of weakness? The latest GDP print of 2.2% was driven in part by solid consumer spending growth of 4.2%, proof positive of a resilient consumer that should be even stronger in 2015 based on a strong jobs market and cheap oil.

Corporate earnings growth drives equity markets. While earnings forecasts admittedly are in constant flux and can sometimes miss actual results by a long shot, S&P 500 companies have a lot of work to do for the index to continue its strong run into 2015. Historical returns show that asset class

Executive Summary

- February's rally showed that the market's most strident bears were overeager in calling the end of this nearly six-year bull run.
- Fourth quarter earnings outpaced expectations that had been ratcheted down sharply in the face of plunging oil prices.
- Massive exposure to large-cap equities could make for a crowded trade should investors look to flee a flagging S&P 500.
- Signs of life in Europe and other non-U.S. markets highlight the importance of broad, global diversification.

Domestic Equities Post Strong Rebound

Index	Feb-15	YTD
Equity		
S&P 500	5.7	2.6
S&P MidCap 400	5.1	3.9
S&P SmallCap 600	6.0	2.3
Global REITs	-0.6	4.4
EAFE	6.0	6.5
Emerging Markets	3.1	3.7
Fixed Income		
Corporate	-1.0	2.0
U.S. Treasury 20+	-5.8	3.0
Global Aggregate	-0.8	-1.0
High Yield	2.4	3.1
Senior Loans	1.3	1.7

Source: FactSet, FTSE NAREIT, Voya Investment Management returns by year are fairly random, with last year's top performers often scraping the bottom of the barrel the next. However, the S&P 500 has been pretty consistent since the market's collapse in 2008, posting double-digit returns in five of the six years since for a total return in excess of 250%. Other indexes have been even more impressive in the recent past, though; since the broader market's trough in March 2009, mid-cap and small-cap stocks are up 307% and 320%, respectively, while high yield bonds have returned 156% with half the risk of the S&P 500.

Moreover, we know from behavioral finance that investors hate losses twice as much as they like gains. What if that worst performer this year is the S&P 500? Diminished earnings, a stronger dollar, a lukewarm housing market and a Fed chair that may just be a hawk in dove's clothing could conspire to derail the S&P's string of success. And given the abundance of large-cap assets the average investor has amassed during this bull market, this could be a crowded trade on the way out, potentially exacerbating losses.

There's no cause for alarm just yet, however. The U.S. economy is improving, which should provide positive backdrop for corporate earnings and stock prices in general. Europe looks to be turning a corner, with the cheaper euro helping exports and ECB stimulus driving bond yields to historical lows. Emerging market economies — many of which are oil importers — have benefitted from the good deflation that comes from lower energy prices. China's manufacturing sector has returned to expansion, and India is projecting an incredible 8.5% GDP growth rate for 2016.

Diversify or Risk Getting Fleeced

As always, global diversification is key in both stocks and bonds; one of these years, S&P 500 companies will fail to deliver the wool, and broad diversification will help mitigate the associated losses. Also key: remaining fully invested in the market in all but the most dire of circumstances, not hiding out in cash or betting against risk assets like so many bears who have but temporary victories — like January 2015 — on which to hang their hats during the bull market's nearly six-year run.

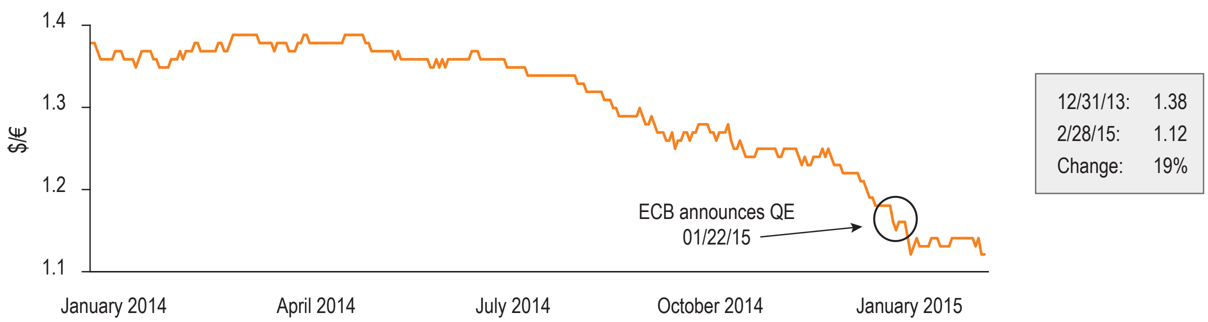
S&P 500 Earnings Beat Diminished Fourth Quarter Expectations Handily

Sector	Reported		Earnings Growth			Earnings Surprise		
	Actual	Total	Percent	Positive	Negative	Percent	Positive	Negative
Health Care	54	54	23.8%	45	10	5%	42	8
Telecommunication Services	5	5	20.7%	3	3	1%	2	2
Consumer Discretionary	80	84	10.9%	53	25	7%	53	18
Information Technology	65	65	9.8%	45	20	8%	56	4
Industrials	63	64	8.9%	54	9	2%	45	10
Materials	29	31	2.0%	20	8	8%	23	3
Financials	85	82	-1.5%	55	27	2%	54	25
Consumer Staples	38	40	-1.9%	23	15	1%	23	10
Utilities	30	30	-2.0%	16	13	5%	17	12
Energy	43	45	-22.2%	19	24	4%	28	15
S&P 500	**492**	**500**	**4.4%**	**333**	**154**	**5%**	**343**	**107**

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

Euro Drops Precipitously on ECB Stimulus, Providing Tailwind to Europe



Source: FactSet

BBGP-COMMENTARY 030515 • 11808 • CN-0315-12533-0417 • **163081**