Market Update | May 6, 2015

# Voya Global Perspectives

Markets. Insights. Opportunities.®

**Douglas Coté, CFA**
Chief Market Strategist

## Executive Summary

- April Fools investors with sharp positive reversals in quarterly profits, crude oil prices and European bond yields.
- Oil prices bounce off their lows, providing relief to the energy sector while continuing to be a positive catalyst to consumers.
- California is coming to the realization that "water is the new oil" as farmers and consumers thirst for a solution to the multi-year drought.
- Perennial laggards Europe and Emerging Markets surge in April demonstrating that patience in diversification matters.

**April Saw Reversals in a Number of Asset Classes**

| Index | April 2015 | YTD |
|---|---|---|
| **Equity** | | |
| S&P 500 | 1.0 | 1.9 |
| S&P MidCap 400 | -1.5 | 3.7 |
| S&P SmallCap 600 | -2.3 | 1.5 |
| Global REITs | -1.5 | 2.6 |
| EAFE | 4.2 | 9.4 |
| Emerging Markets | 7.7 | 10.2 |
| **Fixed Income** | | |
| Corporate | -0.7 | 1.6 |
| U.S. Treasury 20+ | -3.4 | 0.6 |
| Global Aggregate | 1.1 | -0.9 |
| High Yield | 1.2 | 3.8 |
| Senior Loans | 0.7 | 3.0 |

Source: FactSet, FTSE NAREIT, Voya Investment Management
Data as of 04/30/2015

## April Fools Abound as Market Catches Investors off Guard

Investors found themselves fooled by contrarian April markets in any number of ways. Take corporate profits. Though year-over-year S&P 500 earnings were expected to come in negative for the first quarter, companies have shown great resilience in the face of plummeting oil prices and dollar strength and are likely to deliver a slight gain for the period. Turning to the Federal Reserve, you may recall that when the central bank last talked of tightening — in May 2013 when it announced plans to wind down its asset-purchase program — a "taper tantrum" ensued, crushing emerging markets in particular. However, the most recent round of tightening talk — this time in reference to normalization of the federal funds rate — has been accompanied by a surge in developing market equities. Europe and Japan started the year helpless and hapless, but their central banks, taking a page from former Fed Chair Ben Bernanke's easy-money playbook, have pushed their equity markets to new heights. Meanwhile, sovereign debt yields in the core euro zone, which had been plummeting toward zero and beyond, reversed course in April, to the chagrin of bond speculators. Similarly, oil was pegged by many to continue its descent for the foreseeable future, only to pop 25% during the month.

We've seen turnarounds like this before, but it feels "different" this time. While such sentiment is usually worthy of suspicion, we'd suggest the above mentioned reversals are attributable to the real economy exerting itself on the financial markets. Admittedly, GDP grew only 0.2% in the first quarter. But why is oil up 12% year to date? Why are bond yields rising? Why are copper prices climbing higher? Could it be that tectonic shifts are stealthily transforming the economic global landscape?

### Tectonic Shifts and the Real Economy

Tectonic shifts are both catalysts for explosive growth and long-term risks that bear careful watching. They move markets in ways that defy conventional forecasting, often revealing themselves in extraordinary, trend-reversing price shifts. Below we update the five tectonic shifts that are currently having the largest impact on the real economy.

**Energy.** The ability to find new and abundant sources of fossil fuels has been providing a tailwind for U.S. economic growth, jobs and manufacturing for several years. Given the increased supply of oil and, to a lesser degree, moderating demand as a result of slower economic growth, a price drop was inevitable. And with a 30-year average price of around $42/barrel, oil's current level of $58/barrel certainly looks more realistic than the $100/barrel that was the norm before the recent plunge. That's the funny thing about tectonic shifts; they seem to loom inconspicuously in the background until they can no longer be ignored. While low oil has been getting a bad rap this year thanks to its impact on large energy sector companies, cheaper energy prices are an overall positive for consumers and their future spending.

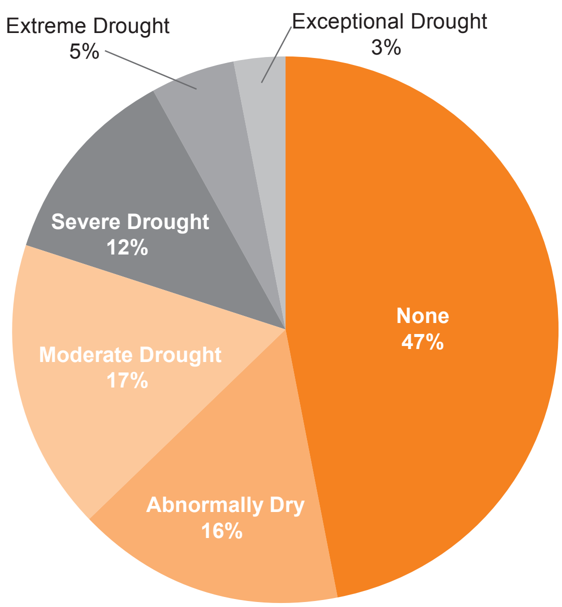
**Global Trade.** Given that 95% of the world's consumers reside beyond our shores, global trade is necessarily a fundamental driver of the domestic economy. Recent years have seen China expand its influence in the trade arena, to the detriment of U.S. economic growth. The Trans-Pacific Partnership — a free-trade agreement ten years in the making that is nearing completion — may help undo some of these gains. The agreement would strengthen U.S. economic ties with Japan, Singapore, Malaysia, Australia, Vietnam, Chile, New Zealand and Brunei — countries that currently account for more than 10% percent of our trade activity. Despite opponents' claims that the pact would result in domestic job losses, it actually will increase economic growth, level the playing field and expand domestic payrolls.

**Frontier Markets.** At 0.2%, the initial print of first quarter U.S. GDP growth was barely positive, highlighting the low-growth rut in which the U.S. and other developed economies have been stuck. Frontier markets, on the other hand, are for the most part outpacing the rest of the globe. The pivot of growth from developed to emerging and frontier markets is not only fueling U.S. corporate profits but also providing attractive — albeit volatile — investment opportunities. Thus far in 2015 the volatility is to the upside; emerging markets are up over 10% this year after two years of underperforming. While the more accommodative monetary policy by the likes of China is partially responsible for this surge, even under normal circumstances non-U.S. markets provide diversification benefits, reducing portfolio risk while offering potential for high returns.

**Water.** Water is the new oil and may just become priced that way before long. By now it's no secret that California is facing a serious drought and has enacted the first urban restriction of water usage in the state's history. Note, however, that although 95% of Californians live in urban areas, they account for only 20% of the state's water usage. The primary consumer of water is the agricultural sector — it takes a gallon of water to grow one almond! While the tectonic shift in water currently is an impediment to growth, it is rife with opportunity as well; the quest for water no doubt will spur growth in technologies such as desalination.

**Water Access Has Become an Issue for U.S. — Will Markets Notice?**

Contiguous 48 United States — Area Impacted




**Abnormally Dry:** Going into drought: short-term dryness slowing planting, growth of crops or pastures. Coming out of drought: some lingering water deficits; pastures or crops not fully recovered.

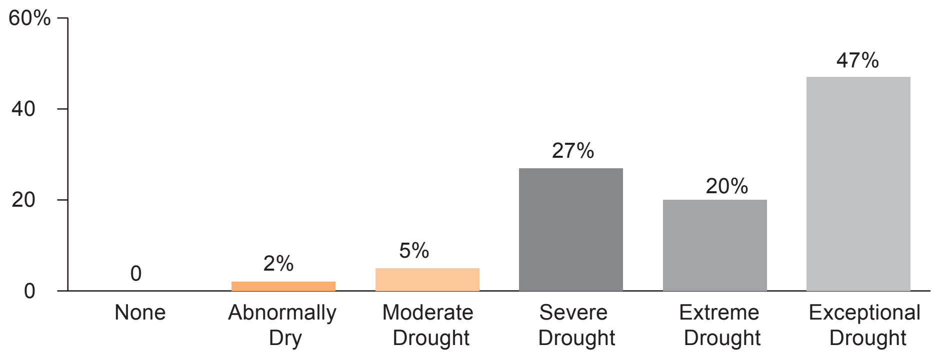
**Moderate Drought:** Some damage to crops, pastures; streams, reservoirs, or wells low, some water shortages developing or imminent.

**Severe Drought:** Crop or pasture losses likely; water shortages common; water restrictions imposed.

**Extreme Drought:** Major crop/pasture losses; widespread water shortages or restrictions.

**Exceptional Drought:** Exceptional and widespread crop/pasture losses; shortages of water in reservoirs, streams, and wells creating water emergencies.

California — Area Impacted




Source: National Drought Mitigation Center as of 4/25/2015

**Technology.** Technology is possibly the most familiar tectonic shift, as it grows more and more integral to the everyday lives of consumers; once-arcane terms like "mobile technology", "big data" and the "internet of things" have become part of the common vernacular. Not only do technology and innovation open doors and pave the way for further advancement, they tend to be the common link among our other tectonic shifts. For example, the technology of desalination — currently prohibitively expensive — may one day allow for cost-effective access to ample supplies of water just as technological advancements in drilling unlocked vast stores of energy in places like shale deposits and oil sands. The tech sector has been and will continue to be a huge driver of corporate profits and thus a driver of stock markets.

## Environment Highlights Value of Global Diversification

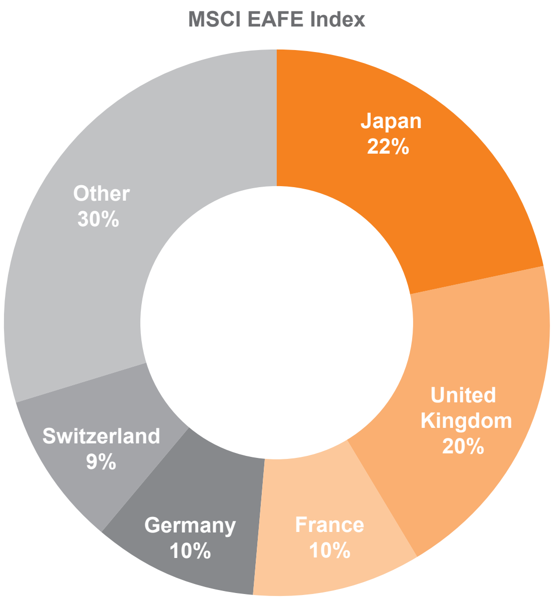
In gauging global growth, the bottom line tends to be the bottom line. Concerns that earnings would contract in the first quarter thanks to collapsing oil prices, massive energy project shutdowns and slowdowns in Europe and China proved unwarranted. With 75% of the S&P 500 having reported first quarter results, almost every sector has beaten analysts' lowered earnings expectations — even energy. We've previously discussed the lagging effect lower energy prices would have on the consumer; if corporate America managed to grow earnings in the first quarter without the additive impact of a savings-bolstered consumer, subsequent quarters are likely to be even stronger once the consumer decides to spend some of this cheap-energy dividend. We also have seen manufacturing in the U.S. continue to expand despite concerns about oil and the strong dollar. These and other factors have supported the resilience and sustainability that characterize this year's markets.

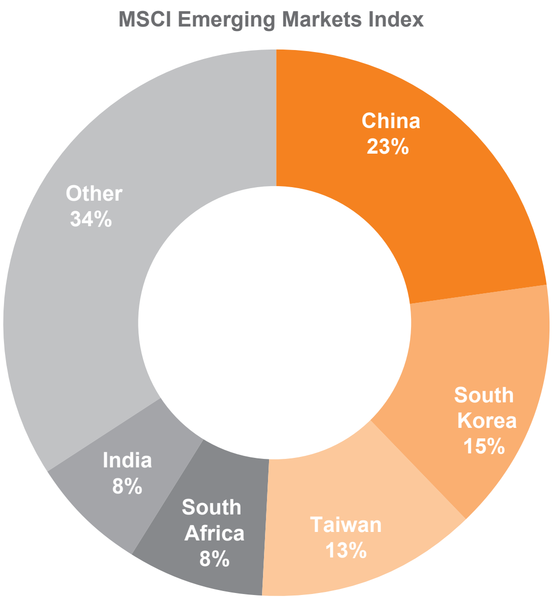
Looking abroad, Europe and China both are benefitting from extraordinarily accommodative central banks. Europe, in particular, has gotten a boost from the decline of its currency; an uptick in Spanish economic activity, meanwhile, suggests much-needed structural reforms are seeing some localized success and might gain traction more broadly. And as central banks abroad grow more accommodating to bolster their shaky economies, the Fed continues planning for a prudent normalization of rates.

Given this environment, the best way to avoid being fooled — in April or otherwise — is via very broad global diversification.

**Opportunity Abounds in Non-U.S. Markets, Both Developed and Emerging**

**Composition by Market Capitalization**




Source: MSCI

BBGP-COMMENTARY 050715 • 12444 • IM-0515-13798-0617 • **163081**