Voya Global Perspectives

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Executive Summary

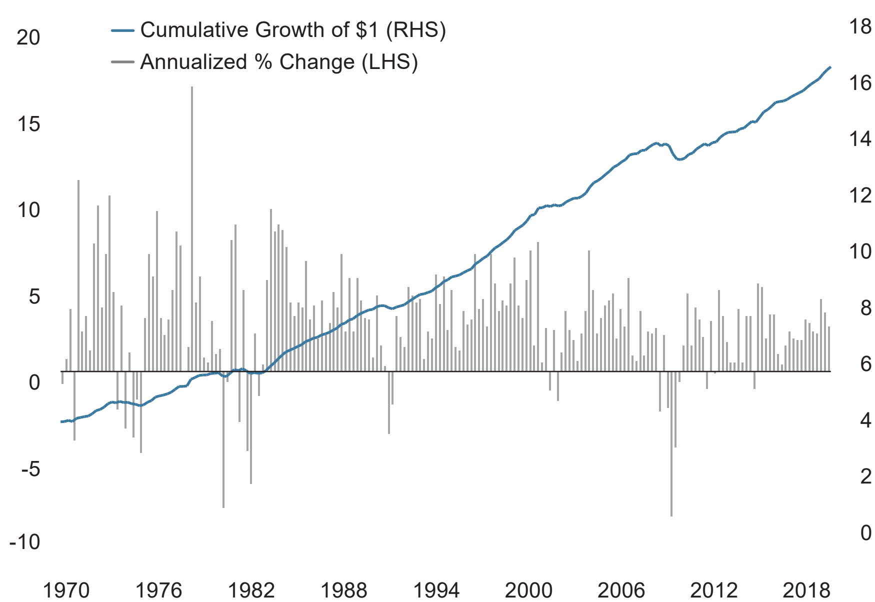
- Slowing global economic growth is a function of the eighth fed funds rate increase in two years
- Now that the Federal Reserve seems on hold, markets have breathed a sigh of relief
- Fundamentals tell us the market backdrop is strong, not so dire as portrayed in some media
- It seems "bear market" concerns have shifted to fear of missing a continuing rally

Markets Springing Ahead, not Springing a Leak

During the first quarter of 2019, a field of green across the board replaced the steep market declines of 4Q18. Double-digit equity returns rewarded investors in U.S. and international markets alike. The China-U.S. trade tensions and global growth worries have not abated; but the Federal Reserve's perceived about face, from hawkish to undeniably dovish, provided just what investors needed to breathe new life into the longest bull market in history. While equity markets were in full bloom, bonds also rallied. Yields slipped lower on the global growth concerns and a Fed on pause, rekindling investor demand, which sent bond prices higher.

Nevertheless, the best first quarter for the S&P 500 index in more than 20 years could not allay the mounting murmurs of recession. China's economic growth numbers have been undeniably negative. The latest China GDP reading of 6.4% is the lowest since 2009.[1] In turn, global manufacturing has been negatively impacted. Contractionary manufacturing readings in Japan and the Eurozone have sparked concern. The United States cannot pull the wagon on its own and domestic GDP has decelerated after reaching 4.2% in 2Q18, slipping to 3.2% in Q3 and 2.2% in Q4 (Figure 1). A slight inversion in the U.S. Treasury yield curve, and massive uncertainty surrounding the already disorderly Brexit process, have added fuel to the recession forecast fire, prompting calls for investors to sell and lock in gains.

Figure 1. Real U.S. GDP Growth



Source: FactSet. Data as of 12/31/18.

[1] Source: FactSet.

Doom and Gloom or Boom?

Not so fast. There is far too much positive economic news that tends to be missed by the sensationalist media. U.S. GDP is at all-time record highs, as are S&P 500 corporate earnings. Consider that these records are occurring during a period of fed fund rate increases designed to slow the economy. The global economy also is powering along and as of 2018 generated annual GDP of $84 trillion, more than double the $38 trillion in 2003 (Figure 2). In addition, China has implemented dozens of stimulus measures – cutting rates and taxes to lift its economic output. As a result, trading partners such as Germany are feeling some relief as capital goods orders and auto production rebound. It may be too soon to call a bottom, but we believe it is close. The current situation is suggestive of 2015, when China dragged down the global economy, then aggressively stimulated its own economy and set the stage for positive surprises in 2017. That prospect, and the pro-business U.S. policies that continue to propel domestic growth, are what make us optimistic.

Inversion Diversion

A slightly inverted yield curve does not portend recession. Rather, it reports what many investors already know: the Fed has raised rates on the short end of the curve, but economic growth has been decelerating and inflation is not a threat, which is muting pressures on long-term rates. In today's post-recession, low-growth environment, the yield curve is flatter than it has been during historical recovery periods, and consequently is more prone to periodic, shallow inversions. A rate cut would certainly remove the inversion diversion, but the strength of the U.S. economy makes a cut unlikely. Even in cases of deeper, prolonged inversions — where in the past the yield curve has been a more reliable predictor — history suggests a recession generally would be about 18 months out and market performance in the interim usually would be positive.

Back to Basics

When economies and markets present justification for multiple conflicting scenarios, it is advisable to get back to basics – the fundamentals or ABCs.

A—Advancing corporate earnings

Corporate earnings are signaling a continuation of the bull market with the tenth consecutive positive string of mostly double-digit growth rates.[2] Looking forward to 1Q19 earnings reports that began in April and will be fully reported by June, we forecast it will be a close call either way.

The 1Q19 earnings growth bar is set high after the corporate tax cut boost last year. Current forecasts are for negative 1.9% growth.[3] Bear in mind, however, that growth for 4Q18 was initially estimated to be 11.7% and actually reached 16.9%.[4] Guidance usually sets the bar low, and on average more than 70% of the companies in the S&P 500 surprise to the upside.[5]

B—Broadening Manufacturing

After a six-month lull, U.S. manufacturing's ISM production manager index rebounded with an upside surprise in its March 2019 reading of 55.3.[6] This is still solidly in expansion territory, i.e., as indicated by any reading over 50; even if lower than the boom levels of more than 60 reached in 2018. Add to this the surge of production in the energy industry led by a boom in oil and natural gas exports, and it is no surprise that industrial production is at an all-time high.

C—Consumer

Consumer spending represents two-thirds of the U.S. economy and is usually the game changer; this time is no exception. We are in a red-hot jobs market with unemployment near 49-year lows.[7] The breadth of prosperity in the jobs market might be the best in U.S. history.

U.S. retail sales, after setting an all-time high of $510 billion per month in January 2019 with a revised 0.7% surge, was off by 0.2% in its most recent February report.[8] Meanwhile, personal incomes and wages are rising while inflation remains low, which accounts for the increase in productivity. The most recent bonus for the consumer is the recent plunge in mortgage rates, which is helping to refresh the stalled housing market.

Figure 2. Global GDP Has More Than Doubled Since 2003

% of World GDP	2003 $38.1 Trillion	2008 $56.8 Trillion	2018 $84.8 Trillion
Advanced Economies	80%	72%	60%
Emerging and Developing Economies	20%	28%	40%

Source: International Monetary Fund (IMF) as of 2018.
Note: Advanced economies comprises 36 countries; developing economies comprises 153 countries.

[2, 3, 4, 5] Source: Thomson Reuters.
[6, 7, 8] Source: FactSet.

Figure 3A. Components of Business Investment

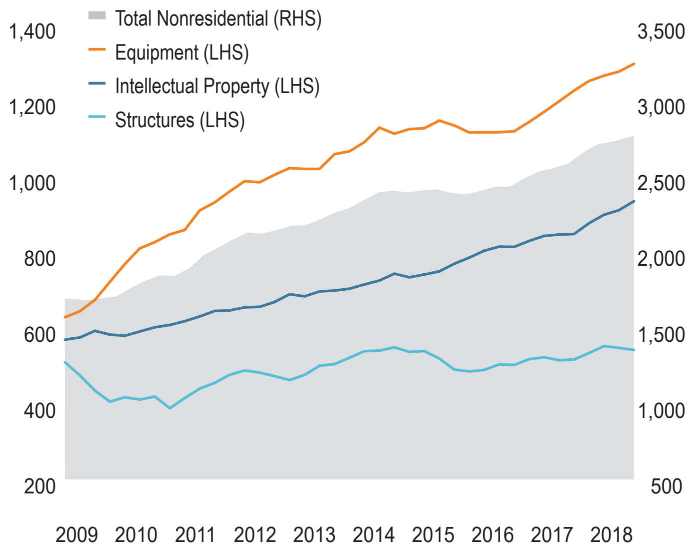
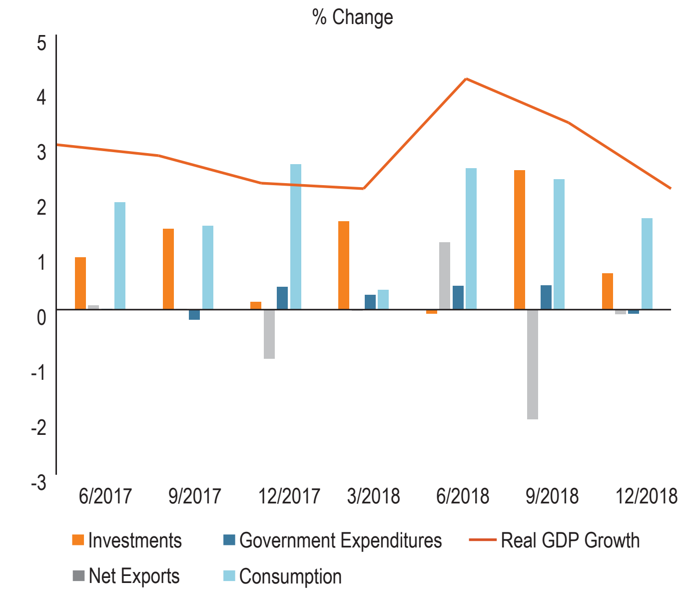


Figure 3B. Components of GDP



Source: FactSet. Voya Investment Management as of 09/28/18; Bureau of Economic Analysis definition of GDP: GDP is equal to the sum of personal consumption expenditures, gross private domestic investment, net exports of goods and services, and government consumption expenditures and gross investment. Gross private domestic investment is divided further into residential fixed investment and nonresidential fixed investment.

The fundamentals are telling investors that the market backdrop is strong and in no way as dire as it is being portrayed in some media outlets (Figures 3A and 3B). Think about if a few items tilted in favor of the market creating a virtuous cycle, such as a solid China-U.S. trade deal or even a fed funds rate cut by the end of 2019?

Market Review

The first quarter was awash in green for equities all around. Global REITS led the path forward in equities surging 14.9% and more than erasing their losses in the fourth quarter. Lower interest rates and strong commercial property demand are supportive of the real estate sector. Midcaps were not far behind, increasing 14.5%. Small caps bounced back from a miserable fourth quarter, when they were down more than 20% on global growth concerns, to return 11.6%. Despite negative economic data such as 4Q18 Eurozone GDP below 1%, even EAFE stocks returned double digits. Finally, emerging markets gained 10% on diminished expectations of a stronger U.S. dollar and rising expectations of China stimulus.

Bonds also posted stellar returns as the Fed called time out and interest rates plummeted. Long U.S. Treasurys appreciated 4.7% for another quarter of solid gains and corporate bonds were up 5.1%. Global bonds provided diversification and returns of 2.2%. High yield bonds offered the best performance, up 7.3% as investors were rewarded with yield and spreads that defied worrymongers, by narrowing rather than widening.

Conclusion

It is clear that global economic growth is slowing but we think that is more of a function of the headwind created in 2018 when the Fed "ripped the band aid off" with its eighth fed funds rate increase in two years. Now that the Fed is arguably on hold with a higher probability of a rate cut than a rate increase, markets have breathed a sigh of relief. Judging from the pronounced snap back of markets in the first quarter, it seems as if the fear has shifted from "bear market" concerns to the fear of "missing out" on a continuing market rally. We were pretty clear when we said in our 2019 forecast that we were in the "storm before the calm." So far, it has worked out that way, but we counsel to be prepared for more storms on your way to your destination. Remember that markets are springing ahead and not springing a leak.

Figure 4. Global Asset Class Diversification Generally Offers Attractive Return Potential

Index	1Q19	2018	3 years	5 years	10 years	15 years	20 years
Equity							
S&P 500	13.65	-4.38	13.51	10.91	15.92	8.57	6.04
S&P Midcap	14.49	-11.08	11.24	8.29	16.28	9.52	10.08
S&P Smallcap	11.61	-8.48	12.56	8.46	17.00	9.56	10.44
Global REITs	14.86	-4.74	6.67	7.37	14.90	7.68	9.33
EAFE	10.13	-13.36	7.80	2.81	9.47	5.59	4.38
Emerging Mkts	9.95	-14.24	11.09	4.06	9.31	8.28	8.73
Average	12.45	-9.38	10.48	6.98	13.81	8.20	8.16
Fixed Income							
Corporate	5.14	-2.51	3.64	3.72	6.66	4.77	5.54
U.S. Treasury 20+	4.73	-2.00	1.50	5.73	5.04	6.08	6.67
Global Aggregate	2.20	-1.20	1.49	1.04	3.05	3.33	4.13
High Yield	7.26	-2.08	8.56	4.68	11.26	7.33	6.83
Average	4.83	-1.95	3.80	3.79	6.50	5.38	5.79
Overall Average	9.40	-6.41	7.81	5.71	10.89	7.07	7.22

Source: FactSet, FTSE NAREIT, 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, Bloomberg Barclays U.S. Corporate Bonds, Bloomberg Barclays U.S. Treasury Bonds, Bloomberg Barclays Global Aggregate Bonds, Bloomberg Barclays U.S. High Yield Bonds. Returns are annualized for periods longer than one year. **Past performance is no guarantee of future results. An investment cannot be made in an index.**

Diversification does not guarantee a profit or ensure against loss

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