Voya Multi-Asset Perspectives

Market Expectations are High but Realistic

Global equity markets continued their advance in the first quarter of the year with developed equities generally outperforming emerging stocks. In the United States, there has been a raft of data showing improvement in economic fundamentals. Retail sales, personal income and industrial production all rose in March. The latest U.S. ISM Services PMI soared to an all-time high of 63.7. This followed March's U.S. ISM Manufacturing PMI hitting the highest level since the early 1980s (Figure 1). The faster than expected revival of both sectors has filtered through to the labor market, where March's employment report was substantially better than anticipated across sectors; nonfarm payrolls climbed to 916,000 and the unemployment rate dropped to 6.0%.

Still, long-term joblessness and weak labor force participation remain major concerns and main reasons the Federal Reserve is holding its dovish posture and guidance for no change in its target rate through 2023. With the Fed pinning short rates near zero and better economic prospects driving long rates higher, the spread between two- and ten-year Treasury yields has widened above 150 basis points for the first time since 2015 (Figure 2). The swift steepening of the yield curve has helped the financial sector deliver strong 1Q21 returns; that sector lagged only energy, which has benefited from oil's recovery to early-2020 price levels as demand for fuel has increased alongside reopening.

Higher yields have been a headwind for bonds, especially long-duration U.S. Treasuries, capping off one of their worst quarterly returns on record. Rising rates didn't help high yield bonds either, but they were more than offset by meaningful spread tightening. This credit spread compression in the face of quickly rising yields indicates the bond market is not concerned with companies' ability to repay debt. This in turn has had the effect of reducing the overall costs of borrowing for lower-quality issuers. Given the historically rock-bottom rates, companies are rushing to capitalize on cheap funding, with 1Q21 U.S. high yield debt sales setting another record. This follows last year's record and adds to a mounting pile of global debt.

Tactical Indicators

Economic Growth (Positive)

After robust consumer credit data, earlier than expected economic stimulus payments and strengthening labor market readouts, 1Q21 U.S. GDP growth estimates climbed to 5.3% with annual growth tracking above 6%

Fundamentals (Positive)

Consensus estimates are for S&P 500 companies to grow earnings by nearly 25% in the first quarter; we think actual results could be even higher

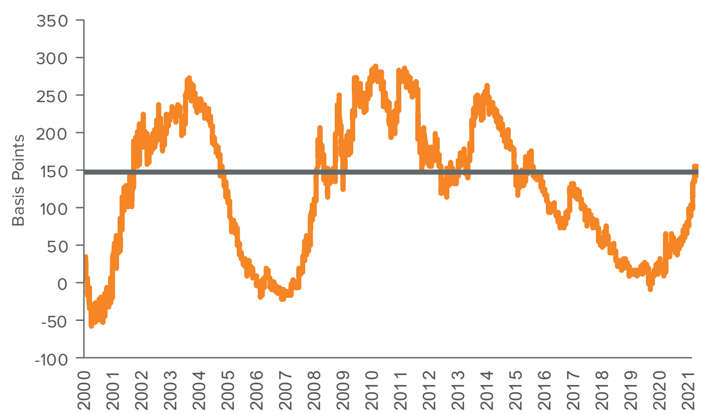
Valuations (Neutral)

Stocks are expensive by most historical measures, but low rates keep the equity risk premium wide enough for stocks to remain attractive

Sentiment (Neutral)

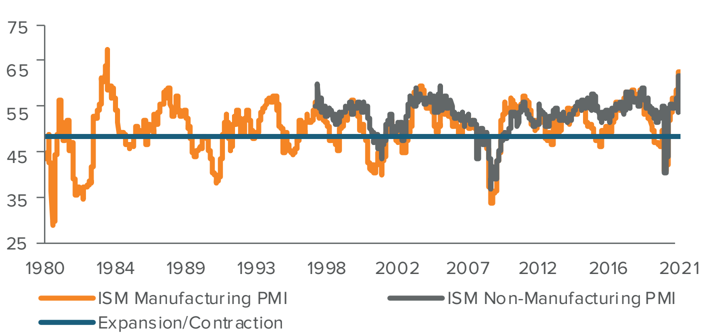
Sentiment is shifting away from high-multiple growth names into more value-oriented and less interest-rate sensitive sectors

Figure 2. The spread between two- and ten-year Treasury yields has widened significantly in 1Q21



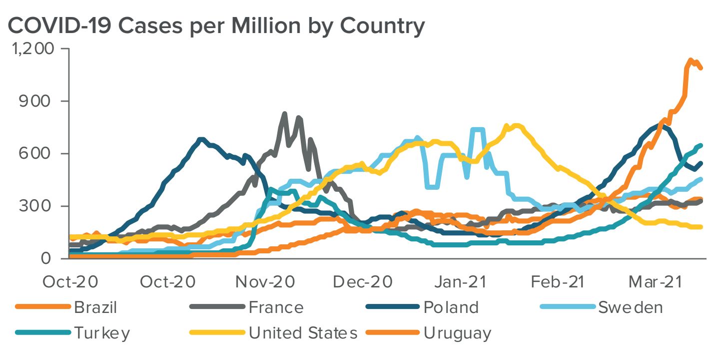
Source: Bloomberg, Voya Investment Management, as of April 12, 2021.

Figure 1. U.S. manufacturing and services PMIs are both near record highs



Source: Bloomberg, Voya Investment Management, as of April 12, 2021.

Figure 3. Vaccination progress and infection rates vary considerably across countries



Source: Our World In Data, Voya Investment Management, as of April 13, 2021.

Portfolio Positioning

Equities	●	
U.S. Large Cap	○-○-●	Scale brings competitive advantages to large caps; extraordinarily stimulative U.S. policy should further tighten the equity risk premium
U.S. Mid Cap	○-●-○	Offer a mix of cyclical gearing with multi-national revenue exposure
U.S. Small Cap	○-●-○	Extended valuations and potential changes to the tax code moved us to neutral in small caps
International	○-●-○	Europe's vaccine rollout challenges and lack of fiscal integration make lifting inflation and interest rates difficult, which could continue to hamper banks
Emerging Markets	○-○-●	Faster economic growth and a weaker U.S. dollar should help EM equities. EM Asia has a better outlook as those countries have had success combatting COVID-19
REITs	●-○-○	Big divergences among REIT sectors, but the underlying trend for commercial real estate is a concern
Fixed Income	●	
U.S. Core	●-○-○	We hold a modestly short duration posture and favor credit given yield pickup over sovereign bonds and generally healthy corporate balance sheets
Inflation (TIPS)	●-○-○	Inflation is going to temporarily bump higher, but it is likely to be ephemeral
Non-Investment Grade	○-○-●	High yield spreads have more room to compress than investment grade; added default risk worth the higher income with policy support in place
International	●-○-○	Low absolute and relative yields lead us to favor U.S. bonds

Underweight ● Neutral ● Overweight ●

Investment Outlook

The outlook for U.S. 2021 growth continues to strengthen. Vaccinations are accelerating, economic mobility and activity are broadening and support from government is unflagging. Significant savings built up throughout the pandemic, coupled with a lot of fiscal stimulus and more coming, has ignited a consumption boom that we believe is in the early innings. The latest consumer price index (CPI) reading stole the headlines with a 2.6% print, but this was skewed by a big recovery in oil. Core CPI also climbed but remained below the Fed's 2% target at 1.6%. Measures of inflation expectations were little changed to lower since April. It would not surprise us to see inflation continue to rise, but we think sizable increases will be transitory. Despite the Food & Drug Administration's decision to pause use of the Johnson & Johnson vaccine, U.S. immunization efforts have contributed to a sharp and steady decline of infections and the population is well on its way to achieving herd immunity.

The global economy also should experience higher than normal growth, but there is more uncertainty around this, as vaccination progress varies considerably across countries and infections are rising in pockets (Figure 3). Europe's inoculation campaign was dealt a blow after several countries temporarily halted use of AstraZeneca's vaccine. Other countries, particularly those less developed, are having difficulties securing supply. As a result, the recovery is likely to be uneven. Nevertheless, the overall trajectory is up, which is a positive for stocks. We acknowledge that if the American Jobs Act is passed in its current form, the increase in corporate taxes would probably provoke a rise in volatility and a rotation away from certain tax sensitive investments. While we expect a bill will be passed, it could require amendments, particularly on the tax side. We also recognize the rate of improvement in most financial metrics may have peaked and valuations relative to history are high, implying reduced forward returns. Nonetheless, with low current interest rates and inflationary forces percolating that could drive rates higher, fixed income's outlook is relatively dim. Thus, relative to bonds, we believe equities are more attractive and therefore maintain equity overweights across portfolios.

Within equities, we recently made modest shifts away from U.S. small-cap stocks in favor of large- and mid-caps. As the economy continues to reopen, the fast accrual of operating leverage that helped small-caps on the way up could be their Achilles heel on the way down. Other potential risks include concerns over labor shortages and higher input costs as reported in purchasing manager surveys. Also, potential corporate tax hikes may cause small-caps to lag in the medium term. Lastly, the Russell 2000 index is trading at 36x earnings, a 50% premium over the S&P 500 index, which is trading at around 23x.

We continue to prefer emerging market (EM) equities over developed market equities. While recent U.S. dollar strength has induced capital outflows and weighed on EM asset returns, global reflation with more modest increases in U.S. real yields, sustained China expansion and broad-based cyclical rotation should benefit EM stocks for the remainder of the year.

Global interest rates appear likely to go higher. We expect the U.S. 10-year Treasury yield to move toward 2%, but not in a linear fashion. Within fixed income, sectors with yield spreads to Treasurys continue to offer better return potential. We think spreads to Treasurys among high yield bonds are more attractive than investment grade spreads. Developed international market yields are unenticing, while the risk-adjusted return profile of international equities outweighs that of the debt.

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Multi-Asset Strategies and Solutions Team

Voya Investment Management's Multi-Asset Strategies and Solutions (MASS) team, led by Chief Investment Officer Paul Zemsky, manages the firm's suite of multi-asset solutions designed to help investors achieve their long term objectives. The team consists of 25 investment professionals who have deep expertise in asset allocation, manager selection and research, quantitative research, portfolio implementation and actuarial sciences. Within MASS, the asset allocation team, led by Barbara Reinhard, is responsible for constructing strategic asset allocations based on their long term views. The team also employs a tactical asset allocation approach, driven by market fundamentals, valuation and sentiment, which is designed to capture market anomalies and/or reduce portfolio risk.

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