Voya Multi-Asset Perspectives

Political Uncertainties and Trade Tensions Agitate International Markets

Following modest returns in April, global equity markets started May strongly, with all major regions posting large gains for the first two weeks. Supporting the "risk-on" sentiment were comments from Treasury Secretary Mnuchin that the U.S.-China trade dispute was "on hold" after mutual concessions and easing tensions ahead of the planned U.S.-North Korea summit.

Worries over global trade and political uncertainties soon re-surfaced. Mixed messages, on the North Korean summit and denuclearization, whipsawed markets. Then the Trump administration announced new tariffs on Chinese goods and chose not to extend tariff exemptions on steel and aluminum imports for Canada, Mexico and the European Union. Political turmoil in Italy weighed on global equities when President Sergio Matterella rejected populist Five-Star and League's choice of Paolo Savona as finance minister. Taken together, May's disruptions bluntly reminded investors of forgotten risks.

As bearish sentiment spread across global markets, bonds generally outperformed stocks. Within equities, the United States was the only region with positive returns, as the S&P 500 rose 2.4%. The MSCI EAFE and emerging markets (EM) indexes fell 2.1% and 3.5%, respectively. Investors seeking safe-haven assets drove the 10-year U.S. Treasury yield to a low of 2.8% and strengthened the U.S. dollar. U.S. small cap stocks were among the best performers, as the Russell 2000 gained 6.1%. Smaller U.S. companies tend to generate more of their revenues domestically, so are less exposed to currency issues.

We continue to have a positive outlook for equities. Even if the U.S. enacts the proposed tariffs, their economic effects should be modest. We believe deregulation and tax cuts have not yet exerted their full effects, and the slowdown in global growth during the first quarter will prove transitory. With consumer and business sentiment nearing multi-decade highs, backed by double-digit earnings and high single-digit sales growth, we expect equities to recover their momentum and surprise to the upside.

Tactical Indicators

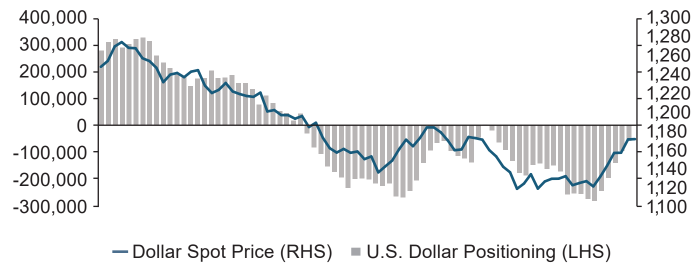
Economic Growth (positive):
Current activity indicators are consistent with rebounding world GDP growth (Figure 1)

Fundamentals (positive):
The counter-trend rally in the U.S. dollar is likely to fade (Figure 2)

Valuations (neutral):
Stock valuations remain attractive compared to bonds

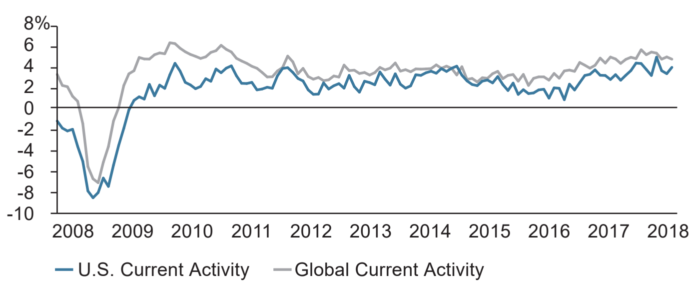
Sentiment (neutral):
Far from overbought levels, suggesting upside to equity markets

Figure 2. Over 80% of U.S. Dollar Short Positioning Has Been Unwound



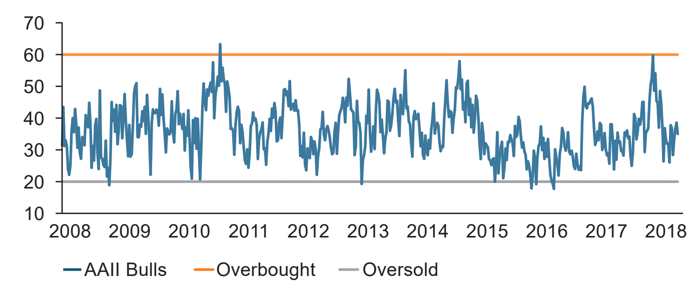
Source: Bloomberg and Voya Investment Management, data as of 5/31/2018.

Figure 1. The World Continues to Experience Above-Trend Growth



Source: Bloomberg, Goldman Sachs and Voya Investment Management, data as of 5/31/2018.

Figure 3. Investor Sentiment is Nowhere Near Overbought Levels



Source: Bloomberg and Voya Investment Management, data as of 5/31/2018.

Portfolio Positioning

Equities	●	
U.S. Large Cap	○ ○ ●	Recent pullback in valuations combined with strong economic growth and robust earnings create relative attractiveness
U.S. Mid Cap	○ ● ○	U.S. corporate tax reforms are fully incorporated into prices from an after-tax profit standpoint
U.S. Small Cap	● ○ ○	U.S. small caps have benefited from short-term outbreak in global risks and stronger U.S. dollar but will face headwinds as financial conditions tighten
International Equities	○ ● ○	Building positions as additional non-U.S. labor market slack and low inflation rates are appealing attributes
Emerging Market Equities	○ ○ ●	Expect recent weakness to abate. We think EMs have been beaten down by idiosyncratic country risk, e.g., Argentina and Turkey
REITS	● ○ ○	Rising interest rates, full valuations and mature real estate cycle have us underweight
Commodities	○ ● ○	Crude oil's climb to around $70/barrel looks durable, but excess capacity within OPEC member countries and among U.S. shale producers make us skeptical of further sustainable increases
Fixed Income	●	
U.S. Core Fixed Income	● ○ ○	Closer to fair value, but stronger economic growth will act to push yields higher
Non-Investment Grade	○ ○ ●	High yield spreads near cycle tights, offer less value in the face of rising rates. Income potential and floating rate coupon still make senior loans attractive
International Fixed Income	● ○ ○	Low absolute and relative yields lead us to favor U.S. bonds

Underweight ● Neutral ● Overweight ●

Investment Outlook

The narrative around the global growth weakness in 1Q18 evolved during May. The U.S. showed clear signs of reacceleration with better data related to manufacturing, construction spending and business activity. When we look at the data, we see that the eurozone has lost momentum and the deceleration has not yet abated. Europe had been growing well above trend for most of 2017 but recent signals — such as IFO current conditions ticking up for two consecutive months — are telegraphing some stabilization. Underlying fundamentals such as business investment, consumer confidence and employment growth are solid for Europe; that should be enough to curtail the weakness. In the emerging markets, economic surprise indexes have started to improve, which is a sign that they too will be contributing to better growth after some relative weakness. As shown in Figure 1, U.S. current activity indicators are rebounding and the rest of the world is behind, but still above trend.

Politics are going to create a lot of noise for the equity markets in the near future. As we saw with Italy in late May, politics normalized almost as quickly as they worsened. We suspect that part of the market reaction to a violent move down and bounce back is quick positioning, as the Italian election results surprised many market participants. It also speaks to some of the fragility of investor sentiment, even as we move past the tenth anniversary of the onset of the great financial crisis this September. When we look at investor sentiment (Figure 3), we see that a lot of the ebullience has been wrung out of equities.

Currencies have been the transmission mechanism of price movements this year. Our long-term view is that the U.S. dollar is on a downtrend: large current account and budget deficits will be difficult to fund, and investors will sell the currency as a result. We note some of the lopsided positioning in the currency futures market has been unwound, which we think is an indication that the U.S. dollar will find its footing over the course of the summer (Figure 2). In our view, the foreign exchange (FX) markets have unduly punished emerging market currencies versus the swift U.S. dollar rise. While we do not think we have seen the trough to EM FX yet, the individual country response of rate hikes and interventions is likely to stem the tide.

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Multi-Asset Strategies and Solutions Team

Paul Zemsky, CFA
Chief Investment Officer,
Multi-Asset Strategies

Barbara Reinhard, CFA
Head of Asset Allocation,
Multi-Asset Strategies

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