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Voya Global Perspectives

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Executive Summary

- Equity markets slumped in the third quarter, as the ongoing commodities rout, uncertainty about a slowing China and negative corporate earnings growth had investors on edge.
- A change of direction in corporate earnings historically has signaled trouble ahead for equity markets.
- The end of the commodity "supercycle" is being felt in financial markets and in the real economy.
- The U.S. consumer has been resilient, highlighting that the directions of the economy and the markets can differ.

Global Markets Reel While Fixed Income Offers Some Cushion

Index	Sep 2015	3Q15	YTD
Equity			
S&P 500	-2.5	-6.4	-5.3
S&P MidCap 400	-3.2	-8.5	-4.7
S&P SmallCap 600	-3.5	-9.3	-5.5
Global REITs	1.2	-1.4	-4.2
EAFE	-5.0	-10.2	-4.9
Emerging Markets	-3.0	-17.8	-15.2
Fixed Income			
Corporate	0.7	0.8	-0.1
U.S. Treasury 20+	1.5	5.3	-0.2
Global Aggregate	0.5	0.9	-2.3
High Yield	-2.6	-4.9	-2.5
Senior Loans	-0.5	-0.3	1.4

Data as of 09/30/2015

Source: FactSet, FTSE NAREIT, Voya Investment Management

Commodities Rout Takes a Toll on Fundamentals

Third quarter 2015 was the worst quarter for equity markets since 2011. While the selloff was deep and broad-based, emerging markets were particularly punished. There is no shortage of concerns weighing on investors, including a global commodities rout, uncertainty about China's slowing growth, an energy sector recession in the U.S. and a contraction in corporate earnings. On the other hand, consumers are back to spending on big-ticket items, as they benefit from low inflation, low energy prices, an improved housing market and nearly full employment. Their resilience also highlights the tendency of the economy and the financial markets to follow their own paths.

Market Dislocation: Trend or Temporary Pause?

Market volatility and even market corrections are normal — these are risk assets after all. We've seen the current bull market in its six years and counting suffer through several bouts of volatility, only to shake off the resistance and surge to new record highs. Key to the market's strength through these difficult episodes were fundamentals, which remained solidly supportive of higher valuations despite occasional market gyrations. We've long said that "fundamentals drive markets"; as long as fundamentals like corporate earnings are positive, the future direction of equity prices likely will be positive as well. A change of direction in the fundamentals historically has been the canary in the coal mine signaling trouble ahead.

Negative year-over-year second quarter earnings growth for the S&P 500 — the most widely followed index in the world and broadly reflective of global conditions given that nearly 50% of its revenue is derived from overseas — represents such a proverbial canary. Perhaps the third quarter selloff was largely remedial, reflecting the reporting of negative earnings and the clearing of excesses in the market. While this may be the case, there are a number of issues — most notably the end of the commodities "supercycle" — suggesting the trouble may not be over.

Bust of the Commodity Supercycle Felt Globally

Commodities often are as important as currencies to the producing economies that rely on them as a vital source of revenue; this is particularly true for emerging markets. Likewise, a wide swath of the private economy worldwide depends on the exploration for or the production of commodities. While the decline of a few commodities is no cause for alarm, the fact that pretty much all global commodities have been falling in unison — and have yet to show signs of bottoming — has us concerned. And even if commodity prices do stabilize, the true carnage of the commodity bust likely has yet to be realized fully. Consider the following:

- Commodity prices have plummeted 38% in the past year to approach lows last seen during the 2008 financial crisis.
- Oil, the most systemic commodity, collapsed by 50% within the past year. As a result, trillions of dollars' worth of global energy projects have been cancelled or suspended.

- Mining, drilling and exploration — capital- and labor-intensive activities that have added significantly to employment and corporate profits in recent years — is undergoing retrenchment globally.
- China's growth continues to slow. The country has dominated the market's demand for commodities of all stripes, accounting for nearly half of the demand for many metals, and is the largest importer of oil in the world.
- Having pinned its fortunes to China's now-waning demand for natural resources, Brazil has slipped into recession and its sovereign debt was downgraded to junk.
- U.S. trade activity has contracted, which typically only happens during recessions. While the rising U.S. dollar could be expected to hurt exports, imports have also been negative despite the tailwind dollar strength typically provides.
- High yield spreads have widened to levels not seen since January 2012, a few months after the first-ever U.S. credit downgrade by Standard & Poor's.

There were many causes for the commodity supercycle — i.e., the multi-decade move higher in prices for a wide range of commodities — that is currently showing significant signs of strain. The demand side of the equation was driven by China, both in terms of its voracious appetite for commodities and its inclination to store substantial excess supply. The fall of the U.S. dollar during the 2008 financial crisis made commodities cheaper and emerging market currencies stronger, inspiring further investment in the complex. More recently, super-low interest rates in the developed markets had investors around the world hunting for yield in emerging markets, which encouraged these economies to issue increasing amounts of dollar-denominated debt that has become harder to repay given the greenback's appreciation. But now it looks like the party's over.

Year-Over-Year Earnings Growth for the S&P 500 Turned Negative in 2Q

Sector	Earnings Growth (%)
Health Care	15.3
Consumer Discretionary	8.8
Telecommunication Services	8.5
Financials	6.7
Utilities	6.5
Information Technology	4.5
Materials	4.2
Consumer Staples	2.7
Industrials	-4.7
Energy	-55.4
S&P 500	**-0.7**

Source: FactSet
Note: Earnings Growth is the percentage change in the cumulative share-weighted earnings from that of a year ago.

Equities Down in Third Quarter, but Fixed Income Provides Stability

Global equity markets were negative across the board in the third quarter on global growth concerns, plunging commodities and the first negative quarterly earnings print since third quarter 2012. Few markets escaped the selloff. U.S. indexes entered correction territory before recovering modestly, with the S&P 500, S&P MidCap 400 and S&P SmallCap 600 indexes posting losses of 6–10% for the quarter. European markets, which had been leading for the year and attracting the bulk of investor inflows, also declined substantially during the period; the MSCI EAFE Index shed about 10%. But the biggest target of investors' ire in the third quarter was the emerging markets, as the MSCI Emerging Market Index plummeted more than 17%. Emerging markets are volatile by nature, but the dramatic selloff in commodities brought to mind contagions of years past and led to an exodus from these securities.

A number of fixed income markets were positive for the quarter, offsetting some of the equity malaise. Corporate and global bonds ticked higher, while long Treasuries lived up to their safe-haven reputation, surging more than 5%. However, the bond market is flashing warning signals; for example, high yield bonds were down nearly 5% in the quarter as spreads to Treasuries widened 154 basis points, suggesting growing economic uncertainty and concerns about the ability of companies to service debt.

What started out as weakness in commodity prices and slowing global growth has already spread to other areas of the real economy; this is particularly true of corporate revenues and earnings, both of which failed to grow in the second quarter and are set to post more substantial negative growth in the third. Given this, we have adjusted our forecast for S&P 500 2015 earnings per share to $119 and lowered our year-end target for the index to 2020 (representing a price-to-earnings ratio of 17x).

The Resilient Consumer Highlights Difference Between Markets and the Economy

Given all the bad news, why did the latest U.S. GDP growth reading come in at 3.9%, a level the U.S. has not reached in quite some time? Much of the credit can go to the resilient U.S. consumer, which appears to have been insulated from the global turmoil. With the job market in its best condition in 15 years and a de facto tax cut in the form of lower gas prices, consumer confidence has spiked to levels seen only one other time since the recession. Meanwhile, the housing rebound continues to impress, with existing home sales and prices up about 6% and 5% year-over-year, respectively. Retail sales reached an all-time high of $447 billion last month, and auto sales are up more than 15%. And while the strong U.S. dollar may be a headwind for corporate revenues, it benefits consumers traveling overseas and buying foreign goods.

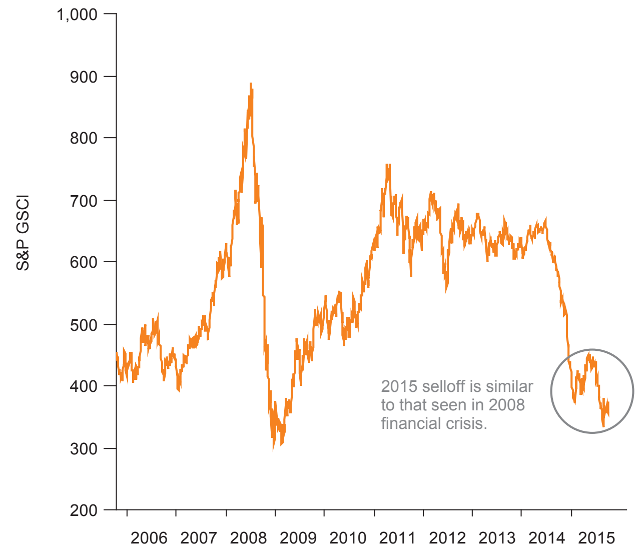
While turmoil grips the financial markets, the consumer is driving GDP to new all-time record highs. This highlights the often-divergent trajectories of the financial markets and the economy. The markets need to get past a number of issues — including the strong dollar, slowing global demand and a commodities bust — but the consumer is 70% of the U.S. economy and is a game changer for growth.

Market Outlook

Beyond all the doom and gloom, there are two bullish things to keep in mind. One, the consumer's strength can be a game changer, especially in light of a positive economic backdrop and currency tail winds that are creating a virtuous cycle. Two, the private economy is nothing if not resilient, and corporate earnings tend to be skewed to the upside. The danger is that the negative impact of falling commodity prices is immediately priced in for corporations, while the benefits to consumers will work their way in over time.

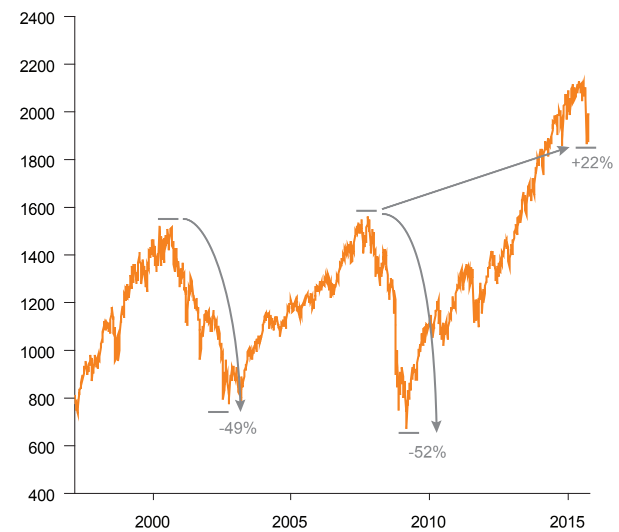
Despite consumer-driven reasons for optimism, fundamentals — as measured by corporate earnings — are negative, which is indicative of headwinds for the markets. Fundamentals drive markets, and it is always prudent to stick with your plan in good times and bad.

Commodity Prices Are Approaching 2008 Financial Crisis Levels



Source: FactSet

The S&P 500 Remains More Than 20% Above Its 2007 Peak



Source: FactSet

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