Voya Multi-Asset Perspectives

Markets Discount Resurgence in COVID Cases, Focus on Vaccines

A scary end to October has been followed by an enthusiastic risk-asset rally in November, as most major equity markets have delivered double-digit returns month-to-date. A build-up of nerve-wracking news and highly consequential events culminated in an apparent avoidance of worst-case scenarios envisioned just a few weeks ago. Data showing that we are amidst a second wave of COVID-19 infections has been difficult for many to stomach. The daily number of confirmed COVID-19 cases in the United States has increased to more than 150,000, almost five times the April peak and more than double the summer peak. The reproductive rate, a key measure of how fast the virus is growing, is above 1.0 for almost every state in the country,* indicating a quickening spread. COVID related hospitalizations continue to set new highs, daily deaths are back near summer highs (less than half of April peaks) and leading experts warn that the situation will likely get worse before it gets better. Only seven states, however, are estimated to have reached ICU capacity of more than 70%; only Georgia is at slightly more than 80%.†

After making hard fought, incremental improvements throughout the summer, the prospect of regressing to lockdowns was more than most could handle. Fortunately, it has been announced over consecutive weeks, that three separate vaccines have proven highly effective in Phase III trials and are ready for regulatory approval, manufacturing and distribution.

Another market overhang has receded this month, with what most believe to be Joe Biden's conclusive victory over President Trump, and, what appears likely to be a Republican controlled Senate. A divided government reduces the probability of extreme outcomes some feared could come with a "blue wave," and could bring back a more conventional political environment, which could reduce the political uncertainties that investors generally dislike. Here too, the story is not over. President Trump has resolved to fight on and, although betting markets and polls show the GOP has good odds to maintain control in the Georgia runoff election, results still could go the other way.

Tactical Indicators

Economic Growth (Neutral)
3Q20 U.S. real GDP grew by 33.1% q/q SAAR; output still 3.5% below 4Q19 level

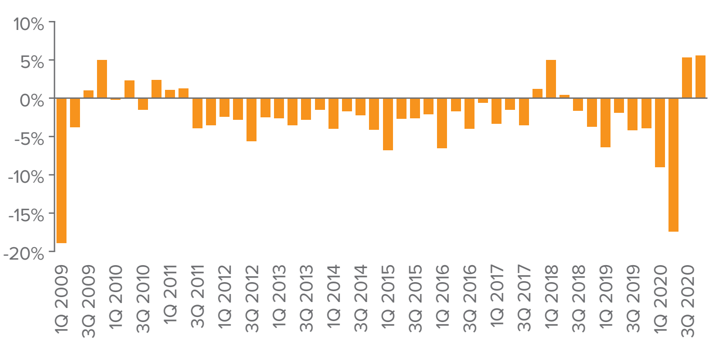
Fundamentals (Improving)
S&P 500 3Q20 earnings revisions have increased by the most since 2009 (Figure 1), but corporate profits are poised to decline by more than 5% y/y

Valuations (Neutral)
By most measures, stocks are expensive relative to history, but with substantial policy stimulus and liquidity the support for equities is meaningful

Sentiment (neutral)
Voya's Market Sentiment Indicator sits in neutral territory

Figure 1. S&P 500 3Q20 earnings revisions have increased by the most since 2009

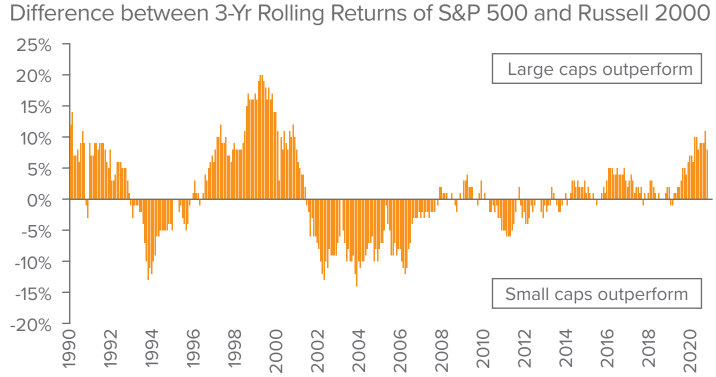
% Upgrade/Downgrade Since Quarter Began



Source: Bloomberg, Voya Investment Management, as of November 24, 2020.

Figure 2. Small cap stocks have lagged large caps by the most since the tech bubble

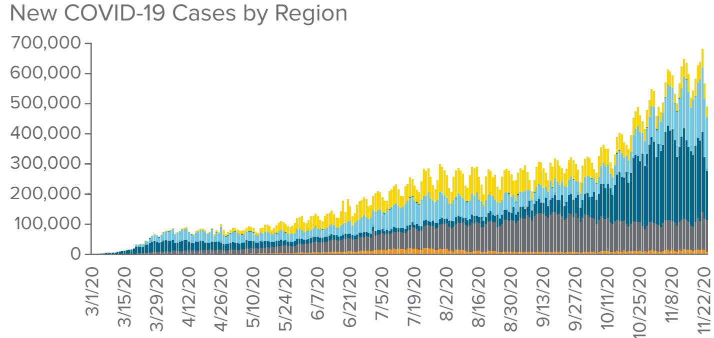
Difference between 3-Yr Rolling Returns of S&P 500 and Russell 2000



Source: Morningstar, Voya Investment Management, as of November 23, 2020.

Figure 3. New COVID cases are decelerating in Europe and accelerating in the U.S.

New COVID-19 Cases by Region



Source: Our World In Data, Voya Investment Management, as of November 23, 2020.

*Source: Centers for Disease Control and Prevention, as of 11/16/20
†*Ibid.*

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	○–●–○	Larger companies have more compelling risk/return characteristics in the short and medium term
U.S. Small Cap	○–○–●	Small caps tend to lead when the economy is at the beginning of an economic recovery, which we saw unfolding in 3Q20
International	○–●–○	Deceleration of new COVID cases in Europe and aggressive government intervention through monetary and fiscal policy in both the Eurozone and Japan will help offset economic drags related to the virus and still challenged fundamental economic backdrop
Emerging Markets	○–○–●	Emerging Asia has a better growth outlook as those countries have had better success combatting COVID-19. We expect the U.S. dollar to continue to show weakness, which usually helps EM equities.
REITs	●–○–○	Big divergences among REIT sectors, but the underlying trend for commercial real estate is a concern
Fixed Income	●	
U.S. Core	○–○–●	We maintain a neutral duration posture and favor quality investment grade bonds, given yield pickup over sovereign bonds and limited downside risk due to Fed backing
Inflation (TIPS)	●–○–○	Deflationary pressures may persist for several years
Non-Investment Grade	○–○–●	Government funding programs combined with state re-openings should tighten spreads further; the default profile may be a near-term headwind, but policy support makes the asset class attractive
International	●–○–○	Low absolute and relative yields lead us to favor U.S. bonds

Underweight ● Neutral ● Overweight ●

Investment Outlook

A once in a generation exogenous shock caused an unusual type of recession that compelled policy makers and the healthcare community to implement extraordinary measures in record-breaking time. This has led to a remarkably quick bottoming in economic growth and a bounce off the lows, which has only been outdone by the incredibly quick snap-back in financial markets that has put global stocks up roughly 10% on the year.[‡] The market's exceptional ability to look forward has been on full display during this crisis. Throughout untold amounts of pain and suffering, investors have been focused on forecasting when the pandemic will be behind us and what the world looks like on the other end. Optimistic early expectations for finding effective vaccines have been realized and provide added credibility to forecasters' ability to predict when normality resumes. Despite the recent coronavirus surge and probable upcoming socially isolating, winter hunkering required, we think stocks can continue to hold their own against bonds for several reasons. First, we are hopeful that the balance of scientific data going forward will be positive, but we are confident that there will be an end; the closer we get, the better view of it we will have. Second, should we be wrong about the first point, policymakers have repeatedly proven their ability and willingness to act. This is being challenged, however, by Treasury Secretary Mnuchin's recent decision not to reauthorize certain Federal Reserve emergency credit facilities.

Stocks would certainly prefer that fiscal authorities are well-aligned with the Fed, but this backstop funding may not be needed. Lending spreads have fallen substantially since the programs were enacted and liquidity is ample in all markets. The existence of the capital cushion would provide an added layer of confidence and support in the event of severe financial distress, but we think this is unlikely; and with the incoming Biden administration, Mnuchin is not long for his role, so the next stimulus package could reinstate or remake something similar in a few months. The last reason we are overweight stocks is that bond yields are incredibly low, and we believe they will stay in a narrow range between 0.50–1.0% for some time to come. In the absence of a fundamental sell-off, this should further attract investors to stocks.

However, the types of stocks investors are drawn to has begun to change and we think this shift has legs. Over the last month we have added to portfolios' U.S. small cap and international developed equity positions, funded by a lessening of our previously big overweight to U.S. large cap equity. Small caps have lagged large caps by the most since the tech bubble (Figure 2). With a more stable global economic picture on the horizon and near extreme valuations in many of the adored big tech growth stocks, small caps look poised to return to life, in our opinion.

The rationale for our shift toward international equities is underpinned by a similar premise. Attractive relative valuations combined with a deceleration of new COVID cases in Europe versus rising cases in the U.S. (Figure 3) and our expectation for a weaker U.S. dollar in the near term should help improve economic fundamentals. We already see signs of this, with German and Eurozone services and manufacturing PMIs both well above 50. The new orders component of the surveys has experienced a marked increase, primarily driven by domestic demand. Labor market conditions also continue to improve, helping to drive a notable increase in confidence. The other major EAFE component, Japan, has been successful in controlling COVID and executed a seamless transition of power from Shinzo Abe to Yoshihide Suga in September, which underscores Japan's political stability. Moreover, the yen is historically weak, and we expect that should help bolster exports going forward. There is also no cheaper major regional equity market than Japan.

[‡] Global stock returns refer to the total return on the MSCI ACWI Index. Source: Bloomberg, as of 11/24/20.

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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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