

Multi-Asset Perspectives



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



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

Capital markets have responded positively to better-than-expected economic outcomes so far this year. While the United States has managed to avoid an official recession, growth is almost certain to slow and increases in profits will be challenged. Given this backdrop, we see equities trading sideways to slightly higher in the near term and we continue to favor the U.S. over the rest of the world.

Tactical indicators



Economic growth (slowing)

Demand is holding up as inflation quickly cools, but we think increasingly tight monetary conditions will slow output notably toward the end of this year and into next. Weaker but still historically strong levels of employment should help prevent a major economic downturn.



Fundamentals (neutral)

Slowing nominal GDP will challenge revenue growth and profit margins. Consensus expectations look optimistic as margins typically contract in a decelerating pricing environment. Nonetheless, strong earnings guidance from company management and improved macro data could help equities grind higher in the near term.



Valuations (negative)

U.S. stocks appear reasonably priced, but the equity risk premium has tightened and higher bond yields make fixed income marginally more attractive from a valuation standpoint.



Sentiment (neutral)

Market-based sentiment indicators have shifted from bearish to modestly bullish.

Consumer sentiment has surged recently, providing evidence of the potential for continued durability in consumer spending.

Quick take

- At the outset of this year, calls for imminent recession proliferated and investor positioning was extremely bearish. Yet **economic and corporate earnings data were generally better than expected** and many of the most feared geopolitical tail risks seem to have lessened (at least temporarily). As a result, risk assets posted another quarter of strong returns, driven by the largest and growthiest names in the U.S. While this trajectory for equity prices is unlikely to persist, we think leadership can broaden to other sectors and don't foresee significant near-term declines.
- Slowing economic growth will weigh not only on prices, but also on profits. Consumer spending is already moderating. If the labor market stays tight, however, **the economy should be able to avoid a significant dent in demand**.
- Following the Federal Reserve's latest rate hike that brought the fed funds rate target range to 5.25–5.50% and a report that inflation is cooling, **the bond market thinks further rate hikes are now off the table**.
- Amid disinflationary forces and an improving macro environment, **U.S. large caps could continue to grind higher** as corporate and investor sentiment perks up.
- **We continue to favor domestic assets and maintain underweights to international equities.** However, our outlook on foreign developed market stocks is primarily driven by our less sanguine view of Europe. Japan looks attractive now.
- Following the reopening of its economy, China's performance has been disappointing. Without the expected economic momentum, structural headwinds have resurfaced; **our underweight to China and to emerging markets remains**.
- **Our preference for high-quality fixed income persists** given high base rates, reasonable spreads and tightening credit conditions.

Portfolio positioning

Fundamentals appear mixed, but lower bond yields and the disinflationary impulse from monetary policy-tightening could continue to provide near-term support to risk assets. Voya recommends balancing risk-seeking positions with high-quality tilts.

Equities	Neutral	
U.S. large cap		Larger U.S. firms are better positioned to withstand inflationary pressures and have more durable earnings streams than companies of other sizes or regions.
U.S. small cap		Small caps continue to trade at a sizable discount to large caps but probably will lag in a risk-off period, given their exposure to regional banks, which are vulnerable to further weakness.
International		Recent European equity market performance has become detached from fundamentals. Japan faces a difficult monetary policy crossroads with uncertain but likely unfavorable outcomes.
Emerging markets		China's reopening has faltered, real estate looks shaky and the contraction in global manufacturing could result in more downside for China and EM broadly.
REITs		REITs are battered and beaten. The near-term outlook for commercial real estate is still unfavorable, but prices now reflect much of dramatically weaker fundamentals.
Commodities		Precious metals may provide some diversification, but the basket approach could struggle during a global slowdown or recession.
Fixed income	Neutral	
US core		Investment-grade fixed income offers attractive yield with reasonable risk and provides a degree of protection against recession. Duration should again provide a hedge to equity and credit risk.
Inflation (TIPS)		Disinflation is underway, but the TIPS curve is too expensive, especially on the front end.
Non-investment grade		High-yield spreads have compressed and don't offer appealing income pick-up overall. But balance sheets are generally sturdy and any default cycle due to tighter lending standards should be mild.
International		Low relative yields and stiff inflation headwinds from Europe keep us favoring U.S. fixed income. Emerging market debt looks more interesting.

Underweight Neutral Overweight

Investment outlook

The U.S. economy has displayed remarkable resilience in the face of persistently high inflation, aggressive monetary tightening, banking sector stress and a standoff over the debt-ceiling limit. While the U.S. has thus far managed to avoid perhaps the most widely anticipated recession in history, **growth is almost certain to slow and profit increases will be difficult to come by.** Consumer spending continues to provide a sturdy foundation but will likely come under increased pressure as government pandemic assistance and the suspension of student loan repayments conclude. Already, the rate of change in consumers spending is moderating and credit card delinquency rates are rising, but not to a concerning degree. This is because the labor market and wages have held up well. The unemployment rate is still near cycle lows of 3.6%. Job openings are trending down but remain well above the number of unemployed. Initial jobless claims have been edging higher and the quits rate has declined, but the overall state of the jobs market remains tight. As a result, average hourly earnings are growing at a pace inconsistent with the Fed's 2% inflation target (Exhibit 1). While indicators suggest wages are set to soften (Exhibit 2) and commodities, core goods and prices overall continue to cool, **we believe the Fed isn't ready to take its foot off the brakes yet.**

Exhibit 1. Wage growth remains strong — and well above the level the Fed wants to see

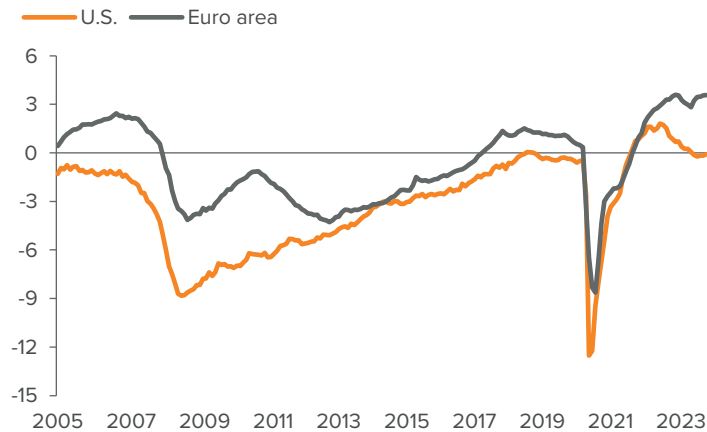
U.S. average hourly earnings index, percent change



As of 07/17/23. Source: Bloomberg, Goldman Sachs.

Exhibit 2. U.S. wage growth is likely to soften, while Europe’s appears stickier

Goldman Sachs wage survey leading indicators



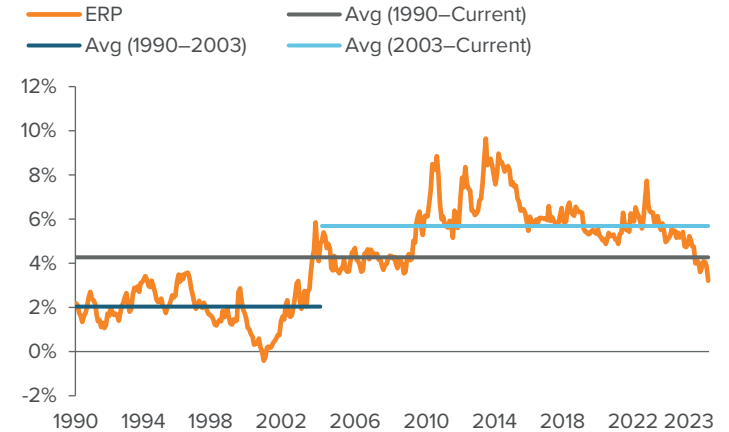
As of 06/30/23. Source: Bloomberg, Goldman Sachs.

The bond market, finally acknowledging this view, has reversed course, with futures pricing out the possibility of interest rate cuts this year and now roughly falling in line with Fed projections. Besides higher rates for longer, stricter credit conditions following the regional bank crisis should tighten financial conditions – which have yet to fully impact businesses and households. These factors support the disinflationary forces that are already in place. **In our view, there are two variables that will weigh on inflation going forward: rents and used car prices.** With respect to the former, the softening in demand should lead to declining prices across an array of discretionary services. For the latter, the steep drop in auto auction prices foretells the impending slump in inflation. **The bottom line is that core inflationary pressures are fading alongside weaker economic growth.** However, it doesn’t mean a recession is imminent or that it will be deep and painful.

Market participants’ recognition of cooling inflation and better-than-expected macro data contributed to surprisingly strong first half equity market returns and, with stocks still under-owned in many investor portfolios, **we think there is room for modest gains from U.S. large caps in the second half of this year.** Valuations look reasonable (Exhibit 3) and earnings offer the potential for upside surprise as corporate sentiment improves and earnings guidance ratios are reaching their highest levels since 2021. We can’t write off potential disappointments, as the range of S&P 500 earnings forecasts is the widest it has been in decades, with a 50% gap between the highest and lowest year-end price targets; however, **we believe strong U.S. fiscal balances should limit any potential economic downturn.**

Exhibit 3. U.S. large cap valuations have increased but the equity risk premium still looks reasonable

S&P 500 implied equity risk premium

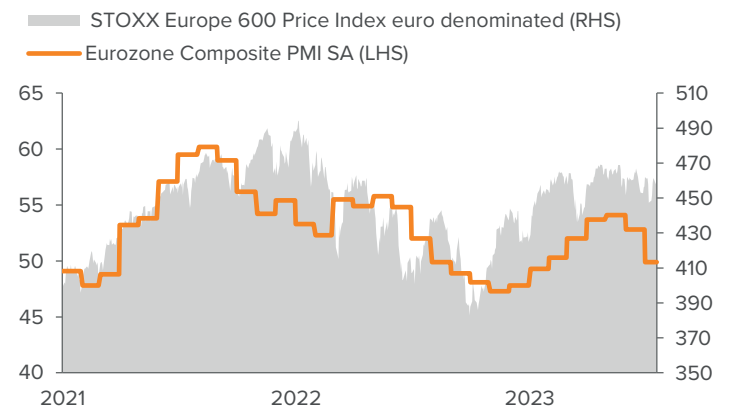


As of 07/17/23. Source: Bloomberg, Voya Investment Management.

The outlook for Japanese equities has improved thanks to governance reforms that have led to higher foreign inflows and earnings revisions that are turning positive. Another potential source of return for foreign investors could come from a stronger yen should the Bank of Japan abandon yield-curve control and Ministry of Finance intervention. Still, **we remain underweight international developed equities given our views on Europe,** which lags the U.S. in the fight against inflation. What’s more, wages in Europe could be even stickier with labor’s relatively stronger bargaining power. While China’s economic slowdown could ease Eurozone price pressures on the margins, given the high correlation between the two economies, the European Central Bank still has more work to do. With policy rates set to move higher and economic momentum decelerating (Exhibit 4), **we think most of Europe’s strong performance has already played out.**

Exhibit 4. Eurozone manufacturing and services activity contracted in July

Eurozone composite PMI seasonally adjusted versus STOXX Europe 600 Index

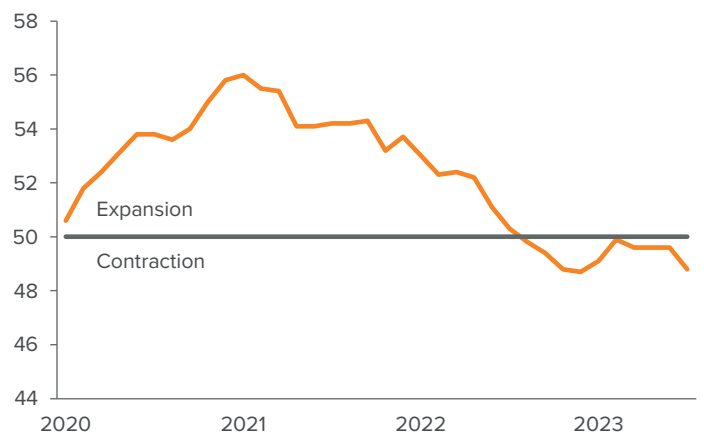


As of 07/17/23. Source: Bloomberg. The STOXX Europe 600 is an index of European stocks that has a fixed number of 600 components representing large-, mid- and small-capitalization companies among 17 European countries, covering approximately 90% of the free-float market capitalization of the European stock market (not limited to the Eurozone). **Investors cannot invest directly in an index. Past performance is no guarantee of future returns.**

In China, frustrations linger — and according to our research could worsen. The post-pandemic economic reopening narrative has faltered, real estate looks shaky and the contraction in global manufacturing (Exhibit 5) could create a headwind for cyclical assets broadly, resulting in more downside for China specifically. In addition, after years of poor market performance, a negative wealth effect could exacerbate a liquidity trap where individuals hoard cash, making policy officials hesitant to aggressively stimulate. **Yet, we think significant stimulus will be necessary to meaningfully boost asset prices, and incremental policy measures ultimately will fail.** We believe China will reluctantly export deflation via a weaker currency, helping to nudge U.S. inflation lower and support the U.S. dollar (which has continued to weaken over the last month). This outlook accounts for our preference for domestic stocks. The move away from the dollar is clearly a long-term concern with foreign country reserves being rebalanced and trade arrangements reworked to “de-dollarize,” but the near-term ramifications have been overstated and the currency now appears to be trading in a fair range with the potential for a reversal should a global risk-off event occur.

Exhibit 5. Global manufacturing output hit a six-month low in June

JPMorgan global manufacturing PMI



As of 07/17/23. Source: Bloomberg.

Concerns about growth and credit losses are valid, as the effect of higher rates weigh more heavily on earnings and borrowers' leverage ratios. As a result, **we have tempered our long U.S. large cap position with underweights to the more economically sensitive areas of the equity market and favor higher-quality U.S. fixed income.** We seek the yield pick-up from spread product, but in our view, it's not worth reaching below investment grade, where most companies have locked in cheap long-term rates.

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 its 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.

Past performance does not guarantee future results.

This market insight has been prepared by Voya Investment Management for informational purposes. Nothing contained herein should be construed as (i) an offer to sell or solicitation of an offer to buy any security or (ii) a recommendation as to the advisability of investing in, purchasing or selling any security. Any opinions expressed herein reflect our judgment and are subject to change. Certain of the statements contained herein are statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (1) general economic conditions, (2) performance of financial markets, (3) interest rate levels, (4) increasing levels of loan defaults, (5) changes in laws and regulations and (6) changes in the policies of governments and/or regulatory authorities.

The opinions, views and information expressed in this commentary regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Fund holdings are fluid and are subject to daily change based on market conditions and other factors.

The distribution in the United Kingdom of this Market Insight and any other marketing materials relating to portfolio management services of the investment vehicle is being addressed to, or directed at, only the following persons: (i) persons having professional experience in matters relating to investments, who are "Investment Professionals" as defined in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Financial Promotion Order"); (ii) persons falling within any of the categories of persons described in Article 49 ("High net worth companies, unincorporated associations etc.") of the Financial Promotion Order; and (iii) any other person to whom it may otherwise lawfully be distributed in accordance with the Financial Promotion Order. The investment opportunities described in this Market Insight are available only to such persons; persons of any other description in the United Kingdom should not act or rely on the information in this Market Insight.

In addition, please be advised that Voya Investment Management is a non-Canadian company. We are not registered as a dealer or adviser under Canadian securities legislation. We operate in the Provinces of Nova Scotia, Ontario and Manitoba based on the international adviser registration exemption provided in National Instrument 31-103. As such, investors will have more limited rights and recourse than if the investment manager were registered under applicable Canadian securities laws.

The Capital Markets Authority and all other Regulatory Bodies in Kuwait assume no responsibility whatsoever for the contents of this Market Insight and do not approve the contents thereof or verify their validity and accuracy. The Capital Markets Authority and all other Regulatory Bodies in Kuwait assume no responsibility whatsoever for any damages that may result from relying on the contents of this Market Insight either wholly or partially. It is recommended to seek the advice of an Investment Advisor.

Voya Investment Management does not carry on a business in a regulated activity in Hong Kong and is not licensed by the Securities and Futures Commission. This Market Insight is issued for informational purposes only. It is not to be construed as an offer or solicitation for the purchase or sale of any financial instruments. It has not been reviewed by the Securities and Futures Commission.

Voya Investment Management accepts no liability whatsoever for any direct, indirect or consequential loss arising from or in connection with any use of, or reliance on, this insight, which does not have any regard to the particular needs of any person. Voya Investment Management takes no responsibility whatsoever for any use, reliance or reference by persons other than the intended recipient of this insight. Any prices referred to herein are indicative only and dependent upon market conditions. Past performance is not indicative of future results. Unless otherwise specified, investments are not bank deposits or other obligations of a bank, and the repayment of principal is not insured or guaranteed. They are subject to investment risks, including the possibility that the value of any investment (and income derived thereof, if any) can increase, decrease or in some cases be entirely lost, and investors may not get back the amount originally invested. The contents of this insight have not been reviewed by any regulatory authority in the countries in which it is distributed. The opinions and views herein do not take into account your individual circumstances, objectives, or needs and are not intended to be recommendations of particular financial instruments or strategies to you. This insight does not identify all the risks (direct or indirect) or other considerations which might be material to you when entering any financial transaction. You are advised to exercise caution in relation to any information in this document. If you are in doubt about any of the contents of this insight, you should seek independent professional advice.

This material may not be reproduced in whole or in part, in any form whatsoever, without the prior written permission of Voya Investment Management.

©2023 Voya Investments Distributor, LLC • 230 Park Ave, New York, NY 10169 • All rights reserved.

IM3027542 • CMMC-MAP-1120 • 073123 • ex073124

