Voya Core Plus Fixed Income SMA

Seeks total return through security selection, sector allocation and risk management

Strategy overview

A total return approach, investing across full spectrum of the fixed income market including up to 20% in below investment grade securities.

Key takeaways

- Risk assets performed, and risk-free assets struggled in 1Q24.
- The SMA outperformed its benchmark, the Bloomberg U.S. Aggregate Bond Index (the Index) on a net asset value (NAV) basis. Sector allocation, duration and yield curve decisions added, while security selection detracted.
- While spreads for many sectors appear tight, all-in yields remain historically attractive, allowing investors to capture high quality yield without overstretching into risk.

Portfolio review

For the quarter ended March 31, 2024, the SMA outperformed the Index on a NAV basis. Sector allocation, duration and yield curve decisions added, while security selection detracted.

Risk assets performed and risk-free assets struggled in 1Q24. The first quarter of 2024 witnessed a series of positive data points indicating a continuation of strong economic growth that characterized much of 2023. As a result, the S&P 500 Index experienced strong performance, delivering a return of over 10%, and excess returns for most fixed income sectors finished in positive territory. This robust showing indicated investor confidence and optimism in the overall economic outlook. Meanwhile, despite strong excess returns, high-quality bond markets, as represented by the Bloomberg US Aggregate Index, posted modestly negative total returns driven primarily by the move higher in interest rates.

The labor market continued to exhibit signs of strength to start the year. With an exceptionally low unemployment rate and continued job gains, economic growth remained on a positive trajectory. However, there were indications of a gradual shift towards a more balanced labor market, characterized by a decline in the quit rate and a deceleration in wage gains. These developments were welcomed by market participants due to their potential implications on inflation. That said, inflation remained elevated throughout the quarter while the disinflation dynamic that characterized 2023 lost momentum. Additionally, it became apparent that a majority of the disinflation was due to the deflation of goods prices, and that services inflation would also need to be tamed in order for broader measures of inflation to reach the U.S. Federal Reserve's 2% target. Because of this, the Fed signaled a cautious approach to monetary policy, reiterating their commitment to maintaining a restrictive policy stance until further progress was achieved. Markets converged with the Fed's guidance, suggesting a growing consensus on the future direction of monetary policy and a rejection of a more significant pivot that was priced at the start of the year.

Non-government sectors outperformed U.S. Treasuries, with agency mortgage-backed securities (MBS) the exception. The positive backdrop of financial markets led to strong excess performance for most non-government sectors, while nominal returns were mixed and weighed down by the rise in interest rates. Once again, non-agency residential mortgage-backed securities (RMBS) posted a strong quarter of performance, as housing markets stood firm, supported by elevated levels of homeowner equity and the "golden handcuffs" effect, where many homeowners locked in mortgages with highly affordable rates below 5%. However, this dynamic did not translate to the Agency MBS sector as rate volatility and a delay in Fed cut expectations was a headwind for the period. Meanwhile, commercial real estate (CRE) began its recovery journey, with generous yields helping to offset the impact of rising interest rates. Meanwhile, CRE began its recovery journey, with generous yields helping to offset the impact of rising interest rates. Commercial mortgage-backed securities (CMBS) benefitted from this recovery with spreads rallying across the stack. However, challenges persisted within the office property segment due to elevated vacancy levels. Asset-backed securities (ABS) remained anchored by a strong consumer supported by a robust labor market, healthy financial asset balances, and manageable debt levels. However, lower-income consumers (aka sub-prime borrowers) continued to face difficulties due to the cumulative impact of inflation over the past two years. On the corporate front, 4Q23 earnings were well received with a significant portion of companies beating expectations. Moreover, positive rating trends were observed, with a series of positive upgrades, reflecting the overall health and resilience of corporate balance sheets. These developments underscored the confidence in the corporate sector's ability to navigate challenges associated with restrictive financial conditions, and resulted in both high yield (HY) and investment grade (IG) spreads rallying to their tightest levels in over a year as well as a meaningful portion of the senior loan market making its way back to par.

Sector allocation, duration and yield curve decisions added, while security selection detracted. The continued risk rally in 1Q24, meant our overweight to credit sectors and underweight in U.S. Treasuries contributed broadly. Securitized sectors represented the largest contributions to relative performance, with allocations to non-agency RMBS benefiting from the robust housing market and despite lingering concerns, CMBS also contributed as the sector started to show signs of a trough. ABS also added, but to a lesser degree given the lower beta nature of the sector. Corporate sectors including IG and HY also added nicely. Agency MBS struggled against a backdrop of rate volatility and Fed uncertainty however our decision to hold an underweight contributed positively to relative performance. Security selection detracted over period. Selections within IG corporates, which included securities with lower spread duration, modestly lagged into the risk on rally. This was partially offset by ABS security selection that included off-benchmark subsectors and higher yielding collateralized loan obligations (CLO), as well as selections within emerging markets (EM) debt.

During the period, the most notable change in allocations included a reduction in exposures to U.S. Treasury and cash, with the largest deployment into IG corporates where we took advantage of the new issue market to add to financials. Other changes occurred within sectors, as opportunities to add value through security selection became available. Duration and yield curve decisions, in aggregate, represented a small contribution. Given market optimism in Fed action at the start of the year, we began the quarter underweight in duration and then added duration as market expectations were tempered and rates rose, presenting an attractive entry point.

.

Current strategy and outlook

While the Fed's hiking cycle is done, the first rate cut remains a source of debate. Looking ahead, we expect economic growth in the United States to slow from 2023, but continue to grow close to trend levels, supported by robust consumer spending as real income and the wealth effect bolster economic activity. Meanwhile, we expect inflation to stabilize above the Fed's target, due to the slowing disinflationary trends in the goods sector and continued stickiness in the services sector, the latter of which has been a product of a tight labor market. We are seeing early signs of softness in the labor market, notably a decline in the quits rate. We expect wage growth to moderate, which would also be a positive for inflation. With this backdrop, along with recent strength in economic data, the Fed's case to remain patient on rate cuts has been bolstered. However, the Fed's data-dependent stance will provide flexibility in adjusting policy measures in response to evolving economic conditions, ensuring a balanced approach to supporting economic growth while addressing inflation concerns.

While spreads for many sectors appear tight, all-in yields remain historically attractive which allows investors to capture high quality yield without overstretching into risk. Corporate bonds illustrate this dynamic, where spreads are tight but nominal yields are enticing yield-based buyers and fundamentals can continue to support the sector. The outlook for non-agency RMBS is also positive as fundamental factors continue to support risk-taking in this sector. CMBS continues to exhibit cheap valuations, offering the most compelling relative value compared to other fixed income sectors. Moreover, outside of the office property type, fundamental factors in CRE are showing early signs of improvement. The additional cushion provided by higher nominal rates compels us to lean into higher-quality spread opportunities and remain underweight in U.S. Treasuries. We will continue to monitor market developments, assess sector fundamental factors and stay attuned to macroeconomic trends to capitalize on opportunities in this dynamic and evolving market environment.

Disclaimers

The **Bloomberg US Aggregate** Index is composed of US securities in Treasury, government-related, corporate, and securitized sectors that are of investment-grade quality or better, have at least one year to maturity and have an outstanding par value of at least $250 million. Indexes do not reflect fees, brokerage commissions, taxes or other expenses of investing. Investors cannot directly invest in an index.

Source: Bloomberg Index Services Limited. Bloomberg® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Bloomberg does not approve or endorse this material, nor guarantee the accuracy or completeness of any information herein, nor make any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, shall not have any liability or responsibility for injury or damages arising in connection therewith.

Past performance is not indicative of future results. All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield inherent in investing. All security transactions involve substantial risk of loss. Please refer to your client statement for a complete review of recent transactions and performance.

The **principal risks** are generally those attributable to bond investing. Holdings are subject to market, issuer, credit, prepayment, extension and other risks, and their values may fluctuate. Market risk is the risk that securities may decline in value due to factors affecting the securities markets or particular industries. Issuer risk is the risk that the value of a security may decline for reasons specific to the issuer, such as changes in its financial condition. The strategy may invest in mortgage-related securities, which can be paid off early if the borrowers on the underlying mortgages pay off their mortgages sooner than scheduled. If interest rates are falling, the strategy will be forced to reinvest this money at lower yields. Conversely, if interest rates are rising, the expected principal payments will slow, thereby locking in the coupon rate at below market levels and extending the security's life and duration while reducing its market value. High yield bonds carry particular market risks and may experience greater volatility in market value than investment grade bonds. Foreign investments could be riskier than US investments because of exchange rate, political, economic, liquidity and regulatory risks. Additionally, investments in emerging market countries are riskier than other foreign investments because the political and economic systems in emerging market countries are less stable.

The strategy employs a quantitative model to execute the strategy. Data imprecision, software or other technology malfunctions, programming inaccuracies and similar circumstances may impair the performance of these systems, which may negatively affect performance. Furthermore, there can be no assurance that the quantitative models used in managing the strategy will perform as anticipated or enable the strategy to achieve its objective.

This commentary 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.

Disclosure for Morgan Stanley Wealth Management clients only: The content is to report on the investment strategies as reports by Voya Investment Management and is for illustrative purposes only. The information contained herein is obtained from multiple sources and believed to be reliable. Information has not been verified by Morgan Stanley Wealth Management, and may differ from documents created by Morgan Stanley Wealth Management. The client should refer to the Profile. This must be preceded or accompanied by the Morgan Stanley Wealth Management Profile, which you can obtain from your Financial Advisor. For additional information on other programs, please speak to your Financial Advisor.

©2024 Voya Investments Distributor, LLC • 230 Park Ave, New York, NY 10169 • All rights reserved.

(800) 992-0180 Individual Investors | (800) 334-3444 Investment Professionals

Not FDIC Insured | May Lose Value | No Bank Guarantee

SMASB-CP 033124 • ex033125 • IM3513048

voyainvestments.com