Voya Enhanced Yield Fixed Income SMA

Higher Credit Quality Approach, Selective High Yield Exposure

Strategy overview

A total return strategy that uses a multi-sector approach with a higher-quality posture through the use of Treasury, agency and corporate credit securities, both investment-grade and below, with 1-10 year maturities.

Key takeaways

- The first quarter of 2024 witnessed a series of positive data points indicating a continuation of strong economic growth that characterized much of 2023.
- In corporate credit markets, spreads remained resilient.
- 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.

Portfolio review

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 Treasuries, with agency mortgage-backed securities 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. In the corporate credit 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 and investment grade spreads rallying to their tightest levels in over a year.

For the quarter, the Voya Enhanced Yield Income SMA underperformed the custom benchmark on a net asset value (NAV) basis. The SMA's underweight allocation and higher quality focus within high yield bonds was the primary detractor, as the sector outperformed during the period, led by lower-rated credits.

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 fundamental factors can continue to support the sector. The additional cushion provided by higher nominal rates compels us to continue to lean into higher-quality spread opportunities. We will continue to monitor market developments, assess sector fundamentals, and stay attuned to macroeconomic trends to capitalize on opportunities in this dynamic and evolving market environment.

The **Bloomberg Barclays Intermediate US Credit Index** measures the investment-grade, US-dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the U.S. Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities. **Investors cannot invest directly in an Index.**

The **Bank of America Merrill Lynch U.S. High Yield Master II Constrained Index** is an unmanaged market value-weighted index of all domestic and Yankee high-yield bonds, including deferred interest bonds and payment-in-kind securities. Issues included in the index have maturities of one year or more and have a credit rating lower than BBB-/Baa3, but are not in default. The Merrill Lynch U.S. High Yield Master II Constrained Index limits any individual issuer to a maximum of 2% benchmark exposure. **Investors cannot invest directly in an index.**

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 U.S. investments because of exchange rate, political, economics, 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. Returns are benchmarked to a customized blend of 60% Bloomberg Barclays Intermediate Gov/Credit Index & 40% Bank of America Merrill Lynch US High Yield Master II Constrained Index, rebalanced on a monthly basis, which does not incur management fees, transaction costs, or other expenses associated with a composite portfolio. Securities prices used to value the benchmark index for the purposes of calculating total return may or may not differ significantly from those used to value securities held within composite portfolios. In December 2006, the High Yield portion of the custom-weighted benchmark was changed from the Citigroup High Yield Cash Pay Index to the Bank of America Merrill Lynch US High Yield Master II Constrained Index, effective from June 1, 2005 to the present. The reason for the change was due to a fundamental change in the composition of the Citigroup index that made it unrepresentative of the strategy's investment process. **Indexes do not reflect fees, brokerage commissions, taxes or other expenses of investing, and investors cannot directly invest in an index. Source: Bloomberg Barclays and Merrill Lynch and Voya Investment Management.**

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