Voya High Yield Bond SMA Strategy

Seeks total return, balancing income and diversification potential

Strategy overview

The Voya High Yield Bond SMA (the SMA) strategy seeks to maximize total return over a full market cycle by taking a broadly diversified and well-balanced approach to discovering risk-adjusted opportunities within the below investment grade (IG) corporate bond sector.

Key takeaways

- The Bank of America Merrill Lynch High Yield Master II Index (the Index) returned 1.51% for the quarter.
- BB rated bonds returned 1.10%, while B rated securities returned 1.48% and CCC rated securities returned 3.39%.
- The SMA underperformed the Index on a net asset value (NAV) basis during the quarter, primarily due to its higher quality focus.

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 (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. In the corporate credit front, 4Q24 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 IG spreads rallying to their tightest levels in over a year. For the context, the average spread of the Bank of America Merrill Lynch High Yield Master II Index tightened by 24 basis points (bp) on an OAS (option-adjusted spread) basis to 315 bp.

For the quarter, the SMA underperformed the Index on a NAV basis. The Strategy's focus on higher quality bonds detracted from returns versus the Index, as lower-rated credits outperformed during the quarter.

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 too much into risk. Corporate bonds illustrate this dynamic, where spreads are tight but nominal yields are enticing yield-based buyers and healthy fundamental factors can continue to support the sector. We will continue to monitor market developments, assess fundamental factors and stay attuned to macroeconomic trends to capitalize on opportunities in this dynamic and evolving market environment.

The **Bank of America Merrill Lynch High Yield Master II Index** is a market value-weighted index consisting of U.S. dollar-denominated, non-investment grade bonds not currently in default and limits any individual issuer to a maximum of 2% benchmark exposure.

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