Commentary | 1Q24

Voya Intermediate Fixed Income SMA

Multi-Sector Approach Focused on Total Return

Strategy overview

A total return approach, utilizing a multi-sector approach with a higher quality posture through the use of Treasury, agency and corporate credit securities with 1-10 year maturities. The primary drivers of our investment-grade fixed income performance are our positioning for rate trends and sector relative value assessments across governments, mortgagesand corporates.

Key takeaways

- For the quarter, the Voya Intermediate Fixed Income SMA underperformed its benchmark, the Bloomberg Intermediate Government/Credit Index (the Index) on a net asset value (NAV) basis.
- In corporate credit markets, spreads remained resilient.
- Looking ahead, we expect economic growth in the U.S. 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

For the quarter, the Voya Intermediate Fixed Income SMA underperformed the Index on a NAV basis. Our strategy's focus on higher-rated bonds within investment grade (IG) was the primary relative detractor. The strategy's relatively shorter duration profile versus the Index was additive to performance, as rates sold off during the quarter.

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 a 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, fourth quarter 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.

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 U.S. 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 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 fundamental factors, and stay attuned to macroeconomic trends to capitalize on opportunities in this dynamic and evolving market environment.

The **Bloomberg US Intermediate Government/Credit Index** includes fixed rate, dollar-denominated, investment grade securities with maturities of 1-10 years held within both the Bloomberg US Government Index (public obligations of the US Treasury, US Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the US Government) and the Bloomberg US Credit Index (publicly issued US corporate and foreign debentures and secured notes).

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, 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.

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