Voya Securitized Credit Fund

Tap into Voya's Flexible "Through-the-Cycle" Approach

Strategy overview

Invests in fixed income sectors collateralized by distinct asset types: commercial real estate (CMBS), residential housing (RMBS) and non-mortgage assets such as asset-backed securities (ABS).

Key takeaways

- Yields rallied and credit outperformed as continued disinflation allowed the U.S. Federal Reserve to shift their focus to labor market conditions and begin an easing cycle.
- The Strategy underperformed its benchmark, the Bloomberg U.S. Securitized Index (the Index) on a net asset value (NAV) basis. Underperformance was driven by the strategies shorter duration profile, while credit exposure broadly contributed.
- Across markets, we maintain a bias towards sectors backed by real-estate and consumer credit, over sectors backed by corporate credit.

Portfolio review

The labor market continued its path of normalization in the third quarter of 2024, with the number of job openings continuing to decline along with the quit rate reverting to pre-pandemic levels. This cooling was further evidenced by the Non-Farm Payroll (NFP) report, which missed expectations for both July and August. The substantial miss for July, reported in August, coincided with a controversial rate hike by the Bank of Japan, unsettling markets and leading to a sharp widening of credit spreads. However, as investors digested the data, spreads eventually retraced, reflecting a more measured perspective on the total economy.

This moderation in the labor market did not significantly hinder consumer spending, which continued to advance at a decent rate. With elevated home prices and strong equity performance, the wealth effect remained in play however the moderation in the labor market may have been responsible for more measured spending growth, relative to more recent quarters. More broadly, the economy continued to advance at a reasonable pace, as evidenced by 2Q gross domestic product (GDP) growth, which exceeded expectations at 2.80% and was later revised to 3.00%.

Inflation continued its downward trend, with core Consumer Price Index approaching 3% year-over-year, despite the shelter component remaining stubbornly elevated. Core goods prices remained in deflation, while core services inflation decelerated significantly, partially attributable to moderating wage gains. The Fed's preferred measure, Core Personal Consumption Expenditure, displayed an even more favorable environment, reading at 2.7% yoy in August. This disinflationary environment provided the Fed with the flexibility to shift its focus from inflation concerns to labor market conditions.

A pivotal moment came in late August with Jerome Powell's speech at Jackson Hole, signaling a shift towards an easing cycle. The Fed, acknowledging the softening labor market, opted for a 50 basis points (bp) cut at their September meeting, larger than the previously anticipated 25 bp reduction. Powell's influence was evident, with only one Federal Open Market Committee member dissenting. This decision underscored the

Fed's proactive approach to preserving a healthy labor market and broader economic stability.

Yields rallied in response to continued disinflation, with front-end rates falling more significantly than long-end rates. Meanwhile, credit performance was mostly positive, while market leadership was dictated by more sector specific factors.

Asset-backed securities (ABS) was saturated with a high level of new supply, and this dynamic was exacerbated by the traditionally slow summer period. Non-benchmark ABS performed better than benchmark sectors, however excess returns were still limited. From a fundamental perspective, macroeconomic signals were supportive of consumer credit behavior, with a moderating but still solid labor market, strong wage growth and positive economic growth. However, concerns remained, particularly in low income and subprime sub-sectors. Collateralized loan obligations (CLO) performance was also modest, as the floating rate attribute caused the sector to lag sectors with longer duration. Spreads widened slightly amidst a similarly heavy new issue calendar, but fundamental factors remained reasonably stable.

On the other hand, commercial mortgage-backed securities (CMBS) were a significant benefactor of the Fed's actions and the resulting rate rally. Within the sector, non-agency outperformed agency and subordinates outperformed seniors as credit appetite was strong. New issuance increased, reflecting improved financial conditions and the recovery of the CMBS and commercial real estate (CRE) credit cycle. Despite the elevated supply, the market was able to absorb it, indicating strong demand and new sources of capital.

Non-agency RMBS also posted positive performance in the third quarter, driven by a feedback loop of lower rates leading to higher total returns and tighter credit spreads. Consistent with this dynamic, credit risk transfer (CRT) (floating-rate) underperformed fixed-rate sub-sectors. While the sector is further along in its credit and market cycle compared to CMBS, residential mortgage credit continued to benefit from a variety of positive fundamental factors, including record high home prices, healthy borrowers, affordable mortgage rates and a resilient labor market. Meanwhile, lower rates have brought prepayment assumptions for non-agency RMBS back into consideration—bullish for credit risk.

In conclusion, the third quarter of 2024 was characterized by a gradual moderation in the labor market, further easing of inflation, and a proactive shift in monetary policy by the Fed. These factors positively influenced market dynamics, resulting in a period of strong returns for securitized credit investors.

For the quarter, the Strategy underperformed its benchmark, the Bloomberg US Securitized Index on a NAV basis. Underperformance was driven by the strategy's shorter duration profile, while credit exposure broadly contributed.

Current strategy and outlook

As we look ahead to the fourth quarter of 2024, we expect the theme of "normalization" to continue shaping the economic landscape. We anticipate growth will stabilize close to trend levels, remaining positive but likely decelerating from the robust pace seen in recent quarters. This dynamic will be driven largely by consumer spending, which, while expected to slow, will continue to be supported by a relatively strong (albeit moderating) labor market and a favorable wealth effect stemming from elevated asset prices.

We project inflation will continue its decline, but at a slow pace and ultimately settling above the Fed's target. Goods inflation is expected to remain at 0% or lower, as consumption growth moderates from historically high levels. Services inflation is likely to continue decelerating as the labor market continues to rebalance and wage growth eases further. Additionally, we anticipate that the shelter component of inflation will eventually align more closely with real-time indicators from sources like Zillow, Apartment List and Yardi, further contributing to the easing of inflationary pressures.

Overall, we expect these dynamics to be broadly positive for securitized credit sectors, however our degree of optimism remains influenced by more sector specific factors.

Mortgage credit behavior remains insulated by a variety of factors, including record high home prices, healthy borrowers, affordable mortgage rates and a resilient labor market. While home prices remain vulnerable in our assessment (due to distorted supply and demand dynamics), we would expect any impact on credit spreads to be short lived and would view it as an opportunity to add risk.

In CMBS, improved financial conditions have helped restore fair value in CMBS and reduced 'easy money' opportunities. However, collateral based security selecting should continue to drive further outperformance as remaining problem loans resolve.

A saturated and fatigued ABS investor base will likely to feel relief as seasonals and the election cycle foster lighter new issuance into 4Q. Improving technical conditions will better ensure the sector's attribute as a safe-haven allocation amidst bouts of market volatility. Risk in sub-sectors with low-income consumer cohorts remain vulnerable, particularly as labor markets moderate; defensive positioning here is warranted, even with the improved rate backdrop.

CLOs remain in late cycle, in our assessment, however the probability of a 'hard landing' or credit-oriented recession appears low. That said, the more attractive environment for duration could lead to investor attrition, which when combined with elevated issuance—particularly from refi's and resets— could move spreads wider.

As of quarter end, non-agency RMBS and CRT represents our top allocation, followed closely by CMBS. Meanwhile, our allocation to CLOs remains relatively low and more concentrated in higher quality (>A rated) tranches.

In summary, as we enter the final quarter of 2024, our economic outlook is characterized by a continued normalization process, with stable growth supported by consumer spending and a moderating labor market backdrop. Across markets, we maintain a bias towards sectors backed by real-estate and consumer credit, over sectors backed by corporate credit. That said, we remain vigilant, ready to adjust our positioning in response to an evolving landscape.

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