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

- Risk assets performed, and risk-free assets struggled in 1Q24.
- The Strategy outperformed its benchmark, the Bloomberg U.S. Securitized Index (the Index) on a net asset value (NAV) basis. Non-agency residential mortgage-backed securities (RMBS) and credit risk transfer (CRT) was the top contributor, followed closely by commercial mortgage-backed securities (CMBS).
- We view non-agency RMBS and CRT as the most actionable opportunity as the sector remains insulated by "golden handcuffs", tight labor markets and buffered by historically high homeowners' equity.

Portfolio review

For the quarter ended March 31, 2024, the Strategy outperformed the Index on a NAV basis. Non-agency RMBS and CRT was the top contributor, followed closely by CMBS.

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' guidance, suggesting a growing consensus on the future direction of monetary policy and a rejection of a more significant pivot that was priced in at the start of the year.

Securitized credit sectors outperformed, while agency mortgage-backed securities (MBS) lagged. Benchmark asset backed securities (ABS) generated solidly positive excess returns during 1Q24, outperforming the broader Index. However, and perhaps predictably, the space lagged longer and traditionally more volatile credit risk sectors. On

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a total return basis, the sector's shorter duration profile allowed for a positive result, outperforming longer duration sectors. Non-benchmark ABS delivered positive excess and total returns across sub-sectors and did so more substantially than the benchmark sectors. Commercial loan obligations (CLOs), enjoyed their floating rate attribute, fostering strong total return outperformance amidst the risk-on credit backdrop. Spread tightening was substantial, with option adjusted spread (OAS) –42 basis points (bp) driving price return and high front-end rates driving coupon return. For the quarter, spreads tightened across tranche ratings in a pronounced credit curve flattener, consistent with overall risk-on market conditions. CMBS remains in the de-leveraging part of its credit cycle, but has benefited from the easing of financial conditions and is advancing into its recovery phase. Benchmark CMBS generated solid excess returns and total returns. On an excess return basis, non-agency CMBS outperformed agency CMBS, reflecting stronger sentiment and liquidity. Non-agency RMBS remained in risk-on mode, alongside CLOs as the strongest total returner within securitized markets and besting even CLOs in excess returns. Its credit cycle is in a firmly different phase than corporate real estate (CRE), supported by a confluence of positive fundamental factors. The space has not suffered from regional banking distress and has been a benefactor of the work-from-home phenomenon. Current mortgage rates, while off the highs, remain a distinct headwind via lower prepays for discount priced bonds and challenged affordability for buyers, keeping new RMBS issuance low.

Non-agency RMBS and CRT was the top contributor, followed closely by CMBS. Within non-agency RMBS and CRT, Jumbo 2.0 was the main contributor followed by CRT and investor collateral. Within CMBS, agency resecuritization of real-estate mortgage investment conduits (ReREMICs) led the contribution while below-investment grade conduits detracted. ABS also contributed (with whole business and student loans as the leading subsectors) as did CLOs.

Current strategy and outlook

Somewhat extended housing market rally is vulnerable as improved financial conditions triggers selling pressure; crippling affordability is the key ingredient for home price declines if and as supply increases. Regardless, mortgage credit behavior remains insulated by "golden handcuffs" of <4% mortgages, tight labor markets and buffered by historically high homeowners' equity. Rock-bottom prepayment speeds remain priced and limited new issuance keep market technical factors favorable. We see RMBS continuing to outperform and maintain a 34% allocation.

With the trough seemingly in for CMBS valuations, will broader CRE follow? More pain to come, seemingly, as stubbornly higher rates harm refinancing prospects and force lenders to reckon with defaults and lower valuations. Offices remain ground zero for stress; attractive opportunities for taking credit risk across retail, industrial and multifamily deals are here. We maintain a 35% allocation to CMBS but expect excess returns to be driven by security selection, as opposed to a broader tightening of spreads.

ABS issuers are monetizing fully-scaled investor affinity via historically high new issuance. This apparent 'harmony' between issuers and investors driving a bonified 'virtuous cycle' of reliable primary market execution inspiring more issuance which attracts more durable capital with attractive return opportunities. We expect this sector to produce strong risk-adjusted-returns and maintain a 13.5% allocation.

With 'hard landing' risk diminished, CLOs have delivered sustained outperformance, even as broader fixed income returns buckled under higher rates. Issuance - both new and refi/reset - has fully resumed and been well received. However, this apparent 'harmony' is assessed as fragile, and will be challenged by slower economic growth and increased potential for rate cuts during the second half of 2024. CLOs remain the securitized sector most vulnerable to a turn in the cycle. Robust structural protections will help insulate the space from a deep credit cycle, but expect more vol in this 'late cycle' sector. Our allocation here remains on the lower end of its historical range, and more heavily concentrated up the stack.

The **Bloomberg U.S. Securitized MBS/ABS/CMBS and Covered Index** includes the MBS, ABS, and CMBS sectors. Indexes do not reflect fees, brokerage commissions, taxes or other expenses of investing, and investors cannot directly invest in an index.

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