Voya Investment Grade Credit Strategy

Focus On Total Return Driven By Security Selection Through US Investment Grade Corporate Bonds

Strategy overview

The Investment Grade Credit strategy seeks to maximize total return over a full market cycle via rigorous security selection and a duration-neutral approach to discovering risk-adjusted opportunities across the full range of U.S. investment grade corporate bonds.

Performance

For the quarter ending June 30, 2024, the Strategy outperformed its benchmark, the Bloomberg U.S. Corporate Index (the Index), on both gross- and net-of-fees basis.

Key takeaways

- Stocks delivered positive returns in the second quarter while bonds finished flat to slightly down as rates closed slightly higher after intra-quarter volatility.
- The Strategy outperformed its benchmark in in the second quarter on both gross- and net-of-fees basis.
- We continue to like investment grade (IG) from a yield perspective, but we remain cautious at current tight spread levels.

Market review

Despite intra-quarter volatility, risk assets largely produced positive returns led by equity markets while bond markets ended flat to slightly negative in the second quarter. Volatility early in the quarter was driven by continued solid economic growth data in the United States, resilience in labor markets and an uneven decline in inflation data. This led a bouncing around of both interest rates as well as expectations of potential U.S. Federal Reserve cuts later in the year. Heading into June, economic and payroll data began showing signs of weakness, while the May Consumer Price Index (CPI) report surprised to the downside, which resulted in a decline in yields from their peak. By the end of the quarter, the yield on the U.S. 10-year Treasury closed 20 basis points (bp) higher overall at 4.40% but off its peaks seen earlier in the period.

IG spreads closed the quarter 4 bp wider to an option-adjusted spread (OAS) of 94 bp, with all the widening occurring in June after spreads hit local tights in May. Spreads are now just 5 bp tighter year to date (YTD). The Bloomberg US Corporate Index finished with total returns of –0.09% in the second quarter, bring the YTD total return to –0.49%. Financials was the best performing sector on the quarter, outpacing industrials and utilities. From a quality perspective, BBB rated issuers continued to outperform higher quality, while the credit curve modestly steepened on the quarter as the long end lagged the front and intermediate segments.

An investor should consider the investment objectives, risks, charges and expenses of the Fund(s) carefully before investing. For a free copy of the Funds' prospectus, or summary prospectus, which contains this and other information, visit us at www.voyainvestments.com or call (800) 992-0180. Please read the prospectus carefully before investing.

Performance review

The Strategy outperformed the benchmark in second quarter of 2024 on both gross- and net-of-fees basis. Security selection drove outperformance for the quarter led by holdings across financials and industrials, while utilities were flat. Within financials, banking was the top contributor to outperformance as the Strategy benefitted from key overweight positions in select U.S. regional and money center banks, as well as select overweights to European and Canadian banks. Selection within the insurance sector, notably holdings in life as well as property and casualty (P&C) insurers, was also additive to outperformance. Within industrials, the Strategy benefitted from several small contributions across holdings in a variety of sectors including consumer cyclicals, technology, communications and capital goods. From a quality perspective, outperformance was driven by selection in high conviction BBB rated issuers, while holdings in both single-A and BB-rated buckets also added to relative results. Sector allocation detracted from relative performance driven primarily by the Strategy's allocation to Treasuries and cash, which acted as a drag on returns with corporate bonds outpacing treasuries during the quarter.

We entered the quarter with a cautious stance and positioned the portfolio modestly long risk relative to the benchmark in order to participate in periods of spread compression but protect the portfolio should spreads widen. As spreads tightened through the first two months, we reduced risk in the portfolio and increased our position in Treasuries and cash in order to have dry powder to deploy at more attractive spread levels. As spreads widened in June, we were active in selectively adding risk to the portfolio across select industries such as banking, consumer cyclical and non-cyclical, as well as technology, primarily via the new issue market. We continue to prefer financials over industrials, while maintaining a market weight posture in utilities. From a quality perspective, we increased our overweight to BBB-rated issuers and modestly added select high yield names focused on highest conviction ideas, while remaining underweight single-A rated issuers. On the curve, we maintained an overweight to the 7-10 year segment as valuations remain attractive and slightly reduced our underweight to the long end late in the period as the credit curve steepened in June.

Outlook and current strategy

Credit fundamental factors remain solid and will continue to strengthen in 2H24 but are unlikely to be a key driver of spreads unless growth weakens meaningfully. The macro outlook remains supportive despite the expected slowdown in economic growth, as expectations of Fed cuts later in the year have increased amid cooling inflation and signs of softening in labor markets. While we saw some deterioration in select credit metrics, such as lower earnings before interest, tax, depreciation and amortization (EBITDA) growth driven mostly by commodity sectors and a decline in interest coverage as a result of higher rates, companies have responded by reducing shareholder payouts and moderating capex spending, both creditor-friendly trends. Looking forward, revenue and earnings are expected to grow at a healthy clip through the rest of 2024 which will stabilize credit ratios. Furthermore, upgrades have continued to outpace downgrades in the first half of the year, which we expect to continue albeit at a slower pace.

The technical environment for IG looks more mixed heading into the second half of the year. Primary markets have been extremely robust this year with about $850 billion in new supply, the second highest half year for new supply on record. Net supply in the second half of the year is still expected to slow but more modestly than originally expected, as falling rates will likely bring some more opportunistic issuance. Additionally, while demand for IG has remained strong, the decline in yields has led to a modest slowdown in inflows to the asset class. We continue to expect technical factors to be a key driver of spreads.

We continue to like IG from a yield perspective, but we remain cautious at current tight spread levels. Spreads widened modestly in June after reaching YTD tights in May, closing the quarter at an OAS of 94 bp. We continue to expect spreads to trade sideways in the intermediate term and look to add incremental risk to the portfolio in periods of spread widening. We continue to like financials as we believe the sector still has room to compress relative to industrials. Within industrials, we like communications and technology and see room for further spread compression in favored BBB-rated names. On the curve, we prefer the 7-10-year segment over the front and long-ends. With supply expected to be slightly higher in the coming months, the new issue calendar will continue to provide opportunities to recycle risk in the portfolio while we maintain a relatively low risk posture versus the benchmark, which will allow us to add risk into a backup in spreads if an opportunity materializes.

The **Bloomberg U.S. Corporate Index** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers. This index is a component of the US Credit and US Aggregate Indices, and provided the necessary inclusion rules are met, US Corporate Index securities also contribute to the multi-currency Global Aggregate Index. Index returns do not reflect fees, brokerage commissions, taxes or other expenses of investing. Investors cannot invest directly in an Index.

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