Commentary | 1Q25

Voya Target Solution Trust Series

Multi Asset Strategies and Solutions

Strategy overview

These portfolios are only offered as an investment option within variable products and retirement programs.

Key takeaways

- U.S. stocks fell due to policy uncertainty and artificial intelligence (AI) spending concerns. Overseas, international equities gained, especially in Europe and China, driven by economic improvements and policy support. Despite volatility, the U.S. economy remains strong but faces risks from new tariffs, highlighting the need for portfolio diversification.
- The Trump administration's trade policies and legal battles have created uncertainty, leading to cautious corporate spending and a decline in consumer confidence, slowing economic growth. Despite this, the U.S. economy remains strong with low unemployment, and we favor U.S. equities for potential earnings growth. In fixed income, we remain neutral on U.S. investment grade (IG) credit, expecting yields to decline if economic growth worsens, providing a hedge against equity risk.
- The Trusts posted mixed absolute and positive relative returns for the period, outperforming their strategic allocation benchmarks on both gross- and net-of-fees basis.

Market review

U.S. stocks fell during the quarter, as policy uncertainty and warnings of a pullback in AI data center spending dampened investor sentiment. The energy and healthcare sectors led, while the consumer discretionary and technology sectors lagged. Large caps held up better than small caps, while value stocks outpaced growth. In contrast, U.S. bonds rallied driven by growing concerns over economic growth, leading to a flight to safety.

Overseas results were better, as international developed and emerging market (EM) equities posted gains. Europe benefitted from improving economic data, falling inflation and growing expectations of policy support from the European Central Bank (ECB) and German government spending. Additionally, the U.S. dollar fell, boosting returns on foreign assets. China also performed well, as breakthroughs in AI, government stimulus measures and improved economic data boosted investor confidence.

Despite significant market volatility and policy shifts, the U.S. economy enters a new paradigm with a healthy starting point. The labor market remains solid, inflation is manageable and companies continue to post impressive earnings. However, the outlook is clouded by new tariffs and the uncertainty of their final levels, making it challenging for companies to navigate the ongoing trade war and operate effectively. In the near term, tariffs may slow growth, boost inflation and erode profits. In this environment, forecasting becomes more difficult, and it is important to diversify portfolios to perform under multiple outcomes.

Outlook

The Trump administration's aggressive trade policies and ongoing legal battles over executive orders have created a challenging environment for businesses and consumers. The resultant uncertainty has led to more cautious corporate spending and hiring, and a decline in consumer confidence. Economic growth has already slowed, and inflation progress has been limited, raising concerns about potential stagflation.

You should consider the investment objectives, risks, and charges and expenses of the variable product and its underlying fund options; or mutual funds offered through a retirement plan, carefully before investing. The prospectuses / prospectus summaries / information booklets contain this and other information, which can be obtained by contacting your local representative or by calling (800) 992-0180. Please read the information carefully before investing.

However, the U.S. economy enters this period of tumult from a position of strength with an unemployment rate near historic lows, which should help it weather this transition. Despite the correction, we continue to favor U.S. equities due to expectations that they will protect profit margins despite rising input costs and deliver earnings growth over the next 6 to 12 months. Furthermore, high-quality companies' valuations have been repriced and could recover with any renegotiated trade deals, deregulation or progress on tax cuts. While earnings downgrades are possible, we think they will be short lived.

The shift in Europe, particularly Germany's increased defense and infrastructure spending, has sparked a rally. However, we question if this defense spending can translate into productivity enhancing output. Europe's demographic challenges and regulatory issues remain significant obstacles. As a result, portfolios remain neutral on international equities. We see EM, particularly China, as the most exposed to adverse changes in U.S. trade policy. China has already responded with retaliatory tariffs and can inflict significant damage to the United States. But the state of the domestic economy constrains them from unleashing all available firepower. Despite record low interest rates and yields, credit growth is meager, their property sector remains over leveraged and consumer spending is weak. While we expect authorities will unveil fiscal stimulus to offset U.S. tariffs, they remain underweight until there is tangible action.

In fixed income, portfolios remain neutral on U.S. IG credit, which offer decent yields and portfolio stability. Spreads have widened, but relative to equities, the sell-off has been tame, reflecting the overall strong financial position of U.S. corporations. Although higher inflation could increase rates, we think yields will decline if there is a material deterioration in economic growth, providing a hedge against equity risk. We expect the Bank of Japan (BoJ) to continue rate hikes, EUR/USD to weaken and eurozone periphery spread widening.

Positioning

At the beginning of the period, Trusts held modest tactical equity underweights and fixed income overweights relative to their strategic allocation benchmarks. Trusts were also tactically overweight to U.S. mid-cap equities, EM equities and short-term bonds, and underweight in U.S. large-cap and small-cap and international developed stocks. As part of its annual review toward the end of February, the Trusts enacted their glide downs, leading to lower equity weights in the 2050-2025 vintages. At the same time, the Trusts' strategic asset allocations were reset, with all tactical positions at the beginning of the period being subsumed into the revised strategic asset allocation, thereby becoming longer-term views.

Additionally, there were several tactical trades implemented during the period. In January, we extended duration in far-dated vintages by adding 5-year U.S. Treasuries funded by 3-month bills to cover an underweight position. Both fundamental and technical models suggested that rates were at an attractive entry point, and this move also served as a hedge against growth risks in the face of policy uncertainty. In February, we increased our exposure to U.S. large cap equities by selling fixed income, as we saw a durable earnings cycle and believed that much of the tariff noise had already been factored into valuations, improving the near-term risk to reward profile. We also added the Health Care Select SPDR ETF and decreased core fixed income. The healthcare sector has been trading at a significant valuation discount, but higher-frequency fundamental factors have improved. We believe this sector can serve both a defensive role due to its stable earnings and an offensive role as it rerates with a stronger fundamental outlook and potential margin benefits from AI adoption. In March, we increased our exposure to small-cap equities and decreased short-term bonds, as the underperformance of U.S. equities and recession risks appeared exaggerated.

Overall, Trusts continue to maintain a balanced posture between equity and fixed income, with overweights to U.S. large cap, U.S. mid cap and core IG bonds, and underweights in U.S. small cap, international equites and international bonds.

During the period, we made two manager changes. First, we replaced Polaris Capital International Value with Acadian ACWI ex US Value Equity. We decided to replace Polaris due to unexpected team changes, a loss of confidence in their ability to evolve their investment process, and disappointing performance. Acadian, a high-conviction manager with whom we have a long-standing relationship in other mandates, better aligns with our desired investment style, focusing on traditional value with a smaller size bias. Second, we replaced MFS Growth Equity with Macquarie Large Cap Growth. After working with MFS since the inception of our CIT Target Date suites, we chose Macquarie for its more defensive posture, which better complements Sands Capital, our other more aggressive large cap growth manager.

Performance

The Voya Target Solution Trusts' primary performance objective is to outperform its strategic allocation composite benchmark over the long-term through tactical asset allocation, i.e., deviating from the composite benchmark over the short and medium-term and active manager selection. The benchmark return is the weighted average return of indices that represent asset classes included in the strategic allocation benchmark. Index returns are gross-of-all fees. The Trusts are generally rebalanced monthly and the strategic asset allocations are updated annually to reflect changes to our capital market assumptions. In the fourth quarter of 2024, Trusts' outperformed their strategic allocation benchmarks. Tactical asset allocation was a detractor, but manager selection contributed.

Tactical asset allocation had a negative impact on performance during the period. Trusts' tactical underweights in U.S. large cap and overweights to EM equities was the main detractor, as large U.S. stocks delivered another period of positive performance, helped by continued strong corporate earnings and despite sharply rising long-term interest rates. EM equities struggled due to geopolitical tensions, economic uncertainties in key regions and a stronger U.S. dollar.

Underlying managers' relative results were positive across the Trusts. Strategies that contributed most to excess returns in the quarter were Voya Mid Cap Growth, Voya Large Cap Value and Wellington International Opportunities. The biggest detractors in the quarter were Voya VACS Series MCV, MFS Growth Equity and Voya VACS Series EME.

Disclaimer

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