Getting Out of the Cash Comfort Zone with Unconstrained Fixed Income

With cash yields continuing to decline, it could be time to consider shifting to a flexible, broadly diversified fixed income strategy.

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Since the Federal Reserve pushed interest rates higher in 2022 to tame inflation, cash securities and money market funds have attracted investors looking to generate income and sidestep market volatility. **But with cash yields off their peak (and set for a further decline with interest rate cuts expected this month and beyond), what's the best way to continue to generate attractive income and lock in higher yields?**

Moving some of that cash into a traditional bond fund consisting of government bonds and high-quality corporate debt is one idea. Another possibility—one that we think could be even more effective—is to **pair a core bond strategy with a nontraditional (or unconstrained) bond fund.**

Cash has been comfortable, but its yield advantage is fleeting

Cash has been a great parking spot for many investors during the past few years, but this will no longer be the case when the Fed continues its rate-cutting cycle this month, with further cuts expected through year end. And **when rate cuts arrive, cash returns will fall fast.** Keeping a substantial portion of a long-term portfolio in cash also comes with an opportunity cost: limiting long-term growth potential by holding an asset whose yield moves in tandem with interest rates, rather than one whose yield moves in an opposite direction.

Forward-looking analysis shows that unconstrained bonds could outperform cash in many scenarios

Historically, bond yields have been good predictors of future returns.

To illustrate why moving a portion of cash into an unconstrained bond fund now is worth considering, let's look at how such a fund might perform in various interest rate and credit spread scenarios in the next 12 months. Our analysis uses a sample unconstrained bond portfolio and we've erred on the conservative side by assuming that cash will continue to yield 4% over the next 12 months (even though we expect the Fed to begin cutting rates this month, which would result in a decline in cash yields) (Exhibit 1).

For the scenarios shown (a +/-200 basis point [bp] change in rates and a +/-100 bp change in spreads), the sample portfolio has a median return of 6.03% over the next 12 months and outperforms cash in 81% of outcomes. **Notably, if credit spreads remain unchanged, the sample portfolio could absorb up to a 150 bp increase in rates and still outperform cash.**

Exhibit 1: A broadly diversified unconstrained bond fund should outperform cash in many interest-rate scenarios

Sample unconstrained bond portfolio projected performance over 12-month time horizon

Return greater than 5.0%
Return between 3.5%–5.5%
Return less than 3.5%

Change in spreads (bp) \ Change in interest rates (bp)	-200	-175	-150	-125	-100	-75	-50	-25	0	25	50	75	100	125	150	175	200
-100	10.69%	10.40%	10.11%	9.81%	9.52%	9.23%	8.94%	8.64%	8.35%	8.06%	7.77%	7.47%	7.18%	6.89%	6.60%	6.30%	6.01%
-75	10.11%	9.82%	9.53%	9.23%	8.94%	8.65%	8.36%	8.06%	7.77%	7.48%	7.19%	6.89%	6.60%	6.31%	6.02%	5.72%	5.43%
-50	9.53%	9.24%	8.95%	8.65%	8.36%	8.07%	7.78%	7.48%	7.19%	6.90%	6.61%	6.31%	6.02%	5.73%	5.44%	5.14%	4.85%
-25	8.95%	8.66%	8.37%	8.07%	7.78%	7.49%	7.20%	6.90%	6.61%	6.32%	6.03%	5.73%	5.44%	5.15%	4.86%	4.56%	4.27%
0	8.37%	8.08%	7.79%	7.49%	7.20%	6.91%	6.62%	6.32%	6.03%	5.74%	5.45%	5.15%	4.86%	4.57%	4.28%	3.98%	3.69%
25	7.79%	7.50%	7.21%	6.91%	6.62%	6.33%	6.04%	5.74%	5.45%	5.16%	4.87%	4.57%	4.28%	3.99%	3.70%	3.40%	3.11%
50	7.21%	6.92%	6.63%	6.33%	6.04%	5.75%	5.46%	5.16%	4.87%	4.58%	4.29%	3.99%	3.70%	3.41%	3.12%	2.82%	2.53%
75	6.63%	6.34%	6.05%	5.75%	5.46%	5.17%	4.88%	4.58%	4.29%	4.00%	3.71%	3.41%	3.12%	2.83%	2.54%	2.24%	1.95%
100	6.05%	5.76%	5.47%	5.17%	4.88%	4.59%	4.30%	4.00%	3.71%	3.42%	3.13%	2.83%	2.54%	2.25%	1.96%	1.66%	1.37%

As of 07/31/25. Source: Bloomberg Index Services Ltd., JP Morgan, Morningstar Direct, Voya IM. Sample portfolio assumes a yield-to-worst of 6.03%, interest rate duration of 2.17 years and credit spread duration of 3.32 years. Return calculations shown in table assume instantaneous moves for interest rates and/or spreads.

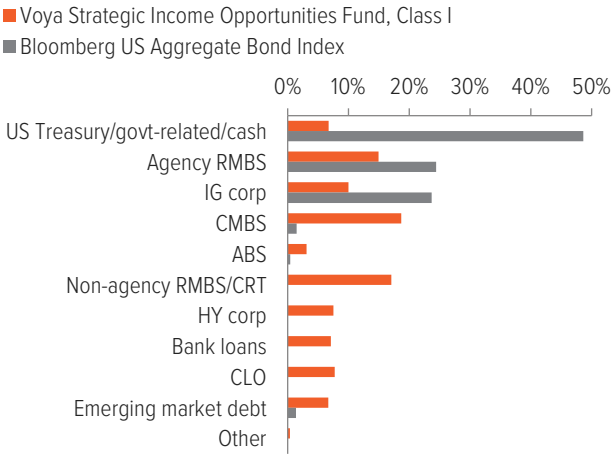
Unconstrained bonds can enhance fixed income portfolios

While a core or core plus bond fund is likely to be the anchor of a fixed income allocation, **adding an unconstrained bond fund may help boost return potential, diversify exposure and increase the resilience of the allocation.** Here's how.

Enhanced yield opportunities without the constraints of a benchmark

Unlike a traditional bond fund, an unconstrained bond fund can seek opportunities for improving yield and mitigating risk without the confines of a benchmark. An unconstrained bond fund manager often has greater flexibility than a traditional bond fund manager to adjust exposures to a broader array of fixed income sectors, shift the portfolio's average credit quality, modify geographical exposure, and fine-tune interest rate sensitivity based on their view of the economy.

Exhibit 2: Adding unconstrained bonds to a traditional core bond allocation provides more diversified sources of potential return

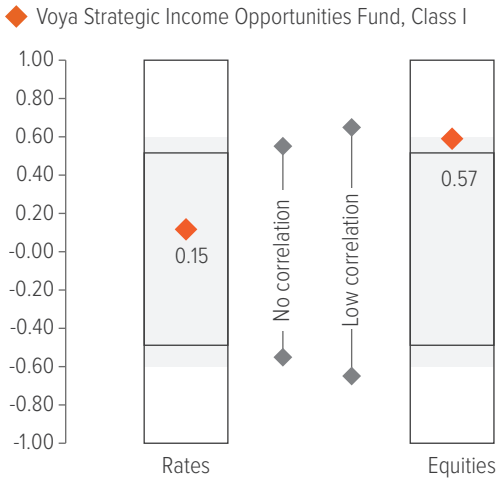


Source: Bloomberg Index Services Ltd., Voya IM. **Past performance does not guarantee future results. Investors cannot invest directly in an index.**

Diversification from traditional bonds and equities

Because it incorporates assets with low correlations to stocks and traditional bonds, **an unconstrained bond fund is less likely to mirror broad market downturns, while increasing portfolio stability and mitigating volatility.**

Exhibit 3: The Voya Strategic Income Opportunities Fund has low correlations to rates and equities

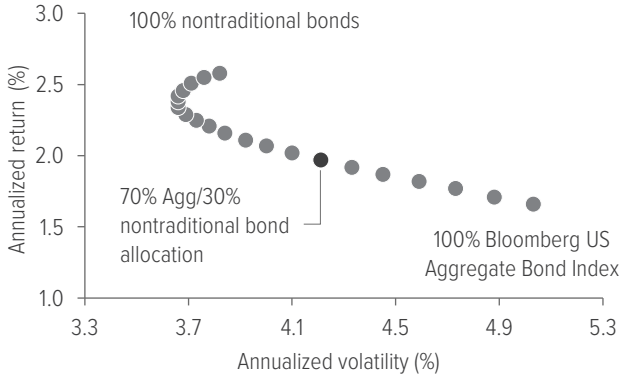


As of 12/31/24. Source: Bloomberg Index Services Ltd., Standard & Poor's, Voya IM. Rates represented by Bloomberg US Treasury Index. Equities represented by S&P 500® Index.

Better long-term total return potential with less risk than core bonds alone

Our research shows that combining an allocation to unconstrained bonds with an allocation to core bonds creates a more efficient portfolio—**higher returns, lower risk**—than a standalone allocation to core bonds.

Exhibit 4: Pairing unconstrained bonds with core bonds can lower portfolio volatility and increase returns



Source: Morningstar Direct, Bloomberg Index Services Ltd., Voya IM. Nontraditional bonds represented by the Morningstar® Nontraditional Bond category. Core bonds represented by Bloomberg US Aggregate Bond Index. Efficient frontier represented by a portfolio that blends core bonds and nontraditional bonds in 5% increments. Portfolios are rebalanced annually back to target weights at calendar year end. **Past performance does not guarantee future results. Investors cannot invest directly in an index.**

A note about risk

All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield inherent in investing. You could lose money on your investment and any of the following risks, among others, could affect investment performance. The following principal risks are presented in alphabetical order which does not imply order of importance or likelihood: Bank Instruments; Company; Convertible Securities; Credit; Credit Default Swaps; Currency; Deflation; Derivative Instruments; Environmental, Social, and Governance (Fixed Income); Floating Rate Loans; Foreign (Non-U.S.) Investments/ Developing and Emerging Markets; High-Yield Securities; Inflation-Indexed Bonds; Interest in Loans; Interest Rate; Liquidity; Market; Market Capitalization; Market Disruption and Geopolitical; Mortgage- and/or Asset-Backed Securities; Other Investment Companies; Preferred Stocks; Prepayment and Extension; Securities Lending; Sovereign Debt; U.S. Government Securities and Obligations. Investors should consult the Portfolio's Prospectus and Statement of Additional Information for a more detailed discussion of the Portfolio's risks. The strategy employs a quantitative investment process. The process is based on a collection of proprietary computer programs, or models, that calculate expected return rankings based on variables such as earnings growth prospects, valuation, and relative strength. Data imprecision, software or other technology malfunctions, programming inaccuracies and similar circumstances may impair the performance of these systems, which may negatively affect performance. Furthermore, there can be no assurance that the quantitative models used in managing the strategy will perform as anticipated or enable the strategy to achieve its objective.

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Morningstar® Categories: Intermediate Core-Plus Bond Fund: Funds investing primarily in corporate and other investment-grade U.S. fixed-income issues with an average duration of 3.5 to 6 years or (if duration is unavailable) an average effective maturity of 4 to 10 years. Nontraditional Bond Fund: Funds that pursue strategies divergent in one or more ways from conventional practice in the broader bond-fund universe. Many funds in this group describe themselves as "absolute return" portfolios, which seek to avoid losses and produce returns uncorrelated with the overall bond market; they employ a variety of methods to achieve those aims. Another large subset are self-described "unconstrained" portfolios that have more flexibility to invest tactically across a wide swath of individual sectors, including high yield and foreign debt, and typically with very large allocations. Funds in the latter group typically have broad freedom to manage interest rate sensitivity, but attempt to tactically manage those exposures in order to minimize volatility. The category is also home to a subset of portfolios that attempt to minimize volatility by maintaining short- or ultra-short duration portfolios, but explicitly court significant credit and foreign bond market risk in order to generate high returns. Funds within this category often will use credit default swaps and other fixed income derivatives to a significant level within their portfolios. Bank Loan: Funds investing primarily in floating-rate bank loans instead of bonds. In exchange for their credit risk, these loans offer high interest payments that typically float above a common short-term benchmark such as the London Interbank Offered Rate, or Libor. High Yield Bond: Funds investing primarily in U.S. high-income fixed-income securities where at least 65% of bond assets are not rated or are rated by a major agency such as Standard & Poor's or Moody's at the level of BB (considered speculative for taxable bonds) and below. World Bond: Funds that seek income by investing in fixed-income securities all over the world. Some funds invest exclusively outside the U.S., while others regularly invest in both U.S. and non-U.S. bonds. Short-Term Bond: Funds investing primarily in corporate and other investment-grade U.S. fixed-income issues with an average duration of 1 to 3.5 years or (if duration is unavailable) an average effective maturity of 1 to 4 years.

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