

Unconstrained Fixed Income

Strategy overview

Unconstrained and flexible approach, investing broadly across the global debt markets.

Key takeaways

- Bond markets ended the year with a spirited rally, with expectations not only that the U.S. Federal Reserve done raising rates, but rate cuts were on the horizon.
- The Strategy outperformed its benchmark, the ICE BofA USD 3M Deposit Offered Rate Constant Maturity Index (the Index), on a net asset value (NAV) basis. Duration and yield curve positioning as well as sector allocations drove returns, while security selection was positive, yet mixed.
- As the market focus shifts from inflation to growth concerns, duration will become an effective offset to risky asset drawdowns.

Portfolio review

For the quarter ended December 31, 2023, the Strategy outperformed the Index on a NAV basis. Duration and yield curve positioning as well as sector allocations drove returns, while security selection was positive, yet mixed.

Rates continued to sell-off into October as strong economic data faded hopes for a Fed “pivot”. In particular, the labor market showed significant strength, with September’s payroll data reporting an impressive pace of job gains. This was followed by the initial reading for third-quarter gross domestic product growth which exceeded already elevated expectations, coming in well above trend. By the end of October, the 10-year Treasury yield had breached 5%, a level not seen since 2007. As rates moved higher, credit spreads widened reflecting the increased risk that comes with a prolonged period of restrictive policy.

Then came November and with it, a notable turn in sentiment. Inflation data, which had already been declining for several months, continued to decline resulting in more balanced market expectations. One Fed governor even suggested the possibility of rate cuts ahead of reaching the 2% inflation target. Additionally, while payroll gains remained strong, they were more measured over the next couple of months, and September’s blockbuster gain was revised downward by a meaningful amount. As a result, rates rallied, and credit spreads tightened.

In the final month of the quarter, the Fed appeared to confirm renewed market expectations that a less restrictive stance was in the near future. The updated dot plot showed that every single participant believed the hiking cycle had concluded, and the median participant projected 75 basis points worth of cuts in 2024. This affirmation from the Fed further contributed to the tightening of credit spreads, and a fall in rates. The experience of November and December stood out from the first 10 months of the year. Rates experienced a significant decline, and the Bloomberg US Aggregate Index rallied, resulting in a 6.82% return for the quarter, with more than 4% coming from November alone. One thing that was consistent throughout the year was that lower credit sectors produced strong excess returns however even higher quality sectors posted respectable outperformance. For example, agency mortgage-backed securities (MBS), which struggled earlier in the quarter due to inconsistent demand, rallied into falling rate volatility and ended the quarter on a high note.

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.

Duration and yield curve positioning as well as sector allocation drove outperformance, and security selection was a small contributor.

The brisk rally into year-end, meant outperformance was propelled by both our duration and yield curve positioning as well as our exposures across corporate and securitized sectors. High yield (HY) was the largest individual contributor, as the sector's higher beta benefited from the risk-on tone across financial markets. Agency residential mortgage-backed securities (RMBS) and non-agency RMBS were also notable contributors. Agency RMBS benefited from the rally in rates as well as the decline in rate volatility, while non-agency RMBS remained supported by the strength in the U.S. housing market. Security selection results were mixed, and in aggregate added to performance. Asset-backed securities (ABS) security selection that included off-benchmark subsectors and higher yielding collateralized loan obligations (CLO) contributed to security selection. Meanwhile, selection within agency MBS detracted, as our investments in off-benchmark collateralized mortgage obligations (CMO) did not keep up with the strong rally in benchmark MBS. Commercial mortgage-backed securities (CMBS) security selection also detracted due to idiosyncratic events within more credit sensitive investments. During the period, the most notable change in allocations included an increase in agency RMBS, as we think the sector offers attractive high-quality income. We have been tactical in this sector throughout the year and expect that to continue in the period ahead. Other changes were modest, with small reductions in our allocations within ABS, with a focus on trimming higher-yielding CLOs as well as a small reduction in allocations to CMBS. Overall portfolio duration was reduced and ended the period at 2.27 years, which is closer to our strategic target.

Current strategy and outlook

Looking forward, the outlook has improved marginally, however we still expect growth to slow below trend. The increased cost of capital will likely curb consumption and investment, however ongoing government support measures at a global level are expected to partially offset these effects. In particular, China's growth focused investment and advanced economies efforts to enhance supply chain security are anticipated to bolster growth in the short term.

As the market focus shifts from inflation to growth concerns, duration will become an effective offset to risky asset drawdowns. Rate volatility, though receding from recent peaks, will remain above pre-pandemic levels due to uncertainty about the timing of rate cuts and concerns about government debt levels. Elevated real rates will incentivize investors to increase allocations to fixed income, creating opportunities during bouts of volatility. That said, many corners of the market appear to be priced for a soft landing. While this has become a more likely outcome, we believe the risks to this outcome materializing are being ignored. Labor markets are coming into better balance which, while good news for inflation, could cause concern among workers that a turn in the cycle is approaching. This in turn could compel workers to boost savings rates which would limit consumption and act as a challenge to growth.

With this dynamic in place, portfolios have a moderate level of risk with focus on higher quality credit, and allocations are skewed towards sectors with better relative value. For example, securitized credit markets are currently trading with wider spreads relative to comparably rated corporates bonds. Meanwhile, the dark clouds facing the sector due to concerns over CMBS appear to be fading as lower rates make refinancing existing loans less challenging. Within corporate credit, we prefer investment grade, however to the extent we are willing to drift into lower quality, we prefer HY over senior loans given the latter is most directly impacted by higher financing costs. Outside of credit, agency MBS remain attractive relative to Treasuries due to historically wide spreads despite minimal prepayment risk and episodic market volatility will present tactical opportunities.

The **Bank of America US Dollar 3-Month Deposit Offered Rate Constant Maturity Index** represents a high-quality base rate for three-month constant maturity dollar denominated deposits. The Index does not reflect fees, brokerage commissions, taxes or other expenses of investing. **Investors cannot invest directly in an Index.**

Principal Risks: All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield. **High-Yield Securities**, or "junk bonds," are rated lower than investment-grade bonds because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities. To the extent that the Fund invests in **Mortgage-Related Securities**, its exposure to prepayment and extension risks may be greater than investments in other fixed-income securities. The Fund may use **Derivatives**, such as options and futures, which can be illiquid, may disproportionately increase losses and have a potentially large impact on Fund performance. **Foreign Investing** poses special risks including currency fluctuation, economic and political risks not found in investments that are solely domestic. As Interest Rates rise, bond prices fall, reducing the value of the Fund's share price. Other risks of the Fund include but are not limited to: **Credit Risks, Extension Risks, Investment Models Risks, Municipal Securities Risks, Other Investment Companies' Risks, Prepayment Risks, Price Volatility Risks, U.S. Government Securities and Obligations Risks, Debt Risks, Liquidity Risks, Portfolio Turnover Risks, and Securities Lending Risks.** An investment in the Fund is not a bank deposit and is not insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

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. Portfolio construction uses a traditional optimizer that maximizes expected return of the portfolio, while managing tracking error.

Data imprecision, software or other technology malfunctions, programming inaccuracies and similar circumstances may impair the performance of these systems, which may negatively affect Fund performance. Furthermore, there can be no assurance that the quantitative models used in managing the Fund will perform as anticipated or enable the Fund to achieve its objective.

This commentary has been prepared by Voya Investment Management for informational purposes. Nothing contained herein should be construed as (i) an offer to sell or solicitation of an offer to buy any security or (ii) a recommendation as to the advisability of investing in, purchasing or selling any security. Any opinions expressed herein reflect our judgment and are subject to change. Certain of the statements contained herein are statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (1) general economic conditions, (2) performance of financial markets, (3) interest rate levels, (4) increasing levels of loan defaults (5) changes in laws and regulations and (6) changes in the policies of governments and/or regulatory authorities. **Past performance is no guarantee of future results.**

The opinions, views and information expressed in this commentary regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Portfolio holdings are fluid and are subject to daily change based on market conditions and other factors. The Fund discussed may be available to you as part of your employer sponsored retirement plan. There may be additional plan level fees resulting in personal performance to vary from stated performance. Please call your benefits office for more information.

©2023 Voya Investments Distributor, LLC • 230 Park Ave, New York, NY 10169 • All rights reserved.

Not FDIC Insured | May Lose Value | No Bank Guarantee
CMFC-SIO 123123 • ex123124 • IM0000000 • WLT250005733

voyainvestments.com

