Commentary | 4Q24

Voya Core Plus Fixed Income SMA

Seeks total return through security selection, sector allocation and risk management

Strategy overview

A total return approach, investing across full spectrum of the fixed income market including up to 20% in below investment grade securities.

Key takeaways

- Strong economic data continued to come through in the final quarter of 2024, which had the impact of driving spreads tighter while reversing the rate rally experienced in 3Q24.
- For the quarter, the Voya Core Plus Fixed Income SMA outperformed it's benchmark, the Bloomberg US Aggregate Bond Index (the Index) on gross-of-fees but slightly underperformed on net-of-fees basis. Sector allocation, duration and yield curve decisions contributed, while security selection decisions detracted.
- Overall, the macro backdrop should be favorable for credit sectors, however we continue to favor high-quality, shorter-dated assets given where valuations are.

Market review

Strong economic data continued to come through in the final quarter of 2024, which had the impact of driving spreads tighter while reversing the rate rally experienced in 3Q24.

The gross domestic product (GDP) report for 3Q24 once again came in elevated (initially reporting at 2.8% and later revised to 3.1%) driven largely by strong consumer and government spending, which grew at 3.7% and 5.1%, respectively. Notably, consumer spending accounted for roughly 80% of the overall growth, highlighting its critical role in the economy.

Inflationary pressures remained a key concern. The Consumer Price Index (CPI) surprised to the upside in early October, and while subsequent data showed stability in both CPI and Personal Consumption Expenditures (PCE) inflation, both remained elevated. Core PCE, the U.S. Federal Reserve's preferred measure of inflation, finished the quarter at 2.8% year over year, slightly above where it was trending in the summer. Notably, core goods prices, which had experienced a deflationary trend for several months, began to reaccelerate.

Labor market dynamics continued to show signs of softening without entering a state of deterioration. Job gains remained reasonable, and although the unemployment rate resumed its upward trajectory, it remained below the high watermark set earlier in the year. Meanwhile, wage growth remained strong, which helps explains both the resilience of consumer spending and the stickiness of services inflation.

While the Fed continued to deliver rate cuts at both the November and December meetings, the December cut was accompanied by more "hawkish" elements. Specifically, the Fed's Dot plot indicated only two cuts projected for 2025—down from four in the previous iteration. Additionally, officials moved their projection for both growth and inflation higher, while their projection for the unemployment rate moved lower and only slightly above the current level.

Overall, the fourth quarter of 2024 was characterized by resilient labor market dynamics, strong economic growth and sticky inflation. The impact on fixed income performance was mixed, with yields rising and credit spreads tightening, leading to modestly negative total returns for most fixed income sectors.

For the quarter, the Voya Core Plus Fixed Income SMA outperformed the Index on gross-of-fees but slightly underperformed on net-of-fees basis. Sector allocation, duration and yield curve decisions contributed, while security selection decisions detracted. Our overweight to credit and underweight in Treasuries broadly contributed. Our allocation to non-agency residential mortgage-backed securities (RMBS) and credit risk transfers (CRT) was a strong contributor as strong borrower characteristics continued to drive spreads tighter. Similarly, our overweight to investment grade (IG) corporates was also a meaningful contributor but was offset by negative security selection results due to our higher quality bias relative to the benchmark. Meanwhile, positive security selection results in commercial mortgage-backed securities (CMBS) were realized due to our bias towards higher yielding tranches. Finally, due to our shorter duration profile relative to the benchmark, the move higher in rates contributed to relative performance.

Outlook

Looking forward, we continue to expect economic growth will remain resilient. The recent election outcome further strengthens this view due to election optimism and productivity gains from deregulation. Meanwhile, we expect inflation to resume its downward trend, driven by moderating service prices. In this area however, the election result lowers our conviction as an adverse policy mix of deficit spending, tariffs and stricter immigration limits would sustain higher levels of demand while constraining supply. That said, we believe a negative market reaction would likely compel the administration to temper those policies before they derail growth.

Assuming this is the case, and inflation does not reaccelerate, we expect the Fed will tolerate inflation that is slightly above their target and deliver a few more rate cuts in an effort to preserve the current cycle.

Overall, this backdrop should be favorable for credit sectors, however we continue to favor high-quality, shorter-dated assets given where valuations are. Over the quarter we reduced our overweight to IG corporates and are now neutral to the benchmark from a spread duration perspective. Similarly, we maintain only a modest allocation to high yield (HY) corporates, while high quality securitized makes up much of our active risk. If there is a misstep in policy implementation, we believe we are well positioned to capitalize on the short-lived market dislocation and will look to add market risk further out the curve. Finally, in response to the move higher in rates, we increased the strategy's duration and are now neutral to the benchmark.

Disclaimers

The **Bloomberg US Aggregate** Index is composed of US securities in Treasury, government-related, corporate, and securitized sectors that are of investment-grade quality or better, have at least one year to maturity and have an outstanding par value of at least $250 million. Indexes do not reflect fees, brokerage commissions, taxes or other expenses of investing. Investors cannot directly invest in an index.

Source: Bloomberg Index Services Limited. Bloomberg® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Bloomberg does not approve or endorse this material, nor guarantee the accuracy or completeness of any information herein, nor make any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, shall not have any liability or responsibility for injury or damages arising in connection therewith.

Past performance is not indicative of future results. All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield inherent in investing. All security transactions involve substantial risk of loss. Please refer to your client statement for a complete review of recent transactions and performance.

The **principal risks** are generally those attributable to bond investing. Holdings are subject to market, issuer, credit, prepayment, extension and other risks, and their values may fluctuate. Market risk is the risk that securities may decline in value due to factors affecting the securities markets or particular industries. Issuer risk is the risk that the value of a security may decline for reasons specific to the issuer, such as changes in its financial condition. The strategy may invest in mortgage-related securities, which can be paid off early if the borrowers on the underlying mortgages pay off their mortgages sooner than scheduled. If interest rates are falling, the strategy will be forced to reinvest this money at lower yields. Conversely, if interest rates are rising, the expected principal payments will slow, thereby locking in the coupon rate at below market levels and extending the security's life and duration while reducing its market value. High yield bonds carry particular market risks and may experience greater volatility in market value than investment grade bonds. Foreign investments could be riskier than US investments because of exchange rate, political, economic, liquidity and regulatory risks. Additionally, investments in emerging market countries are riskier than other foreign investments because the political and economic systems in emerging market countries are less stable.

The strategy employs a quantitative model to execute the strategy. 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.

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.

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. Fund holdings are fluid and are subject to daily change based on market conditions and other factors.

Disclosure for Morgan Stanley Wealth Management clients only: The content is to report on the investment strategies as reports by Voya Investment Management and is for illustrative purposes only. The information contained herein is obtained from multiple sources and believed to be reliable. Information has not been verified by Morgan Stanley Wealth Management, and may differ from documents created by Morgan Stanley Wealth Management. The client should refer to the Profile. This must be preceded or accompanied by the Morgan Stanley Wealth Management Profile, which you can obtain from your Financial Advisor. For additional information on other programs, please speak to your Financial Advisor.

(800) 992-0180 Individual Investors | (800) 334-3444 Investment Professionals

SMASB-CP 123124 • ex123125 • IM4182148