Commentary | 1Q25

Voya Enhanced Yield Fixed Income SMA

Higher Credit Quality Approach, Selective High Yield Exposure

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Strategy overview

A total return strategy that uses a multi-sector approach with a higher quality posture through the use of Treasury, Agency, and Corporate Credit securities, both Investment Grade and Below, with 1-10 year maturities.

Key takeaways

- The first quarter of 2025 was marked by volatility in the fixed income markets, primarily driven by tariff policies and associated economic uncertainty. Despite robust job gains and a low unemployment rate, fixed income spreads widened, leading to broadly negative excess returns.
- For the quarter, the Voya Enhanced Yield Income SMA outperformed the custom benchmark on a gross-of-fees basis but underperformed on a net-of-fees basis.
- Looking ahead, fundamental factors remain supportive due to positive expected growth, a healthy labor market and resilient consumer.

Market review

The first quarter of 2025 was marked by volatility in the fixed income markets, primarily driven by tariff policies and associated economic uncertainty. Despite robust job gains and a low unemployment rate, fixed income spreads widened, leading to broadly negative excess returns. Credit spreads began to widen in mid-February when tariff threats intensified. Investment grade (IG) corporates delivered negative excess returns, as did high yield (HY) corporates, although the higher carry profile of HY helped the sector modestly outperform its IG counterpart.

The labor market remained strong, with job gains averaging around 200,000 per month and an unemployment rate only slightly above 4%. However, tariff policies were the primary driver of market moves. The uncertainty surrounding these tariffs, along with the potential for an escalating trade war, negatively impacted risk assets. Similarly, rates fell during the quarter in response to lower growth expectations, which helped deliver positive total returns for most sectors.

The U.S. Federal Reserve maintained a cautious stance during the quarter. The Fed cited stronger than expected economic data as reasons for not cutting rates further. However, in response to tariffs, the updated Summary of Economic Projections (SEP) released following the March meeting showed the median projection for growth moving lower, while inflation projections were higher; however, there was no change to rate expectations, with the median projection still indicating one to two cuts through year end.

Portfolio review

For the quarter, the Voya Enhanced Yield Income SMA outperformed the custom benchmark on a gross-of-fees basis but underperformed on a net-of-fees basis. The SMA's higher quality focus within both IG and HY corporates was the primary contributor to relative performance, as higher quality generally held up better in the volatile market environment.

Outlook

Looking ahead, fundamental factors remain supportive. Growth has been roughly 2–3% for the last three years, most recently delivering 2.5% in 4Q24. The labor market is healthy with only 4.1% unemployment. And on the consumer side, balance sheets remain healthy.

That said, survey data has indicated tariffs have negatively impacted both business and consumer sentiment. We have already seen consumers pull back (negative growth numbers in both Personal Consumption Expenditures Price Index (PCE) and retail sales numbers for January) and we will likely see a similar reaction on the business investment side. Even if tariffs are watered down, the associated uncertainty will remain a headwind.

That said, while a recession is not our base case, the probability has clearly increased. While there will likely be an impact on personal consumption and investment, household and corporate balance sheets still remain healthy. In addition, the downside to growth should be limited as the Fed has the room to cut rates, especially if employment numbers weaken. However, much depends on how much, and for how long, the announced tariffs remain in place.

Over the past several quarters, we have been constructive on fundamental factors, but believed valuations were ignoring potential risks. As a result, we came into the quarter positioned with a higher quality bias. While spreads have widened, the macro-outlook has clearly weakened. We continue to remain cautious in our positioning and prefer high-quality assets, while we will look to add market risk should spreads widen further.

Read our strategy brief

Returns are benchmarked to a customized blend of 60% Bloomberg Intermediate Gov/Credit Index and 40% Bank of America US High Yield Master II Constrained Index, rebalanced on a monthly basis, which does not incur management fees, transaction costs, or other expenses associated with a composite portfolio. Securities prices used to value the benchmark index for the purposes of calculating total return may or may not differ significantly from those used to value securities held within composite portfolios. Index returns do not reflect fees, brokerage commissions, taxes or other expenses of investing. **Investors cannot invest directly in an index.**

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 U.S. investments because of exchange rate, political, economics, 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 Composite performance information represents the investment results of a group of fully discretionary accounts managed with the investment objective of outperforming the benchmark.

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