Commentary | 1Q25

Voya High Yield SMA

Seeks total return, balancing income and diversification potential

Strategy overview

Total return approach, investing in below-investment grade corporate securities with a bias towards higher quality and a concentrated posture.

Key takeaways

- The Bank of America Merrill Lynch High Yield Master II Index (the Index) returned 0.94% for the quarter.
- The SMA outperformed the Index during the quarter on both gross- and net-of-fees basis, primarily due to its higher quality focus.
- Within high yield, our base case is that growth remains sufficient to support credit fundamental factors, and we still expect a shift to a more growth-friendly and business-friendly policy, but the risk of a policy error is growing.

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. HY spreads ended the quarter at 355 basis points (bp) on an option adjusted basis (OAS), having widened 68 bp over the course of the quarter.

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, despite solid labor market dynamics. 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 in the first quarter of 2025, resisting further interest rate cuts after having cut rates by 100 bp in 2024. The Fed cited stronger than expected economic data, including robust job gains and a low unemployment rate, 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. Meanwhile, the median projection for inflation moved higher, however there was no change to rate expectations, with the median projection still indicating one to two cuts through year end, and another two cuts in 2026.

Portfolio review

For the quarter, the SMA outperformed the Index on both gross- and net-of-fees basis. Given the volatile market environment and related risk-off sentiment, the strategy's focus on higher quality bonds benefited returns versus the Index, as lower-rated credits underperformed during the quarter.

Outlook

Looking ahead, fundamental factors remain supportive. Growth has been roughly 2–3% for the last 3 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 Expenditure (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.

Within HY, our base case is that growth remains sufficient to support credit fundamental factors, and we still expect a shift to a more growth-friendly and business-friendly policy, but the risk of a policy error is growing. The supply and demand balance within HY remains supportive as new money supply has continued to underwhelm with only limited debt-funded merger and acquisition, and all-in yields are likely sufficient to attract capital, but potential equity market weakness creates a headwind for risk appetite. The current yield still provides a cushion to returns should spreads widen further. We continue to remain cautious and relatively defensive in our positioning, as plenty of uncertainties remain top of mind.

Read our strategy brief

Returns are benchmarked to the **ICE Bank of America U.S. High Yield Master II Constrained Index**, which does not incur management fees, transaction costs, or other expenses associated with a composite portfolio. The ICE Bank of America High Yield Master II Index is a market value-weighted index consisting of U.S. dollar-denominated, non-investment grade bonds not currently in default and limits any individual issuer to a maximum of 2% benchmark exposure. 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.**

All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield inherent in investing. 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. The strategy may use Derivatives, such as options and futures, which can be illiquid, may disproportionately increase losses and have a potentially large impact on performance. Foreign Investing does pose special risks including currency fluctuation, economic and political risks not found in investments that are solely domestic. Risks of foreign investing are generally intensified in Emerging Markets. As Interest Rates rise, bond prices may fall, reducing the value of the share price. Debt Securities with longer durations tend to be more sensitive to interest rate changes. Other risks include but are not limited to: Credit Risks; Other Investment Companies' Risks; Price Volatility Risks; Inability to Sell Securities Risks; and Securities Lending Risks.

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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