Commentary | 4Q23

Voya Floating Rate Fund

An Attractive Income Option for a Strategic Allocation

Strategy overview

Actively managed, ultra-short duration floating-rate income strategy that invests primarily in privately syndicated, below investment grade senior secured corporate loans.

Key takeaways

- For the quarter, the Morningstar® LSTA ® US Leveraged Loan Index (the Index) returned 2.87%.
- On a net asset value (NAV) basis, Class I shares of the Fund underperformed the Index.
- Looking ahead, we expect a continued supportive technical backdrop in 2024, as net issuance creation remains low, while demand continues at a steady clip.

Portfolio review

The U.S. Federal Reserve's decision to keep interest rates unchanged at its final two policy meeting of 2023 along with ongoing disinflation in the United States resulted in a sharp rally across both fixed income and equity markets in 4Q23, as the soft-landing narrative gained momentum. For the quarter, the Morningstar® LSTA ® US Leveraged Loan Index returned 2.87%. The average bid price increased by 67 basis points (bp), closing out the year at 96.23. Price appreciation and elevated base rates contributed to this year's strong return of 13.32% (the strongest return since Global Financial Crisis).

There was minimal dispersion among credit cohorts during the quarter. Double-B and single-B rated loans trading levels experienced an uptick, while CCC rated loan saw a slight decline. In terms of performance, single-B rated loans surpassed the broader Index and the other quality counterparts in 4Q23. For context, double-B, single-B and CCC rated loans returned 2.71%, 3.16% and 2.18%, respectively.

Supply in the primary market moderated compared to 3Q23 due to the typical year end seasonal slowdown. Volume was mainly driven by opportunistic transactions, although acquisition-related deals were prevalent in November. For the quarter, total supply stood at $55.7 billion. The size of the loan market, as represented by total Index outstandings, is now slightly below $1.4 trillion. Turing to the investor demand, collateralized loan obligations (CLO) issuance increased in 4Q23 to $31.9 billion across 74 deals from $27.96 billion last quarter. Full year CLO volume was at $116 billion, behind last year's issuance of $129 billion. On the other hand, retail loan funds experienced a net outflow of $960 million during the quarter.

There were three defaults in the Index during the quarter as the trailing 12-month default rate by principal amount moved higher to 1.53% (from 1.34% in September).

On a NAV basis, Class I shares of the Fund underperformed the Index. By ratings, the Fund was negatively impacted by selection in CCC rated loans. From an industry perspective, the main detractor was consumer staples distribution and retail sector. This was mainly driven by the overweight allocation to Save-A-Lot. Conversely, the Fund benefited from selection in BB rated loan. The main contributions were selection in containers and packaging, media, as well as construction and engineering. Away from loan-level performance, the Fund's modest exposure to high yield (HY) bonds positively impacted performance, as the HY bond market outperformed loans in 4Q23 (7.07% return for the Bloomberg U.S. Corporate High Yield Index).

Portfolio and positioning changes were both mostly minimal during the period. The number of individual names in the portfolio deceased from 400 to 394, while the average spread level of the Fund decreased to 349 bp (versus 362 bp in the prior quarter).

Current strategy and outlook

We expect macro-related volatility to remain a prominent theme globally, as economies shift to below-trend growth. Globally, the increased cost of capital will curb investment and consumption, an effect that will be partially countered by ongoing global government support. While the United States economic outlook has been favorable compared to the rest of the world, policy rates will remain restrictive in the medium term and there are risks that consumer spending weakens in 2024. With inflation cooling and labor markets moderating, we believe the Fed is done hiking but think markets may be too aggressively projecting cuts in 2024, as the last mile in getting inflation back to its 2% target will be the most difficult.

Looking ahead, we expect a continued supportive technical backdrop in 2024 for the loan market, as net issuance creation remains low, while demand continues at a steady clip. CLO issuance should remain the primary driver of demand in the loan market, while retail loan fund flows are expected to ebb-and-flow in 2024, corresponding to general investor sentiment. In terms of fundamental factors, we believe the sustained "higher for longer" rate environment, nearing maturity walls and an expected slowdown in gross domestic product (GDP) growth will lead to an uptick in downgrade and defaults. As a result, our focus will remain on credit selection, while our portfolios continue to exhibit a high single-B rated profile, with an underweight in the lower tail of the market.

Holdings detail

Companies mentioned in this report-percentage of Fund investments, as of 12/31/2023: Save—A-Lot 0.50%. 0% indicates that the security is no longer in the portfolio. Portfolio holdings are subjected to change on a daily basis.

Disclaimer

The **Morningstar® LSTA ® US Leveraged Loan** index is an unmanaged total return index that captures accrued interest, repayments, and market value changes. 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. **Investment Risks:** The Fund invests primarily in below investment grade, floating rate senior loans (also known as "high yield" or "junk" instruments), which are subject to greater levels of liquidity, credit, and other risks than are investment grade instruments. There is a limited secondary market for floating rate loans, which may limit the Fund's ability to sell a loan in a timely fashion or at a favorable price. If a loan is illiquid, the value of the loan may be negatively impacted and the manager may not be able to sell the loan in order to meet redemption needs or other portfolio cash requirements. The value of loans in the Fund could be negatively impacted by adverse economic or market conditions and by the failure of borrowers to repay principal or interest. A decrease in demand for loans may adversely affect the value of the Fund's investments, causing the Fund's net asset value to fall. Because of the limited market for floating rate senior loans, it may be difficult to value loans in the Fund on a daily basis. The actual price the Fund receives upon the sale of a loan could differ significantly from the value assigned to it in the Fund. The Fund may invest in foreign instruments, which may present increased market, liquidity, currency, interest rate, political, information, and other risks. These risks may be greater in the case of emerging market loans. Although interest rates for floating rate senior loans typically reset periodically, changes in market interest rates may impact the valuation of loans in the portfolio. In the case of early prepayment of loans in the Fund, the Fund may realize proceeds from the repayment that are less than the valuation assigned to the loan by the Fund. In the case of extensions of payment periods by borrowers on loans in the Fund, the valuation of the loans may be reduced. The Fund may also invest in other investment companies and will pay a proportional share of the expenses of the other investment company. **Derivative Instruments:** Derivative instruments are subject to a number of risks, including the risk of changes in the market price of the underlying securities, credit risk with respect to the counterparty, risk of loss due to changes in interest rates and liquidity risk. The use of certain derivatives may also have a leveraging effect which may increase the volatility of the Fund and reduce its returns. Other investment risks of the Fund include, but are not limited to: **Equity Securities, Foreign Investments, High-Yield Securities, Leverage, Liquidity, Prepayment and Extension. Investors should consult the Fund's prospectus and statement of additional information for a more detailed discussion of the Fund's 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.**

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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.

Performance Attribution: During the period from January 1, 2017 to July 31, 2020, an unaffiliated data provider, which is used by the Funds to identify individual senior loans and groups of senior loans that detracted from or contributed to portfolio performance on an absolute or relative basis (commonly known as "attribution analysis"), provided the Funds with inaccurate data. As a result, the attribution analysis used to explain and analyze a portfolio's performance against a particular benchmark was inaccurate in some instances during the period. Importantly, the Funds' actual performance information and performance comparison to their respective benchmark which appeared in various Fund commentaries during this period were correct and were not impacted by the inaccurate data. The data provider has identified and corrected the issue that caused the transmission of inaccurate information, and correct information is reflected in attribution analysis used in commentaries prepared after September 30, 2020.performance. Please call your benefits office for more information.

The Standard & Poor's rating scale is as follows, from excellent (high grade) to poor (including default): AAA to D, with intermediate ratings offered at each level between AA and CCC. Anything lower than a BBB- rating is considered a non-investment grade or junk bond. Any security that is not rated by Standard & Poor's is placed in the NR (Not Rated) category.