Commentary | 3Q20

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

- In 3Q20, investor sentiment was buoyed by further improvement in macro and economic conditions, which led to another rally in broad risk markets. In turn, the U.S. loan market, as represented by the S&P/LSTA Leveraged Loan index (the “index”), returned a strong 4.14% for the quarter
- Loan market technical factors were buoyed by a notable uptick in new loan supply
- For the quarter, the Fund return underperformed the benchmark

Current Strategy and Outlook

In 3Q20, investor sentiment was buoyed by further improvement in macro and economic conditions, which led to another rally in broad risk markets. In turn, the U.S. loan market, as represented by the index, returned a strong 4.14% for the quarter. The average bid price of the index finished the quarter at 93.18, up 3.31% from the end of 2Q20. The upward movement in secondary prices had a disproportionate benefit to lower-rated segments of the market, as many of these loans, particularly those rated CCC, staged a strong technical recovery as overall downgrade activity slowed and the bear case COVID-19 outcome did not materialize.

The highly volatile CCC-rated cohort returned 8.51% over this period, while single-B- and BB-rated loans returned 4.33% and 2.68%, respectively. On a year-to-date (YTD) basis, B-rated loans remained the standout performer, as this rating cohort (by far, the largest within the index), underpinned by strong collateralized loan obligation (CLO) buying, is in the black for the YTD period with a positive 3 basis point (bp) return. BB-rated loans lag at -1.94%, while CCC-rated loans are still deep in the red (-4.45%).

New issuance, at $73.8 billion for the quarter, resulted in a significant rebound from the four-year quarterly low of just $44.5 billion in 2Q20. A big part of that flow was refinancing activity (roughly 48% of all transactions), while merger and acquisition (M&A)-related deals, although down from historical norms, came in steady at about 40% of overall volume. Dividend recaps, on the other hand, experienced a notable uptick during the quarter, amounting to $15.8 billion, the most since first quarter of 2017. On the other end of the technical spectrum, measurable investor demand – CLO issuance and retail fund flows – was generally steady due to a resurgence of CLO origination. This component increased to $23.4 billion during the quarter, a function of tighter liability costs and increased loan supply. At the same time, retail fund flows, while still a negative for the quarter (-$3.1 billion), improved notably from 2Q20, when the volume of redemption activity was more than double ($6.7 billion).

To no one’s surprise, default activity continued in the loan market, with 12 new index constituents added to the tally in 3Q20. As a result, the trailing-12-month default rate by principal amount finished the quarter at 4.17%, up 94 bp from the previous quarter and the highest since June of 2014. Retail and oil and gas were the main drivers of this quarter’s...
default activity, as half of the defaulted issuers were rooted within these two sectors. Based on a survey conducted by LCD, market participants are expecting the default rate to climb above 5% by year-end, with a 2021 peak of approximately 6.6%.

As we head into the final stretch of the year, the primary focus will be centered around coronavirus and vaccine news and U.S. election results, both of which will likely have strong influence over financial markets. In addition to this, the winter months could result in increased risk of infection rates, potentially dampening the current economic recovery, which has already – by some measures – downshifted since the early summer months. As it pertains to the loan market, there will remain a heightened focus on credit selection amid the pandemic fallout, and loan investors will continue to assess the future ramifications of the coronavirus-related disruption and what the long-lasting impacts will be on the most-exposed industries and issuers.

**Portfolio Review**

For the quarter, the Fund underperformed the index after deducting fees and operating expenses. At the portfolio level, relative contributors slightly offset relative detractors. The primary relative contributions stemmed from price improvement in three of the Fund’s defaulted issuers: Save-A-Lot, Tailored Brands (formerly known as Men’s Wearhouse) and Covia Holdings Corporation (formerly known as Unimin Corporation). From an industry perspective, the Fund benefited from selection in nonferrous metals and minerals, food and drug retailers and retailers (except food and drug), as well as from selection and underweight to utilities.

By contrast, the primary relative detraction resulted from selection in single-B-rated loans; also detracting from relative returns were selection in leisure goods/activities/movies, business equipment and services, health care and all telecom. At an issuer level, the main laggards were iQor, American Airlines, Inc. and 24 Hour Fitness Worldwide, Inc. iQor and 24 Hour Fitness Worldwide defaulted during the period, while American Airlines was severely impacted by the global reduction in air travel.

The Fund experienced two defaults during the quarter (Tailored Brands and iQor), compared to 12 new defaults for the index. Diversification measures remain robust, with 33 industries and 281 individual issuers represented.

**Holdings Detail**

Companies mentioned in this report – percentage of portfolio investments, as of 9/30/20: Save-A-Lot 0.53%, Tailored Brands (formerly known as Men’s Wearhouse) 0.09%, Covia Holdings Corporation (formerly known as Unimin Corporation) 0.65%, iQor 0.04%, 24 Hour Fitness Worldwide 0.28%, and American Airlines 0.47%; 0% indicates that the security is no longer in the portfolio. Portfolio holdings are subject to daily change.
The S&P/LSTA 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.

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