Commentary | 3Q24

Voya Global Bond Fund

Discover a World of Risk-adjusted Opportunities in Global Bond Markets

Strategy overview

Invests in broad global bond sectors including a wide range of debt and derivative securities and currencies.

Key takeaways

- For the quarter ended September 30, 2024, the Voya Global Bond Fund Class I Share outperformed its benchmark, Bloomberg Global Aggregate Bond Index (the Index) on a net asset value (NAV) basis.
- During the third quarter, global yields declined and the U.S. dollar weakened as the U.S. Federal Reserve began its rate cutting cycle joining other central banks in easing policy with the exception of a rate hike by the Bank of Japan (BoJ) which strengthened the yen over the quarter.

Portfolio review

For the quarter ended September 30, 2024, the Voya Global Bond Fund Class I Share outperformed the Index on a NAV basis. Sector allocation along with duration and yield curve decisions contributed to performance while currency allocations detracted for the period.

During the third quarter, global yields declined and the U.S. dollar weakened as the Fed began its rate cutting cycle joining other central banks in easing policy with the exception of a rate hike by the BoJ which strengthened the yen over the quarter. Inflation data continued to show a downward path, while two weaker than expected payrolls reports in a row sparked fears that the Fed was behind the curve. This dynamic allowed the Fed to shift its attention to preventing further weakening, culminating in a 50 basis points (bp) policy "recalibration" to start the easing cycle. Overseas, the Bank of England (BoE) moved to cut rates for the first time since the pandemic in a split decision, with commentary alongside the decision expressing a cautious message about the sustainability of the disinflation seen. This messaging was reinforced in the expected September decision to hold rates steady. In Europe, more progress inflation and weaker signals from activity indicators led the European Central Bank (ECB) to cut rates in September after holding them steady in July. The BoJ once again raised its benchmark interest rates in late July, citing its economic activity and prices have developed in line with their outlook. The narrowing interest rate gap between Japan and the U.S. strengthened the yen sharply against the U.S. dollar.

The U.S. labor market continued its path of normalization in the third quarter of 2024, with the number of job openings continuing to decline along with the quit rate reverting to pre-pandemic levels. This cooling was further evidenced by the Non-Farm Payroll (NFP) report, which missed expectations for both July and August. The substantial miss for July, reported in August, coincided with a controversial rate hike by the BoJ, unsettling markets and leading to a sharp widening of credit spreads. However, as investors digested the data, spreads eventually retraced, reflecting a more measured perspective on the total economy.

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This moderation in the labor market did not significantly hinder consumer spending, which continued to advance at a decent rate. With elevated home prices and strong equity performance, the wealth effect remained in play however the moderation in the labor market may have been responsible for more measured spending growth, relative to more recent quarters. More broadly, the economy continued to advance at a reasonable pace, as evidenced by 2Q24 gross domestic product (GDP) growth, which exceeded expectations at 2.8% and was later revised to 3.0%.

Inflation continued its downward trend, with core Consumer Price Index (CPI) approaching 3% year over year, despite the shelter component remaining stubbornly elevated. Core goods prices remained in deflation, while core services inflation decelerated significantly, partially attributable to moderating wage gains. The Fed's preferred measure, Core Personal Consumption Expenditure (PCE), displayed an even more favorable environment, reading at 2.7% YoY in August. This disinflationary environment provided the Fed with the flexibility to shift its focus from inflation concerns to labor market conditions.

A pivotal moment came in late August with Jerome Powell's speech at Jackson Hole, signaling a shift towards an easing cycle. The Fed, acknowledging the softening labor market, opted for a 50 bp cut at their September meeting, larger than the previously anticipated 25 bp reduction. Powell's influence was evident, with only one Federal Open Market Committee member dissenting. This decision underscored the Fed's proactive approach to preserving a healthy labor market and broader economic stability.

Credit spreads began the quarter at tight levels, reflecting a macro environment that balanced disinflation with stable growth. Despite the early August volatility, driven by labor market data and the BoJ's actions, spreads finished the quarter at similarly tight levels as the disinflationary trend allowed the Fed to begin an easing cycle.

Yields rallied in response to continued disinflation, with front-end rates falling more significantly than long-end rates. This bull steepening of the yield curve was driven by expectations of the Fed's easing, which prompted front-end rates to aggressively rally, while a stable growth outlook translated to a more measured decline in the long end.

In conclusion, the third quarter of 2024 was characterized by a gradual moderation in the labor market, further easing of inflation and a proactive shift in monetary policy by the Fed. These factors positively influenced market dynamics, resulting in a period of strong returns for fixed income investors.

Sector allocation along with duration and yield curve positioning decisions contributed over the quarter, while currency allocations were detractors for the period. Our duration and yield curve positioning drove performance as developed markets (DM) rates ended the quarter lower. The strongest contribution was sourced from high yield (HY), where a tactical credit default swap (CDX) trade at the beginning of August amid increased volatility contributed meaningfully to performance. Securitized credit broadly contributed over the quarter, where commercial mortgage-backed securities (CMBS) was the largest contributor to performance as it benefitted from the Fed easing cycle and rally in rates. Within emerging markets (EM) rates, our positioning in Brazilian and Mexican rates added to performance over the quarter. Meanwhile, DM currencies detracted over the quarter due to a tactical short position in the Euro. We tactically added risk during spikes of volatility, then reduced allocation as valuations became rich. Duration was unchanged over the quarter.

Current strategy and outlook

As we look ahead to the fourth quarter of 2024, we expect the theme of "normalization" to continue shaping the economic landscape. We anticipate growth will stabilize close to trend levels, remaining positive but likely decelerating from the robust pace seen in recent quarters. This dynamic will be driven largely by consumer spending, which, while expected to slow, will continue to be supported by a relatively strong (albeit moderating) labor market and a favorable wealth effect stemming from elevated asset prices.

We project inflation will continue its decline, but at a slow pace and ultimately settling above the Fed's target. Goods inflation is expected to remain at 0% or lower, as consumption growth moderates from historically high levels. Services inflation is likely to continue decelerating as the labor market continues to rebalance and wage growth eases further. Additionally, we anticipate that the shelter component of inflation will eventually align more closely with real-time indicators from sources like Zillow, Apartment List and Yardi, further contributing to the easing of inflationary pressures.

While all this points to a soft landing, markets appear to have priced in this scenario with a high degree of certainty. Investment-grade (IG) corporate spreads are currently below 100 bp, while HY spreads hover around 300 bp. These levels suggests that markets are highly optimistic that disinflation can continue without a recession materializing. While we tend to agree this is a likely outcome, there remains a risk of more rapid deterioration in the labor market, particularly if corporate margins face further pressures.

Given these tight valuations, we favor assets with higher credit quality or shorter spread durations, as we believe spreads are too tight relative to the underlying risks. However, we remain confident in the fundamental factors that support the economy and are prepared to add risk where appropriate, especially in the face of market volatility stemming from data releases, Fed actions, elections and geopolitical developments.

On the interest rate front, following the substantial rally in 3Q24—particularly at the front end of the curve—the market is now pointing to the Fed reaching its terminal rate roughly one year ahead of the most recent dot plot projections. We believe this reflects a skew of potential outcomes related to monetary policy. Specifically, we believe that the likelihood of reacceleration of inflation that prompts the Fed to reverse course is significantly lower than the probability of a faster cutting cycle if the labor market deteriorates more rapidly.

In summary, as we enter the final quarter of 2024, our economic outlook is characterized by a continued normalization process, with stable growth supported by consumer spending and a moderating labor market backdrop. While we maintain a cautious optimism, we remain vigilant, ready to adjust our positioning in response to an evolving landscape.

The Bloomberg Global Aggregate Index is an unmanaged index that provides a broad-based measure of the global investment-grade fixed-rate debt markets. 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. **Currency** To the extent that the Portfolio invests directly in foreign currencies or in securities denominated in, or that trade in, foreign (non-U.S.) currencies, it is subject to the risk that those currencies will decline in value relative to the U.S. dollar or, in the case of hedging positions, that the U.S. dollar will decline in value relative to the currency being hedged. **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 Portfolio and reduce its returns. **Foreign Investments/Developing and Emerging Markets** Investing in foreign (non-U.S.) securities may result in the Portfolio experiencing more rapid and extreme changes in value than a fund that invests exclusively in securities of U.S. companies, due to smaller markets, differing reporting, accounting and auditing standards, and nationalization, expropriation or confiscatory taxation, foreign currency fluctuations, currency blockage, or political changes or diplomatic developments. Foreign investment risks typically are greater in developing and emerging markets than in developed markets. **Asset-Backed (including Mortgage-Related) Securities** Defaults on or the low credit quality or liquidity of the underlying assets of the asset-backed (including mortgage-related) securities held by the Portfolio may impair the value of the securities. **Credit Derivatives** The Portfolio may enter into credit default swaps, either as a buyer or a seller of the swap. As a buyer of the swap, the Portfolio pays a fee to protect against the risk that a security held by the Portfolio will default. As a seller of the swap, the Portfolio receives payment(s) in return for its obligation to pay the counterparty an agreed upon value of a security in the event of a default of the security issuer. Credit default swaps are largely unregulated and susceptible to liquidity, credit, and counterparty risks. Other risks of the Portfolio include but are not limited to: **Leverage, Liquidity, Other Investment Companies, Call, Credit, High-Yield Securities, Prepayment and Extension and Securities Lending. Investors should consult the Portfolio's Prospectus and Statement of Additional Information for a more detailed discussion of the Portfolio's risks. An investment in the Portfolio is not a bank deposit and is not insured or guaranteed by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.**

The strategy employs a quantitative investment process. The process is based on a collection of proprietary computer programs, or models, that calculate expected return rankings based on variables such as earnings growth prospects, valuation, and relative strength. Portfolio construction uses a traditional optimizer that maximizes expected return of the portfolio, while managing tracking error.

Data imprecision, software or other technology malfunctions, programming inaccuracies and similar circumstances may impair the performance of these systems, which may negatively affect Fund performance. Furthermore, there can be no assurance that the quantitative models used in managing the Fund will perform as anticipated or enable the Fund to achieve its objective.

The strategy is available as a mutual fund or variable portfolio. The mutual fund may be available to you as part of your employer sponsored retirement plan. There may be additional plan level fees resulting in personal performance that varies from stated performance. Please call your benefits office for more information.

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