Commentary | 2Q23

Voya Global Bond Strategy

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

- Monetary policy continued to produce market volatility in the second quarter of 2023 yields whip-sawed during the quarter. Global central banks remained hawkish in their assessment for monetary policy pressing rates higher.
- The U.S. dollar continued to trend higher against developed market currencies as the Fed has been resolute in its commitment to higher official rates.
- Inflation is moving in the right direction but remains beyond target levels for most central banks, and labor markets suggest no need for interest rate cuts in the near term.

Portfolio review

For the quarter ended June 30, 2023, the Strategy outperformed its benchmark, Bloomberg Global Aggregate Bond Index (the Index) on a net asset value (NAV) basis. Sector allocation decisions, as well as duration and yield curve positioning added, while currency investments detracted from performance.

Monetary policy continued to produce market volatility in the second quarter of 2023. Despite the failure of a fourth U.S. regional bank just two days prior, the U.S Federal Reserve delivered another 25 basis points hike at their meeting in May and the European Central Bank (ECB) followed in June. While inflation is trending in the right direction, the United States is clearly 'ahead' of Europe, and it is widely believed that the Fed will conclude its rate hiking program before the ECB. Meanwhile, the U.S. labor market remained strong. Monthly job gains surpassed already elevated expectations, with each monthly gain exceeding the previous one. While the Fed did not deliver a hike at their meeting in June, these upside surprises in the U.S. labor market all but eliminated hope of a "pause", with market participants instead viewing the Fed's inaction as a "skip". Meanwhile, emerging markets (EM) outperformed as the culmination in developed market rate hikes opens the window for cuts from emerging central banks.

In corporate credit markets, spreads moved to the tightest levels of the year after setting recent wides post bank failures in March. While First Republic became another casualty, remaining regional banks found sufficient support in the Fed's bank term lending facility and deposit outflows were not as bad as feared. On the earnings side, 1Q23 figures came in much better than expected (albeit negative) which was also supportive of credit spreads. The fallout from the bank failures also had implications for other sectors of the bond market, particularly agency mortgage-backed securities (MBS) given the Federal Deposit Insurance Corporation needed to liquidate roughly $90 billion. To the surprise of many, MBS overcame this challenge, and posted decent excess returns for the quarter as money manager demand for high quality assets was high. Across other securitized markets, performance was also positive. While the challenges in commercial real estate (CRE) are ongoing, commercial mortgage-backed securities (CMBS) took a break from recent spread widening and managed to post modest excess returns.

Sector allocations across all sectors added for the period. The strongest contributions were sourced from securitized sectors. Duration positioning, particularly in relative decisions between developed and EM also added over the period. Currency decisions across developed and EM detracted. Over the period, we trimmed exposures to non-government sectors as relative valuations compels us to reduce our overall risk profile. Meanwhile, the increase in interest rates is offering attractive entry points and we increased our duration over the period.

Current strategy and outlook

We expect growth to continue to slow, and the threat of recession to remain elevated. With corporate earnings in decline, leverage ratios are beginning to move higher. And while most corporate borrowers termed out their debt at very low fixed rates, this is not the case for senior bank loan issuers, where leverage is higher. Meanwhile, CRE financing markets remain challenging, which could become problematic as many loans are approaching their maturity date. And finally, while consumer spending is supported by the strength in the labor market, this strength is also keeping inflation elevated, in turn motivating the Fed to keep rates higher for longer.

Portfolio strategy remains broadly defensive, with a preference for high quality spread opportunities. Having increased our dry powder and improved liquidity over the last few quarters, we continue to look for the right opportunities to redeploy capital but would need to see markets more appropriately discount the risks mentioned above. From a duration perspective, while we do recognize the additional yield pick-up in going shorter, we believe the diversification benefit between bonds and stocks has finally returned and have chosen to increase duration over the period.

The fate of the U.S. dollar rests with the Fed. A more hawkish Fed combined with delayed expectations for a recession in the U.S. have served as anchors to dollar valuations relative to other developed market currencies. Any trend to lower will only occur after the Fed comes to the end of its hiking cycle.

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.

Variable annuities and group annuities are long-term investments designed for retirement purposes. If withdrawals are taken prior to age 59½, an IRS 10% premature distribution penalty tax may apply. Money taken from the annuity will be taxed as ordinary income in the year the money is distributed. An annuity does not provide any additional tax deferral benefit, as tax deferral is provided by the plan. Annuities may be subject to additional fees and expenses to which other tax-qualified funding vehicles may not be subject. However, an annuity does provide other features and benefits, such as lifetime income payments and death benefits, which may be valuable to you.

Variable investments, of any kind, are not guaranteed and are subject to investment risk including the possible loss of principal. The investment return and principal value of the security will fluctuate so that when redeemed, it may be worth more or less than the original investment. In addition, there is no guarantee that any variable investment option will meet its stated objective. All guarantees are based on the financial strength and claims paying ability of the issuing insurance company, who is solely responsible for all obligations under its policies.

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