Commentary | 3Q20
Voya GNMA Income Fund

Access High Quality Mortgage Securities

Strategy overview

Primarily invests in Government National Mortgage Association (GNMA) securities with maturities in excess of one year and which have the same credit quality as U.S. Treasury securities, but higher yields to compensate for prepayment uncertainty.

Key Takeaways

- The U.S. housing market continues to persevere through the social-distancing economy in the times of COVID-19 as demand remains robust (+23% YoY) in response to low mortgage rates. This has led to accelerated home price appreciation (+5% YoY), as well as growth in housing starts (+15% YoY) and building permits (+12% YoY)

- The agency mortgage-backed securities (MBS) market underperformed Treasurys by 0.07% on the back of unfavorable technical factors fanned by overwhelming supply, which outpaced solid demand from the Federal Reserve (the “Fed”) and domestic banks. Government national mortgage association (GNMA) collateral was supported by Fed purchases, but weak overseas demand and heightened delinquency activity suppressed quarterly performance. Underperformance was blanketed across the coupon stack, but the 3% coupon led the underperformance due to fast prepayments

- For the quarter, the Fund outperformed its benchmark, the Bloomberg Barclays GNMA index

Current Strategy and Outlook

Agency mortgages continue to be a monetary policy tool to provide accommodative financial conditions and to support growth. The Fed is expected to buy MBS at the current pace of $40 billion net per month through 2020 and may increase the mortgage holdings on its balance sheet to $3 trillion by the end of this easing cycle. Prompted by the Fed’s purchase composition to mimic production coupon mortgage origination, the “to be announced” market is expected to “roll special,” meaning that its implied financing rate is below current market rates.

In terms of supply and demand technical factors, net issuance has been revised up to ~$400 billion and demand is expected to strengthen. Fed net purchases are expected to end the year at ~$830 billion; bank demand estimates have been increased to $200 billion due to an uptick in deposit growth and reserves. Given the recent tightening in mortgage spreads and the weakening U.S. dollar, overseas and mortgage real estate investment trust (REIT) demand is expected to remain muted for the rest of the year.

Prepayment speeds remain a fundamental risk to mortgages. Over the quarter, faster-than-expected speeds have dampened expectations of borrower “burnout.” One of the most controversial factors contributing to the speeds was a 0.50% increase in guarantee fees that the Federal Housing Finance Agency (FHFA) will charge lenders for guaranteeing conventional mortgages. Though the fee increase was delayed until December, originators rushed to refinance borrowers prior to the delay. On the GNMA side, lender buyout speeds for delinquent borrowers have increased in an effort to stop advancing cash payments on behalf of borrowers. Once the loan has been bought out, the lenders can do loan modification and re-sell the pool into the market at a premium. Meanwhile, the prevalence of property inspection waivers (PIWs), the increased market share of technologically efficient lenders and automated income and asset verification procedures, have made refinancing more readily available for most borrowers.

An investor should consider the investment objectives, risks, charges and expenses of the Fund(s) carefully before investing. For a free copy of the Funds’ prospectus, or summary prospectus, which contains this and other information, visit us at www.voyainvestments.com or call (800) 992-0180. Please read the prospectus carefully before investing.
Portfolio Review

The Fund outperformed its benchmark; Fund performance was attributable to security selection within TBA coupon exposure on the back of the Fed’s intervention in the dollar-roll market, among other factors. We made opportunistic purchases in the form of off-benchmark fixed and floating collateralized mortgage obligation (CMO) holdings, home equity conversion mortgages (floating reverse mortgages) securities and mortgage derivatives. By contrast, duration and yield curve positioning detracted from relative results, as did security selection among agency CMOs.