Commentary | 4Q20
Voya Intermediate Bond Strategy

Intermediate Bond Strategy

Strategy Overview
Total return approach, investing across full spectrum of the fixed income market including up to 20% in below investment grade securities.

Key Takeaways
- For the quarter ending December 31, 2020, Voya’s Intermediate Bond strategy outperformed its benchmark, the Bloomberg Barclays U.S. Aggregate Bond Index.
- Outperformance was primarily driven by sector allocation and security selection decisions, followed by duration / yield curve positioning.
- In the near term, cyclical sectors across securitized credit, corporate credit and emerging market debt are relatively attractive. We believe that a rebound in economic growth, fostered by a duality of fiscal and central bank support, will push spreads uncomfortably tight in 2021.

Portfolio Review
For the quarter ending December 31, 2020, the portfolio outperformed its benchmark, the Bloomberg Barclays U.S. Aggregate Bond Index. Outperformance was primarily driven by sector allocation and security selection decisions, followed by duration / yield curve positioning.

Yields rose and spread sectors continued their outperformance in the final quarter of 2020. The U.S. and global economy showed signs of re-emerging from economic challenges earlier in the year and the approval of two vaccines extended the outperformance of risks assets, favoring sectors that had been lagging in the summer rally. U.S. GDP rose 33% on an annualized basis in the third quarter (after a decline of -31% in the second quarter) and U.S. unemployment levels declined to 6.7% in November. While unemployment declines occurred at a slower pace, it still represented a meaningful reduction from the peak level of 14.7% recorded in April. Fiscal stimulus, varying levels of re-openings around the country and simply adjusting to living in a “COVID world” supported healing in the economy.

While the U.S. elections were expected to be the center of attention, the announcement of two vaccines and their rapid approval by the FDA stole the spotlight. The news from both Pfizer and Moderna fueled hope for a return to normal and added momentum to the demand for risk assets. As a result, the 10-year Treasury yield rose from 0.69% to 0.92% at year-end and non-government sectors outperformed. The Bloomberg Barclays U.S. Aggregate was up 0.67% for the quarter and 7.51% for the year.

In aggregate, our underweight to U.S. Treasuries in favor of non-government sectors added to returns, with corporate allocations to both High Yield and Investment Grade representing the largest contribution as spreads continued to narrow going into year end. During the quarter, we elected to reduce our overweight to Non-Agency Residential Mortgage-Backed Securities (RMBS) and re-deploy capital to High Yield Corporates and Hard Currency Emerging Markets based on relative valuations and our belief these two sectors are likely to benefit more from a continued recovery in the global economy.
Allocations to Non-Agency RMBS and Credit Risk Transfer (CRTs) were buoyed by the vaccine news, and our decision to be underweight Agency MBS also contributed. Allocations to Asset-Backed Securities (ABS) detracted due to their lower beta characteristics and were offset by contributions from security selection that included higher yielding CLOs. In addition, Commercial Mortgage-Backed Securities (CMBS) security selection and investment grade corporates also added. Meanwhile, duration / yield curve positioning that shifted modestly underweight heading into year-end and positioned for a steeper curve was a small contributor to performance.

Current Strategy and Outlook

Heading into 2021, the market backdrop for cyclical sectors is extraordinarily positive. Consumers, supported by excess savings, robust net worth and additional fiscal aid, will drive a recovery in discretionary spending, leading to a full re-engagement of the service sector as the vaccine rollout is more widespread. The recovery in services spending coupled with resilience in goods demand will usher in an extended period of synchronized above trend global growth easing pressure on the income divide.

In the near term, cyclical sectors across securitized credit, corporate credit and emerging market debt are relatively attractive. We believe that a rebound in economic growth, fostered by a duality of fiscal and central bank support, will push spreads uncomfortably tight in 2021.

However, we also recognize the market seems to be very aligned on the near-term positive direction of risk assets. This one-way sentiment opens the door for volatility. The vaccine news is overwhelmingly positive and, we believe, ultimately the vaccine will succeed. However, the potential for episodic market stresses, whether connected to the vaccine or other global factors, should not be overlooked.

The heavy use of economic stabilizers creates fragility to shocks and will leave investors exposed to increasingly asymmetric risk profiles. Security selection, which is always important, has become absolutely critical, as the dispersion between “winning” and “losing” investments within sectors will remain extremely wide. Diversification, tail risk hedging and careful analysis of cyclical versus structural factors are necessary to mitigate downside risks and prepare portfolios for the income-starved world we face ahead.
The Bloomberg Barclays U.S. Aggregate Bond Index is a widely recognized, unmanaged index of publicly issued investment grade U.S. Government, mortgage-backed, asset-backed and corporate debt securities. 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. High-Yield Securities, or “junk bonds,” are rated lower than investment-grade bonds because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities. To the extent that the Fund invests in Mortgage-Related Securities, its exposure to prepayment and extension risks may be greater than investments in other fixed-income securities. The Fund may use Derivatives, such as options and futures, which can be illiquid, may disproportionately increase losses and have a potentially large impact on Fund performance. Foreign Investing poses special risks including currency fluctuation, economic and political risks not found in investments that are solely domestic. As Interest Rates rise, bond prices fall, reducing the value of the Fund’s share price. Other risks of the Fund include but are not limited to: Credit Risks, Extension Risks, Investment Models Risks, Municipal Securities Risks, Other Investment Companies’ Risks, Prepayment Risks, Price Volatility Risks, U.S. Government Securities and Obligations Risks, Debt Risks, Liquidity Risks, Portfolio Turnover Risks, and Securities Lending 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.

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