Key Takeaways

- For the quarter ending September 30, 2020, Voya’s Intermediate Bond strategy outperformed its benchmark, the Bloomberg Barclays U.S. Aggregate Bond Index.
- The largest contributions to relative performance came from the strategy’s high yield allocation and non-agency residential mortgage-backed securities (RMBS) and credit risk transfer (CRTs), supported by the rebound in the U.S. economy and resilient U.S. consumer.
- We expect a “K economy” and assessing sectors and industries through a lens of winners and losers will be critical to investment success going forward, with security selection having the potential to yield an outsized impact on performance in the months ahead.

Portfolio Review

For the quarter ending September 30, 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.

The recovery in the U.S. and global economy led to outperformance in credit sectors, while lingering concerns regarding COVID-19 and the steady hand of the Federal Reserve left U.S. rates rangebound in the third quarter. Continued signs of economic healing evidenced by sentiment surveys, employment trends and upward revisions to Q3 U.S. GDP forecasts, supported risk taking across corporate and securitized sectors. The corporate rally extended across the credit curve, with lower-rated securities outperforming higher rated securities. Meanwhile securitized credit also performed well, with commercial mortgage-backed securities (CMBS) posting the best excess returns in the index for the quarter. The one sector to lag was agency mortgage-backed securities (MBS), where performance was challenged in today’s low-rate environment and concerns about continued re-financing trends impacting pre-payments.

In September, the Fed extended its commitment to Zero Interest Rate Policy (ZIRP) with the latest dot plot forecasts highlighting official short-term rates would remain close to zero through 2023. Meanwhile, the long-awaited announcement from the Fed on inflation targeting caused a brief uptick in real yields as the Fed revealed they are inclined to let inflation run higher for longer to achieve a long-term average inflation target. As a result, the Fed will be slower to raise official rates and be less proactive when compared to previous Fed cycles.

Overweights to non-government sectors added to performance. The largest contributions came from High Yield allocation and the robust credit rally and Non-Agency RMBS and CRTs, supported by the rebound in the U.S. economy and resilient U.S. consumer. Positive
security selection largely came from asset-backed securities (ABS), which included higher-yielding collateralized loan obligations (CLOs) and CMBS, which benefited from normalization in the economy, followed by agency MBS, which included investments in collateralized mortgage obligations (CMOs). Meanwhile, duration / yield curve positioning was a modest contributor to performance.

**Current Strategy and Outlook**

The response to the COVID-19 pandemic has accelerated or exacerbated trends that were already in place. The resulting uneven pressures will create winners and losers with broad strokes across the fixed income spectrum and is being referred to as the “K-economy”.

From our view, the winners and losers in the post-COVID world fall into two camps. In the first camp are investments that are being affected by trends that were already in place and have accelerated because of the world’s response to the pandemic and the resulting uneven economic recovery. For example, among commercial mortgage-backed securities (CMBS), a potential “loser” would be brick and mortar properties anchored by lower-tiered malls. These properties already were facing significant pressure from the shift towards online retail; the response to COVID simply exacerbated their problems and accelerated the deterioration in their fundamentals.

In the second camp are sectors and investments that are being affected disproportionately by the COVID-19 pandemic. In this camp there will be industries that will either be negatively affected such as the decline in air travel and entertainment, or on the positive side online retail and other technology that have adapted to changes caused by the continuation of work from home.

Assessing sectors and industries through this lens of winners and losers will be critical to investment success going forward, with security selection having the potential to yield an outsized impact on performance in the months 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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