Commentary | 1Q24

Voya Investment Grade Credit Strategy

Focus On Total Return Driven By Security Selection Through US Investment Grade Corporate Bonds

Strategy overview

The Investment Grade Credit strategy seeks to maximize total return over a full market cycle via rigorous security selection and a duration-neutral approach to discovering risk-adjusted opportunities across the full range of U.S. investment grade corporate bonds.

Performance

For the quarter ending March 31, 2024, the Strategy outperformed its benchmark, the Bloomberg U.S. Corporate Index (the Index), on a both gross- and net-of-fees basis.

Key takeaways

- Risks assets continued to perform and rates moved higher as growth and inflation surprised to the upside.
- The Strategy outperformed its benchmark in the first quarter of 2024 on a both gross- and net-of-fees basis driven by security selection.
- We are neutral on spreads at current levels but remain positive on investment grade (IG) overall due to high all-in yields.

Market review

Risk assets enjoyed a strong first quarter as inflation's downward trend continued and U.S. economic growth beat expectations. The S&P 500 Index reached a new high and advanced by 10.56% on a total return basis during the quarter and the Nasdaq Composite had a price return of 9.11%. Credit spreads across corporate, securitized and emerging markets sectors finished broadly tighter. The Federal Open Market Committee voted to hold interest rates steady for the fifth consecutive time at its March meeting; however, three rate cuts are still expected this year, with the first potentially to happen in June. The 10-year U.S. Treasury yield rose from 3.95% in January to 4.20% by quarter end on early concerns that lingering high inflation could change the U.S. Federal Reserve's rate cut plans; however, it remained essentially flat in March following favorable comments from Fed Chair Powell.

IG spreads finished the quarter 9 basis points (bp) tighter to an option- adjusted spread (OAS) of 90 bp, 2 bp off the year-to-date tights. Tighter spreads led to positive excess returns for IG of 0.89% over like-duration U.S. Treasuries, but the move higher in rates produced negative total returns of –0.40% for the asset class in 1Q24. Spreads were supported by strong demand for the asset class despite record supply for the quarter. Financials outperformed utilities and industrials from a sector standpoint, while BBB- rated securities outpaced higher quality single-A issuers, and the credit curve saw a modest bull-steepening with front-end spreads outperforming the intermediate and long segments.

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Performance review

The Strategy outperformed its benchmark on a both gross- and net- of fees basis in the first quarter of 2024. Security selection was the key driver of outperformance, led by holdings across financials and industrials, while the Strategy's holdings in utilities did not materially contribute to relative returns. Within financials, the Strategy benefitted from strong selection within the banking sector, led by key overweight positions in select money center and super-regional banks, as financials outperformed on the quarter. Selection within the insurance sector, notably holdings in life and property and casualty insurers, were also a notable contributor to outperformance. Within industrials, key contributors included holdings in pharmaceuticals and energy, as well as airline bonds securities within transportation. From a quality standpoint, selection was led by BBB-rated issuers, while selection in the single-A bucket also added driven largely by financials. Sector allocation detracted from relative performance driven primarily by the Strategy's allocation to U.S. Treasuries and cash, which acted as a drag on returns with corporate bonds outpacing treasuries during the quarter.

The Strategy entered the quarter with a defensive risk posture given the rally in spreads seen late in 2023 and in anticipation of a heavy new issue calendar to start 2024. We were active in the new issue market but overall recycled risk through the quarter, increasing portfolio risk on the margin but overall maintaining a more defensive stance in the portfolio. From a sector standpoint, we increased risk in financials, mostly within insurance via the new issue market, driven by attractive relative valuations. Within industrials, we reduced tighter trading single-A bonds across consumer non-cyclicals and capital goods, in favor of select BBB-rated issuers in consumer cyclicals, energy and technology. We maintained a modest overweight to utilities given the sector's defensive posture. From a credit quality standpoint, we increased our underweight to single A- rated securities and modestly increased our overweight to BBB- rated securities. The front end of the credit curve saw spreads outpace that of the intermediate and long segments, and as a result we reduced front-end exposure in favor of the intermediate bucket of the curve where we maintain an overweight. We remain market weight the long end of the curve driven by attractive yields and continued demand, which we believe will support spreads in the near term.

Outlook and current strategy

The macro-outlook remains supportive, with strong data suggesting corporate fundamental factors will remain solid, and a backstop of Fed rate cuts should growth slow. The timing and pace of Fed rate cuts remains uncertain, but the repricing of expectations by the market and the subsequent move higher in rates added to the attractiveness of US IG yields. Earnings kick off mid-April for 1Q24 and are expected to continue to expand throughout 2024 with tech earnings coming off the highs and ex-Tech S&P numbers set to improve. Net leverage improved in the fourth quarter as companies built cash balances, while share buybacks ticked up but remain below 2021 levels. Ratings trends continue to be positive overall, although the number of BBB-rated bonds on negative outlook grew, suggesting possible more fallen angels later in the year. Overall, fundamental factors remain solid and will continue to improve, but will unlikely be a key driver of spreads in the near term.

Market technical factors have shifted positive as continued strong demand for IG coupled with an expected slowdown in new issuance will support spreads. The first quarter saw record new issuance despite a lower-than-expected new issue calendar in March. The new supply was well-absorbed, however, as strong inflows continued into the asset class, providing support for spreads. We expect this trend to continue given the back-up in yields to over 5.5% and subsequent heavy demand from yield-based buyers.

We continue to like IG from a yield perspective, but spreads at current levels remain less compelling and continue to warrant a defensive stance. IG spreads closed 9 bp tighter on the quarter, hitting year-to-date tights of 88 bp late in the period. We continue expect spreads to trade in a fairly tight range in the near term and prefer to maintain a more defensive risk posture in the Strategy given continued uncertainties over Fed policy. Banking continues to look attractive relative to industrials despite its strong start to the year, while insurance continues to provide attractive relative value opportunities. We continue to like utilities but remain tactical in the sector given heavy new issuance and increased liquidity. Within industrials, are leaning away from tighter-trading sectors with elevated merger and acquisition risk. We remain modestly overweight BBB-rated issuers from a quality standpoint and see more value in the front and intermediate segments than in longer-dated bonds given the flatness of the credit curve.

The **Bloomberg U.S. Corporate Index** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers. This index is a component of the US Credit and US Aggregate Indices, and provided the necessary inclusion rules are met, US Corporate Index securities also contribute to the multi-currency Global Aggregate Index. Index returns do not reflect fees, brokerage commissions, taxes or other expenses of investing. Investors cannot invest directly in an Index.

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