Commentary | 2Q20

Voya Senior Income Fund

Senior Loan Access through Closed-End Interval Fund

Strategy Overview

Actively managed, ultra-short duration floating-rate income strategy that invests primarily in privately syndicated, below investment grade senior secured corporate loans.

Key Takeaways

- In conjunction with broader financial markets, senior loans posted a significant recovery in 2Q20
- The S&P/LSTA Leveraged Loan index (the "index") returned 9.70% during the period, resulting in the best performing quarter since 2009
- As loan prices recovered, this dynamic helped provide some much-needed support for the loan market's technical balance
- For the quarter, the Fund return outperformed the benchmark

Current Strategy and Outlook

In conjunction with broader financial markets, senior loans posted a significant recovery in 2Q20. The index returned 9.70% during the period, resulting in the best performing quarter since 2009. The strong reversal in secondary trading levels brought the index bid to 89.88, which was more than a seven-point improvement from the end of March. While higher-rated loans outperformed amid last quarter's turmoil, the riskier segments of the index led the rally in 2Q20. Investors searched for discounts in industries that were perceived to be oversold, mainly those directly impacted by COVID-19-related risks. With a disproportionate number of loans within these sectors falling into the CCC-rated loans category, it was this rating group that, following a dismal performance in 1Q20, led the pack in the second quarter with an outsized gain of 14.13%. Single-B-rated loans followed suit by returning 11.12%, while BB-rated loans trailed given the improvement in sentiment, at 7.16%. Perhaps surprisingly to many, BB-rated loans now lag their single-B counterparts in the year-to-date (YTD) leaderboard, highlighting the speed at which single-B-rated loans – on average – have improved from their March lows.

As loan prices recovered, this dynamic helped provide some much-needed support for the loan market's technical balance. Despite overall supply trailing 1Q20 levels, largely a product of the primary market being virtually shut-off in April, the pace of activity saw a substantial uptick as the quarter went on. In this timeframe, arrangers took advantage of the healthier conditions and strong demand for new paper to get a handful of merger and acquisition deals through the finish line, many of which were inked before the pandemic. Of course, these deals were ascribed deeper discounts in order to attract investors, but many also included investor-friendly protections typically uncommon under normal circumstances, solidifying the view that a return to pre-COVID conditions has yet to materialize in the primary market. On the opposite end of the technical spectrum, measurable investor demand was underpinned by collateralized loan obligation (CLO) origination, which equaled $17.4 billion, matching the previous quarterly total. Retail investors, however, continued to withdraw their investment allocations from retail loan funds but at a considerably slower pace than in March. This activity amounted to $6.1 billion, compared to $17.1 billion in 1Q20.

After a prolonged low-default environment, the impact of the unprecedented COVID-19-related business disruption was brought into focus during the quarter with 27 index constituents

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defaulting, the highest quarterly amount since the global financial crisis. Unsurprisingly, the increased volume of defaults breached the historical default rate for the first time in more than five years, as the trailing-12-month default rate by principal closed out the period at 3.23%, above the historical average of 2.91%. Despite the severe effects of the coronavirus, a large portion of these companies were already facing pre-existing business challenges that were further magnified by the full or partial shuttering of operations.

While the range of default expectations among loan mangers and arrangers through year-end varies widely, most market participants do not expect default activity to materially abate anytime soon given the list of uncertainties that remain. Topping that list would include coronavirus volatility, macro and political headwinds and the potential for additional downgrade activity among leveraged loan and bond issuers. Given this view, we expect there to be a heightened focus on credit selection in the coming months, as the next wave of earnings will ascertain the haves from the have-nots, and provide some clarity on the lost economic output from the pandemic.

Portfolio Review

The Fund outperformed the index, which reflects no cash allocation or expenses. The relative outperformance was largely attributable to the Fund's use of leverage during a period of materially stronger loan bids. Leverage typically magnifies returns, both to the downside and upside; additionally, the index does not include the use of leverage. Investment portfolio-level positioning also contributed to relative results. From a structural perspective, pricing methodology differences — i.e., the portfolio prices at the mean of a loan's quoted bid and ask, while the index prices at the bid — were a partially offsetting detractor over the period. As with leverage, the impact of these structural factors is amplified in periods when prices are dramatically declining (1Q20) and increasing (2Q20).

At the portfolio level, relative loan portfolio contributors more than offset detractors. The primary contributors by ratings included selection and overweight to the single-C-rated loans, selection and underweight to BB-rated loans, an underweight to BBB-rated loans and selection in defaulted loans. From an industry perspective, the Fund primarily benefited from selection in electronics/electrical and business equipment and services, while additional, albeit smaller performance boosts, were due to selection in leisure goods/activities/movies, nonferrous metals/minerals and health care. At the issuer level, relative performance was helped by overweights to Iqor, Jo-Ann Stores, Inc., Quest Software US Holdings Inc., Encino Energy, Covia Holdings Corporation (this issuer defaulted on the last day of June) and Verifone, Inc. Many of these loans traded off in the previous quarter but found stronger bid support during the broad-based market rally in 2Q20.

Conversely, the primary detractor by ratings cohorts was selection in single-B-rated loans and CCC-rated loans. On an industry level, the main detractors were selection in retailers (except food and drug), selection and underweight to oil and gas, selection in cosmetics/toiletries and selection in telecommunications. At the issuer level, the portfolio's overweight in Tailored Brands (formerly Men's Wearhouse) was the primary detractor, as the company continues to face performance headwinds in the challenged retail segment. Other notable issuer laggards included overweights to Anastasia Beverly Hills, Skillsoft Corp. (2Q20 default), Belk LLC and Longview Power, LLC (2Q20 default).

The Fund experienced four defaults during the quarter (Longview Power, Skillsoft, 24 Hour Fitness Worldwide, Inc and Covia Holdings Corporation), compared to 27 new defaults for the index, as mentioned above. Diversification measures remain robust, with 33 industries and 292 individual issuers represented.

Holdings Detail

Companies mentioned in this report – percentage of portfolio investments, as of 6/30/20: Iqor 0.86%, Jo-Ann Stores, Inc. 0.17%, Quest Software US Holdings Inc. 0.80%, Encino Energy 0.17%, Covia Holdings Corporation 0.28%, Verifone, Inc. 0.52%, Tailored Brands 0.19%, Anastasia Beverly Hills 0.07%, Skillsoft Corp. 0.79%, Belk 0.13%, Longview Power 0.14%, LLC, and 24 Hour Fitness Worldwide, Inc 0.22%; 0% indicates that the security is no longer in the portfolio. Portfolio holdings are subject to daily change.

The S&P/LSTA Leveraged Loan Index is an unmanaged total return index that captures accrued interest, repayments, and market value changes. 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. **Investment Risks:** The Fund invests primarily in below investment grade, floating rate senior loans (also known as "high yield" or "junk" instruments), which are subject to greater levels of liquidity, credit, and other risks than are investment grade instruments. There is a limited secondary market for floating rate loans, which may limit the Fund's ability to sell a loan in a timely fashion or at a favorable price. If a loan is illiquid, the value of the loan may be negatively impacted and the manager may not be able to sell the loan in order to meet redemption needs or other portfolio cash requirements. The value of loans in the Fund could be negatively impacted by adverse economic or market conditions and by the failure of borrowers to repay principal or interest. A decrease in demand for loans may adversely affect the value of the Fund's investments, causing the Fund's net asset value to fall. Because of the limited market for floating rate senior loans, it may be difficult to value loans in the Fund on a daily basis. The actual price the Fund receives upon the sale of a loan could differ significantly from the value assigned to it in the Fund. The Fund may invest in foreign instruments, which may present increased market, liquidity, currency, interest rate, political, information, and other risks. These risks may be greater in the case of emerging market loans. Although interest rates for floating rate senior loans typically reset periodically, changes in market interest rates may impact the valuation of loans in the portfolio. In the case of early prepayment of loans in the Fund, the Fund may realize proceeds from the repayment that are less than the valuation assigned to the loan by the Fund. In the case of extensions of payment periods by borrowers on loans in the Fund, the valuation of the loans may be reduced. The Fund may also invest in other investment companies and will pay a proportional share of the expenses of the other investment company. **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 Fund and reduce its returns. Other investment risks of the Fund include, but are not limited to: **Equity Securities, Foreign Investments, High-Yield Securities, Leverage, Liquidity, Prepayment and Extension. Investors should consult the Fund's prospectus and statement of additional information for a more detailed discussion of the Fund's 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.**

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The opinions, views and information expressed in this commentary regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Portfolio holdings are fluid and are subject to daily change based on market conditions and other factors.

The Fund discussed may be available to you as part of your employer sponsored retirement plan. There may be additional plan level fees resulting in personal performance to vary from stated performance. Please call your benefits office for more information.

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