Voya SmallCap Opportunities Portfolio

Focusing on High-Quality Companies with Sustainable Growth Trends

Strategy overview

Actively managed small cap growth strategy driven by bottom-up fundamental research seeking high-quality companies with strong balance sheets and cash flow characteristics that are beneficiaries of sustainable growth trends.

Key takeaways

- The bull market run, over the first half of the year took a pause as markets pulled back during the third quarter. The specter of a government shutdown was avoided but that has done little to quell market volatility thus far.
- Small cap growth stocks, especially those considered longer-duration, came under fire in 3Q23 as the "soft landing" debate leaned toward the potential of "higher for longer".
- There remains a great deal of uncertainty ahead regarding the prospect of slowing economic growth and whether or not inflation has truly been tamed by the unprecedented rate cuts over the past year. It appears that the U.S Federal Reserve is nearing the end of the rate-hike cycle. We are cautiously optimistic that we can achieve the soft-landing scenario.

Portfolio review

For the quarter ended September 30, 2023, the Voya Small Cap Opportunities Portfolio outperformed the benchmark, the Russell 2000 Growth Index (the Index) on a net asset value (NAV) basis, due to both sector allocation and individual stock selection. Specifically, stock selection within the industrials, information technology and energy sectors were the largest contributors.

Key individual contributors to performance included Helix Energy Solutions Group, Inc., Weatherford International PLC and Reata Pharmaceuticals, Inc.

Helix Energy Solutions Group, Inc. (HLX), an energy company specializing in construction, maintenance and salvage services to the offshore natural gas and oil industry, was the largest contributor for the quarter. Following a solid 2Q23 earnings announcement that saw positive top and bottom-line growth combined with solid cash flows, HLX raised forward guidance on the expectations of continued demand and pricing leverage. The position was trimmed on strength, but we continue to maintain a position given strong supply and demand, as well as utilization trends within the industry.

Weatherford International PLC (WFRD), also in the energy sector and a provider of equipment and drilling services to the oil and natural gas exploration and production industry, performed well during the quarter. WFRD has seen strong earnings before interest, taxes, depreciation and amortization (EBITDA) margin expansion as a result of their international and offshore exposure. However, considering the significant run in the stock price our team is paying close attention to estimate revisions to 2024 and 2025 earnings while continuing to assess the risk and reward of the stock going forward.

Reata Pharmaceuticals, Inc. (RETA), a specialty neurological pharmaceutical company, was acquired by Biogen during the quarter. The $7.3 billion acquisition closed in late 3Q23, and our team took the opportunity to lock in profits by selling the position in its' entirety during the quarter.

Key detractors from performance included Harmonic Inc., Penumbra, Inc. and Inspire Medical Systems, Inc.

Harmonic, Inc. (HLIT) was the largest detractor from performance for the quarter. HLIT, a developer of video delivery software and products to the cable industry, has faced challenges surrounding inventory absorption and a technology transition at several of their core customers, i.e. Comcast and Charter. Run rates are expected to improve into 2024 and beyond following the completion of Comcast and Charter's adoption of DOCSIS 4.0 technology, which greatly improves capacity and speed of video delivery. We continue to hold the name in the Portfolio.

Penumbra, Inc. (PEN), a medical device company focused on neurovascular technologies and tools, underperformed for the quarter. Despite a consensus revenue and earnings per share (EPS) beat in 2Q23, PEN has been plagued with delayed Food and Drug Administration approval for its' anticipated "Thunderbolt" stroke treatment rollout, thus dampening forward revenue and EPS growth estimates. Upon the news of the push-out of this key product, the stock was sold.

Inspire Medical Systems, Inc. (INSP), a medical device company focused on the development of minimally invasive solutions for patients with obstructive sleep apnea (OSA), was a detractor from performance for the quarter. The benefits of weight loss drugs and GLP-1s continue to gain traction and pressure a wide range of businesses including INSP. However, historically drug-fear related pullbacks are overblown. INSP currently trades at a significant discount to past valuation levels and there is little data to support the anticipated slowdown in OSA related procedures and treatment. The Voya Small Cap Growth team has chosen to maintain the current position and expects INSP to maintain market share and solid long-term growth potential as they are expecting to introduce new technology in 2024.

Current strategy and outlook

The relative valuation discount favoring small cap growth over large cap growth continues to be attractive and near multi-year highs as the Fed remains steadfast on bringing inflation to their stated 2% target. Amidst the macro hurdles of government shutdowns, striking unions, the renewal of student loan payments, a slowdown in consumer spending, mortgage rates at 30-year highs, the Chinese economy struggling and the consensus "higher for longer" economic environment, U.S. corporate earnings have so far been resilient and are expected to continue to grow in 2024, albeit at a slower pace. In this environment, active management and the ability to discern winners from losers plays an increasingly important role. At Voya Small Cap Growth, we focus on company fundamental factors and continue to favor companies with solid revenue, earnings and cash flow potential that are trading at sustainable valuations. We believe this approach will perform well throughout a full market cycle and the team continues to find opportunities across sectors and industries that meet our criteria. Portfolios are currently overweight to industrials and information technology sectors and underweighted in healthcare. The anticipated lagging effect of the Fed hikes has all eyes on the upcoming earnings season to gauge consumer and corporate resilience and market direction for the remainder of the year and into 2024.

Holdings detail

Companies mentioned in this report – average percentage of Fund and Portfolio investments, as of 09/30/23: Helix Energy Solutions Group, Inc. 1.42%, Weatherford International PLC 2.47%, Reata Pharmaceuticals, Inc. 0%, Harmonic, Inc. 0.77%, Penumbra, Inc. 0% and Inspire Medical Systems, Inc. 0.90%; 0% indicates that the security is no longer in the Fund. Portfolio holdings are subject to daily change.

The **Russell 2000® Growth Index** is an unmanaged Index that measures the performance of securities of smaller US companies with greater-than-average growth orientation. 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. In exchange for higher growth potential, investing in stocks of **Smaller Companies** may entail greater price volatility and less liquidity than investing in stocks of larger companies. Other risks of the Portfolio include but are not limited to: **Growth Investing Risks, Market Trends Risks, Other Investment Companies' Risks, Price Volatility Risks, Liquidity Risks, Portfolio Turnover Risks and Securities Lending Risks. Investors should consult the Portfolio's Prospectus and Statement of Additional Information for a more detailed discussion of the Portfolio's risks. An investment in the Portfolio 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.

Variable annuities and group annuities are long-term investments designed for retirement purposes. If withdrawals are taken prior to age 59½, an IRS 10% premature distribution penalty tax may apply. Money taken from the annuity will be taxed as ordinary income in the year the money is distributed. An annuity does not provide any additional tax deferral benefit, as tax deferral is provided by the plan. Annuities may be subject to additional fees and expenses to which other tax-qualified funding vehicles may not be subject. However, an annuity does provide other features and benefits, such as lifetime income payments and death benefits, which may be valuable to you.

Variable investments, of any kind, are not guaranteed and are subject to investment risk including the possible loss of principal. The investment return and principal value of the security will fluctuate so that when redeemed, it may be worth more or less than the original investment. In addition, there is no guarantee that any variable investment option will meet its stated objective. All guarantees are based on the financial strength and claims paying ability of the issuing insurance company, who is solely responsible for all obligations under its policies.

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Past performance is no guarantee of future returns. All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield inherent in investing. All security transactions involve substantial risk of loss. Please reference your client statement for a complete review of recent transactions and performance.

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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.

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