Unconstrained Fixed Income

Strategy overview

Unconstrained and flexible approach, investing broadly across the global debt markets.

Key Takeaways

- For the quarter, the strategy outperformed its benchmark, the Merrill Lynch LIBOR Three-Month Constant Maturity index.
- The U.S. and global economy showed signs of re-emerging from economic challenges earlier in the year and the approval of vaccines extended the outperformance of risks assets, favoring sectors that had been lagging in the summer rally.
- Yields rose and spread sectors continued their outperformance in the final quarter of 2020.
- Sector allocation contributed the most to relative performance, followed by security selection, which also added over the period.

Portfolio Review

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, decisions to allocate to corporate credit sectors including investment grade (IG) corporates, high yield (HY) corporates, bank loans and emerging market debt (EM) added to results as these sectors benefited with the continued recovery in the global economy. Securitized credit allocations benefited from a continued recovery, as non-agency residential mortgage-backed securities (RMBS), credit risk transfer (CRT), and commercial mortgage-backed securities (CMBS) added to results. In addition, security selection among IG corporates, EM, CMBS and asset backed securities (ABS) also added.

While we pivoted our portfolios to capture what we viewed as a tactical opportunity in corporate credit, our bias remains skewed towards securitized credit and the U.S. consumer. From a recovery perspective, securitized credit has lagged; fiscal- and monetary-policy-driven spending and programs directed towards securitized credit markets have been slower to become active. Longer term, we continue to believe that securitized credit represents attractive exposure to the relatively strong fundamentals of the U.S. consumer.
Security selection added to results. Positive security selection largely came from CMBS, where our security selection is focused on more credit sensitive investments. Security selection in ABS also contributed, which included investments in higher-yielding CLOs. BBB-rated IG Corporates and emerging market sovereigns that traversed high grade and high yield also added, while agency MBS modestly detracted. Duration / yield curve positioning did not meaningfully contribute to performance. Currency exposures in developed markets detracted.

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.

1 The firm relies upon quantitative models for certain investment strategies in developed currency markets.

The Bank of America Merrill Lynch U.S. Dollar Three-Month LIBOR Constant Maturity Index is designed to track the performance of a synthetic asset paying LIBOR to a stated maturity. The index is based on the assumed purchase at par of a synthetic instrument having exactly its stated maturity and with a coupon equal to that day’s fixing rate. That issue is assumed to be sold the following business day (priced at a yield equal to the current day rate) and rolled into a new instrument. The Index does not reflect fees, brokerage commissions, taxes or other expenses of investing. Investors cannot directly invest in an index. BofAML Indices used with permission, are provided “AS IS”, without warranty, and with no liability. BofAML does not sponsor, endorse, review, or recommend Voya or its products or services.

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The strategy employs a quantitative investment process. The process is based on a collection of proprietary computer programs, or models, that calculate expected return rankings based on variables such as earnings growth prospects, valuation, and relative strength. Portfolio construction uses a traditional optimizer that maximizes expected return of the portfolio, while managing tracking error.

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

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