Fixed Income Perspectives

While growth in the U.S and globally is expected to cool from its torrid pace in 1H21, fundamentals remain broadly positive and opportunities could arise in any meaningful bout of spread volatility.

Positioning for a Growth Slowdown in Q3

Global growth appears to have peaked, with China clearly slowing and U.S. and European growth resilient but marginally softer. Easy base effects have largely passed, and ongoing pockets of COVID-related weakness continue to take their toll, particularly consumer expectation indicators. Among the major economies, U.S. growth remains the leader, due in part to less stringency on lockdowns and a general consumer willingness to largely maintain activity levels despite a resurgence in COVID cases.

While growth expectations in the U.S. remain resilient, headwinds have emerged, leading to lower revisions for Q3. Consumer spending has cooled as stimulus has expired and the Delta variant has led to a pullback in services-oriented spending such as restaurants, airfare, and hotels; with that said, the latest retail sales print highlighted a rebound in goods spending (excluding autos). Housing investment has also cooled as lack of inventory and high prices have offset sustained low mortgage rates. Elsewhere, uncertainty around the timing and composition of fiscal stimulus coming out of Washington has increased as lawmakers debate how to fund investment. This is notable as fiscal spending is expected to be a key source of sustaining above-trend growth. Despite these headwinds, we expect the Fed will likely begin tapering in November or December of this year, barring any meaningful payroll misses. While Fed Chair Powell has reiterated that the end of taper was de-linked from the initiation of rate hikes, an earlier end to tapering would give the Fed an option to pull rate hikes forward, if necessary.

With the potential of spread volatility in the near term, we have begun taking some chips off the table where we believe further upside is limited. This includes taking gains in select areas of CMBS and Non-Agency RMBS; we remain overweight Securitized broadly compared to corporate credit. However, given corporate fundamentals look strong, we would view bouts of spread widening as opportunities to add higher quality risk in sectors such as investment grade and BB-rated high yield corporates. We remain more cautious on emerging markets given the potential contagion from China and the Evergrande debacle. With growth expected to slow and inflation potentially peaking, we do not expect a meaningful move higher in U.S. interest rates, and have therefore reduced our short-duration posture across portfolios.

Bond Market Outlook

Global Rates: Policy rates stay to stay low over the near term as investors digest growth, monetary policy outlook post-reopening rebound

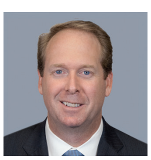
Global Currencies: U.S. dollar to remain resilient vs DM, EM currencies

Investment Grade: Near-term outlook for IG credit remains positive, but valuations warrant defensive positioning

High Yield: Overall we remain neutral as fundamentals feel a touch softer

Securitized: Prefer areas in CMBS, CLOs where yield opportunities remain; residential credit still facing prepayment headwinds

Emerging Markets: Global economic strength helped, and will likely continue to help EM overall, although unsynchronized growth within the cohort is also an ongoing factor

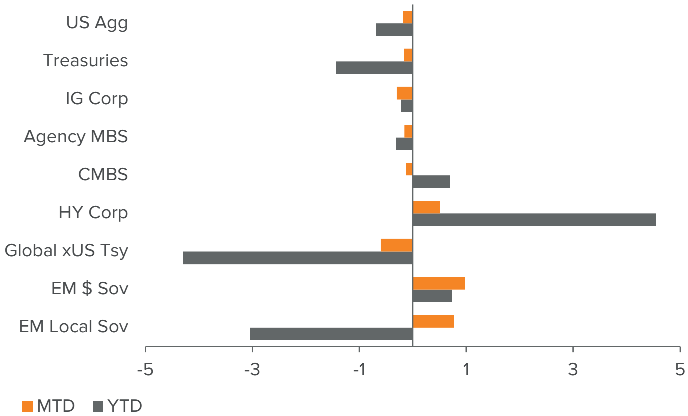


Matt Toms, CFA
CIO Fixed Income

Voya Investment Management's fixed-income strategies cover a broad range of maturities, sectors and instruments, giving investors wide latitude to create a new portfolio structure or complement an existing one. We offer investment strategies across the yield curve and credit spectrum, as well as in specialized disciplines that focus on individual market sectors. We build portfolios one bond at a time, with a critical review of each security by experienced fixed income managers.

Rates, Spreads and Yields

Fixed Income Sector Total Returns



		31-Aug	30-Jun	1Y Low	1Y High
Yields	US 2 Yr	0.21	0.25	0.11	0.26
	US 10 Yr	1.31	1.47	0.64	1.74
	GER 10 Yr	-0.38	-0.21	-0.64	-0.10
	JPN 10 Yr	0.03	0.06	0.01	0.16
	EM Local Sov	4.99	4.98	4.19	5.06
Spreads	IG Corp	87	80	80	140
	Agency MBS	33	27	7	69
	CMBS	95	95	92	176
	HY Corp	288	268	262	537
	HY x-Egy Corp	275	257	252	492
	EM $ Sov	343	340	330	440

As of 08/31/21. Source: Bloomberg, Bloomberg/Barclays, JP Morgan and Voya. **Past performance is no guarantee of future results.**

Sector Outlooks

Global Rates and Currencies

Inflation data remains firm, but the peak has probably past, in our view. Monthly readings have been decelerating since April and the YoY rate likely peaked in June. However, lingering impacts from supply disruptions seem likely to intersect with firming shelter inflation, which has some transient influences through supply, but structural support from still-firming wage growth.

In Europe, reopening has gained ground with the PMI now surpassing the U.S. Indeed, European activity remained resilient, while services activity in the U.S. slowed due to weaker demand and staffing issues. Within Europe, the services PMI has now overtaken the somewhat supply constrained manufacturing PMI. Similar to the U.S., reopening frictions have contributed to higher inflation in Europe, but the odds of stickiness seem lower than in the U.S. And while recent ECB commentary opened the door to some slowing of pandemic QE purchases in September, leadership probably does not favor a meaningful retracement of the recent step-up in purchases. The remaining PEPP allocation appears to necessitate a taper at some point which may lessen the signaling value of any action. The ECB's Chief Economist Lane recently argued that the PEPP should be used to maintain favorable financing conditions while downside risks remain. In contrast, he suggested that the APP should be used to address the inflation gap vs. projections and differences in bond supply and demand. If needed, a slower PEPP purchase pace could be countered if needed by increases in the APP program, which still needs to be defined in the context of the new ECB 2% symmetrical inflation framework.

Investment Grade (IG) Corporates

Heavy supply at the beginning of August contributed to a slight sell-off, but as expectations for lighter September volumes began to form, investors stepped back in. Also, the move higher in interest rates attracted demand from yield-based buyers. A mixed bag of economic numbers increased concerns around the Delta variant's impact on the reopening trade. However, while the pause in momentum likely gives the FED cover to maintain a dovish stance, comments from Jackson Hole suggest they are still on target for tapering asset purchases this year. While our near-term outlook for credit remains positive, we keep our strategic and tactical rating at Neutral. Seasonally heavy supply in September may provide an opportunity to add some IG risk at the margin. We see the most value in 7- to 10-year bonds with the long-end of the Treasury curve flattening. Sector wise, we like Telecoms, Utilities and Technology.

High Yield Corporates

In a reversal from July, August supply was very heavy early-on, but a slowdown late in the month saw the technical environment improve materially once the flow abated. Higher credit rated issues outperformed a bit as Treasuries settled into a comfortable range and CCC's lagged slightly on Delta concerns. While new supply mercifully shut down from the heavy volume earlier in August, we expect the onslaught to return in September. With year-over-year positive comparables easing - mostly due to Delta, supply chain issues and cost increases for nearly every input - there still seems to be enough pricing power to maintain or even improve margins. Indeed, ratings are trending positively and the default rate is near zero. While the Delta wave is slowing in the Sunbelt, it seems inevitable it will follow seasonal patterns and make its way northward. Oil has bounced back nicely and Natural Gas remains strong. We see the likelihood of continued positive "event-risk" as legacy names get upgraded or taken out.

Securitized Assets

Agency MBS underperformed Treasuries as investors remained cautious on the sector due to taper risk. Technicals were biased towards more MBS issuance while banks continue to add MBS at a much slower pace. Although spreads are expected to widen as FED tapering approaches, bank buying should support mortgages and continued strong-roll financing should help mortgages out-carry Treasuries in the near-term. Additionally, prepayment speeds are slowing and dampened taper talk from the Fed meeting should renew appetite for MBS outside the Fed if rates can stabilize.

We continue to carry a negative outlook for Mortgage Credit, but with a different qualification than earlier in the Spring. With prepayment and call risk still issues for total return driven market participants, the space is poised to continue to lag. Add in significant supply spillover from overloaded GSEs, elevated Prime Jumbo issuance and a better focused non-QM ecosystem, RMBS can add technically induced sloppiness to prepay risk catalyzed negatives.

CMBS's strong start to the year, which extended well into the summer, appears to be cooling with the approaching Fall temperatures. Although credit appetite is deep and perceptions of risk have shifted definitively lower, the now-tighter spreads offer less room to move lower and the path of least resistance favors spread-widening. While euphoria from the vaccines, reopening, etc., is fading, sentiment is weaker heading into a period of what is expected to be elevated issuance. As spreads in competing risk sectors continue to rally, CMBS cheapness remains and this becomes clearer as fundamentals continue to evolve mostly favorably.

With lots of deals working their way through the system this month, a potential source of stress on market conditions, we think they are nonetheless likely to do reasonably well given liquidity conditions. Non-benchmark ABS will continue to perform well fundamentally and command strong sponsorship from money managers with low-vol, low-return seeking strategies. However, with spreads now at, or through, pre-COVID tights after a strong June, outperformance is likely to be limited, with returns coming from carry and idiosyncratic tightening from ratings upgrades. We maintain our assessment as positive and increase our conviction. The fiscally improved profile of the US consumer coupled with ABS structural dynamics were already believed to provide the sector with solid footing to withstand this sustained period of elevated, albeit improving, unemployment. Indeed, recently enacted stimulus is acting as a fortifying bridge to the end of the pandemic.

Emerging Market (EM) Debt

The momentum and strength of the US economy coupled with the gradual re-opening in Europe continued to be supportive of the global recovery, however regional divergences in consumption patterns remain. Nonetheless, we expect global capital flows to EMs will correlate to favorable global financial conditions. The multi-speed and unsynchronized EM growth rebound is expected to continue, along with a strong rebound in goods trade as demand picks up, but supply chain uncertainties are a concern. Headline inflation continues to rise due to consumer demand, forex pass-through and higher commodity prices. EM corporates continued to see earnings improvement, led by commodity producers that benefited from rebounding oil and metal prices.

Disclaimer

IM1845054 • WLT250007570

voyainvestments.com