Fixed Income Perspectives

The onset of tapering will not automatically start the countdown for rate hikes to begin.

Bond Market Outlook

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

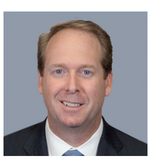
Global Currencies: U.S. dollar to remain resilient versus DM, EM currencies

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

High Yield: Overall, we remain neutral as valuations are on the tighter side

Securitized: Prefer areas in CMBS and CLOs where yield opportunities remain; residential credit still facing prepayment headwinds but outlook is positive

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



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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.

Fed Tapering is Mole Hill, Not a Mountain

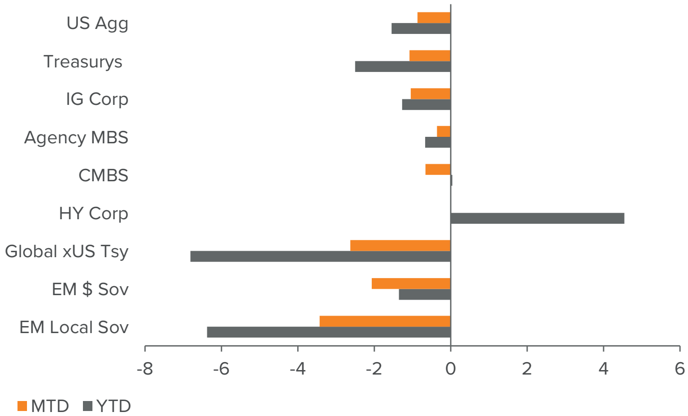
While many have been fixated on the taper timeline, for us, the more important factor was that the Federal Reserve de-linked interest rate hikes from tapering operations. Put another way, the onset of tapering will not automatically start the countdown for rate hikes to begin. Indeed, Fed Chairman Powell has done a good job of communicating as much to the markets, helping to quell concerns about the impact of receding liquidity.

Another fixation we believe is misguided but needs addressing, is that the word *stagflation* is being thrown around a lot. While we believe that stagflation is highly unlikely, it is fair to characterize the incremental "impulses" on growth to be lower, and on inflation to be higher. Many have characterized inflation as transitory, but we think this characterization is too short-sighted. Rather, we see the current inflationary environment as *cyclical*, i.e., persistent during this phase of above-trend growth which is likely to continue over the next two-plus years. With the Fed now signaling rate hikes no later than 2023, we see upward pressure on long-term yields. Inflation will remain a key driver for rates going into year-end and next year. While we see a higher inflation baseline, ultimately, we do not expect structural inflation to take hold that could create a significant headwind for fixed income investors. As a result, we expect the 10-year Treasury yield could rise up to 2% in the coming quarters.

While growth expectations in the United States remain resilient, headwinds have emerged, leading to downward revisions for 3Q21. While valuations remain on the tighter end, fundamentals remain supportive for risk-taking. We trimmed some overweights where we believe further upside is limited. This includes reducing exposures in select areas of commercial mortgage-backed securities (CMBS) and non-agency residential mortgage-backed securities (RMBS). We remain overweight securitized credit compared to corporate credit, believing structured securities offer an attractive source of income in today's environment. Meanwhile, we remain underweight agency MBS based on relative valuations. Given that 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 will continue to monitor emerging markets given the potential contagion from China and the Evergrande debt debacle; in our view, outsized moves may yield select opportunities.

Rates, Spreads and Yields

Fixed Income Sector Total Returns



		30-Sep	30-Jun	1Y Low	1Y High
Yields	US 2 Yr	0.29	0.25	0.11	0.29
	US 10 Yr	1.49	1.47	0.68	1.74
	GER 10 Yr	-0.20	-0.21	-0.64	-0.10
	JPN 10 Yr	0.07	0.06	0.01	0.16
	EM Local Sov	5.30	4.98	4.19	5.30
Spreads	IG Corp	84	80	80	136
	Agency MBS	27	27	7	61
	CMBS	95	95	92	164
	HY Corp	289	268	262	517
	HY x-Egy Corp	281	257	252	470
	EM $ Sov	358	340	330	432

As of 09/30/21. Source: Bloomberg, JP Morgan and Voya Investments. **Past performance is no guarantee of future results.**

Sector Outlooks

Global Rates and Currencies

With COVID fears largely subsiding, the economy turning upward in the United States and broad-based wage gains, there are plenty of reasons for optimism. Very real uncertainties prevail, however, including China's economy having crested its peak and regulation there growing more pervasive, supply chain bottlenecks intensifying and energy prices soaring in the European Union and China.

Among the major economies, U.S. growth remains the leader, due in part to less stringency on lockdowns and a general consumer willingness to maintain activity levels despite a resurgence in COVID cases. While the Federal Reserve's dot plot tilted slightly hawkish, there are more nuances under the surface. In our view, there is a 90% chance that a start to tapering in November is a done deal. And while incoming inflation data remain firm, the peak has probably also passed as monthly readings have been decelerating since April, and the year-over-year rate likely peaked in June. Nonetheless, lingering impacts from supply disruptions seem likely to intersect with firming shelter inflation, which has some transient influences through supply, but also structural support from still firming wage growth. Finally, although the unemployment insurance benefit expiration is boosting job searching among the unemployed, it is not clear if it is raising workforce participation.

Reopening in Europe has gained ground, with PMIs there now surpassing the U.S. Economic activity in Europe has remained resilient, while service activity in the U.S. has slowed due to weaker demand and staffing issues. Within Europe, the services PMI has now overtaken the somewhat supply-constrained manufacturing PMI. The PMI data also showed healthy activity in the periphery. 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.

Investment Grade (IG) Corporates

Heavy supply to start September led to attractive new issue opportunities, which then gave way to a rally in the secondary market as volume tapered off through the month. Supply of $154 billion was about 10% above the five-year average but the market easily absorbed it. The move higher in rates helped demand from yield-based buyers. Looking ahead, the fundamental picture could be less positive than Q2, driven by lowered expectations for 3Q GDP as a result of the impact of the Delta variant. While the near-term outlook for credit remains positive, we keep our strategic and tactical rating at neutral. We see the most value in seven- to ten-year bonds with the long-end of the Treasury curve flattening. Sector-wise, we like telecoms, utilities and technology.

High Yield Corporates

Conditions are getting a little choppier heading in to the end of the year, as BB-rated issues have seen some push-back on the pickup of interest rate volatility. Noise around China, tapering, supply chains and the dreaded "S" word – stagflation– are all weighing a bit on sentiment. While new debt sales may not end up as heavy as thought, there are *plenty* of deals coming to market to choose from. At this point, we maintain our neutral – or market weight – recommendation, with a willingness to be opportunistic. For us, the big downside scenario would be the Fed being forced into a rate action due to inflation against a weaker growth picture. Indeed, ratings are trending positively and the default rate is near zero. While the Delta wave is slowing in the Sunbelt, it seems inevitable that 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 issues get upgraded or taken out.

Securitized Assets

Agency MBS outperformed Treasurys on the back of a bear steepener, which was initially led by the middle of the yield curve, followed by the long end. The technical backdrop was positive, as investors took advantage of lower dollar prices, higher yields and slightly lower mortgage origination volumes. Although spreads are expected to widen as Fed tapering approaches, bank buying should support mortgages and continued strong "roll" financing should help mortgages offer better "carry" than Treasurys in the near term. Prepayment speeds are slowing and dampened taper talk from the Fed meeting should renew appetite for MBS outside the Fed if rates can stabilize.

Our outlook for mortgage credit has changed to positive. While perhaps early, this view reconciles much better with some of the best credit conditions we have ever seen, between housing market dynamics, economic growth and a well-positioned consumer. Although the prepay outlook isn't ideal, we look for a more favorable set of conditions into year-end, which could improve sponsorship in this already "credit-risk blessed" space. Affordability is a key risk to housing market dynamics, but it stops short of threatening strong mortgage credit behavior through the investment horizon, and could perhaps prove a tailwind if it plays a role in moderating new issue supply from its current pace.

The more broadly weaker sentiment from markets now risks leaking into CMBS. While the sector has navigated a daunting new issue calendar reasonably well, some fatigue is to be expected, and is likely to conspire with weaker market conditions. Nonetheless, credit appetite is deep and perceptions of risk have shifted definitively lower, so we expect widening to prove short-lived. To be clear, the markets are open for financing, and with the Delta surge seemingly fading and good news with Merck's therapeutic, we continue to like the prospects for more seasoned risks.

The asset-backed securities (ABS) market successfully navigated its surge of new issuance in September, displaying deep sponsorship across a broad range of subsectors and issuers. While valuations remain on the rich side with spreads at or through pre-COVID tights, the apparent turn lower in broader market sentiment should allow ABS to really shine. We maintain our assessment as positive and increase our conviction. The fiscally improved profile of U.S. consumers coupled with ABS structural dynamics already were believed to provide the sector with a solid footing to withstand this sustained period of elevated, albeit improving, unemployment. In our view, recently enacted stimulus is acting as a fortifying bridge to the end of the pandemic.

Emerging Market (EM) Debt

We expect the economic recovery to carry through into 2022 even if the pace of U.S. and European growth eases on supply chain bottlenecks, the embedded nature of inflation and Delta variants. That said, as reopening materializes, regional divergences in economic paths are likely to remain, which will impact inflation differently. We expect global capital flows to EMs will correlate to favorable global financial conditions. The multi-speed, unsynchronous EM growth rebound is expected to continue, with most countries failing to close the output gap until 2H22/1H23. Parts of EM are facing inflationary pressures, with supply-side constraints in focus amid rising domestic and external demand, and high commodity prices. A number of proactive central banks in Central and Eastern Europe, the Middle East, Africa and Latin America remain hawkish; while Asia (excluding-Korea) remains accommodative. EM corporates continue to see earnings improvement, led by commodity producers that are benefiting from the rebound in oil and metals prices.

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