Voya Securitized Credit Fund

Tap into Voya's Flexible "Through-the-Cycle" Approach

Strategy overview

Invests in fixed income sectors collateralized by distinct asset types: commercial real estate (CMBS), residential housing (RMBS) and non-mortgage assets such as asset-backed securities (ABS).

Key takeaways

- Rates ended lower and credit spreads tightened due to encouraging economic data and renewed hopes for rate cuts.
- The Fund underperformed its benchmark, the Bloomberg U.S. Securitized MBS/ABS/CMBS (the Index) on a net asset value (NAV) basis. Non-agency residential mortgage backed-securities (RMBS), asset-backed securities (ABS) and collateralized loan obligations (CLOs) generated positive excess returns, however all securitized credit sectors underperformed the agency-heavy benchmark.
- Corporate markets appear to be priced for a soft landing and therefore the portfolio is more focused on securities backed by consumer credit and commercial real estate (CRE).

Portfolio review

Rates continued to sell-off into October as strong economic data faded hopes for a U.S. Federal Reserve "pivot". In particular, the labor market showed significant strength, with September's payroll data reporting an impressive pace of job gains. This was followed by the initial reading for third-quarter gross domestic product (GDP) growth which exceeded already elevated expectations, coming in well above trend. By the end of October, the 10-year Treasury yield had breached 5%, a level not seen since 2007. As rates moved higher, credit spreads widened reflecting the increased risk that comes with a prolonged period of restrictive policy.

Then came November and with it, a notable turn in sentiment. Inflation data, which had already been declining for several months, continued to decline resulting in more balanced market expectations. One Fed governor even suggested the possibility of rate cuts ahead of reaching the 2% inflation target. Additionally, while payroll gains remained strong, they were more measured over the next couple of months, and September's blockbuster gain was revised downward by a meaningful amount. As a result, rates rallied and credit spreads tightened.

In the final month of the quarter, the Fed appeared to confirm renewed market expectations that a less restrictive stance was in the near future. The updated dot plot showed that every single participant believed the hiking cycle had concluded, and the median participant projected 75 basis points (bp) worth of cuts in 2024. This affirmation from the Fed further contributed to the tightening of credit spreads, and a fall in rates.

The experience of November and December stood out from the first 10 months of the year. Rates experienced a significant decline, and the Bloomberg US Aggregate Index rallied, resulting in a 6.82% return for the quarter, with more than 4% coming from November alone. One thing that was consistent throughout the year was that lower credit sectors produced strong excess returns however even higher quality sectors posted respectable outperformance. For example, agency mortgage-backed securities (MBS), which struggled earlier in the quarter due to inconsistent demand, rallied into falling rate volatility and ended the quarter on a high note.

RMBS was the top contributor to excess returns, adding 33 bp to the portfolio total. Credit risk transfer (CRT) was the main contributor followed by Jumbo 2.0 and Expanded Prime collateral. CLOs outperformed on a per dollar basis and contributed 10 bp to the portfolio excess return. Single-A rated issuers were the top contributor followed by AA rated issuers. ABS contributed 9 bp to aggregate excess in 4Q23. Student Loan, Whole Business and Solar were the top contributing subsectors. CMBS performance lagged with the sector detracting –51 bp to portfolio excess returns. A handful of subordinate conduit credit positions were responsible for most of the negative excess returns while CMBS interest only and agency real estate mortgage investment conduit (ReREMICs) contributed positively. That said, all securitized credit sectors underperformed agency MBS leading the Fund to underperform the benchmark for the quarter.

Current strategy and outlook

Looking forward, the outlook has improved marginally, however we still expect growth to slow below trend. The increased cost of capital will likely curb consumption and investment, however ongoing government support measures at a global level are expected to partially offset these effects. In particular, China's growth focused investment and advanced economies efforts to enhance supply chain security are anticipated to bolster growth in the short term.

As the market focus shifts from inflation to growth concerns, duration will become an effective offset to risky asset drawdowns. Rate volatility, though receding from recent peaks, will remain above pre-pandemic levels due to uncertainty about the timing of rate cuts and concerns about government debt levels. Elevated real rates will incent investors to increase allocations to fixed income, creating opportunities during bouts of volatility.

That said, many corners of the market appear to be priced for a soft landing. While this has become a more likely outcome, we believe the risks to this outcome materializing are being ignored. Labor markets are coming into better balance which, while good news for inflation, could cause concern among workers that a turn in the cycle is approaching. This in turn could compel workers to boost savings rates which would limit consumption and act as a challenge to growth.

With this dynamic in place, portfolios have a moderate level of risk with focus on higher quality credit, and allocations are skewed towards sectors with better relative value. For example, securities backed by consumer credit and CRE are currently trading with wider spreads relative to CLOs. Meanwhile, the dark clouds over CMBS appear to be fading as lower rates make refinancing existing loans less challenging. Within CLOs, our exposure is almost exclusively single-A and above, having reduced our lower rated holdings over the past several months.

The **Bloomberg U.S. Securitized MBS/ABS/CMBS and Covered Index** includes the MBS, ABS, and CMBS sectors. Indexes do not reflect fees, brokerage commissions, taxes or other expenses of investing, and investors cannot directly invest in an index.

All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield inherent in investing. **High-Yield Securities,** or "junk bonds", are rated lower than investment-grade bonds because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities. To the extent that the Fund invests in **Mortgage-Related Securities**, its exposure to prepayment and extension risks may be greater than investments in other fixed-income securities. The Fund may use **Derivatives**, such as options and futures, which can be illiquid, may disproportionately increase losses and have a potentially large impact on Fund performance. **Foreign Investing** does pose special risks including currency fluctuation, economic and political risks not found in investments that are solely domestic. As **Interest Rates** rise, bond prices fall, reducing the value of the Fund's share price. **Other risks of the Fund include but are not limited to: Credit Risks; Credit Default Swaps; Currency; Interest in Loans; Liquidity; Other Investment Companies' Risks; Prepayment and Extension; Price Volatility Risks; U.S. Government Securities and Obligations; Sovereign Debt; and Securities Lending Risks. Investors should consult the Fund's Prospectus and Statement of Additional Information.**

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