Commentary | 2Q23

Voya Floating Rate Fund

An Attractive Income Option for a Strategic Allocation

Strategy overview

Actively managed, ultra-short duration floating-rate income strategy that invests primarily in privately syndicated, below investment grade senior secured corporate loans.

Key takeaways

- Against a challenging macro backdrop, the U.S. loan market delivered a strong performance in 2Q23, as the Morningstar® LSTA ® US Leveraged Loan Index (the Index) returned 3.15% during the quarter.
- On a Net asset value (NAV) basis, Class I shares of the Fund underperformed the Index.
- As the banking concerns precipitated by the collapse of Silicon Valley Bank and other regional banks seem to have waned, we expect U.S. Federal Reserve policy to be primarily driven by economic data releases going forward.

Portfolio review

Monetary policy continued to produce market volatility in the second quarter of 2023. Despite the failure of a fourth U.S. Regional Bank just two days prior, the Fed delivered another 25 basis point hike at their meeting in May. That said, with inflation trending in the right direction, and lending from banks expected to tighten, it was widely believed that this hike might be the last. Inflation data over the next couple months was relatively well behaved. While the numbers remained elevated, they avoided moving higher. Meanwhile, the labor market remained strong. Monthly job gains surpassed already elevated expectations, with each monthly gain exceeding the previous one. While the Fed did not deliver a hike at their meeting in June, these upside surprises in the labor market eliminated any hope of a "pause", with market participants instead viewing the Fed's inaction as a "skip". Accordingly, a hawkish Fed dot plot signaled that two more rate hikes could be on the horizon for the balance of the year.

Against this challenging macro backdrop, the U.S. loan market delivered a strong performance in 2Q23, as the Index returned 3.15% during the quarter. Overall, the average Index bid price increased by 86 bp to 94.24. On a year to date basis, loans have returned 6.48% (the highest return since 2009 for any comparable period). In terms of ratings, secondary trading levels moved higher across the board during the quarter. Similar to the prior quarter, lower-rated loans continued to outperform higher-rated credits, as BB, B and CCC rated loans returned 2.81%, 3.25% and 4.39%, respectively.

Consistent with the theme in 1Q23, supply in the primary market remained low and largely consisted of opportunistic transactions, while M&A formation was limited. Total institutional volume amounted to $49.6 billion during the quarter, versus $55.9 billion for the comparable period last year. The size of the loan market, as represented by total Index outstandings, declined by $4.77 billion in 2Q23 to $1.39 trillion. On the investor front, collateralized loan obligation (CLO) volume decreased to $21.6 billion from $33.5 billion in the previous quarter, representing a 36% decline quarter-over-quarter. For additional context, 2Q23 represented the lowest quarterly issuance since 2Q20. On the other hand, outflows in retail loan funds and exchange-traded funds continued. While retail outflow activity decelerated in the final month of 2Q23, investors still withdrew $7.8 billion in aggregate from funds during the quarter.

On a NAV basis, Class I shares of the Fund underperformed the Index. By ratings, the Fund was negatively impacted by selection in BB rated credits. From an industry perspective, the main relative drag was selection within semiconductors and semiconductor equipment, which was primarily driven by an overweight position to Lumileds. The company was recently downgraded after they gave a weak earnings outlook. In contrast, the Fund was helped by selection and an underweight allocation to health care providers and services, as the avoidance of a few issuers that lagged the broader market helped boost performance, most notably Us Renal Care Inc. Additionally, selection in trading companies and distributors also added, mostly due to Yak Mat, which benefited from improved market tone that disproportionately benefited the riskier and distressed parts of the market. Other positive outliers were overweights to Telesat Canada (diversified telecommunication services sector) and Nautilus Power, LLc. (independent power and renewable electricity producers sector). The former company reaffirmed fiscal year 2023 guidance, while the latter company completed a comprehensive out of court restructuring where lenders extended debt maturities into a super priority term loan and the equity sponsor provided an additional loan for enhanced liquidity. Away from loan-level performance, the Fund's modest exposure to high yield bonds (HY) resulted in a drag, as the HY bond market underperformed in 2Q23 relative to loans (1.75% return for the Bloomberg U.S. Corporate High Yield Index).

Portfolio and positioning changes were both mostly minimal during the period. The number of individual names in the portfolio decreased from 385 to 375, while the average spread level of the Fund decreased to 361 bp (versus 372 bp in the prior quarter).

Current strategy and outlook

As the banking concerns precipitated by the collapse of SVB and other regional banks seem to have waned, we expect Fed policy to be primarily driven by economic data releases going forward. While the Fed's rate-hiking cycle is nearing an end, the resilience of the labor market combined with sticky core inflation will continue to result in a hawkish posture, which has been evidenced by the recent lift in dot-plot projections. As a result, there are risks that vulnerabilities start to surface again, as higher terminal rates continue to weigh on the weaker parts of the economy.

Specific to the loan market, we believe credit decompression among lower quality borrowers is highly probable in the second half of the year, given the higher rates environment and muted economic growth. While companies have seen an inflection point on supply chain issues, elevated input costs and peak in labor shortages and cost pressure, we expect corporate margins to be impacted by decelerating revenue, as volume declines offset prior price increases (limited ability to continue to pass through into consumers). Understandably, corporate fundamental factors for companies could become more challenged, resulting in higher dispersion across sectors, weaker issuers, and ratings cohorts. However, supportive technical factors could provide a favorable backdrop in the medium term due to ramping CLOs and light new-issue supply. Despite 1Q23 earnings being better than expected, we generally maintain previously held cautious sectoral views and up-in-quality positioning.

Holdings detail

Companies mentioned in this report – percentage of Fund investments, as of 6/30/23: Lumileds 0.21%, US Renal Care 0%, Yak Mat 0.52%, Telesat Canada 0.21%, and Nautilus Power 0.78%; 0% indicates that the security is no longer in the portfolio. Portfolio holdings are subject to change on a daily basis.

Disclaimer

The **Morningstar® LSTA ® US Leveraged Loan** index is an unmanaged total return index that captures accrued interest, repayments, and market value changes. 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. **Investment Risks:** The Fund invests primarily in below investment grade, floating rate senior loans (also known as "high yield" or "junk" instruments), which are subject to greater levels of liquidity, credit, and other risks than are investment grade instruments. There is a limited secondary market for floating rate loans, which may limit the Fund's ability to sell a loan in a timely fashion or at a favorable price. If a loan is illiquid, the value of the loan may be negatively impacted and the manager may not be able to sell the loan in order to meet redemption needs or other portfolio cash requirements. The value of loans in the Fund could be negatively impacted by adverse economic or market conditions and by the failure of borrowers to repay principal or interest. A decrease in demand for loans may adversely affect the value of the Fund's investments, causing the Fund's net asset value to fall. Because of the limited market for floating rate senior loans, it may be difficult to value loans in the Fund on a daily basis. The actual price the Fund receives upon the sale of a loan could differ significantly from the value assigned to it in the Fund. The Fund may invest in foreign instruments, which may present increased market, liquidity, currency, interest rate, political, information, and other risks. These risks may be greater in the case of emerging market loans. Although interest rates for floating rate senior loans typically reset periodically, changes in market interest rates may impact the valuation of loans in the portfolio. In the case of early prepayment of loans in the Fund, the Fund may realize proceeds from the repayment that are less than the valuation assigned to the loan by the Fund. In the case of extensions of payment periods by borrowers on loans in the Fund, the valuation of the loans may be reduced. The Fund may also invest in other investment companies and will pay a proportional share of the expenses of the other investment company. **Derivative Instruments:** Derivative instruments are subject to a number of risks, including the risk of changes in the market price of the underlying securities, credit risk with respect to the counterparty, risk of loss due to changes in interest rates and liquidity risk. The use of certain derivatives may also have a leveraging effect which may increase the volatility of the Fund and reduce its returns. Other investment risks of the Fund include, but are not limited to: **Equity Securities, Foreign Investments, High-Yield Securities, Leverage, Liquidity, Prepayment and Extension. Investors should consult the Fund's prospectus and statement of additional information for a more detailed discussion of the Fund's risks. An investment in the Fund is not a bank deposit and is not insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.**

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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.

The Fund discussed may be available to you as part of your employer sponsored retirement plan. There may be additional plan level fees resulting in personal performance to vary from stated performance. Please call your benefits office for more information.

Performance Attribution: During the period from January 1, 2017 to July 31, 2020, an unaffiliated data provider, which is used by the Funds to identify individual senior loans and groups of senior loans that detracted from or contributed to portfolio performance on an absolute or relative basis (commonly known as "attribution analysis"), provided the Funds with inaccurate data. As a result, the attribution analysis used to explain and analyze a portfolio's performance against a particular benchmark was inaccurate in some instances during the period. Importantly, the Funds' actual performance information and performance comparison to their respective benchmark which appeared in various Fund commentaries during this period were correct and were not impacted by the inaccurate data. The data provider has identified and corrected the issue that caused the transmission of inaccurate information, and correct information is reflected in attribution analysis used in commentaries prepared after September 30, 2020.performance. Please call your benefits office for more information.

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