Commentary | 2Q24

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

- The loan Index returned 1.90% in 2Q24 (the weakest quarterly return since Q3 2022), down from 2.46% last quarter.
- On a net asset value (NAV) basis, Class I shares of the Fund outperformed the Index.
- We expect the technical backdrop to remain largely supportive in the loan market, as the ongoing demand and supply imbalance will likely persist for the balance of the year.

Portfolio review

The second quarter was marked by a series of conflicting economic data releases, which led to the anticipation of two rate cuts in 2024. The disinflationary and soft landing narrative, which came into question in 1Q24 following a series of upside surprises, regained credibility in2Q24 as the data came in mostly in line with expectations. Corporate credit sectors were further supported by 1Q24 earnings, which exceeded analyst expectations. The loan Index returned 1.90% in 2Q24 (the weakest quarterly return since Q3 2022), down from 2.46% last quarter. This softness was driven by weakness in price return. High base rates continued to provide a steady coupon stream for the loan asset class, pushing year to date return to 4.40% (outperforming comparable periods in 2020, 2021 and 2022). By ratings, single-B rated loans outperformed this quarter, posting gains of 2.06%, while double-B and CCC rated loans returned 1.80% and 1.24%, respectively. However, for the year, CCC loans have outperformed by posting a strong return of 6.48%, followed by single-B and double-B rated loans at 4.57% and 3.84%, respectively.

Opportunistic transactions continued to be the main driver of issuance in the primary market. Repricings are on a record pace in 2024, reaching a total of $223 billion in 2Q24 and $372 billion YTD. In addition, dividend recapitalization transaction reached a record high of $35 billion YTD, exceeding the full year volume of 2022 and 2023 combined. Excluding repricings and amendments, total institutional volume slightly increased to $146 billion from $143 billion in 1Q24. About $95 billion of total issuance were tied to refinancings (the third highest quarterly volume on record). On the demand side, collateralized loan obligations (CLO) issuance increased from 1Q24 volume as spreads tightened. The current YTD volume is now tracking $101 billion across 214 deals up from last year's volume of $56 billion. There was a notable increase in inflows into retail loan funds, as $5.5 billion entered the retail fund space during the quarter.

There were four defaults in the Index during the quarter as the trailing 12-month default rate by principal amount decreased to 0.92% (from 1.14% in March).

On a NAV basis, Class I shares of the Fund outperformed the Index. The Fund's primary relative contribution stemmed from selling the equity position of Longview which was received as part of a prior restructuring. By ratings, selection in single B rated loans contributed to the Fund's performance. From an industry perspective, the main positive drivers were selection in media and software and the underweight allocation in diversified telecommunication services. Away from loan-level performance, the Fund's modest exposure to high yield (HY) bonds slightly weighed on relative performance, as the HY bond market underperformed loans in 2Q24 (1.07% return for the Bloomberg U.S. Corporate High Yield Index). In contrast, selection in health care providers and services detracted from performance.

Portfolio and positioning changes were both mostly minimal during the period. The number of individual names in the portfolio increased from 350 to 362.

Current strategy and outlook

The recently cooler inflation data and softer labor market conditions have strengthened the case for a rate cut as early as September. However, with growth remaining near trend and inflation still comfortably above 2%, the pace at which the U.S. Federal Reserve cuts will remain slow and measured. We expect the technical backdrop to remain largely supportive in the loan market, as the ongoing demand and supply imbalance will likely persist for the balance of the year. Fundamental factors will remain supportive (mainly among stronger rated issuers) with high demand and decent margins. However, dispersion and bifurcation among weaker credits and consumer discretionary sectors will remain prevalent while slower growth and elevated rates could lead to higher downgrades and default risk within some sectors. Therefore, we generally maintain previously held cautious sectoral views, focus on credit selection and up-in-quality positioning.

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 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.

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