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 Morningstar® LSTA ® US Leveraged Loan Index (the Index) returned 3.46% during the quarter.
- On a net asset value (NAV) basis, Class I shares of the Fund underperformed the Index.
- Looking ahead, we expect technical factors to remain supportive in the near term due to persistent collateralized loan obligations creation, a positive reversal in retail fund flows, and still light (albeit increasing) new-issue supply volume.

Portfolio review

The third quarter of 2023 contained an abundance of strong data, as the prospect of a soft landing gained credibility. Inflation continued to trend in the right direction, as Core Personal Consumption Expenditures Price Index , which at its peak was running at a year over year rate of 5.6%, fell to 3.8% by the end of August. Meanwhile, the economy continued to add jobs at a fast pace. The combination of falling inflation and a strong labor market allowed consumers to continue spending, creating a tailwind for gross domestic product growth. Maintaining a data dependent stance, the U.S. Federal Reserve responded to this better-than-expected data by hiking rates at their July meeting. In September, the Fed kept rates unchanged, however their updated dot plot projection reinforced a “higher for longer” message. This led to a broad sell-off across rates, leading to disappointing returns across both fixed income and equities. Despite the weaker tone in risk assets, senior loans remained resilient.

The Index returned 3.46% during the quarter (the highest quarterly return since 4Q20). Rising coupons, driven by an increase in base rates and stable nominal spreads, continue to be a large contributor to positive returns alongside a slow uptick in price appreciation. The average Index bid price moved higher by 132 basis points (bp), closing out September at 95.56. On a year-to-date basis, the Index has now returned 10.16% (the strongest return since Global Financial Crisis). Lower-rated names continued to outperform their higher quality counterparts. For context, CCC, B and BB rated loans posted gains of 6.05%, 3.85%, and 2.21% respectively.

Unlike 2Q23, issuance in the primary market picked up this quarter. Total supply for the quarter was $76.3 billion, marking the highest quarterly issuance since early 2022, which was the start of the Fed’s aggressive rate hike campaign. The size of the loan market, as represented by total Index outstandings, grew by $14.1 billion in 3Q23 to $1.41 trillion. On the demand front, investors had a strong appetite for the asset class. CLO issuance increased in 3Q23, as liability spreads tightened throughout the debt stack, creating opportunities for issuance. The total volume grew to $28 billion from $22.4 billion last quarter but down 15.7% from last year’s level of $33.2 billion. Meanwhile, retail loan funds reported the first positive quarter since 1Q22 with an inflow of $1.04 billion.

On a NAV basis, Class I shares of the Fund underperformed the Index. By ratings, the Fund was negatively impacted by selection in CCC rated loans, followed by selection in BB rated loans. From an industry perspective, the main challenges were selection in consumer staples distribution and retail, as well as specialty retail. The former was entirely driven by an overweight allocation to Save-A-Lot (posted weak quarterly earnings), while the latter largely resulted from an overweight allocation to Jo-Ann Stores, Inc., which experienced macro-related challenges and softer demand for its products. On the other hand, the Fund benefited from its small exposure to the defaulted and non-rated loan categories. This was primarily driven by an overweight allocation to a few distressed names that disproportionately benefited from the firmer market backdrop, including the likes of Diamond Sports Group, LLC, Riverbed Technology, Inc. and Yak Mat. Away from loan-level performance, the Fund's modest exposure to high yield (HY) bonds resulted in a drag, as the HY bond market notably underperformed in 3Q23 relative to loans (0.46% 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 increased from 375 to 400 as the portfolio added positions in both the primary and secondary markets on a selective basis, while the average spread level of the Fund increased slightly to 362 bp (versus 361 bp in the prior quarter).

Current strategy and outlook

We expect macro-related volatility to remain a prominent theme in the near term, as the "higher-for-longer" rates backdrop and uncertain path to lower inflation will continue to influence market sentiment. While the U.S. economic outlook has been favorable and appears to have de coupled from the rest of the world, policy rates remain highly restrictive in the medium term and there are risks that consumer spending eventually weakens as the built-up excess savings from the pandemic diminish, credit conditions tighten further, and student loan repayments resume. The Fed is expected to remain firmly data-dependent and hold a hawkish bias until there is high conviction that inflation is firmly under control.

Supported by healthy technical factors and a historically high level of interest carry, performance in the loan market has been resilient despite some increased volatility in other asset classes. Looking ahead, we expect technical factors to remain supportive in the near term due to persistent CLO creation, a positive reversal in retail fund flows, and still light (albeit increasing) new-issue supply volume. Key concerns are centered around the impact on cash flows and coverage ratios for weaker and lower-rated credit profiles in a "higher for longer" interest rate environment, as we have seen a notable pick up in borrowing costs on a sequential and last 12 months basis. In addition, we expect dispersion in performance among borrowers to remain a theme and pockets of stress to emerge as the cycle matures. As such, our focus will be on security selection and finding pockets of value in a continuously dispersed market.

Holdings detail

Companies mentioned in this report – percentage of Fund investments, as of 9/30/23: Save-A-Lot 0.87%, Jo-Ann Stores, Inc. 0.07%, Diamond Sports Group, LLC 0.05%, Riverbed Technology, Inc. 0.16% and Yak Mat 0.52%; 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.**

This commentary has been prepared by Voya Investment Management for informational purposes. Nothing contained herein should be construed as (i) an offer to sell or solicitation of an offer to buy any security or (ii) a recommendation as to the advisability of investing in, purchasing or selling any security. Any opinions expressed herein reflect our judgment and are subject to change. Certain of the statements contained herein are statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (1) general economic conditions, (2) performance of financial markets, (3) interest rate levels, (4) increasing levels of loan defaults (5) changes in laws and regulations and (6) changes in the policies of governments and/or regulatory authorities. **Past performance is no guarantee of future results.**

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.

The Standard & Poor's rating scale is as follows, from excellent (high grade) to poor (including default): AAA to D, with intermediate ratings offered at each level between AA and CCC. Anything lower than a BBB- rating is considered a non-investment grade or junk bond. Any security that is not rated by Standard & Poor's is placed in the NR (Not Rated) category.

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