Voya High Yield Bond Fund

Comprehensive Research, Broad Diversification

Strategy overview

Total return approach, investing in below investment grade corporate securities.

Key takeaways

- Despite a volatile environment, the high yield (HY) market benefitted from the macroeconomic backdrop and increased risk appetite, producing positive returns across the credit stack.
- For the quarter, the Fund underperformed on a net asset value (NAV) basis.
- As always, our focus will be on security selection and finding pockets of value in an increasingly dispersed market.

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 U.S. Federal Reserve delivered another 25 basis points 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 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.

In the HY market, credit spreads tightened during the quarter and now sit at the lowest level since early February. On an option-adjusted spread (OAS) basis, spreads finished the period 65 bp tighter at 390 bp. The HY market produced positive returns across the credit stack. However, much like the prior quarter, down-in-quality outperformance remained a theme, with BB rated bonds returning 0.89%, B rated bonds returning 1.90% and CCC rated bonds returning 4.18%, represented by securities within the Index. Despite the strong risk-on sentiment, performance has not been uniform across HY issuers, as dispersion remains elevated due to idiosyncratic reasons.

For the quarter, the Fund underperformed on a NAV basis. From a sector perspective, the portfolio’s exposure to retailers was the primary detractor during the period. While an overweight allocation to the sector provided a small boost, it was not enough to offset the performance drag resulting from security selection. Within the sector, the Fund was negatively impacted by its exposure to Victoria’s Secret and Co., which underperformed due to poor earnings, as well as the avoidance of Carvana, which rallied from distressed levels despite the lack of a fundamental change in the company’s business.

Current strategy and outlook

Looking forward, we believe the recent data releases on the economic front have minimized the prospect of a near-term recession. However, the strength of the labor market and, in turn, the consumer should influence the Fed to maintain a hawkish stance until inflation moderates further. While corporate earnings have remained somewhat resilient, we expect margins to decline during the second half of the year, as pricing power diminishes while the sticky components of core inflation remain elevated.

In the HY market, performance has been resilient, supported by strong technical factors. Yields are arguably more attractive than spreads and will allow the market to absorb a modest back-up and still produce positive returns. While spreads will undoubtably move wider in a pronounced economic slowdown, we believe the HY market should be able to successfully navigate a milder recessionary scenario, as the path to materially wider spreads remains limited, given healthy starting point in issuer fundamental factors and the improved rating profile of the HY market.

In terms of sector positioning, we remain positive on building materials due to favorable supply and demand dynamics in the housing sector. While our overweight to the energy sector has decreased relative to historical norms, we remain constructive on the sector, given positive view on the underlying oil and gas commodity. In terms of ratings, we remain fairly risk neutral across cohorts but have pared down a bit of cyclical exposure, particularly in lower-rated ratings, with the view of gross domestic product growth slowing amid the more difficult macro backdrop. In addition, we expect dispersion in performance among borrowers to continue 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 an increasingly dispersed market.

The **Bloomberg Barclays High Yield Bond—2% Issuer Constrained Composite Index** is an unmanaged index that includes all fixed income securities having a maximum quality rating of Ba1, a minimum amount outstanding of $150 million, and at least one year to maturity. **Investors cannot invest directly in an index.**

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CMFC-HYBOND 063023 • ex063024 • IM3017089 • WLT250007101