Commentary | 4Q24

Voya High Yield Bond Fund

Comprehensive Research, Broad Diversification

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Strategy overview

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

Key takeaways

- Overall, the fourth quarter of 2024 was characterized by resilient labor market dynamics, strong economic growth and sticky inflation.
- For the quarter, the class I shares of the Fund underperformed the Index on a net asset value (NAV) basis.
- Looking ahead, we believe a healthy macro environment supported by a focus on growth and deregulation will be constructive for risk assets.

Portfolio review

Overall, the fourth quarter of 2024 was characterized by resilient labor market dynamics, strong economic growth and sticky inflation. The impact on fixed income performance was mixed, with yields rising and credit spreads tightening, leading to modestly negative total returns for most fixed income sectors. Third quarter gross domestic product (GDP) once again came in elevated, driven largely by strong consumer and government spending. Labor market dynamics continued to show signs of rebalancing, while wage growth remained elevated, allowing for the sustained resilience of consumer spending and stickiness of inflation, particularly the services segment. While the U.S. Federal Reserve delivered two additional rate cuts on the quarter, the December cut was accompanied by more hawkish elements. Specifically, the Fed's Dot plot indicated only two cuts projected for 2025, down from four in the previous iteration, while officials moved their projections for both growth and inflation higher. These factors resulted in a sharp move higher in yields across the curve, most of which came in December, with the 10-year U.S. Treasury yield closing 79 basis points (bp) higher to 4.57%.

High yield (HY) credit spreads continued to tighten in the fourth quarter. Following the election, the average option-adjusted spread (OAS) of the Bloomberg High Yield 2% Issuer Cap Index (Index) hit an intra-year tight of 253 bp before ending the year at 287 bp, which was 8 bp tighter since the end of the third quarter and 36 bp tighter since the start of the year. Despite the back-up in rates producing negatives returns for most fixed income categories, HY eked out a positive return of 0.17% in the quarter. This brought the 2024 full-year return for the asset class to 8.19%. Following the election, the average option-adjusted spread (OAS) of the Bloomberg High Yield 2% Issuer Cap Index (Index) hit an intra-year tight of 253 bp before ending the year at 287 bp, which was 8 bp tighter since the end of the third quarter and 36 bp tighter since the start of the year. Despite the back-up in rates producing negatives returns for most fixed income categories, HY eked out a positive return of 0.17% in the quarter. This brought the 2024 full-year return for the asset class to 8.19%. From a quality perspective, lower-rated bonds continued to outperform in the quarter, as BB, B and CCC returned –0.49%, 0.31% and 2.26%, respectively. Primary market issuance remained muted given the seasonal summer slowdown, while the use of proceeds continues to primarily consist of refinancings. Meanwhile, investor inflows remained elevated given the attractive yields and positive backdrop for credit.

For the quarter, the class I shares of the Fund underperformed the Index on a NAV basis. Detractors for the quarter included Altice International, weighed down by challenges in the telecom space, and Medical Properties Trust, a medical real estate investment trust (REIT) facing challenges in its tenant base, as well as the opportunity cost of some distressed names not owned by the fund that rallied in the period. Positive drivers of performance include security selection within chemicals, primarily due to successful refinancings of Trinseo Materials and Innophos, and financials, where the fund's overweight to wealth management firms and insurance brokers positively impacted performance. The portfolio also benefited from positions in bank loans in select names, as the senior loan market outperformed HY in 4Q24 given the sell-off in rates. The underperformance was driven by fees as the Fund outperformed on a gross-of-fees basis.

Current strategy and outlook

Looking ahead, we believe a healthy macro environment supported by a focus on growth and deregulation will be constructive for risk assets. Fundamental factors in the HY market remain generally healthy, barring a few pockets of stress in secularly challenged sectors. Although downside risk has diminished recently, we remain attuned to potential headwinds that could create volatility and widen spreads in coming quarters. On the macro front, we believe the main "known" risks are inflation stalling above the Fed's target and lower consumer spending stemming from a weakening of the labor market, with a material external shock being a wildcard. Market technical factors should remain supportive in the near term, driven by steady investor inflows and still muted net issuance levels. While valuations aren't particularly cheap, high all-in carry should continue to support returns even if spreads widen modestly.

Our constructive base case view supports an overweight to single-B rated bonds and a modest underweight in BB, but spreads largely reflect that view, leaving us underweight the distressed "tail" of the market and favoring more defensive sectors. We remain focused on name-specific risk, focused on income and capital preservation given the challenged upside to downside skew of current prices. In terms of sector positioning, we are more constructive on U.S. cyclicals relative to global cyclicals with the view of the U.S. economy continuing to outperform in 2025. To that end, we've increased exposure to more U.S. centric business versus those more dependent on revenues in growth challenged geographies such as China and Europe. Examples include healthcare providers and U.S. based energy producers, which we favor over global commodity producers and autos.

The **Bloomberg U.S. High Yield 2% Issuer Capped Index** is an unmanaged index comprised of fixed rate, non-investment grade debt securities that are dollar denominated and non-convertible. The index limits the maximum exposure to any one issuer to 2%.Index returns do not reflect fees, brokerage commissions, taxes or other expenses of investing. **Investors cannot invest directly in an index.**

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