Voya Intermediate Fixed Income SMA

Multi-Sector Approach Focused on Total Return

Strategy overview

A total return approach, utilizing a multi-sector approach with a higher quality posture through the use of Treasury, agency and corporate credit securities with 1-10 year maturities. The primary drivers of our investment-grade fixed income performance are our positioning for rate trends and sector relative value assessments across governments, mortgagesand corporates.

Key takeaways

- For the quarter, the Voya Intermediate Fixed Income SMA underperformed its benchmark, the Bloomberg Intermediate Government/Credit Index (the Index) on a net asset value (NAV) basis.
- In corporate credit markets, spreads remained resilient.
- Strong fundamental factors will continue to support tight spreads, while periods of volatility spurred by expectations of lower growth and post-election policies change will provide opportunities to episodically add risk.

Portfolio review

For the quarter, the Voya Intermediate Fixed Income SMA underperformed the Index, on a NAV basis. Our strategy's continued focus on higher-rated bonds within investment grade was the primary relative detractor. However, the SMA's relatively shorter duration profile versus the Index was additive to performance, as rates finished slightly higher during the quarter.

The second quarter of 2024 was marked by a series of evolving and, at times, conflicting economic signals. The interplay between labor market dynamics, inflation and consumer behavior painted a complex picture for investors and policymakers alike. The quarter began with a significant upside surprise in the March Non-Farm Payroll (NFP) report, contradicting other employment indicators such as Institute for Supply Management (ISM) Employment and National Federation of Independent Business (NFIB) hiring intentions. Notably, job growth was primarily concentrated in part-time employment, potentially masking broader weakness that was evidenced by a decline in full-time employment that had been ongoing since peaking in May 2023. One month later, NFP missed to the downside, which helped to quell reflation fears but was still strong enough to avoid igniting concerns of a recession. Altogether, the trend over the quarter signaled a return to a more "balanced" labor market, with the pace of wage gains slowing, the quit rate declining, and the unemployment rate tick up modestly off of extreme lows.

Similarly, consumer spending, which has led growth over the last several quarters, showed signs of weakening, with only modest growth numbers reported in both personal spending and retail sales data. Major retailers like Walmart, Target and Dollar Tree reported cautious outlooks in their earnings reports, reflecting the strain on lower-income consumers. Rising credit card delinquencies and a low savings rate further underscored the financial challenges facing some consumers.

The disinflationary narrative, which came into question in 1Q24 following a series of upside surprises, regained credibility in 2Q24 as the data came in mostly in line with expectations. That said, U.S. Federal Reserve officials maintained a cautious stance, and emphasized that no immediate rate cuts were necessary. The Fed's updated dot plot in mid-June revealed a relatively hawkish stance, projecting only one rate cut through the end of the year, compared to three in the March projection.

Markets, like the Fed, were very data dependent. With better growth data reported at the beginning of the quarter, spreads continued to trade at tight levels and credit sectors posted solid excess returns. Interest rates also responding by continuing the selloff that was sparked by the hot inflation data in 1Q24, but ultimately finished the quarter only slightly higher.

Corporate credit sectors were further supported by 1Q24 earnings, which again exceeded analyst expectations. While leverage and coverage ratios continued to slowly deteriorate, aggregate fundamental factors remained acceptable, and ratings trends continued to be positive overall. From a technical standpoint, both IG and high yield sectors were well bid due to higher all-in yields, despite tight spread levels.

Current strategy and outlook

From a fundamental perspective, the outlook has undoubtedly improved. Inflation has managed to decline without significantly impacting growth, and labor markets have managed to rebalance without a meaningful uptick in unemployment. We believe inflation will continue to trend lower, as the lagged impact of declining rent prices will take hold in the coming months, and overcapacity in China will keep goods prices in deflation. We expect growth to remain positive but will continue at a more measured pace. Consumption growth will likely slow due to slowing wage gains and higher prices but will remain positive as the wealth effect (stock prices and home values at all-time highs) continues to be supportive. Similarly, high financing costs will likely curb private investment, however this will be at least partially offset by investment in artificial intelligence technology.

Stress on lower income consumers is, unfortunately, a key outlier in this otherwise positive dynamic. While not a systemic risk, we do think this will allow the Fed to cut rates prior to the election. That said, with the labor market still intact and consumer spending still supportive in aggregate, along with inflation still above 2%, we believe the extent to which the Fed will cut will be limited and the pace will be slow.

All of this points to the realization of a soft landing for the economy. A scenario thought to be impossible only one year ago. While this would otherwise compel us to be more active in taking credit risk, spreads remain tight in corporate credit sectors. Meanwhile, duration-oriented risks are poised to benefit from the implementation of central bank policy and the resulting decrease in rate volatility. Strong fundamental factors will continue to support tight spreads, while periods of volatility spurred by expectations of lower growth and post-election policies changes will provide opportunities to episodically add risk.

The **Bloomberg US Intermediate Government/Credit Index** includes fixed rate, dollar-denominated, investment grade securities with maturities of 1-10 years held within both the Bloomberg US Government Index (public obligations of the US Treasury, US Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the US Government) and the Bloomberg US Credit Index (publicly issued US corporate and foreign debentures and secured notes).

The principal risks are generally those attributable to bond investing. Holdings are subject to market, issuer, credit, prepayment, extension, and other risks, and their values may fluctuate. Market risk is the risk that securities may decline in value due to factors affecting the securities markets or particular industries. Issuer risk is the risk that the value of a security may decline for reasons specific to the issuer, such as changes in its financial condition. The strategy may invest in mortgage-related securities, which can be paid off early if the borrowers on the underlying mortgages pay off their mortgages sooner than scheduled. If interest rates are falling, the strategy will be forced to reinvest this money at lower yields. Conversely, if interest rates are rising, the expected principal payments will slow, thereby locking in the coupon rate at below market levels and extending the security's life and duration while reducing its market value. High yield bonds carry particular market risks and may experience greater volatility in market value than investment grade bonds. Foreign investments could be riskier than US investments because of exchange rate, political, economics, liquidity, and regulatory risks. Additionally, investments in emerging market countries are riskier than other foreign investments because the political and economic systems in emerging market countries are less stable.

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