Voya Strategic Income Opportunities Fund

Unconstrained Fixed Income

Strategy overview

Unconstrained and flexible approach, investing broadly across the global debt markets.

Key takeaways

- Risk assets performed, and risk-free assets struggled in 1Q24. The Strategy outperformed its benchmark, the ICE BofA USD 3M Deposit Offered Rate Constant Maturity Index (the Index), on a net asset value (NAV) basis.
- Sector allocation and security selection drove performance, while duration and yield curve positioning detracted in the wake of a retracement in rates.
- While spreads for many sectors appear tight, all-in yields remain historically attractive, allowing investors to capture high quality yield without overstretching into risk.

Portfolio review

Risk assets performed and risk-free assets struggled in 1Q24. The first quarter of 2024 witnessed a series of positive data points indicating a continuation of strong economic growth that characterized much of 2023. As a result, the S&P 500 Index experienced strong performance, delivering a return of over 10%, and excess returns for most fixed income sectors finished in positive territory. This robust showing indicated investor confidence and optimism in the overall economic outlook. Meanwhile, despite strong excess returns, high-quality bond markets, as represented by the Bloomberg US Aggregate Index, posted modestly negative total returns driven primarily by the move higher in interest rates.

The labor market continued to exhibit signs of strength to start the year. With an exceptionally low unemployment rate and continued job gains, economic growth remained on a positive trajectory. However, there were indications of a gradual shift towards a more balanced labor market, characterized by a decline in the quit rate and a deceleration in wage gains. These developments were welcomed by market participants due to their potential implications on inflation. That said, inflation remained elevated throughout the quarter while the disinflation dynamic that characterized 2023 lost momentum. Additionally, it became apparent that a majority of the disinflation was due to the deflation of goods prices, and that services inflation would also need to be tamed in order for broader measures of inflation to reach the U.S. Federal Reserve's 2% target. Because of this, the Fed signaled a cautious approach to monetary policy, reiterating their commitment to maintaining a restrictive policy stance until further progress was achieved. Markets converged with the Fed's guidance, suggesting a growing consensus on the future direction of monetary policy and a rejection of a more significant pivot that was priced at the start of the year.

Non-government sectors outperformed Treasuries, with agency mortgage-backed securities (MBS) the exception. The positive backdrop of financial markets led to strong excess performance for most non-government sectors, while nominal returns were mixed and weighed down by the rise in interest rates. Once again, non-agency residential mortgage-backed securities (RMBS) posted a strong quarter of performance, as housing markets stood firm, supported by elevated levels of homeowner equity and the "golden handcuffs" effect, where many homeowners locked in mortgages with highly affordable rates below 5%. However, this dynamic did not translate to the agency MBS sector as rate

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volatility and a delay in Fed cut expectations was a headwind for the period. Meanwhile, commercial real estate began its recovery journey, with generous yields helping to offset the impact of rising interest rates. Commercial mortgage-backed securities (CMBS) benefitted from this recovery with spreads rallying across the stack. However, challenges persisted within the office property segment due to elevated vacancy levels. Asset-backed securities (ABS) remained anchored by a strong consumer supported by a robust labor market, healthy financial asset balances and manageable debt levels. However, lower-income consumers (aka sub-prime borrowers) continued to face difficulties due to the cumulative impact of inflation over the past two years. On the corporate front, 4Q earnings were well received with a significant portion of companies beating expectations. Moreover, positive rating trends were observed, with a series of positive upgrades, reflecting the overall health and resilience of corporate balance sheets. These developments underscored the confidence in the corporate sector's ability to navigate challenges associated with restrictive financial conditions, and resulted in both high yield (HY) and investment grade (IG) spreads rallying to their tightest levels in over a year as well as a meaningful portion of the senior loan market making its way back to par.

Sector allocation and security selection drove performance, while duration and yield curve positioning detracted in the wake of a retracement in rates. The continued rally in capital markets in 1Q24, meant sector allocations across securitized and corporate segments buoyed performance. With a majority of the Fund invested in securitized markets, it's not surprising that non-agency RMBS and credit risk transfer (CRT) were the largest contributor as the sector benefited from the strength in the U.S. housing market. CMBS also added nicely as the sector started to show signs of a trough. Corporate allocations also contributed, albeit to a lesser degree given our lower allocations to corporate bonds, bank loans and collateralized loan obligations (CLO). Nonetheless, the Fund capitalized on the further narrowing of credit spreads and accompanying outperformance. Agency MBS was the exception as rate volatility and debates on the Fed weighed on the sector and modestly detracted from performance. Security selection added during the period. The largest gain was sourced from agency MBS, with investments in collateralized mortgage obligations (CMO), including interest-only tranches faring well in an environment of low prepayments. Elsewhere in securitized, ABS security selection that included off-benchmark subsectors and higher yielding CLO contributed. IG corporate selection also contributed supported by our preference for A and BBB rated issuers. Meanwhile, CMBS security selection was a modest offset to our gains reflecting idiosyncratic events. During the period, the most notable change in allocations was a significant reduction in agency RMBS, reflecting a tactical assessment after strong outperformance early in the year. Other changes were modest, with small additions to CMBS and reductions from our allocations to IG corporates. Overall portfolio duration was increased as market expectations for Fed cuts were tempered and rates rose, presenting an attractive entry point. The Fund's duration ended the period at 2.65 years.

Current strategy and outlook

While the Fed's hiking cycle is done, the first rate cut remains a source of debate. Looking ahead, we expect economic growth in the United States to slow from 2023, but continue to grow close to trend levels, supported by robust consumer spending as real income and the wealth effect bolster economic activity. Meanwhile, we expect inflation to stabilize above the Fed's target, due to the slowing disinflationary trends in the goods sector and continued stickiness in the services sector, the latter of which has been a product of a tight labor market. We are seeing early signs of softness in the labor market, notably a decline in the quits rate. We expect wage growth to moderate, which would also be a positive for inflation. With this backdrop, along with recent strength in economic data, the Fed's case to remain patient on rate cuts has been bolstered. However, the Fed's data-dependent stance will provide flexibility in adjusting policy measures in response to evolving economic conditions, ensuring a balanced approach to supporting economic growth while addressing inflation concerns.

While spreads for many sectors appear tight, all-in yields remain historically attractive which allows investors to capture high quality yield without overstretching into risk. Corporate bonds illustrate this dynamic, where spreads are tight but nominal yields are enticing yield-based buyers and fundamental factors can continue to support the sector. Agency MBS valuations remain appealing given muted prepayment risk and the headwind of Fed rate hikes behind us. The outlook for non-agency RMBS is also positive as fundamental factors continue to support risk-taking in this sector. CMBS continues to exhibit cheap valuations, offering the most compelling relative value compared to other fixed income sectors. Moreover, outside of the office property type, fundamental factors in commercial real-estate are showing early signs of improvement. The additional cushion provided by higher nominal rates compels us to lean into higher-quality spread opportunities and remain underweight in U.S. Treasuries. We will continue to monitor market developments, assess sector fundamental factors and stay attuned to macroeconomic trends to capitalize on opportunities in this dynamic and evolving market environment.

The **Bank of America US Dollar 3-Month Deposit Offered Rate Constant Maturity Index** represents a high-quality base rate for three-month constant maturity dollar denominated deposits. 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. **High-Yield Securities**, or "junk bonds," are rated lower than investment-grade bonds because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities. To the extent that the Fund invests in **Mortgage-Related Securities**, its exposure to prepayment and extension risks may be greater than investments in other fixed-income securities. The Fund may use **Derivatives**, such as options and futures, which can be illiquid, may disproportionately increase losses and have a potentially large impact on Fund performance. **Foreign Investing** poses special risks including currency fluctuation, economic and political risks not found in investments that are solely domestic. As Interest Rates rise, bond prices fall, reducing the value of the Fund's share price. Other risks of the Fund include but are not limited to: **Credit Risks, Extension Risks, Investment Models Risks, Municipal Securities Risks, Other Investment Companies' Risks, Prepayment Risks, Price Volatility Risks, U.S. Government Securities and Obligations Risks, Debt Risks, Liquidity Risks, Portfolio Turnover Risks, and Securities Lending 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.**

The strategy employs a quantitative investment process. The process is based on a collection of proprietary computer programs, or models, that calculate expected return rankings based on variables such as earnings growth prospects, valuation, and relative strength. Portfolio construction uses a traditional optimizer that maximizes expected return of the portfolio, while managing tracking error.

Data imprecision, software or other technology malfunctions, programming inaccuracies and similar circumstances may impair the performance of these systems, which may negatively affect Fund performance. Furthermore, there can be no assurance that the quantitative models used in managing the Fund will perform as anticipated or enable the Fund to achieve its objective.

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