Voya Strategic Income Opportunities Fund

Unconstrained Fixed Income

Strategy overview

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

Key takeaways

- Monetary policy continued to produce market volatility in the second quarter of 2023.
- The Strategy underperformed its benchmark, the ICE BofA USD 3M Deposit Offered Rate Constant Maturity Index (the Index) on a net asset value basis. Security selection and sector allocation added to performance, while duration and yield curve decisions detracted.
- We expect growth to continue to slow, and the threat of recession to remain elevated and our strategy remains broadly defensive, with a preference for high quality spread opportunities.

Portfolio review

For the quarter ended June 30, 2023, the Strategy underperformed the Index. Duration and yield curve positioning depressed returns, while sector allocation and security selection both added.

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 (bp) 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 of 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 all but eliminated hope of a "pause", with market participants instead viewing the Fed's inaction as a "skip".

In corporate credit markets, spreads moved to the tightest levels of the year after setting recent wides post bank failures in March. While First Republic became another casualty, remaining regional banks found sufficient support in the Fed's bank term lending facility and deposit outflows were not as bad as feared. On the earnings side, 1Q23 figures came in much better than expected (albeit negative) which was also supportive of credit spreads.

The fallout from the bank failures also had implications for other sectors of the bond market, particularly agency mortgage-backed securities (MBS) given the Federal Deposit Insurance Corporation (FDIC) needed to liquidate roughly $90 billion. To the surprise of many, MBS overcame this challenge and posted decent excess returns for the quarter as money manager demand for high quality assets was high.

Across other securitized markets, performance was also positive. While the challenges in commercial real estate (CRE) are ongoing, commercial mortgage-backed securities (CMBS) took a break from recent spread widening and managed to post modest excess returns. Collateralized loan obligations (CLOs) were supported by the performance of their bank loan collateral and asset-backed securities (ABS) continued to be supported by mostly strong consumer balance sheets. The economy and financial markets in 2Q23 could best be described as "resilient". And this may be best illustrated by activity in the housing market. As mortgage rates moved from multi-decade lows to multi-decade highs in relatively short order, many expected a quick and substantial drop in home prices. Not only has that yet to occur, but home prices have been moving slightly higher over the last couple of months, supporting the non-agency residential mortgage-backed securities (RMBS) and credit risk transfer (CRT) segments.

Duration held back returns as yields rose, while sector allocation and security selection contributed as risk assets outperformed. The duration profile was maintained above our 2-year central tendency and weighed on performance as the Fed maintained their hawkish tone and the economy proved resilient. A positive risk sentiment tone meant that our allocations across a range of securitized and corporate sectors contributed. Allocations to non-agency RMBS and CRTs added the most, buoyed by the durability of the U.S. housing market and U.S. consumer. In corporate credit, lower-rated allocations to high yield (HY) and bank loans also contributed as the credit rally benefited lower-rated issuers. Security selection, in aggregate, also added to performance. Gains in ABS security selection which included high quality (CLOs) added to relative returns as the sector's yield advantage and collateral performance in the broader loan market positively contributed. Agency RMBS selection was supported by collateralized mortgage obligations (CMOs) and other non-standard pool investments. Changes in portfolio positioning over the period were modest. Within in corporate sectors, we trimmed allocations in investment grade corporates and bank loans, while deploying some capital to HY corporates. Across securitized, allocations in non-agency RMBS and CMBS were modestly lower, while allocations to agency RMBS and ABS were incrementally higher. We also deployed additional capital across emerging markets, with an emphasis in local currency emerging market opportunities. After the re-set in global yields last year and the Fed nearing the conclusion of their tightening cycle we are think duration can serve as a risk mitigant to our credit exposures in times of market volatility.

Current strategy and outlook

We expect growth to continue to slow, and the threat of recession to remain elevated. With corporate earnings in decline, leverage ratios are beginning to move higher. And while most corporate borrowers termed out their debt at very low fixed rates, this is not the case for senior bank loan issuers, where leverage is higher. Meanwhile, CRE financing markets remain challenging, which could become problematic as many loans are approaching their maturity date. And finally, while consumer spending is supported by the strength in the labor market, this strength is also keeping inflation elevated, in turn motivating the Fed to keep rates higher for longer.

Portfolio strategy remains diversified, with exposures criss-crossing the fixed income universe. Having increased our dry powder and improved liquidity over the last few quarters, we continue to look for the right opportunities to redeploy capital but would need to see markets more appropriately discount the risks mentioned above. From a duration perspective, while we do recognize the additional yield pick-up in going shorter, we believe the diversification benefit between bonds and stocks has finally returned and have chosen to have a duration profile longer than our central tendency.

The **Bank of America Merrill Lynch U.S. Dollar Three- Month LIBOR Constant Maturity Index** is designed to track the performance of a synthetic asset paying LIBOR to a stated maturity. The index is based on the assumed purchase at par of a synthetic instrument having exactly its stated maturity and with a coupon equal to that day's fixing rate. That issue is assumed to be sold the following business day (priced at a yield equal to the current day rate) and rolled into a new instrument. The Index does not reflect fees, brokerage commissions, taxes or other expenses of investing. **Investors cannot directly invest in an index.** BofA Merrill Lynch® indices used with permission, are provided "AS IS", without warranties, and with no liability. BofAML does not sponsor, endorse, review, or recommend Voya or its products or services.

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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