Voya Strategic Income Opportunities Fund

Unconstrained Fixed Income

Strategy overview

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

Key takeaways

- The third quarter of 2024 was characterized by a gradual moderation in the labor market, further easing of inflation and a proactive shift in monetary policy by the U.S. Federal Reserve.
- 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 along with duration and yield curve positioning contributed over the quarter as the repricing of Fed cut expectations lead to a bull steepening of the curve while security selection detracted.
- As we look ahead to the fourth quarter of 2024, we expect the theme of "normalization" to continue shaping the economic landscape.

Portfolio review

The labor market continued its path of normalization in the third quarter of 2024, with the number of job openings continuing to decline along with the quit rate reverting to pre-pandemic levels. This cooling was further evidenced by the Non-Farm Payroll (NFP) report, which missed expectations for both July and August. The substantial miss for July, reported in August, coincided with a controversial rate hike by the Bank of Japan (BoJ), unsettling markets and leading to a sharp widening of credit spreads. However, as investors digested the data, spreads eventually retraced, reflecting a more measured perspective on the total economy.

This moderation in the labor market did not significantly hinder consumer spending, which continued to advance at a decent rate. With elevated home prices and strong equity performance, the wealth effect remained in play however the moderation in the labor market may have been responsible for more measured spending growth, relative to more recent quarters. More broadly, the economy continued to advance at a reasonable pace, as evidenced by 2Q24 gross domestic product (GDP) growth, which exceeded expectations at 2.80% and was later revised to 3.00%.

Inflation continued its downward trend, with core Consumer Price Index (CPI) approaching 3.00% year over year, despite the shelter component remaining stubbornly elevated. Core goods prices remained in deflation, while core services inflation decelerated significantly, partially attributable to moderating wage gains. The Fed's preferred measure, Core Personal Consumption Expenditure (PCE), displayed an even more favorable environment, reading at 2.70% YoY in August. This disinflationary environment provided the Fed with the flexibility to shift its focus from inflation concerns to labor market conditions.

A pivotal moment came in late August with Jerome Powell's speech at Jackson Hole, signaling a shift towards an easing cycle. The Fed, acknowledging the softening labor market, opted for a 50 basis points (bp) cut at their September meeting, larger than the previously anticipated 25 bp reduction. Powell's influence was evident, with only one Federal Open Market Committee member dissenting. This decision underscored the Fed's proactive approach to preserving a healthy labor market and broader economic stability.

Credit spreads began the quarter at tight levels, reflecting a macro environment that balanced disinflation with stable growth. Despite the early August volatility, driven by labor market data and the BoJ's actions, spreads finished the quarter at similarly tight levels as the disinflationary trend allowed the Fed to begin an easing cycle.

Yields rallied in response to continued disinflation, with front-end rates falling more significantly than long-end rates. This bull steepening of the yield curve was driven by expectations of the Fed's easing, which prompted front-end rates to aggressively rally, while a stable growth outlook translated to a more measured decline in the long end.

In conclusion, the third quarter of 2024 was characterized by a gradual moderation in the labor market, further easing of inflation and a proactive shift in monetary policy by the Fed. These factors positively influenced market dynamics, resulting in a period of strong returns for fixed income investors.

Sector allocation along with duration and yield curve positioning contributed over the quarter as the repricing of Fed cut expectations lead to a bull steepening of the curve while security selection detracted. Sector allocation broadly contributed over the quarter. The largest contribution came from high yield (HY) corporates, where attractive yields and strong fundamental factors drew inflows to the sector. Investment grade (IG) corporates contributed modestly. Allocation to securitized credit sectors contributed over the quarter, where non-agency residential mortgage-backed securities (RMBS) and credit risk transfers (CRT) were the largest contributors. Security selection detracted from performance over the period. The detraction was mostly from agency mortgages, specifically through collateralized mortgage obligations (CMO), where a weaker technical backdrop and growing prepayment concerns hindered the sector. Selection in commercial mortgage-backed securities (CMBS) also detracted, where idiosyncratic stories drove performance. Allocation changes over the quarter included a reduction of our overweight to asset-backed securities, primarily via collateralized loan obligations (CLO). The reduction was made in response to weaker relative value given the rally in the front of the curve. Other allocation changes came from agency mortgages, where we reduced some of our higher coupon pool exposure. We reduced our duration during the quarter after the rally in yields left the front end of the curve looking less attractive.

Current strategy and outlook

As we look ahead to the fourth quarter of 2024, we expect the theme of "normalization" to continue shaping the economic landscape. We anticipate growth will stabilize close to trend levels, remaining positive but likely decelerating from the robust pace seen in recent quarters. This dynamic will be driven largely by consumer spending, which, while expected to slow, will continue to be supported by a relatively strong (albeit moderating) labor market and a favorable wealth effect stemming from elevated asset prices.

We project inflation will continue its decline, but at a slow pace and ultimately settling above the Fed's target. Goods inflation is expected to remain at 0% or lower, as consumption growth moderates from historically high levels. Services inflation is likely to continue decelerating as the labor market continues to rebalance and wage growth eases further. Additionally, we anticipate that the shelter component of inflation will eventually align more closely with real-time indicators from sources like Zillow, Apartment List and Yardi, further contributing to the easing of inflationary pressures.

While all this points to a soft landing, markets appear to have priced in this scenario with a high degree of certainty. IG corporate spreads are currently below 100 bp, while HY spreads hover around 300 bp. These levels suggests that markets are highly optimistic that disinflation can continue without a recession materializing. While we tend to agree this is a likely outcome, there remains a risk of more rapid deterioration in the labor market, particularly if corporate margins face further pressures.

Given these tight valuations, we favor assets with higher credit quality or shorter spread durations, as we believe spreads are too tight relative to the underlying risks. However, we remain confident in the fundamental factors that support the economy and are prepared to add risk where appropriate, especially in the face of market volatility stemming from data releases, Fed actions, elections and geopolitical developments.

On the interest rate front, following the substantial rally in 3Q24—particularly at the front end of the curve—the market is now pointing to the Fed reaching its terminal rate roughly one year ahead of the most recent dot plot projections. We believe this reflects a skew of potential outcomes related to monetary policy. Specifically, we believe that the likelihood of reacceleration of inflation that prompts the Fed to reverse course is significantly lower than the probability of a faster cutting cycle if the labor market deteriorates more rapidly.

In summary, as we enter the final quarter of 2024, our economic outlook is characterized by a continued normalization process, with stable growth supported by consumer spending and a moderating labor market backdrop. While we maintain a cautious optimism, we remain vigilant, ready to adjust our positioning in response to an evolving landscape.

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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