Fixed Income Perspectives

Now that yields have reset higher, bonds are positioned to protect portfolios while delivering higher income.

Bond Market Outlook

Global rates: Treasury yields are likely to remain range-bound after the Fed funds rate increase, as markets digest impacts on the economy.

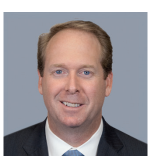
Investment grade corporates: We remain defensive given the macro backdrop, with an overweight to financials and utilities versus industrials.

High yield corporates: Strong corporate balance sheets should be able to absorb a slowdown in growth. While we expect profit margins to be challenged, a little give back from record levels should not lead to rising default expectations.

Senior loans: The U.S. loan market continues to exhibit resilience amidst ongoing broad market weakness.

Securitized assets: We prefer certain higher quality, collateralized loan obligations (CLOs) where yield opportunities remain; the mortgage credit outlook remains positive.

Emerging markets (EM): We remain cautious given headwinds from declining growth expectations, tightening financial conditions and impact of rising food and energy prices on EM consumers.



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CIO Fixed Income

Voya Investment Management's fixed-income strategies cover a broad range of maturities, sectors and instruments, giving investors wide latitude to create a new portfolio structure or complement an existing one. We offer investment strategies across the yield curve and credit spectrum, as well as in specialized disciplines that focus on individual market sectors. We build portfolios one bond at a time, with a critical review of each security by experienced fixed income managers.

Silver Linings Playbook: Opportunities after Bond Market Rout

Last month, we noted the end of an era. After more than a decade, the market's main measuring stick for macroeconomic risk shifted from what the Federal Reserve might do, to what the Fed will be forced to do. It's all about inflation. And after the May CPI report showed an 8.6% year over year increase in headline inflation (the fastest pace since December 1981), risk assets promptly sold off. To the Fed's credit, it took what the market was giving it and promptly raised rates 75 basis points (bp) as opposed to the previously conveyed 50 bp hike. The Fed kept the door open for another 75 bp hike in July; and the dot plot in the Summary of Economic Projections now shows a further 175 bp in hikes this year, to combat what may be persistently sticky inflation readings.

To that end, we believe the Fed will remain data dependent and only move aggressively as needed, since it still hopes to stick a "soft landing" and not force the economy into a recession. While the odds of achieving this are declining, and the chances of a recession within the next 12 months are continuing to increase, we believe the Fed's ultimate goal is to get monetary policy to a place where it does not have to fully reverse course and return to a zero bound on the Fed funds rate. That said, Chairman Powell certainly has an increasingly thin needle to thread as the Fed seeks to balance its inflation and labor market targets going forward.

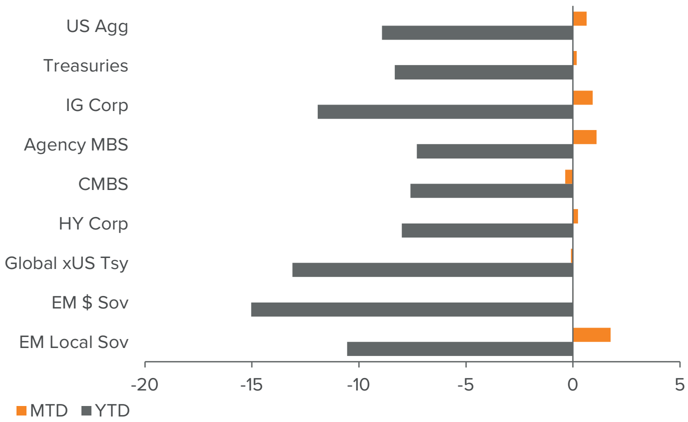
Cash remains king in this volatile, uncertain environment. By keeping liquidity on hand, we seek the ability to take advantage of opportunities that become oversold and lock in higher yields across the fixed income spectrum. For example, the volatility in rate markets continues to support strong demand for floating rate securities such as CLOs and senior loans, and there are attractive opportunities in both sectors, particularly after recent underperformance.

After a difficult start to the year for the broad fixed income index, signs are also emerging that "core" bonds are starting to act like "core" bonds. Agency residential mortgage-backed securities rebounded strongly in May, as the sector experienced its first month of positive excess returns in 2022. In addition, if recession risk were to increase, other "core" bonds such as U.S. Treasury securities would likely rally due to their perceived safe-haven status. As a bonus, now that yields have reset higher, investors potentially may protect their portfolios while receiving higher income.

We expect the macroeconomic backdrop to remain volatile and uncertain, with all eyes on each month's inflation report. That said, we have dry powder on hand to take advantage of opportunities created by market dislocation.

Rates, Spreads and Yields

Fixed Income Sector Total Returns



		31-May	31-Mar	1Y Low	1Y High
Yields	US 2 Yr	2.55	2.32	0.14	2.77
	US 10 Yr	2.85	2.34	1.17	3.13
	GER 10 Yr	1.12	0.55	-0.50	1.13
	JPN 10 Yr	0.24	0.22	0.01	0.25
	EM Local Sov	6.76	6.23	4.91	7.47
Spreads	IG Corp	130	116	80	149
	Agency MBS	34	24	16	48
	CMBS	160	129	92	165
	HY Corp	406	325	262	482
	HY x-Egy Corp	416	328	252	493
	EM $ Sov	448	400	330	526

As of 05/31/22. Source: Bloomberg, Bloomberg/Barclays, JPMorgan and Voya. **Past performance is no guarantee of future results**.

Sector Outlooks

Global rates and currencies

Yields on U.S. Treasury securities jumped after the latest CPI print and continued higher after the Fed hiked 75 basis points in response. This reflects the market's belief that a higher rate structure will be needed to cool inflation. In Europe, the European Central Bank (ECB) is on track to end negative rates, while its asset purchasing program will end in early 3Q22. This likely will be followed by rate hikes in July and September, and possibly another hike in 4Q22. High inflation and weak growth leaves the ECB vulnerable; we expect European growth to underperform the United States due to higher inflation and growth shocks emanating from the Russia–Ukraine conflict and a slowdown in China.

European Union and U.S. consumers are still benefiting from excess savings, while corporate cash flow profiles remain healthy. But will these healthy financial balances provide enough defense against a recession? The U.S. is arguably more at risk of an inventory recession than a consumer recession. That may not be the case in Europe, as the inflation shock could lead to a consumer recession in the Eurozone. Among major economies, the U.S. is more insulated from food and energy price shocks, but is likely more exposed to the normalization of goods demand along with its associated trading partners. Therefore, the U.S. likely needs continued capital investment to help support economic growth and relieve labor shortages for low-skilled jobs.

Investment grade corporates

It was another tale of two markets during May, with IG spreads initially widening 14 bp to 149, before rallying back to finish the month at 130 bp. The most likely catalyst was a decline in rate volatility, which allowed yield-based IG investors to feel comfortable stepping back into the market. Rate volatility declined in May as economic numbers and consumer-oriented earnings disappointed, suggesting central bank tightening was already having an effect. Like other markets, all eyes in the IG market are on inflation, as the market is pricing in between the likelihood of a soft economic landing versus inflation continuing to spike and forcing the Fed to act. Technical factors improved in May as outflows slowed and new issue supply fell below expectations. At the sector level, we continue to like telecommunications, utilities and financials, maintaining a defensive posture given broader macroeconomic uncertainty. In addition, financials potentially provide a hedge against higher rates.

High yield corporates

The high yield selloff that started in March and April carried into May and turned into a significant drawdown as investors switched their focus from rate concerns to concerns about growth. BB-rated bonds gained back some ground but are back to looking fully valued. Single B-rated bonds have been the steady spot, and CCC-rated bonds have sold off significantly. From our perspective, the good news is that consumer and corporate balance sheets (and income statements) are in good shape for now, and should be able to absorb a slowdown in growth. From a positioning standpoint, we remain overweight building products, independent energy and media and entertainment. We are underweight financials and consumer cyclicals. We are seeking yield with duration roughly below index; given the heightened uncertainty, we are trying to be surgically precise about where we take on duration risk.

Senior loans

Consistent with the improved backdrop, primary market activity experienced a resurgence in the first week of June after being largely shut down in May. Market participants welcomed roughly $7 billion of new issue volume, the most since the last week of April. Although secondary levels firmed, the move higher wasn't uniform across ratings categories, with a continued cautious stance present in CCC-rated loans. The volatile cohort saw its average bid price move only modestly higher, compared to large recent advances in B- and BB-rated loans. Overall, the U.S. loan market continues to exhibit resilience amidst ongoing broad market weakness.

Securitized assets

Agency residential mortgage-backed securities (RMBS) continued the rally seen in May, with spreads tightening to more ordinary levels. Pay-ups on specified pools have moved higher as money managers cover their underweights and relatively less value remains in the dollar roll market. With volatility expected to continue, agency RMBS likely will benefit as a safe-haven asset class.

We are overweighted in CLOs, which in our view offer attractive relative value, thanks to the sector's attractive yields and investors' broad affinity for floating rate, low duration bonds. We continue to favor tier 1 managers and clean collateral pools with shorter spread duration, especially for lower credit quality positions.

In asset-backed securities (ABS), we maintain our positive near-term outlook. A reasonable new issue pipeline should lead to additional spread tightening, and significantly improved yield/spread profiles are attracting more interest from income focused buyers. With higher cash balances available to meet redemptions, we expect a more liquid environment to emerge with tight bid-offers, which will also support spreads.

In commercial mortgage-backed securities (CMBS), we have a favorable outlook. Longer-term prospects look promising as financing conditions have evolved unfavorably for issuers versus other lending channels. Within the CMBS ecosystem, credit appetite is deep and perceptions of risk have shifted lower. Accordingly, we see tightening potential. We continue to favor single asset/single borrower securities and retain our long-standing bias against hotel and class B enclosed malls.

Emerging markets

The global backdrop remains challenging for EM assets: continued inflation pressures, declining growth expectations, a hawkish Fed and tightening financial conditions are clear headwinds. Risk to Chinese growth remains despite the government's pledge to provide more stimulus, while the ongoing war in Ukraine is unlikely to find a swift resolution. Energy and agriculture commodities are likely to remain elevated due to supply constraints, low spare capacity and the ongoing transition to more renewable sources of energy. Against this backdrop, we remain cautious on the asset class.

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