Short-Duration High Income Bonds as a Defensive Building Block

Portfolio Manager Jim Dudnick discusses how, where and when to consider short-duration high yield bonds — and why the Voya Short Duration High Income Strategy is different.

Jim Dudnick, CFA

Lead Portfolio Manager, Income & Growth

Key takeaways

- The high yield universe appears well positioned: J.P. Morgan research shows that yields near today's levels have historically been associated with strong returns over the ensuing 1–2 years.
- Adding U.S. high yield bonds to a core fixed income allocation has historically improved risk/reward profiles, but short-duration high yield in particular can help expand the efficient frontier.
- Voya's Short Duration High Income Strategy has historically provided consistent income and strong risk-adjusted performance, outperformed core bonds with similar volatility, and delivered broad high yield bond market returns with less volatility.

Why is U.S. high yield attractive today?

Looking at the broader U.S. high yield market, we see multiple reasons why this is a compelling asset class — including its appealing yields, discount to par and support from healthy fundamentals.

Yields for the category sit well above 8% after the recent sharp rise in interest rates.[1] According to a 2022 study by J.P. Morgan analyzing 35 years of performance data, this bodes well for future total returns (Exhibit 1). When high yield bonds have been in the 8–9% range, returns over the ensuing 12–24 months have historically been in the mid to high single digits, on average.

When we look at fundamentals, we also see strong support for the asset class:

- **Low net leverage:** Many company management teams have made debt reduction a priority in recent years,[2] pushing average leverage to its lowest level in about a decade.
- **Elevated interest coverage:** Interest coverage in the high yield market resides just below all-time highs,[3] which should help companies weather a potential economic slowdown (should one occur).
- **Limited near-term maturities:** Near-term refinancing obligations are low by historical standards, with only $168 billion of bonds maturing in 2024–2025.[4]
- **Higher-quality ratings profile:** Today's high yield market includes a lower-than-normal exposure to CCC rated bonds, which have historically had higher default rates than higher-quality bonds.[5]

1. Bloomberg, 09/23. High yield bonds are represented by the ICE BofA U.S. High Yield Index. 2. Bloomberg, 07/23. 3. J.P. Morgan Chase, 09/23. 4. BofA Global Research, ICE Data Indices LLC, 09/23. 5. BofA Global Research, ICE Data Indices LLC, 07/23.

Exhibit 1: Yields near today's levels have historically been associated with strong returns
High yield forward return (%) over X months (Jan 1987 – Oct 2022)

Starting yield	12M	18M	24M
<6%	2.0	1.4	2.0
6–7%	4.2	5.3	5.4
7–8%	7.2	6.5	5.9
8–9%	9.1	7.3	6.4
9–10%	8.4	8.0	7.9
10–11%	6.6	9.0	8.9
11–12%	12.4	12.2	10.9
>12%	13.6	13.0	12.9

← current yield range

Source: J.P. Morgan. Based on J.P. Morgan Domestic High Yield Index. Performance for periods greater than one year have been annualized. **Past performance is no guarantee of future results.**

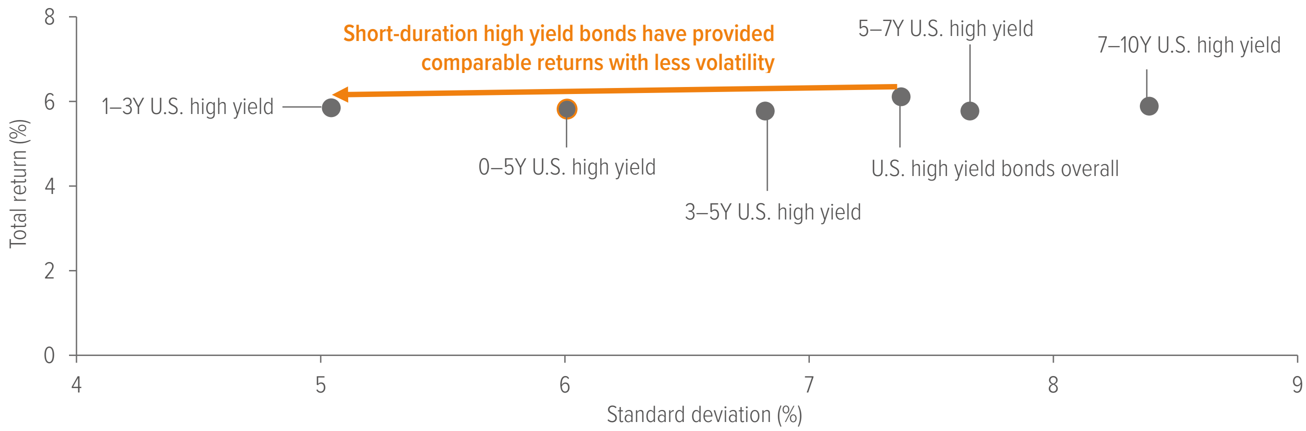
Why invest in the short end of the high yield market?

We see three primary benefits to investing in the front end of this asset class:

1. **A better risk/return ratio.** The front end of the U.S. high yield market (as measured by the 1-3 Year U.S. High Yield Index) has provided comparable returns to the broader U.S. high yield market, but with significantly lower volatility (Exhibit 2).
2. **An expanded efficient frontier.** Investors have long known that adding U.S. high yield bonds to their core fixed income allocations can improve outcomes and expand the efficient frontier. But many investors don't know that short-duration high yield has done a particularly good job of expanding the efficient frontier (Exhibit 3).
3. **A compelling yield-to-duration tradeoff.** Record-high new issuance and refinancing activity in 2020 and 2021 pushed coupons and interest expense down and maturities out, creating an even more compelling yield-to-duration trade-off at the short end of the U.S. high yield market (Exhibit 4).

Exhibit 2: High yield bonds have historically been less risky closer to maturity, without giving up much return

U.S. high yield risk/return variability by maturity



Data: November 2009 to June 2023.

Source: Voya Investment Management, FactSet, ICE Data Services. **Past performance is not indicative of future results.** This statement reflects performance and characteristics for the time period shown, results over a different time period may have been more or less favorable. See index associations and additional disclosures at the end of this document. Investors cannot invest directly in an index. Index returns are presented as net returns, which reflect both price performance and income from dividend payments, if any, but do not reflect fees, brokerage commissions or other expenses of investing.

Exhibit 3: Adding short-duration high yield has boosted returns and lowered volatility

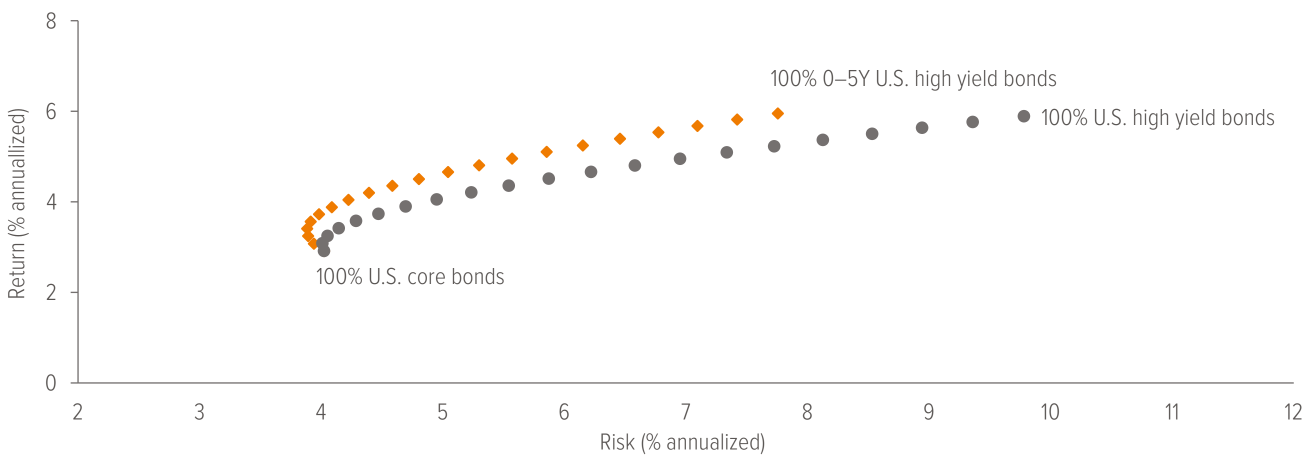


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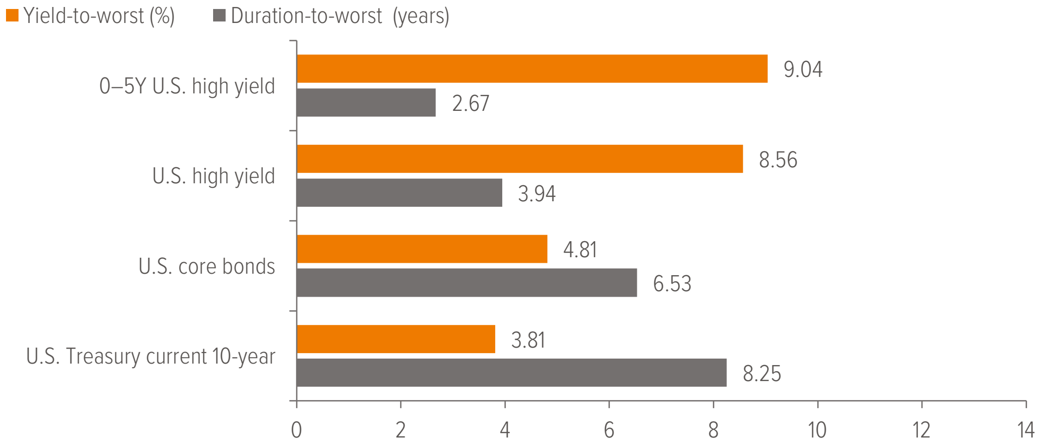
Exhibit 4: Short-duration high yield has historically offered the greatest yield to duration tradeoff

Nov 2009 – Jun 2023



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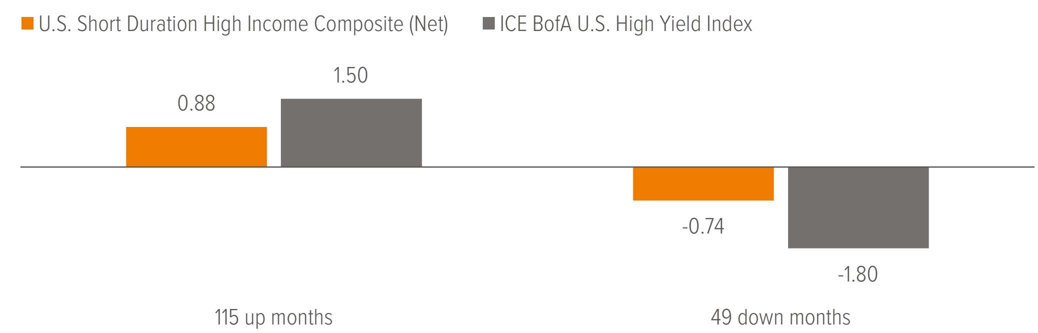
How has the Voya Short Duration High Income (SDHI) Strategy performed over time?

A key aspect of SDHI's history is its asymmetrical return profile. It has provided attractive upside with lower risk than the broader high yield market — including less price volatility, less drawdown and lower interest rate risk. Exhibits 5 and 6 highlight the Strategy's upside and downside participation relative to the U.S. high yield market, as well as its attractive overall risk-adjusted returns (driven largely by credit selection) compared with other fixed income segments.

Exhibit 5: Resilience in down markets

Average monthly returns in up/down markets since 11/01/09 inception of the Voya U.S. Short Duration High Income (SDHI) Composite



As of 06/30/23. Source: Voya IM, ICE Data Services. **Past performance is not indicative of future results.** This statement reflects performance and characteristics for the time period shown, results over a different time period may have been more or less favorable. Composite performance inception date: 11/01/2009. The Composite represents the investment results of a group of fully discretionary portfolios managed according to the Strategy. Market participation is based on the average of monthly returns in up and down markets as determined by the respective index. Composite market participation is supplemental information to the U.S. Short Duration High Income GIPS-compliant composite presentation at the end of this document. See index associations and additional disclosures at the end of this document. Investors cannot invest directly in an index. Index returns are presented as net returns, which reflect both price performance and income from dividend payments, if any, but do not reflect fees, brokerage commissions or other expenses of investing.

Exhibit 6: An attractive risk/return profile

					Notable down years for high yield		
Total return (%)	**1Y**	**3Y**	**5Y**	**10Y**	**2015**	**2018**	**2022**
SDHI							
Gross	10.77	5.70	4.47	4.66	0.54	0.56	-4.27
Net	10.33	5.34	4.08	4.29	0.27	0.11	-4.59
1–3Y Treasuries	0.13	-1.05	0.95	0.77	0.54	1.58	-3.65
U.S. high yield	8.87	3.21	3.19	4.34	-4.64	-2.26	-11.22
U.S. Agg	-0.94	-3.97	0.77	1.52	0.55	0.01	-13.01

Since SDHI inception (11/01/09)	Total return (%)	Volatility (%)	Sharpe ratio	Sortino ratio
SDHI				
Gross	5.07	4.79	0.89	1.26
Net	4.77	4.79	0.83	1.17
1–3Y Treasuries	0.86	1.23	0.05	0.07
U.S. high yield	6.10	7.38	0.73	1.06
U.S. Agg	2.24	4.00	0.37	0.53

As of 06/30/23. Source: Voya IM, Morningstar Direct. **Past performance is not indicative of future results.** Composite performance inception date: 11/01/2009. The Composite represents the investment results of a group of fully discretionary portfolios managed according to the Strategy. Composite market participation is supplemental information to the U.S. Short Duration High Income GIPS-compliant composite presentation at the end of this document. See index associations and additional disclosures at the end of this document. Investors cannot invest directly in an index. Index returns are presented as net returns, which reflect both price performance and income from dividend payments, if any, but do not reflect fees, brokerage commissions or other expenses of investing.

Where does Voya's SDHI Strategy fit into investor portfolios?

The Strategy has historically provided consistent income and strong risk-adjusted performance compared with fixed income, outperformed core bonds with similar volatility (Exhibit 7), and delivered broad high yield bond market returns with less volatility (Exhibit 8).

As a result, one way to use SDHI is to complement an allocation to full-market high yield. The Strategy has a lower beta to the high yield market, potentially enhancing portfolio diversification by offering a narrower range of annual returns, and providing an asymmetric return profile.

SDHI can also be a good complement to a core fixed income allocation (Exhibit 9). The Strategy's low correlation to core bonds helps diminish the magnitude of negative performance outcomes and reduces overall volatility — all while enhancing returns and improving positioning with a higher yield and a lower duration.

Exhibit 7: A fixed income diversifier

Nov 2009 – Jun 2023

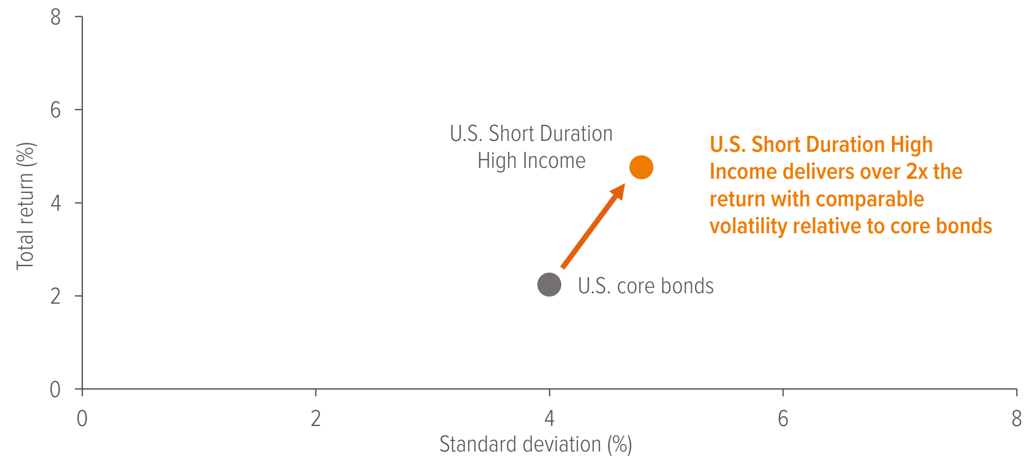


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Exhibit 8: A complement/alternative to high yield

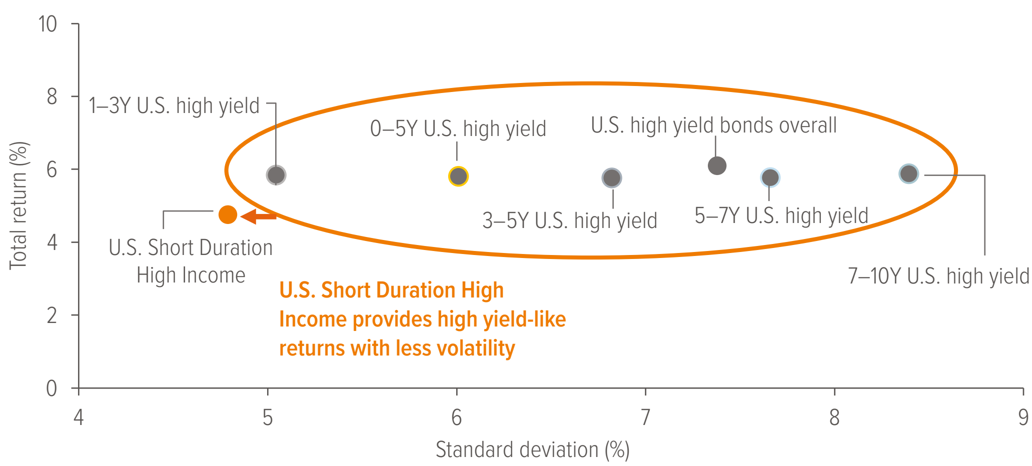

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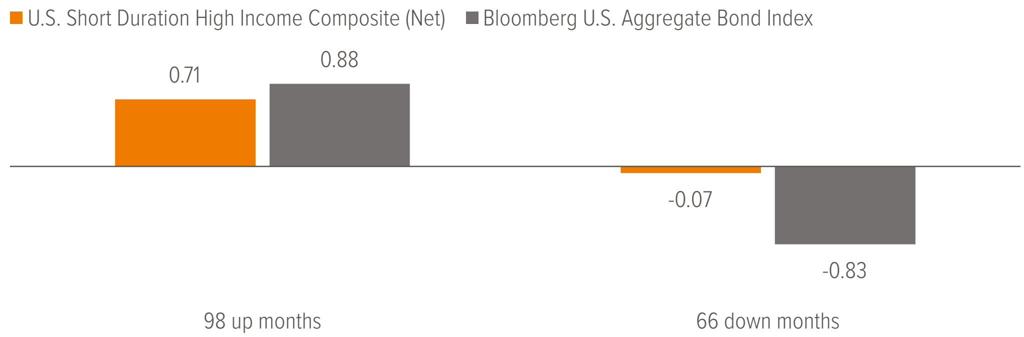
Exhibit 9: A complement to core bonds, capturing much of the upside with significantly less downside

Average monthly returns (%), Nov 2009 – Jun 2023



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How did the Strategy perform in 2022?

Despite market volatility, the Strategy performed well as higher interest rates pressured fixed income. High yield corporates and core bonds returned -11.2% and -13.0%, respectively, in 2022.[6] By contrast, the Voya SDHI Composite declined just -4.6% (net).[7] Our focus on shorter-duration issues and industries with positive business trends, along with a bias towards quality companies prioritizing the repayment of debt, helped cushion downside volatility.

Voya U.S. Short Duration High Income

Objective	Capital preservation, consistent income and liquidity
Average duration	1.5–2.0 years
Weighted average life	3.25–3.75 years
Typical portfolio	Invests in bonds with less than five years to maturity; avoids the added cost and complexity of derivatives, leverage, hedging and foreign currencies, and can invest up to 20% in bank loans.
Philosophy	Active management focused on in-depth industry assessment, thorough fundamental analysis, and rigorous credit research can uncover compelling investment opportunities and minimize portfolio volatility producing superior risk-adjusted performance.
Proven investment process	The bottom-up investment process combines in-depth industry assessment with thorough fundamental analysis and rigorous credit research. Emphasis is placed on relative value, disciplined trading and minimizing overall portfolio risk. This approach is predicated on minimizing the three main risks of fixed income investing — interest rate, credit and liquidity — and has enabled the Strategy to consistently meet its investment objectives.
Compelling performance track record	The U.S. Short Duration High Income Strategy has outperformed core bonds with similar levels of volatility, delivered broad high yield market returns with less volatility, and consistently provided strong risk-adjusted performance.

[6] Source: Morningstar Direct.
[7] Source: Voya IM.

Voya U.S. Short Duration High Income Composite

Schedule of composite performance results as of December 31, 2022

Year	Gross returns (%)	Net returns (%)	Short Duration High Income Linked Benchmark (%)[1]	Composite 3-yr. standard deviation (%)	Benchmark 3-yr. standard deviation (%)[2]	Dispersion of portfolio returns (%)[3]		Number of portfolios	Assets in this composite ($mm)	Total firm assets ($mm)
						High	Low			
2022	-4.27	-4.53	-3.65	8.95	1.71	-3.75	-3.75	≤5	251	227,973
2021	6.0	5.7	-0.6	7.9	1.2	6.1	5.3	≤5	1,033	N/A
2020	7.2	6.7	3.1	7.9	1.2	7.7	6.1	≤5	1,002	N/A
2019	8.1	7.7	3.6	2.0	0.9	8.1	8.1	≤5	1,746	N/A
2018	0.6	0.1	1.6	2.6	0.8	0.6	0.6	≤5	1,311	N/A
2017	4.9	4.4	0.4	3.0	0.7	4.9	4.6	≤5	1,643	N/A
2016	10.8	10.5	0.9	3.2	0.8	11.1	8.5	≤5	1,732	N/A
2015	0.5	0.3	0.5	2.6	0.5	2.3	0.3	≤5	987	N/A
2014	2.8	2.5	0.6	2.0	0.3	3.2	2.2	≤5	929	N/A
2013	5.0	4.7	0.3	2.0	0.1	5.2	3.3	≤5	827	N/A

[1] The Barclays 9-12 Treasury Index returns through December 31, 2013 and the ICE BOA 1-3 Year US Treasury Index from January 1, 2014 forward, which do not reflect the deduction of investment fees, have been provided for comparison purposes and have not been examined by independent accountants.

[2] Composite 3-Yr St Dev" and "Benchmark 3-Yr St Dev" are rolling 3-year standard deviation calculations, which measure the variability of the gross-of-fee monthly performance returns for the composite and benchmark index return over the preceding 36-month period on an annualized basis. If the composite has not been in existence for at least 3 years as of a particular year-end then "N/A" will be displayed.

[3] Dispersion of Portfolio Returns" presented for each annual period is based on gross-of-fees returns and is equal to the highest and lowest annual return among the portfolios that are included in the composite for the full year. If there is not at least 1 account that was in the composite for the entire year, then "N/A" will be displayed.

An investor cannot invest directly in an index, and index performance does not reflect the deduction of any fees, expenses or taxes. Index comparisons have limitations, as volatility and other characteristics may differ from a particular investment.

Index associations: 1–3 year U.S. high yield: ICE BofA 1-3 Year U.S. Cash Pay High Yield Index; 3–5 year U.S. high yield: ICE BofA 3-5 Year U.S. Cash Pay High Yield Index; 5–7 year U.S. high yield: ICE BofA 5-7 Year U.S. Cash Pay High Yield Index; 7–10 year U.S. high yield: ICE BofA 7-10 Year U.S. Cash Pay High Yield Index; U.S. high yield bonds: ICE BofA U.S. High Yield Index; 0–5 year U.S. high yield:: ICE BofA 0-5 Year U.S. High Yield Constrained Index; U.S. core bonds: Bloomberg U.S. Aggregate Bond Index; U.S. Treasury current 10-year: ICE BofA U.S. Treasury Current 10 Year Index.

Index definitions: The Bloomberg U.S. Aggregate Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, fixed-rate agency MBS, ABS and CMBS (agency and non-agency). The ICE BofA U.S. Treasury Index series is an unmanaged index that tracks the performance of the direct sovereign debt of the U.S. government with maturities in the ranges indicated. The Bloomberg U.S. Government/Credit 1-3 Year Index covers Treasuries, agencies, publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity and quality requirements. The ICE BofA U.S. High Yield Index is a market value–weighted index consisting of USD-denominated, non–investment grade bonds not currently in default. The J.P. Morgan Domestic High Yield Index is designed to mirror the investable universe of the USD domestic high yield corporate debt market. The J.P. Morgan Emerging Markets Bond (EMBI) Global Core Index tracks liquid, USD-denominated emerging market fixed and floating-rate debt instruments issued by sovereign and quasi-sovereign entities.

Key risks

Debt instruments: Debt instruments are subject to greater levels of credit and liquidity risk, may be speculative, and may decline in value due to changes in interest rates or an issuer's or counterparty's deterioration or default. **High yield fixed income securities:** There is a greater risk of issuer default, less liquidity, and increased price volatility related to high yield securities than investment grade securities. **Market volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Price changes may be short or long term. Local, regional or global events such as war, acts of terrorism, the spread of infectious illness or other public health issues, recessions, or other events could have a significant impact on the portfolio and its investments, including hampering the ability of the portfolio's manager(s) to invest the portfolio's assets as intended. **Issuer risk:** The portfolio will be affected by factors specific to the issuers of securities and other instruments in which the portfolio invests, including actual or perceived changes in the financial condition or business prospects of such issuers. **Interest rate risk:** The values of debt instruments may rise or fall in response to changes in interest rates, and this risk may be enhanced for securities with longer maturities. **Credit risk:** If the issuer of a debt instrument fails to pay interest or principal in a timely manner, or negative perceptions exist in the market of the issuer's ability to make such payments, the price of the security may decline.

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