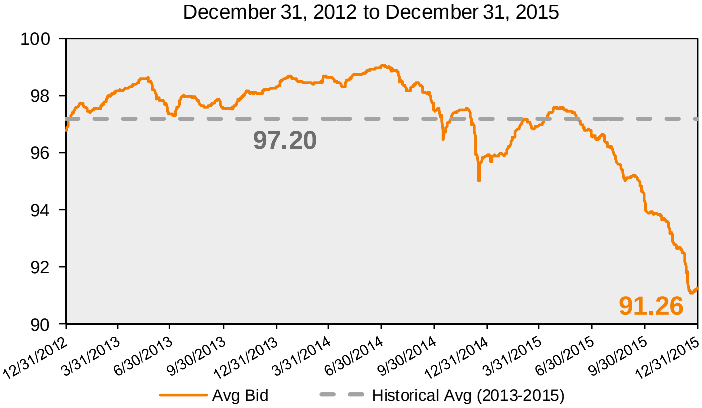
Voya Senior Loan Group: 2015 Recap and 2016 Outlook

2015 in Review

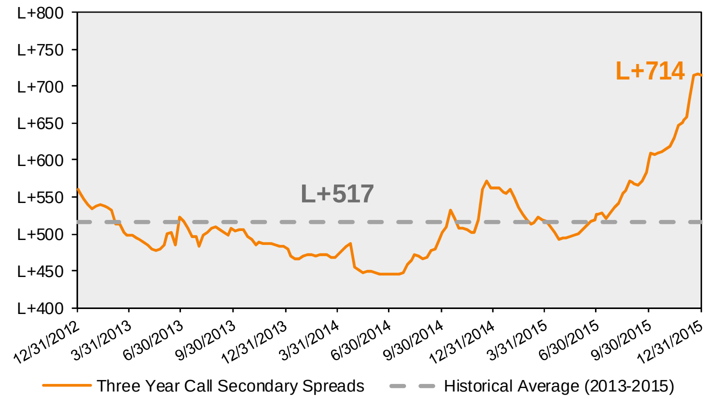
Despite solid performance in the first half of the year, the U.S. loan market's total return fell short of initial expectations, as volatility across broad capital markets weighed on loan prices beginning in late summer and continuing through the end of the year. Although credit fundamentals (ex-energy and commodities) remained relatively solid, overall investor sentiment was soured in the latter part of the year by a number of external headwinds, particularly in the high yield bond market, resulting in shifting market technicals and a heightened focus on liquidity.

A general lack of risk appetite, despite an underweight to energy as compared to high yield, resulted in a slow but steady decline in loan prices. As a result, the S&P/LSTA Leveraged Loan Index (the "Index") returned -0.69% for the year, with a year-ending weighted average price of 91.26 *(chart below)*, the lowest year-end level since 2009. Given these circumstances, it is also not surprising that quality outperformed. BB loans returned 2.23% for the year, as compared to -0.82% for single B loans and -8.43% for CCC loans. Defaulted loans lost a remarkable -42.86%, much of which was attributable to a precipitous decline in bids for the still troubled mega-issue from Energy Futures Holdings (formerly TXU).

Average Bid
S&P/LSTA Leveraged Loan Index
December 31, 2012 to December 31, 2015



Average Three Year Call Secondary Spreads
S&P/LSTA Leveraged Loan Index [1,2]
December 31, 2012 to December 31, 2015

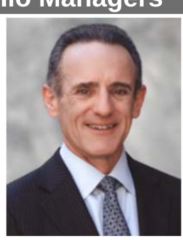


As a result of the price depreciation, as of December 31, the discount yield to 3-year call for loans *(chart above)* stood at L+714 (vs. L+561 at the end of 2014), a yield more reminiscent of an unsecured high yield bond. Taken in that context alone, loans have rarely been so seemingly undervalued in a relatively benign current and forward implied default rate environment.

While absolute returns left a lot to be desired, 2015 continued to demonstrate the lower volatility of loans vs. high yield, particularly in stressed market conditions, at least in the post-crisis era. Loans outperformed high yield (-4.64%, as represented by the Bank of America/Merrill Lynch High Yield Bond Index) for the full year, much of the difference a result of heightened credit concerns (i.e., unsecured exposure to the energy/metals sectors) as opposed to simple duration fears. In line with historical performance, loans during the year posted a lagging 12-month standard deviation of 0.74%, just 40% that of high yield bonds at 1.86%.

Fundamental credit risk, as measured by actual default activity, remained mostly stable during the year. Trailing default rates picked up slightly in 2015, measuring 1.54% by principal amount and 1.19% by issuer count *(chart on following page)*. During the year, there were 11 Index defaults, up from five in 2014. The default rate by principal amount closed the year still below the long-term average of 3.17%. *(continued on next page)*

Portfolio Managers



Dan Norman
Group Head

Jeff Bakalar
Group Head

Voya Senior Loan Strategy

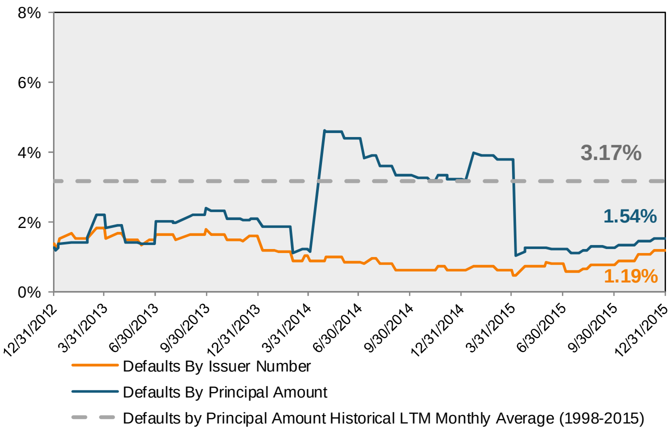
The Voya Senior Loan Group is a part of Voya Investment Management. The team is comprised of 28 investment professionals and 29 dedicated support staff. There are five portfolio management teams in Scottsdale, each of which is responsible for particular industries, and a team located in London that is responsible for sourcing overseas loans.

The Voya Senior Loan Strategy is an actively managed, ultra-short duration floating rate income strategy that invests primarily in privately syndicated, below investment grade senior secured corporate loans. Senior loans are floating rate instruments that can provide a natural hedge against rising interest rates. They are typically secured by a first priority lien on a borrower's assets, resulting in historically higher recoveries than unsecured corporate bonds.

2015 in Review (cont.)

Against that relatively uneventful fundamental credit backdrop, shifting market technicals (i.e., investor demand versus overall supply, both new issue and secondary market) continued to dominate the year's story once again. Looking at the supply/demand data for 2015, we saw primary market loan issuance at $258 billion, against slowing net positive demand. Visible demand (excludes non-CLO institutional flows) can be traced to two primary sources: CLO issuance and retail loan funds. CLOs posted $97.3 billion in issuance for the year, a solid showing but certainly down from 2014's $124 billion. Meanwhile, retail loan funds spent most of the year in moderate outflows, netting a year end outflow of $16.4 billion.

Lagging 12 Month Default Rate[3]
S&P/LSTA Leveraged Loan Index
December 31, 2012 to December 31, 2015



Finally, the Federal Reserve's role in sculpting the 2015 shifting technical landscape cannot be discounted. Although the Fed finally made a move in 2015, short term rates spent nearly another full year at near-zero, with a lack of market consensus until around October. Now that the first move upward is in hand, we have yet to see a discernable pick-up in loan demand from retail investors (again a function, we believe, of risk avoidance generally), although the shift toward positive retail demand may certainly be slower than in past rate lifting cycles – a result of the likely slow pace of further rate increases and the continued influence of LIBOR floors in the near term.

2016 Outlook and Expectations

Not surprisingly, our outlook for 2016 bears a reasonably strong resemblance to what we (and the bulk of market participants) envisioned for 2015: an attractive risk-adjusted return based on low relative beta, above historical average credit spreads, and forward implied credit risks that remain below long-term averages. In terms of fundamental credit, the loan asset class has performed well (by way of, to a large degree, only modest direct exposure to energy and other commodities) and investors have enjoyed a nearly full coupon-clipping experience. We expect the same to be true for 2016. In the absence of low realized credit losses, the total return story for senior loans has been about beta. As a Sharpe Ratio leader, senior loans have been approximately 60% less volatile than U.S. high yield bonds and 80% less volatile than equities over the last three years, as calculated by the annualized standard deviations of each asset class over the time period. However, loan total returns during that time have responded to supply and demand dynamics driven by a kaleidoscope of macroeconomic events, including geopolitical risks, U.S. and European regulatory shifts, monetary policy-induced asset bubbles, and a renewed focus on credit liquidity premium pricing.

Street Predictions	2016 Base Case
Credit Suisse	2.5%
Bank of America	2.0% to 3.0%
Barclays	2.5% to 3.5%
Citi	3.9%
Morgan Stanley	4.8%
JPMorgan	5.0%

Considering this backdrop, our base case outlook for 2016 is, yet again, more or less a coupon-clipping year with a relatively small deduction for potential credit loss, i.e., between 4% and 5%. (Note that the gross year-end Index coupon was an even 5%.) A more bullish case is supported by macro stability and a potential for strengthening demand stemming from increasing short-term rates in the U.S. All things held equal, this would lead to a partial recovery of the existing market value discount and thus raise our base case expectation to 6% to 7%. As for the downside, after the fourth quarter of 2015, we believe the liquidity premium that is now built into a highly bifurcated market (large and liquid vs. mid and small cap; higher quality performing vs. lower quality/underperforming) has limited the bear case for senior loans, given our view on fundamental credit and already wide spreads. However, if broader markets sell off further, even low beta senior loans would likely experience secondary market pressure. We believe that this has the potential to reduce our base case to approximately 2% to 3%.

Finally, we believe long-term institutional and retail investors that strategically allocate to senior loans will be rewarded, because total return calculations include price movements related to market technicals (supply vs. demand) and often obscure the underlying credit performance of senior loans, which by and large repay at par. *(continued on next page)*

An Expectations Dashboard

Total Return: Positive in 2016 +

- Attractive carry, plus opportunity to recover market price declines given that most performing loans are trading below par

Fundamental Risk and Defaults: Manageable in 2016 +

- Leverage levels appear to have peaked for this cycle, a function of greater discipline on the part of originating banks
- Default rates are likely to rise, but moderately, staying inside historical averages; energy and mining remain on watch

Market Technicals: Neutral to Slightly Positive in First Half of 2016 +

- Secondary prices, new issue spreads and total return performance will remain subject to aggregate supply/demand dynamics and overall risk sentiment; market technicals should see better balance in early 2016

Volatility: Neutral to Slightly Negative in First Half of 2016 −

- Overall volatility across credit markets will increase as rates rise, but loan volatility should remain lower relative to most credit asset classes

Fed Policy: Neutral to Slightly Positive in 2016 +

- Near-term Fed action notwithstanding, the hunt for yield will continue and demand for floating rate investment solutions should increase as LIBOR reaches/exceeds LIBOR floors

Macro Headwinds ?

- Potential challenges include weak commodity prices, material shifts in investment flows across credit markets, slowing Chinese economy, Eurozone, and regulatory impacts (e.g., Volker Rules, Risk Retention, Leverage Lending Guidelines)

General Risks for Floating Rate Senior Bank Loans: Floating rate senior bank loans involve certain risks. Below investment grade assets carry a higher than normal risk that borrowers may default in the timely payment of principal and interest on their loans, which would likely cause the value of the investment to decrease. Changes in short-term market interest rates will directly affect the yield on investments in floating rate senior bank loans. If such rates fall, the investment's yield will also fall. If interest rate spreads on loans decline in general, the yield on such loans will fall and the value of such loans may decrease. When short-term market interest rates rise, because of the lag between changes in such short term rates and the resetting of the floating rates on senior loans, the impact of rising rates will be delayed to the extent of such lag. Because of the limited secondary market for floating rate senior bank loans, the ability to sell these loans in a timely fashion and/or at a favorable price may be limited. An increase or decrease in the demand for loans may adversely affect the loans.

Unless otherwise noted, the source for all data in this report is Standard & Poor's/LCD. S&P/LCD does not make any representations or warranties as to the completeness, accuracy or sufficiency of the data in this report.

1 – Comprises all loans, including those not tracked in the LSTA/LPC mark-to-market service. Vast majority are institutional tranches. Issuer default rate is calculated as the number of defaults over the last twelve months divided by the number of issuers in the Index at the beginning of the twelve-month period. Principal default rate is calculated as the amount defaulted over the last twelve months divided by the amount outstanding at the beginning of the twelve-month period.

2 –Assumes 3 Year Maturity. Three year maturity assumption: (i) all loans pay off at par in 3 years, (ii) discount from par is amortized evenly over the 3 years as additional spread, and (iii) no other principal payments during the 3 years. Discounted spread is calculated based upon the current bid price, not on par.

3 – Excludes facilities that are currently in default.

Group Heads

Dan Norman
Telephone - 480-477-2112
dan.norman@voya.com

Jeff Bakalar
Telephone - 480-477-2210
jeff.bakalar@voya.com