

Fixed Income Perspectives



Matt Toms, CFA, 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. As of March 31, 2016, Voya Investment Management managed \$129 billion in fixed income strategies in the United States.

Seven Investment Themes for the First Half of 2017

Like a game plan for a football team, our semi-annual themes provide a framework for our investment decisions. For single-sector strategies, this macro input helps inform our bottom-up strategy. For multi-sector strategies, our holistic view of the economy and global monetary policy helps determine the overall risk budget and portfolio positioning to capitalize on relative value across sectors.

Investment Themes

- 1. U.S. Economy:** Expectations of tax cuts, deregulation and fiscal policy will cause a near term acceleration of U.S. growth. However, structural issues such as the consumer's ongoing aversion to leverage along with subdued productivity will continue to limit the upside of potential growth.
- 2. Inflation Outlook:** Near-term global inflationary pressures will continue to build; however, the structural pressures caused by demographics and the persistent savings glut will suppress the longevity of this rise and will keep longer term inflation expectations contained.
- 3. Central Banks:** Cyclical tailwinds reduce the need to rely so heavily on global monetary policy accommodation, but the Fed will continue a cautious pace of rate normalization, as guided by market expectations. The ECB is near the end of viable policy options and will begin stepping away from existing measures.
- 4. Emerging Markets:** Green shoots within emerging markets will take root, facilitated by developed market stability and local infrastructure spending, despite the headwinds of an incrementally stronger dollar and higher global interest rates.
- 5. China:** Chinese growth will be stable; however, CNY will continue to weaken as concerns of asset bubbles move back to the forefront. China's high potential growth rate and commitment to structural reforms will allow the central government sufficient tools to address these bubbles and the volatility that accompanies them in the near term.
- 6. Europe:** Within Europe, populism will reinforce local country social contracts to spend but in turn stress the broader European construct, creating uncertainty and volatility; however, this will not result in departures from the European Union.
- 7. Corporate Health:** Improvement in corporate revenues and earnings from incrementally higher nominal growth create a constructive fundamental backdrop for corporate credit.

U.S. Economy: Constructive Environment for Near Term Growth

We believe the expectations of tax cuts, deregulation and fiscal policy will result in the near-term acceleration of economic growth in the United States. These changes will likely reverberate throughout the broad economy, resulting in further improvement of corporate fundamentals, as well as expectations for higher wages. Longer term, however, we believe structural issues such as subdued productivity and consumers' ongoing aversion to leverage will continue to limit growth potential.

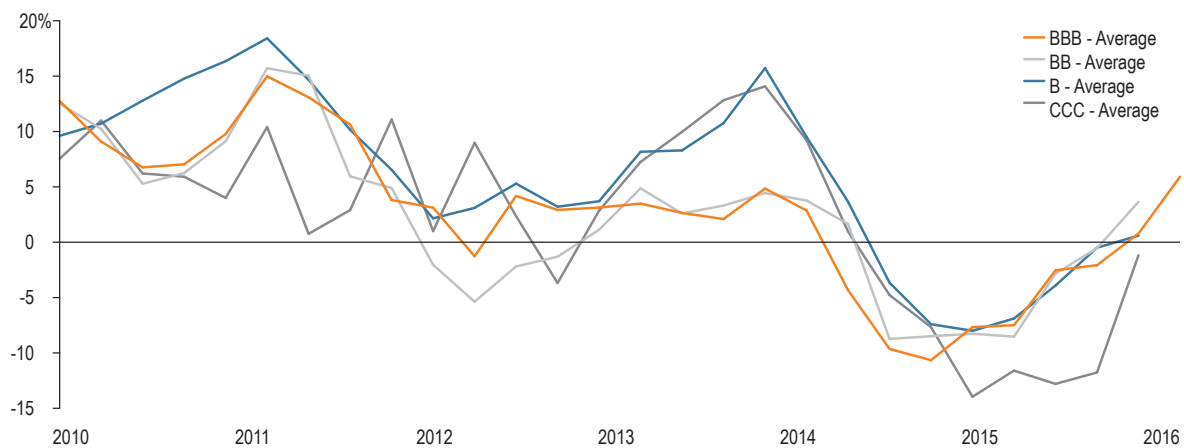
Recent developments seem to support near-term prospects for improved growth. December payrolls along with revisions to November's count point to a healthy three-month labor trend. Additionally, the NFIB Small Business Survey surged to its

highest rating in over a decade in reaction to the outcome of the presidential election.

Our expectations for near-term economic growth reinforce our positive bias towards domestically-oriented spread assets. These asset classes continue to be supported by strong technical factors and an increased risk appetite. While corporate credit, both investment grade and high yield, should benefit from a long-desired increase in nominal growth (Figure 1), securitized assets also should benefit from a stronger consumer and overall improved economic activity. We also see value in bonds on the lower end of the quality spectrum, which we expect to benefit significantly from higher nominal growth.

Figure 1. Revenue Growth is Trending Upward across the Ratings Spectrum

Average Revenue Growth Year-over-Year by Credit Rating



Source: Bloomberg, Datastream and Voya Investment Management.

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U.S. Fed: Cautious Pace of Rate Normalization

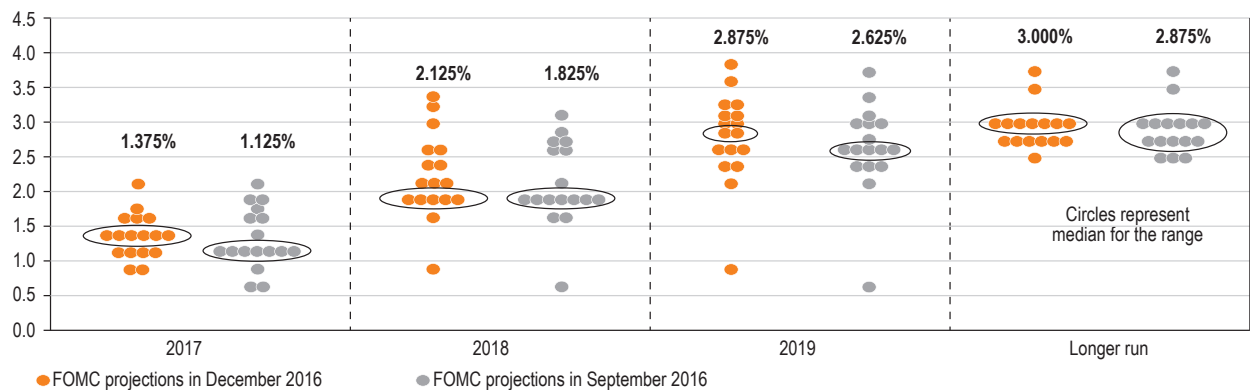
The Federal Reserve's 2017 plan cites increased GDP and a lower unemployment rate, setting up the possibility of three rate hikes for the year. The upturn in global growth that preceded the election, coupled with increasing wage pressures, reduces the need to rely so heavily on monetary policy accommodation. But this does not dissuade us from our belief that the Fed will continue its cautious pace of interest-rate normalizing. The December Fed minutes reiterated this as the tone skewed dovish and confirmed a gradual path for hiking rates.

Our belief that there will be a measured increase in the Federal Funds Rate, as well as higher long-term rates caused by stronger

near-term growth and inflation, have led us to position our portfolios with a shorter duration profile, while adding a small allocation to Treasury Inflation-Protected Securities (TIPS). We believe these measures will help protect our clients' assets. We are maintaining an underweight to agency residential mortgage-backed securities (RMBS) due to their sensitivity to interest rates. Instead we prefer shorter-duration securities that deliver exposure to mortgage credit, such as non-agency RMBS, commercial mortgage-backed securities and credit-risk-transfer securities.

Figure 2. U.S. Federal Reserve Rate Hike Projections Have Risen over the Intermediate Term

Target Federal Funds Rate at Year End



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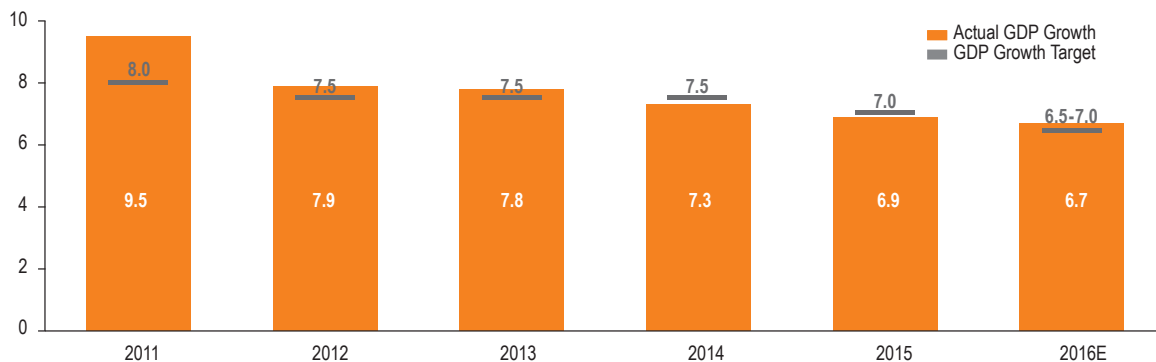
The Rest of the World: Europe, China and Emerging Markets

Globally, near-term cyclical tailwinds and easier fiscal policies should reduce the heavy reliance on monetary policy accommodation to which many economies have become accustomed. In Europe, the ECB is near the end of viable policy options as officials realize that low-to-negative interest rates have unintended consequences. With the rebound in global growth, particularly European growth, and with inflation likely past its trough, Draghi and company will feel less pressure to maintain their current, accommodative stance and will begin reducing it.

As the global wave of populism now shifts to Europe, we will keep a close eye on upcoming elections and political action within the euro zone. We see populism reinforcing local country social contracts, thus some loosening of purse strings is expected. While this may cause volatility as the populist movement remains in the forefront, this is not likely to result in departures from the European Union.

We expect Chinese growth to be stable in 2017 (Figure 3). Its high growth potential and the government's commitment to structural reform should allow China to address any asset bubbles that may form as a result of a weaker yuan. The latest global PMIs highlight continued improvement in global manufacturing, which should continue to support the recovery of commodities since early 2016. We expect emerging markets (EM) to remain somewhat volatile, partially due to the U.S. political environment. Nonetheless, the commodities recovery and increased infrastructure spending should help select EM economies battle the headwinds of a stronger U.S. dollar and higher global interest rates. These factors, combined with broad stability in the developed world, should enable country by country opportunities to arise within EM.

Figure 3. Chinese GDP Growth is Stabilizing



Source: Morgan Stanley Research.

Past performance does not guarantee future results.

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