

Voya Multi-Strategy Fixed Income SMA

> Investment Summary

- > Multi-strategy fixed income style consists of an existing Voya intermediate-maturity fixed income SMA style, combined with an embedded mutual fund structure called Voya Investment Grade Corporate Fund.
- > Voya may invest up to 40% of a client's assets in the embedded Voya Investment Grade Corporate Fund mutual fund structure. The objective of the structure is to enhance the overall effectiveness of an account by modeling institutional-level investment strategy

> Portfolio Management

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Portfolio Review and Outlook

The Bank of America Merrill Lynch 1-10 Year U.S. Corporate & Government Index posted a total return of 0.92% for the quarter. Our diversified security selection within corporates was the primary driver of the strategy's outperformance.

We maintained our investment grade (IG) credit versus an underweight to U.S. Treasury securities. We prefer "spread" assets with potential to benefit from improving global growth. Corporations look healthier as sales growth continues to recover; recent quarterly earnings have shown strong improvement over prior quarters. With limited overall cost pressures, corporate profit margins will be resilient. Leverage is slowly rising but looks supportable, and interest coverage remains elevated. Our diversified security selection within corporates was positive.

We've maintained a shorter duration posture than the benchmark which was flat compared to the index. The Federal Reserve (Fed) hiked short-term interest rates 25 basis points in June, as expected. The announcement struck a rather hawkish tone, emphasizing moderate economic expansion and downplaying softer inflation data. The Fed also discussed its plan to begin gradually trimming its balance sheet this year, with perhaps another interest rate hike in play as well. Fed Chair Janet Yellen emphasized that employing gradual rate hikes eliminates the potential to fall behind the curve and therefore the need to hike more quickly and risk recession.

With that, we believe the Fed's focus will be on balance sheet reduction for now, before resuming its cautious pace of rate normalization as guided by market expectations. While the Fed did not specify an endpoint for its total balance sheet size, it noted

that afterward the level of assets will remain higher than before the financial crisis. It seems that the Fed is signaling it will be less "data dependent" and therefore will be more forecast driven, which has the potential to continue to suppress market volatility. We believe this continuation of easy monetary policy will keep volatility uncomfortably low, supporting full but sustainable valuations of risk assets.

The optimism that drove the so-called "Trump trade" in the first half of 2017 has all but evaporated. The market is questioning the possibility of a tax deal, but policy analysts still expect some fiscal stimulus, which they believe would add 0.3–0.5 percentage points to GDP in 2018. Even if this view proves correct, policy action is likely to be slow and unlikely to boost the economic growth trajectory much above its current 1.5–2.0% trend for any sustainable time period.

With that in mind, we believe subdued productivity and consumers' ongoing aversion to leverage will continue to limit growth potential over the longer term. Therefore, any benefits from demand-oriented policies such as tax cuts are likely to be limited and short-lived. Supply-oriented policies, e.g., significant deregulation or true tax reform, would provide more lasting benefits to growth but are unlikely to be delivered.

Wage pressures within the U.S. economy will continue to increase unevenly across industries. Wage increases for lower income workers will help offset current spending constraints and improve debt service capacity. Despite this increase in wages, overall inflation pressure will be limited by global excess supply. There are advantages to this more stable and therefore more sustainable growth. These include manageable wage and inflation

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pressures and a slower and limited rise of interest rates, both of which will support consumer spending and encourage business investment. Additionally, we believe this will temper any appreciation of the U.S. dollar. Finally, the combination of improving credit fundamentals and continued easy monetary policy will push credit spreads to new post-crisis tights.

Our outlook is that near-term growth in the United States will be closely tethered to trend level. The benefit from demand-oriented policy (tax cuts) is likely to be limited and short-lived. Supply-oriented policies, such as significant deregulation or true tax reform, are unlikely but would have more lasting benefits on growth. Wage pressure within the U.S. economy will continue to increase, albeit unevenly across industries. Overall inflation pressure will be limited by global excess supply. Wage increases for lower income workers will help offset current spending constraints and improve debt service capacity. Balance sheet reduction will be the near-term focus of the Federal Reserve; a cautious pace of rate normalization guided by market expectations will continue later. Continued easy monetary policy will keep volatility uncomfortably low, supporting full but sustainable valuations of risk assets. With limited overall input cost pressure, corporate profit margins will be resilient. The combination of improving credit fundamentals and continued easy monetary policy will push credit spreads to new post-crisis tights even as we move closer to the end of the current cycle.

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SMAC-SCF12