Fixed Income Strategies in a Rising Rate Environment

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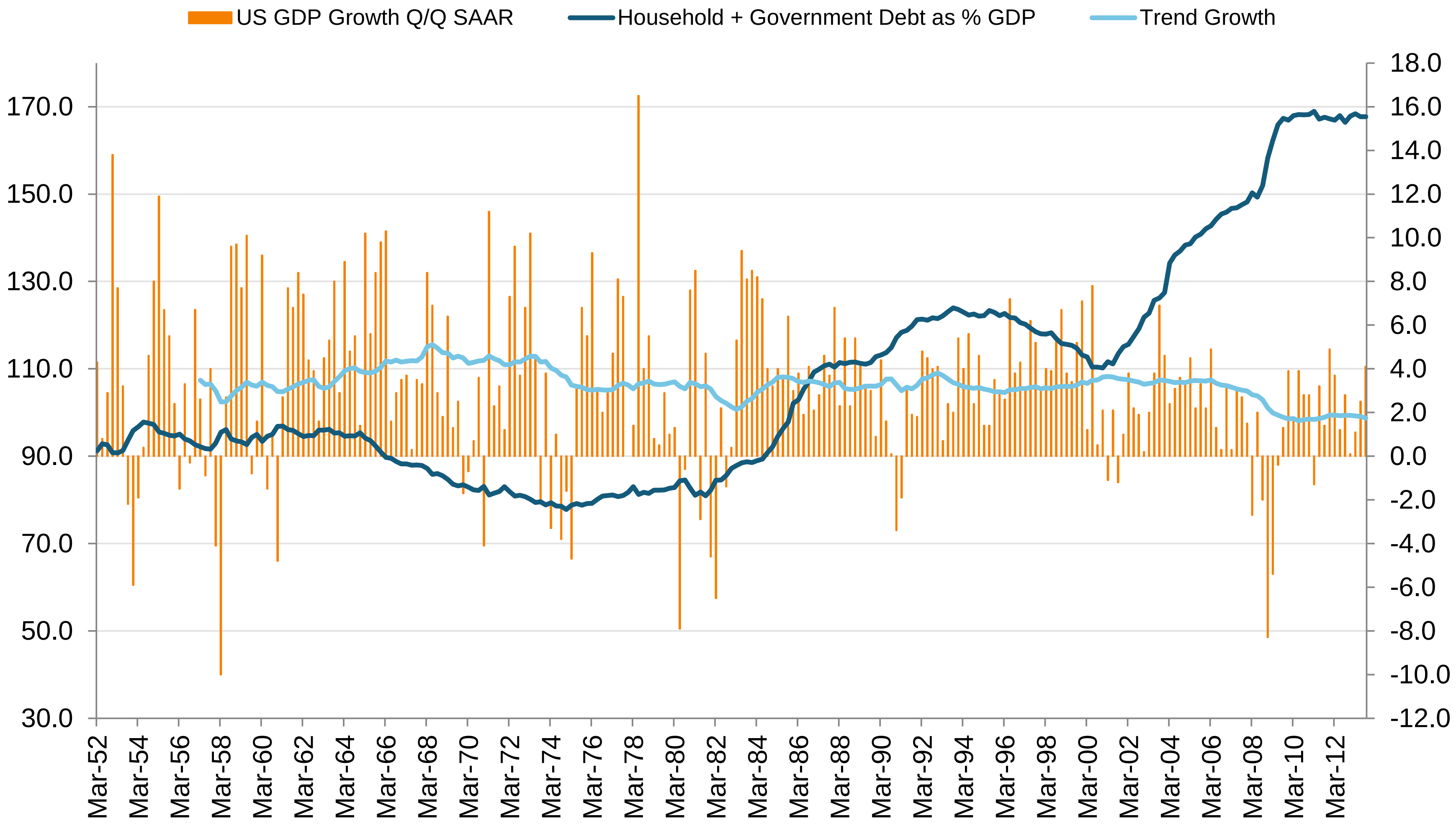
CID #9666

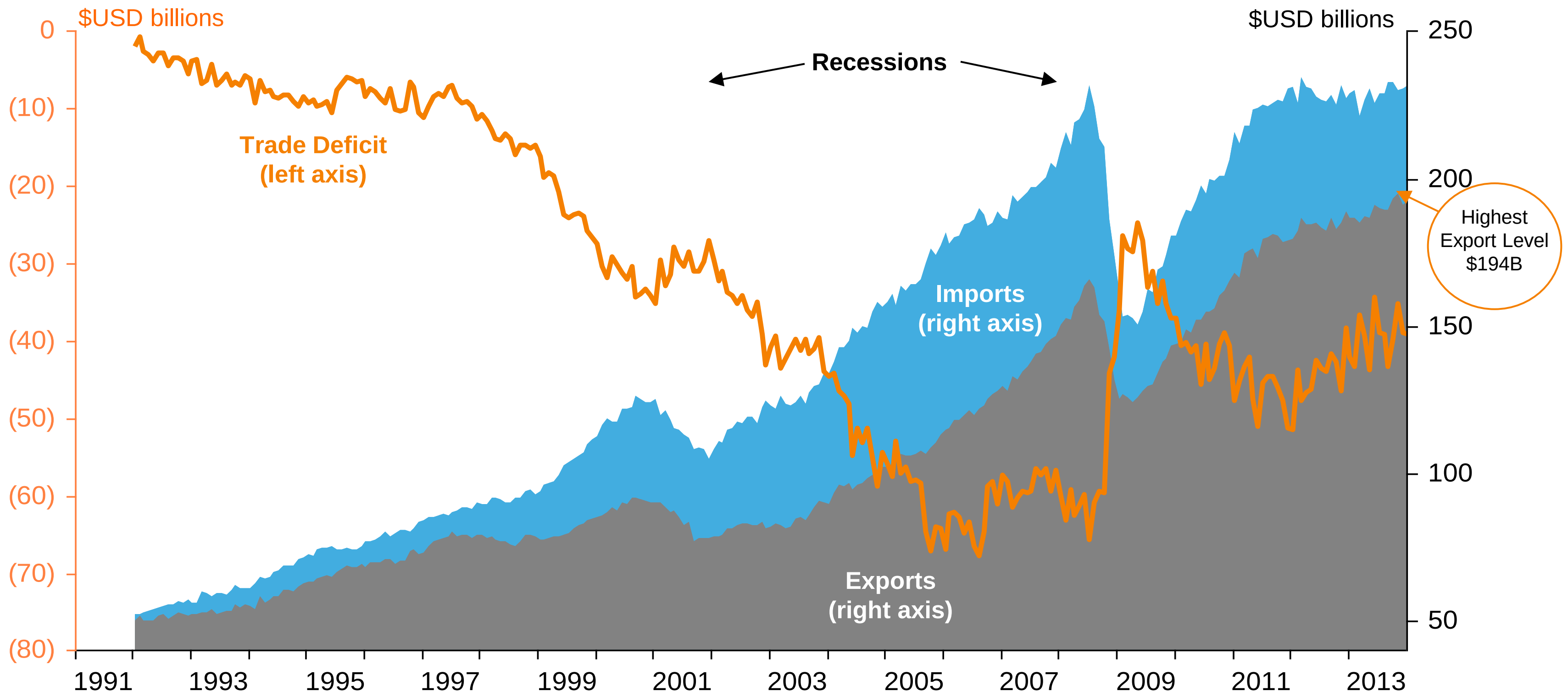
Gross Oversimplification of How Bond Markets Got to This Point…



Source: Bloomberg. As of March 31, 2014

Tectonic Shift: Trade

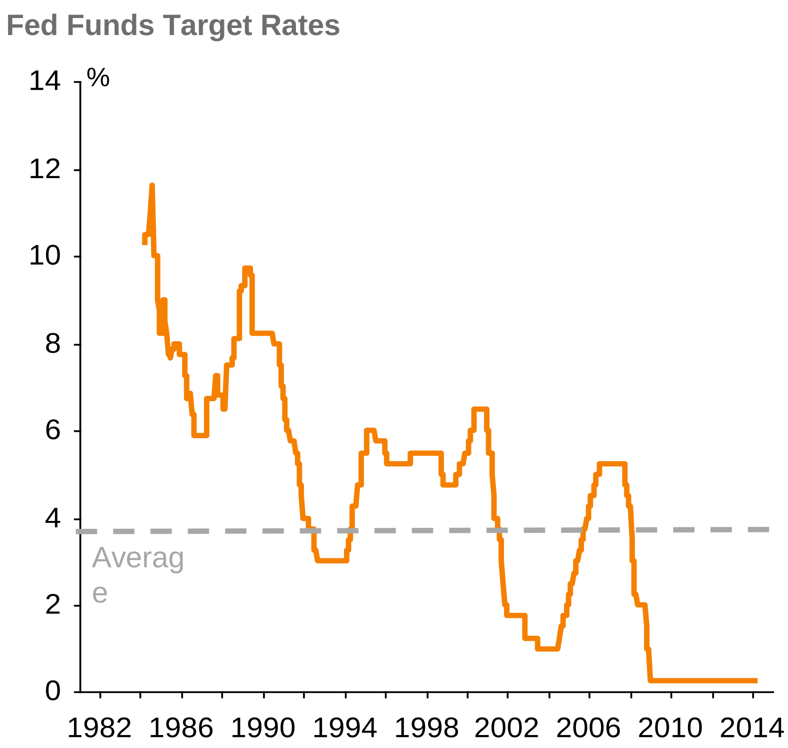
Economic growth fuels demand for imports, aggravating the trade deficit, which hit a 10-year low in the great recession as demand dwindled. Exports have since expanded, reaching their highest level ever.

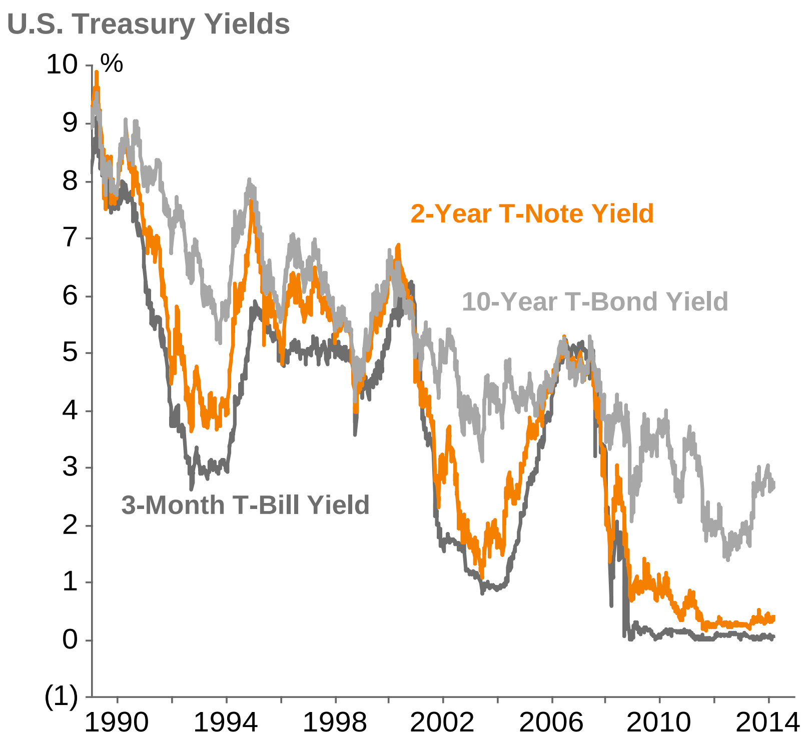


Source: FactSet

Fed Funds Target Rates and U.S. Treasury Yields

Despite a rise in the ten-year U.S. Treasury yield, the Fed funds rate and Treasury yields are historically low, and the Fed has indicated it intends to keep rates low until economic growth and inflation reach actionable levels.





Note: 3-Month T-Bill Yield is annualized based on purchase at a discount and holding to maturity. The 2-Year Treasury Note Rate is annualized.
Source: Reuters, Bloomberg, FactSet

What Is Desired From Bond Portfolios

- **Stability of returns**
- **Income**
- **Liquidity**
- **Volatility offset alongside of equity or alternatives portfolios**
- **Matched liability profile**

The Fallout - Two New Camps Emerge…

Aggregate Based Strategies

Risk framed as deviation relative to market benchmark

LDI

Risk defined as return volatility relative to a custom liability profile

Unconstrained

Risk defined as return relative to the risk-free rate?

The Fallout - Two New Camps Emerge…

Aggregate Based Strategies

Slow, steady, uncomfortable at times, but reliable.

LDI

You know where you are going to end up, even if the ride is inherently volatile.

Unconstrained

Can turn into lots of cool things and can go seemingly anywhere with few constraints.

Components of the Barclay's U.S. Agg Index by Percentage

U.S. Treasury 35.65%	**IG Corporates** 22.96%
U.S. MBS 29.17%	**CMBS** 1.69%
Gov't Related 10.00%	**ABS** 0.49%

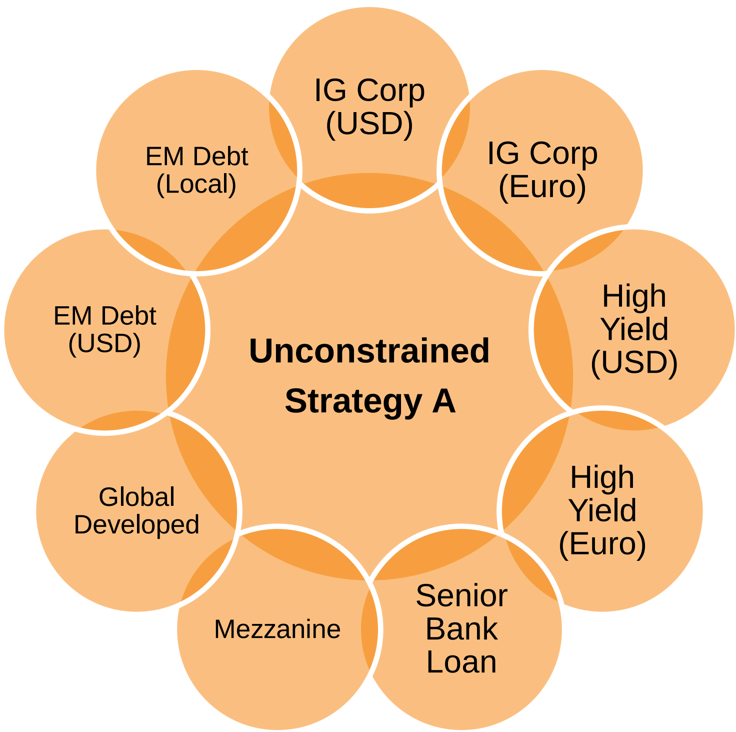
Source: Barclay's U.S. Aggregate Index
As of March 31, 2014

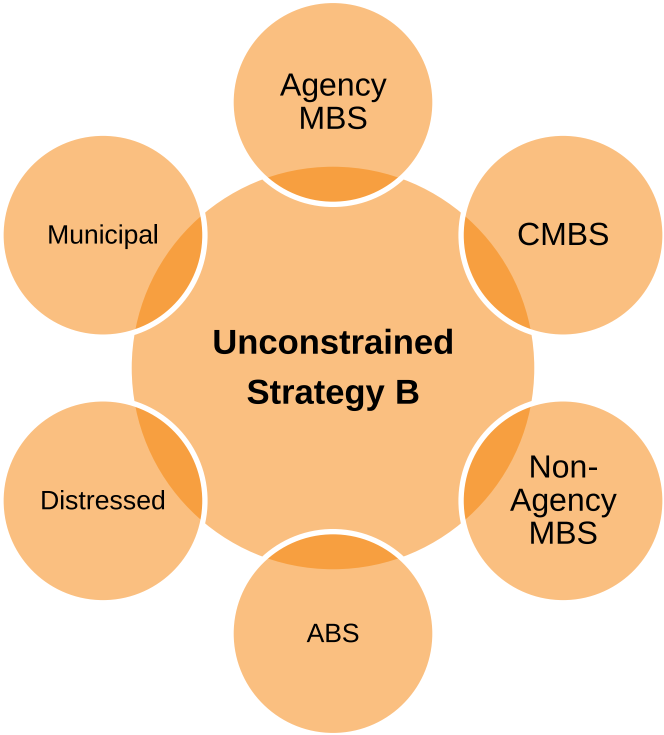
Components of the Barclay’s U.S. Agg Index by Risk Contribution

U.S. Treasury	352bps
IG Corporates	-6.98bps
U.S. MBS	8.28bps
CMBS	-0.11bps
Gov’t Related	0.32bps
ABS	0bps

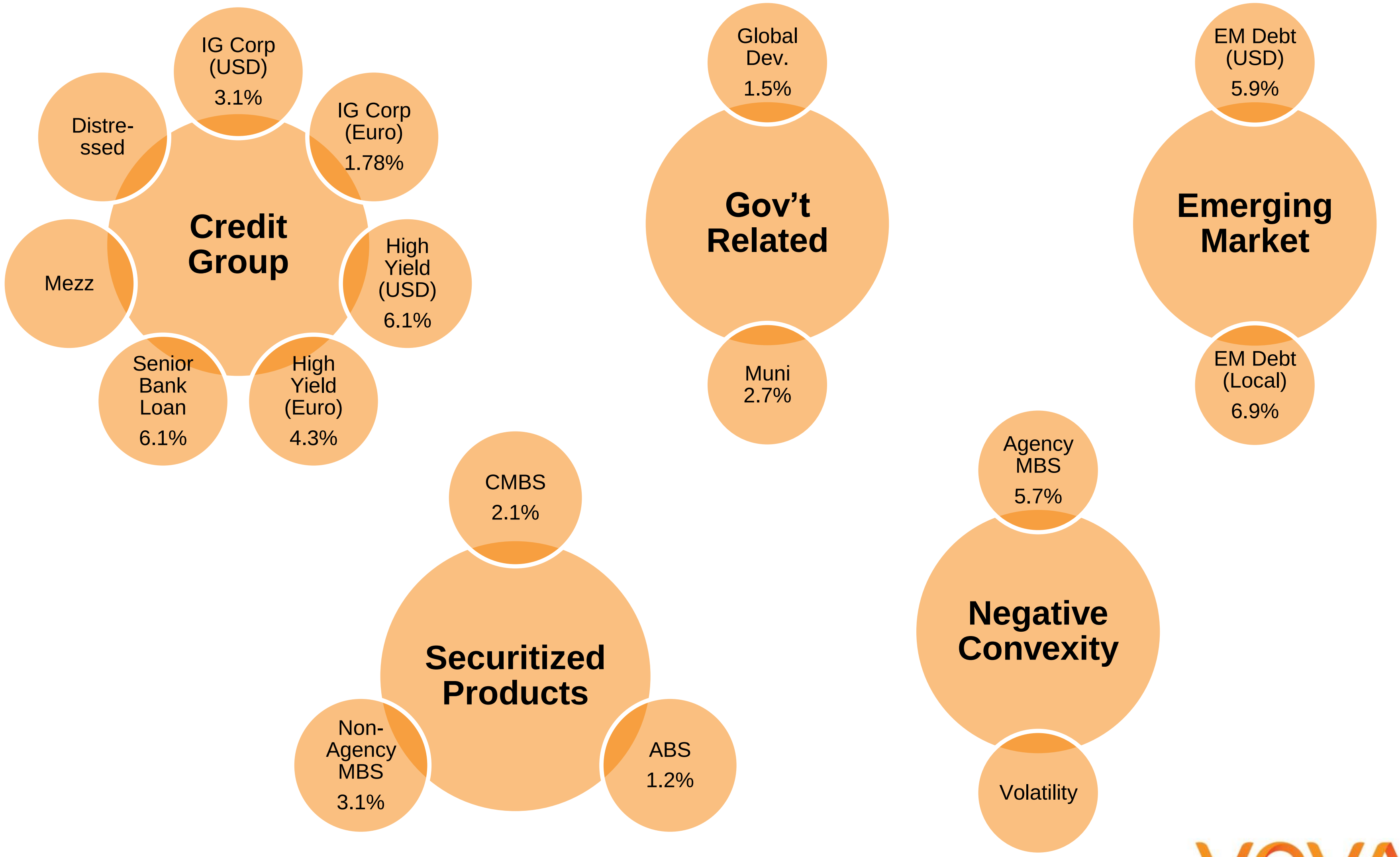
Source: Barclay’s U.S. Aggregate Index
As of March 31, 2014
The metrics provided represent the stand-alone absolute risk (Value at Risk) of the Barclay’s U.S. Aggregate benchmark. Standalone risk for the Barclays U.S. Aggregate is dominated by USD interest rate risk factors, consistent with the representative universe of the benchmark.

Potential Components to an Unconstrained Fixed Income Strategy





Headwinds – Less Diverse Than They May Appear

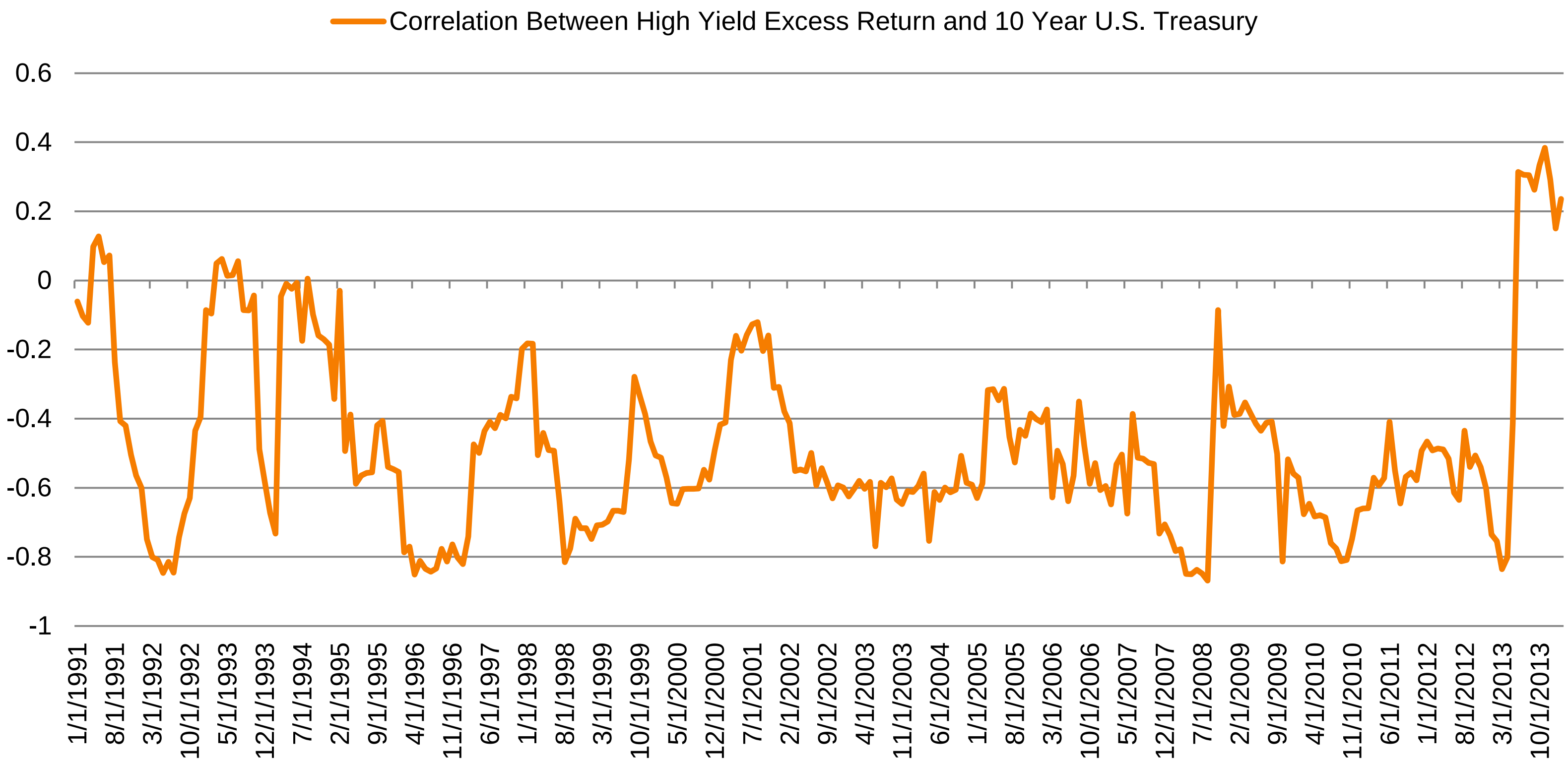


Headwinds - Correlations

	SPX	Barclays Euro IG	US IG	Muni	Barclays Euro HY	US HY	US Bank Loan	CMBS	US ABS	US MBS	Non Agency MBS	MIF	Global Treasury	EMBI	GBI
SPX	1.0	0.2	0.2	0.0	0.7	0.7	0.5	0.4	0.1	-0.2	-0.1	0.1	-0.3	0.5	0.4
Barclays Euro IG		1.0	0.8	0.5	0.5	0.5	0.4	0.4	0.5	0.4	0.4	0.2	0.5	0.6	0.5
US IG			1.0	0.6	0.6	0.6	0.4	0.5	0.6	0.6	0.5	0.1	0.5	0.8	0.6
Muni				1.0	0.3	0.3	0.3	0.4	0.6	0.5	0.4	0.0	0.5	0.5	0.4
Barclays Euro HY					1.0	1.0	0.8	0.6	0.6	0.1	0.1	0.2	-0.1	0.8	0.5
US HY						1.0	0.8	0.6	0.5	0.0	0.1	0.3	-0.2	0.7	0.5
US Bank Loan							1.0	0.5	0.6	-0.2	-0.1	0.3	-0.4	0.5	0.1
CMBS								1.0	0.4	0.2	0.2	0.2	0.2	0.5	0.4
US ABS									1.0	0.4	0.3	0.2	0.2	0.5	0.3
US MBS										1.0	0.8	0.1	0.8	0.5	0.5
Non Agency MBS											1.0	0.0	0.6	0.4	0.4
Mortgage Derivatives												1.0	0.0	0.1	0.0
Global Treasury													1.0	0.3	0.5
EMBI														1.0	0.7
GBI															1.0

Correlations cover the period from January 1, 2002 through March 2014. Except for the Mortgage Derivatives component, the correlations are calculated for the S&P/LSTA Leveraged Loan Index, the Barclays U.S. High Yield 2% Issuer Cap Index, the Barclays U.S. CMBS Index, the Barclays U.S. Treasury 7-10 Year Index and the Private Label / Non-Agency Residential Mortgage-Backed Securities Market index. The Mortgage Derivatives correlations are based on the ING Mortgage Derivatives strategy as further described in this presentation. **Past performance is no guarantee of future results.**

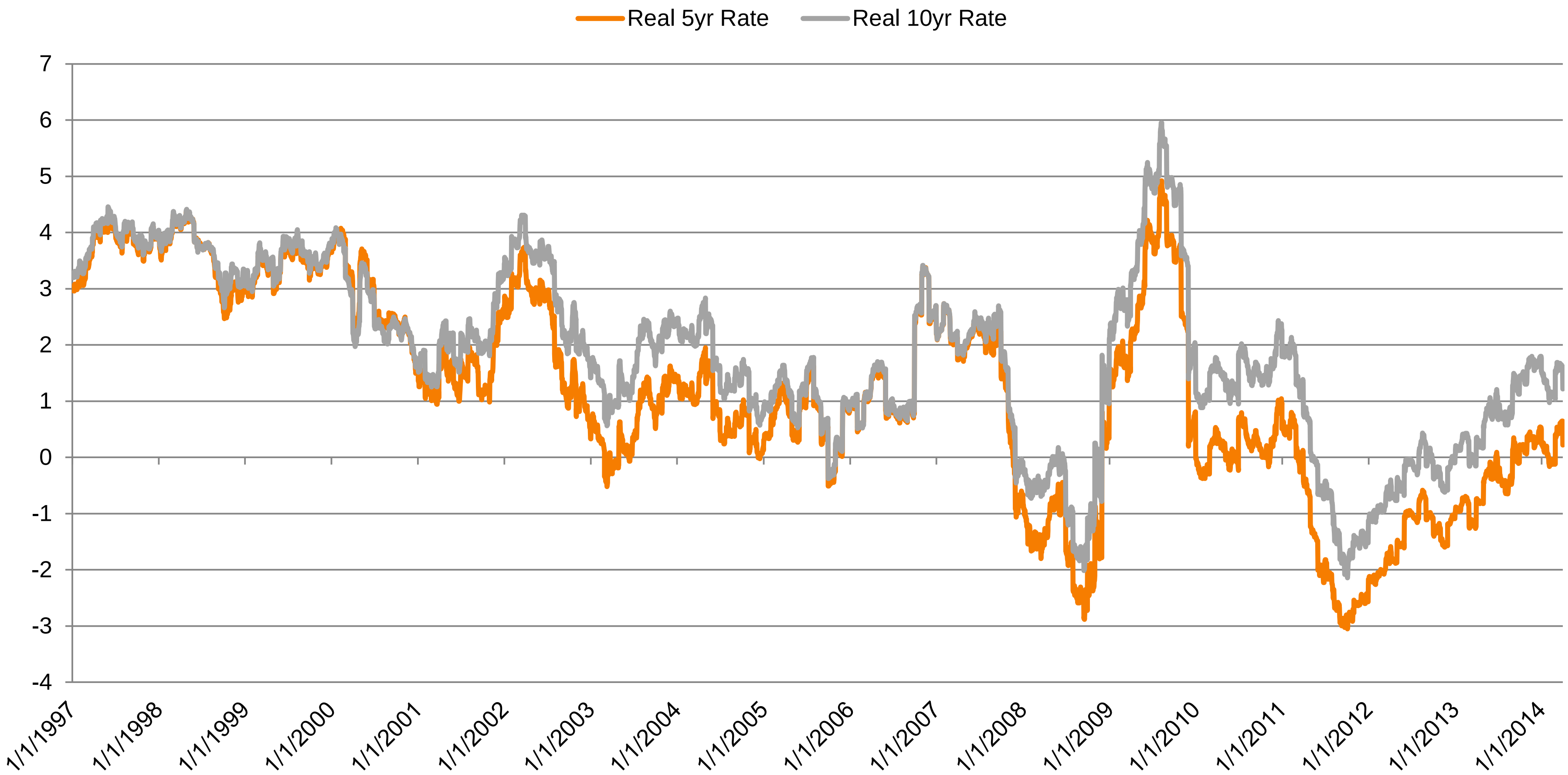
Headwinds - Correlations



Correlations cover the period from January 1, 1991 through March 2014. The correlations are calculated for the Barclays U.S. High Yield 2% Issuer Cap Index, and the Barclays U.S. Treasury 7-10 Year Index.

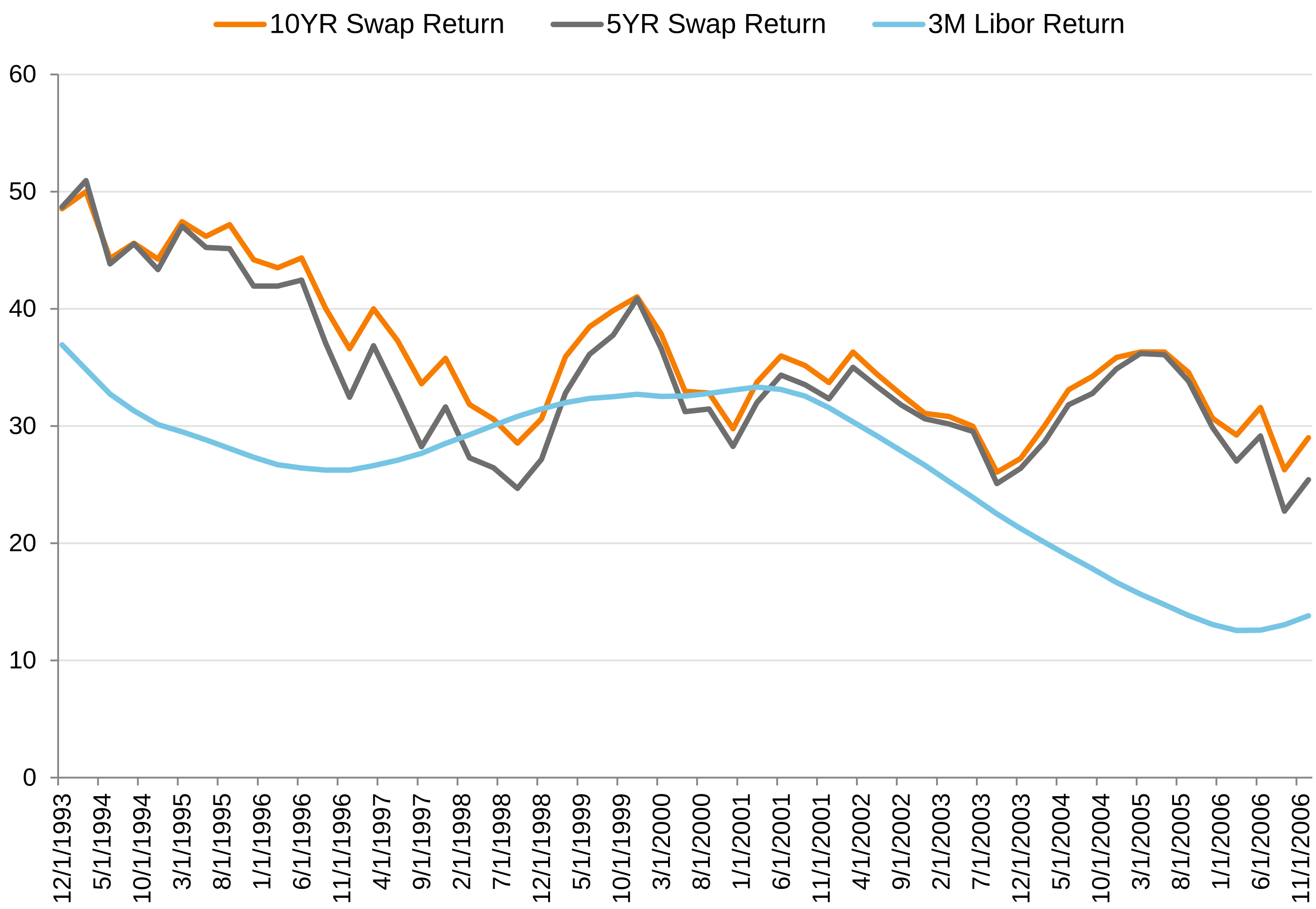
As of March 2014
Source: Bloomberg and Voya Investment Management

Just How Unattractive is Duration Risk Anyway



Source: Bloomberg
As of April 2014

Just How Unattractive is Duration Risk Anyway



Source: Bloomberg

Risks vs. Rewards

So, investors need to be certain what their unconstrained fixed income allocation will prove to be over time:

Pragmatic, Intelligent Garnering of Spread-product?

OR

Prolific and Indiscriminate Gluttony of Spread-product?

Conclusions

- U.S. Treasury duration has historically had an attractively low or negative correlation to many of the sectors to which unconstrained fixed income strategies allocate. Overly limiting treasury duration exposure in such strategies will likely prove to be a near-term benefit. For unconstrained fixed income strategies to provide the long-term characteristics that investors typically require, duration will likely need to be used to an even greater degree than what is currently seen in Aggregate Strategies.

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