For Professional Advisers Only

# Notes From The CIO

**29 March 2022**

- The bond market has remained extremely challenged in the 2 weeks since the Fed's first of several rate hikes. The 2-year Treasury has risen another 50 bps, the 10-year has risen 25 bps, and the curve is very flat in the 2.40% context. Q1 and March performance for most bonds will represent the largest declines of the century. Through yesterday the Bloomberg Aggregate Index performance is -7.28% quarter-to-date and -4.20% month-to-date. In the last 20 years the Aggregate Index has only posted one month below -3%, in July 2003. The Bloomberg Corporate Index is down -8.75% YTD and the Bloomberg High Yield Index is down -5.74% YTD. Duration has been and may continue to be the largest contributor to negative performance

- **Non-Agency RMBS are increasingly standing out as having the best combination of fundamental credit quality and yield, generally with much less duration**. RMBS spreads have widened sharply and much more widely than the broader fixed income credit markets on technical, extension concerns and macro economic related factors despite very strong fundamentals and an equally strong outlook. Agency CRT spreads have widened by 125 to 450 bps YTD. Non-QM spreads have widened 85 to 175 bps. SFR bonds have widened from 60 to 175 bps. **Yields for investment grade bonds are now 5% - 6%+, while mezzanine profiles are now yielding 7% to 10%**+. Most bonds are now trading at a discount to par, resulting in even more favorable convexity for these mostly fully amortizing cash flows



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- The market is pricing in an increasing number of Fed hikes over the next year, increasingly likely to include 50 bp hikes – while a negative for most of the bond market, this remains a strong positive for the RMBS sector overall. The outlook has changed from 6-7 hikes in 2022 to 8-12 hikes (2.0 – 3.0%)

- The large portion of the Non-Agency RMBS market consisting of floating rate profiles has started to benefit from the Fed hawkish path, with SOFR and LIBOR increases already reflected in many bonds' coupons. These uncapped coupons will move higher over the next several quarters

- Recently released remittance data shows continued fundamental credit strength. Today's home price updates from FHFA and CoreLogic show accelerating prices again, a credit positive. In our view, housing related bonds remain the best bet for this economic cycle and RMBS is aided by higher inflationary environment - asset prices like homes rise with inflation as do wages, but mortgage payments are fixed, strengthening the overall credit position of the securities combined with growing home equity

- Fannie Mae priced their last Agency CRT new issue of the first quarter. While pricing yields were wider, bonds have remained firmer over the last several trading days. In our view Agency CRT bonds, which have witnessed the most spread widening and price declines across RMBS have shown some stability. As we move past quarter end, we believe we may start to see more stability from here



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