

Notes From The CIO

26 May 2022



- Treasury yields have at least temporarily settled into lower ranges, seemingly reflecting some amount of focus from inflation to recession. Irrespective of which path the economy traces, we believe that seasoned, next generation non-agency RMBS like Non QM, Jumbo 2.0, CRT, and SFR are well positioned to outperform. Strong demographic trends and constrained housing supply should sustain modest home price appreciation during a weaker economy, while housing has frequently demonstrated its strength as an inflation hedge. In our view, moderating HPA is actually a positive for housing since further rapid HPA increases would put a strain on affordability.
- This week's monthly remittance data continues to show positively trending credit fundamentals, with delinquencies in most cohorts lower again, loss severities lower, and LTV's lower on the strength of the robust HPA that has already been realized YTD.
- Prepayments speeds slowed across all sectors as expected. With the sharp rise in interest rates and RMBS spreads this year, most bonds are trading at significant discounts to par, and most bonds are now priced to reflect full maturities or extensions with no call optionality. This is one of the reasons for lower RMBS prices, but is not accurate in our view. Many bonds still have call optionality for both economic and non-economic issuer-specific reasons. This optionality along with strong and strengthening bond and borrower credit strength will be supportive to prices when we move beyond the current environment of macro volatility and diminished liquidity.
- The coupons on floating rate RMBS increased by about 50 bps this week, reflecting the latest Fed rate hike. We expect carry on these bonds to continue to rise for the remainder of the year, increasing return expectations. Rising coupons will not materially impact credit quality of RMBS if at all. In the case of Agency CRT there is no impact because the coupon payments are the direct obligation of Fannie Mae and Freddie Mac.