For Professional Advisers Only

Notes From The CIO

18 July 2022

SEMPER
CAPITAL MANAGEMENT

- We are seeing substantial signs of new issue supply slowing in RMBS, with the exception of Non-QM which is still working through a backlog of collateral. Overall, second half issuance should be about ½ of the first half record levels. Importantly, CRT new issue supply, one of the initial triggers leading to sharply wider spreads, is slowing

- We believe that RMBS spread widening is topping out from the combination of this lower supply and very attractive relative value compared to other spread sectors. Further extension risk, another source of pricing weakness, seems to be effectively off the table as models are pricing most profiles at or near maximum extension – this is likely an overreaction. Jumbo 2.0 issuance has effectively halted because of the inefficiency of issuing with today's spread levels; Non-QM collateral is starting to see a rise in weighted average coupons, which will make excess spread and other deal factors much more attractive, allowing for spread compression; delevering and ratings upgrades are ongoing for seasoned profiles; and Agency CRT continues to perform across all credit metrics – even factoring in economic weakness and reduced housing affordability

- Credit upgrades in RMBS are over 2,100 year to date, versus 3,600 for all of last year and ~350 in 2020 and 700 in 2019. In contrast, the ratio of corporate bond credit upgrades to downgrades has been deteriorating this year. Combined with higher yields in RMBS than corporates across the capital stack, we view RMBS relative value as very compelling

- Meanwhile, all but certain additional large Fed rate hikes will continue to boost carry on portfolios containing floating rate RMBS. Market participants are generally expecting 2% to 2.5% of additional hikes this year, increasing RMBS floating rate coupons by as much as 4% from the beginning of the year