Notes From The CIO

8 September 2022

- Following several weeks of reasonably strong spread tightening in RMBS, especially in CRT – in keeping with our expectation that the market would firm up after we got through the supply wave and into the second half of the year – our sector has paused. It's largely due to the near term uptick in rate volatility and sharp rise in rates which has further reduced call assumptions for many RMBS profiles, coupled with downward revisions to home price outlooks

- With the sharp rise in rates late last month along with earlier this week, many fixed rate profiles, including Non-QM and Jumbo 2.0 mezzanine profiles are being viewed by investors as having increasingly longer profiles. We believe that average lives/durations will prove to be shorter than market consensus, but this has pushed prices lower

- Meanwhile, the coupons on CRT and other floating rate MBS continue to reset higher. Today's most common benchmark, the 30 Day Average Secured Overnight Financing Rate, has risen from 5 bps to nearly 2.3% year to date, and is likely to move higher with the Fed's next hike. This over-2% rise in yield will continue to be a meaningful contributor to total returns

- The housing market suffered its first decline in prices month-over month in a decade in July, which was reported earlier this week. Home prices are likely to decline further, especially in higher priced markets given lower home affordability. But the housing market's severe supply/demand imbalance won't be cured quickly, and this will provide downside support. This risk does highlight the importance of owning seasoned bonds, like the bonds Semper has focused on, with average LTVs of about 50%. In our view this provides significant protection and asset coverage even in the case of a severe downturn in the economy, and makes the RMBS versus (unsecured) corporate bond market relative value comparison even more attractive