For Professional Advisers Only

Notes From The CIO

28 September 2022

- In the midst of the overwhelmingly negative headlines and corresponding moves in stock and bond markets this month, mortgage remittance data reported this week highlight the continued fundamental support in the non-agency MBS sector, especially for seasoned bonds

- While we are seeing the first signs of home price declines at the national level based on July information, primarily focused on areas that exhibited the highest levels of home price appreciation since 2020, we are continuing to see very low delinquencies and continued growth in credit enhancement

- For example, the credit enhancement of the cohort of agency CRT B2 subordinated bonds in Semper's portfolios increased to about 40 bps last month, and stands at approximately 3 to 4 times lifetime loss projections. This is especially meaningful since loss projections include expectations for home price declines in the near term

- Remittance data also reflects a continued slowdown in prepayment activity. At the current level of speeds we believe that prepayments are approaching levels of baseline housing turnover and reflect very little refinancing activity. Our expectation is that slow prepayments are nearing the point of being fully priced into bond spreads as they approach baseline housing turnover levels. This creates incremental upside if rates reverse course in subsequent years as speeds pick up on bonds priced at discount prices

- Despite this fundamental strength, non-agency prices have moved lower in the past several days, caught up in the broad risk-off sentiment surrounding Fed tightening, rapid rate rises, quarter end dealer inventory pressures, and mutual fund redemptive pressures leading to some forced selling including seasoned profiles. Bloomberg's Aggregate, MBS, and High Yield indices are all down 4% to 6% month to date

- Meanwhile, rising rates and Fed hikes have ratcheted up RMBS coupons and yields, now ranging from 6% for AAA profiles to 10%-15% and higher for mezzanine profiles. We believe that this combination of strong fundamentals and currently very weak market technicals will lead to a very positive scenario for seasoned RMBS profiles. In fact, we are seeing increased buying activity from a range of investors including insurance companies, REITs, and opportunistic investors. This is helpful in gauging market depth and could shift to a positive technical once quarter end pressures ease