For Professional Advisers Only

Notes From The CIO

01 March 2023

- Our team just returned from the Structured Finance Association's ABS West Conference. The tone was generally positive with a consensus view that the RMBS sector remains strong from a fundamental credit and technical perspective

- In the near term, after recent reports of inflation and economic conditions, there is heightened concern that the Fed's tightening cycle will be longer and higher than expected just several weeks ago. There has also been an increase in exogenous geopolitical risks that can potentially lead to more macro volatility which in turn could have an impact on all spread sectors

- Given the fundamental and technical strength in RMBS versus other spread sectors, we believe that RMBS are poised to provide superior risk adjusted returns versus other credit sectors. With RMBS' current spread advantage, valuations are likely to remain more resilient to a spread widening scenario, and are also poised to outperform in a risk-on scenario that drives spreads tighter

- We have been of the view that the Fed would remain more aggressive, making floating rate mortgage securities including Agency Credit Risk Transfer bonds increasingly attractive during 2023

- Demand for RMBS remains strong so far in '23, especially from insurance companies and money managers focusing on more senior and shorter profiles. Meanwhile, due to the sharp decline in loan origination, new issuance has been running at a much slower pace than last year as expected and is providing a supportive supply/demand technical in the RMBS sector

- December home price data reveals that prices continue to soften nationally, but peak to current price decline nationally is still only a few percent – the housing sector generally remains resilient because of the structural housing shortage that we have described. With mortgage rates back up to about 7% we believe that home prices should still decline from here to restore better affordability metrics

- For that reason, we continue to focus on owning seasoned bonds with lower loan to value and higher home equity embedded in the collateral pools. We have seen growing demand for seasoned bonds and expect that to lead to incremental price support relative to more recent vintages