Securitized Product Market Update

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

AUGUST 2020: OUTLOOK AND IMPLEMENTATION

	AUGUST 2020	YTD Change
ABS Returns	0.25%	4.01%
Yield	0.59%	-1.56%
CMBS Returns	0.14%	6.62%
Yield	1.48%	-1.00%
MBS Returns	0.04%	3.73%
Yield	1.23%	-1.31%

Source: Bloomberg Barclays U.S. Aggregate Bond Index

► Securitized credit spreads continued to rally in August as evidenced by the positive total and excess returns for the month. Thus far, federal stimulus programs to aid consumers and small business have had a positive impact on fundamental performance. Month-over-month improvements in total vehicle and home sales point to a U.S. consumer who is extremely resilient.

Fundamentals

- U.S. consumer performance within our asset-backed security deals has been better than expected as federal stimulus programs have cushioned the unemployment rate of 10.2%. Consumer debt service levels have been surprisingly strong given the current state of the job market, driven primarily by the stimulus programs in place that have muted delinquency and loss levels.
- With respect to commercial real estate, COVID continues to wreak havoc on CRE valuations. For example, hotel occupancy rates saw some improvement this month off of very anemic lows.
- Mortgage rates continue to hover at all-time lows, buoying the residential housing market.
- The Federal Reserve's buying of MBS continues unabated, keeping yields near all-time lows.

Technicals

- The technical picture for securitized product is extremely strong. Supply with respect to ABS, CMBS, and RMBS is down 20 plus percent versus 2019. Fiscal and monetary intervention has prevented the destruction of capital. In addition, positive flows into the bond market and monthly reinvestment of principal and interest have created a situation whereby too much cash is chasing too few assets.

Valuations and Implementation

- Although yields are at record lows, spreads that are currently available in the securitized arena are still very compelling versus comparable-duration, risk-free assets.
- Valuations have continued to improve month over month and although spreads are still bid wider than pre-COVID, the insatiable demand for risk assets should continue to drive spreads tighter.
- Historically, post a market dislocation, rating agencies increase levels of credit support to securitized transactions. This time is no different as we are witnessing increased credit enhancement levels to protect investors. We are currently investing in new issuer deals that have better risk/reward results than pre-COVID at wider spreads.
- We have been selective but we have continued to add subordinate securitized risk to the portfolio based on the above comment.
- We remain focused on the latest monetary and fiscal responses in regard to the Coronavirus and the possible effects on the consumer and securitized sectors going forward.

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