Securitized Product Market Update

MARCH 2021: OUTLOOK AND IMPLEMENTATION

	March 2021	YTD Change
ABS Returns	-0.16%	0.16%
Yield	0.56%	0.11%
CMBS Returns	-1.12%	-2.32%
Yield	1.71%	0.43%
MBS Returns	-0.51%	-1.10%
Yield	1.82%	0.57%

Source: Bloomberg Barclays U.S. Aggregate Bond Index
Past performance is not indicative of future results

► The belly of the U.S. Treasury curve along with the long end of the curve continued to back up during this past month as evidenced by the 10-year U.S. Treasury rate closing the month 34 bps higher at 1.74%. Returns were negative for the month across securitized product with shorter duration product outperforming longer duration product. In addition, floating rate paper outperformed fixed rate product during the month. Except for agency mortgages, spreads softened a bit for the rest of the securitized product suite, which is uncharacteristic in a rising rate environment. On a year-to-date basis, ABS and non-agency RMBS are two of only a few asset classes generating a positive total return. Fund flows continue to dominate the front part of the yield curve as investors try to avoid interest rate risk. CMBS returns were heavily impacted as this sector has the longest duration within the securitized market. Given the current fundamental and technical picture in place, we continue to favor short duration credit for the portfolios.

Fundamentals

- The economy added 916,000 jobs during the month of March and the unemployment rate decreased from 6.2 to 6.0%.
- A third stimulus package hit the consumer's wallet in March and along with ensuing tax refunds improves a consumer's balance sheet from a debt service perspective.
- With respect to commercial real estate, performance continues to be bifurcated with property types such as multi-family and industrial performing extremely well versus weaker performance with respect to hotels and retail (i.e., malls).
- The Federal Reserve's buying of MBS continues unabated, keeping yields and mortgage rates near all-time lows.

Technicals

- Other than ABS, year-to-date supply is running behind last year's issuance levels which, coupled with positive fund flows as mentioned above, creates an extremely positive technical for securitized assets. The securitized asset class is shorter duration and, given good market technicals, the demand for shorter assets should keep spreads grinding tighter.

Valuations and Implementation

- The slight move wider in spreads should see a pretty quick retracement in April. Yields are low but spreads are still compelling in the securitized arena versus comparable-duration corporate and risk-free assets.
- That being said, we believe we are in a coupon-clipping environment for the remainder of 2021. With a fairly flat credit curve, an investor is not getting paid much to take on more credit risk and therefore we continue to invest new dollars in the more conservative parts of deal capital structures.
- We have been selective but we have continued to add subordinate securitized risk to the portfolio based on the above comment. We continue to favor consumer and residential exposures.
- The challenge for 2021 is to remain disciplined with respect to investing dollars into the securitized market. As yields shrink, investors can be forced into riskier assets to maintain yield.

Paul Privitera

Director – Institutional

Paul.Privitera@Newfleet.com

Phone: (860) 839-0705

The **Bloomberg Barclays U.S. Aggregate Bond Index** is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

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