Securitized Product Market Update

SEPTEMBER 2021: OUTLOOK AND IMPLEMENTATION

	SEP 2021	YTD Change
ABS Returns	-0.15%	0.23%
Yield	0.62%	0.17%
CMBS Returns	-0.77%	-0.53%
Yield	1.58%	0.30%
MBS Returns	-0.36%	-0.67%
Yield	1.83%	0.58%

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

► The U.S. Treasury curve moved higher and steeper in September. The Fed's taper timeline was discussed, leading to a small rate sell-off. Spreads for most securitized sectors were unchanged during the month despite record supply across ABS, RMBS, and CMBS. In turn, total returns were negative across the asset class. We continue to emphasize asset-backed and non-agency mortgage-backed securities within our portfolio. This is driven by the strong performance of the U.S. consumer and demand for residential housing assets.

Fundamentals

- The unemployment rate and continuing jobless claims data continue to move in the right direction.
- Delinquencies remain extremely low with respect to consumer and mortgage debt, driven by the continued jobs picture improvement and lower debt service requirements.
- Domestic leisure travel has reached 2019 levels, driving a rebound in hotel occupancy rates.
- Return to office is still a work-in-progress for office properties but long-lease maturities limit valuation declines.
- The Federal Reserve's taper timeline is forming but the buying of MBS continues, keeping yields and mortgage rates near all-time lows.
- Record-setting housing values bring about future affordability questions.

Technicals

- Year-to-date securitized product supply is exceeding 2019 supply issuance by a healthy margin.
- Strong mutual fund flows on the front part of the yield curve easily offsets the increase in supply.
- The shorter duration of the securitized asset class lends itself perfectly to a positive technical backdrop.
- With an anemic yield curve and the threat of the back-end of the yield curve steepening in the future, investors continue to seek short-duration assets with some yield.

Valuations and Implementation

- Spreads have stayed near all-time tights since June, driven by investor hunt for yield. The one exception is CMBS subordinate classes, which have widened again in September, though conduit spreads are still trading well within their three-year averages. Overall, spreads for securitized products are still compelling compared with comparable-duration corporate bonds and risk-free assets.
- That said, we still believe we are in a coupon-clipping environment for the remainder of 2021. With a flattish credit curve, an investor is not getting paid much to take on increasingly more credit risk. Therefore, we continue to invest new dollars in the more conservative parts of deal capital structures.
- We have continued to add subordinate securitized risk to the portfolio on a selective basis. We continue to favor consumer and residential exposures.
- The challenge for the remainder of 2021 is to remain disciplined when investing dollars into the securitized market. With overall yields at such paltry levels, the cost of being wrong is heightened.

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The **Bloomberg 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.