Securitized Product Market Update

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

OCTOBER 2021: OUTLOOK AND IMPLEMENTATION

	Oct 2021	YTD Change
ABS Returns	-0.35%	- 0.11%
Yield	0.87%	0.32%
CMBS Returns	-0.39%	-0.91%
Yield	1.73%	0.45%
MBS Returns	-0.19%	-0.86%
Yield	1.89%	0.64%

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

► The front end of the U.S. Treasury curve moved sharply higher during October, with the 2-year U.S. Treasury note up 22 basis points to yield 0.50%. Essentially, the 2-year U.S. Treasury went up 81% over this past month on a yield basis, causing short duration products to post negative returns across the board. However, spreads for most securitized products continued to remain firm versus U.S. Treasuries. The more credit sensitive components of securitized outperformed higher quality counterparts and posted a positive return for the month. 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.
- During the first week of November, the Federal Reserve announced it would taper its monthly U.S. Treasury and MBS buying program by $10 billion and $5 billion, respectively.
- 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 income.

Valuations and Implementation

- Most securitized spreads have stayed near all-time tights since June. However, we did see non-agency RMBS widen due to a large amount of issuance during the month of October. The threat of higher mortgage rates also added to pricing pressures. We are looking to take advantage of this technical. 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, investors are not getting paid enough 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 with an eye towards adding CMBS.

- 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.