Securitized Product Market Update

DECEMBER 2021: OUTLOOK AND IMPLEMENTATION

	Dec 2021	YTD Change
ABS Returns	-0.16%	- 0.34%
Yield	1.13%	0.58%
CMBS Returns	-0.15%	-1.16%
Yield	1.88%	0.59%
MBS Returns	-0.09%	-1.04%
Yield	1.98%	0.73%

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

► The yield curve continued to flatten during December as the 2-year U.S. Treasury note moved higher by 17 basis points to yield 0.73% and the 10-year Treasury note moved higher by 7 basis points to yield 1.51%. The negative rate move on the front end of the yield curve was the primary driver of returns for the month for short duration risk assets. Spreads which widened in November driven by a tremendous supply wave steadied themselves in December. Issuance for securitized products was muted the last two weeks of the year, which helped keep a lid on spread levels. The credit risk bid was still intact as we observed insatiable demand for subordinate risk as investors continue to reach for yield. 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 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 destination and drive-up hotel occupancy rates.
- Return to office is still a work-in-progress for office properties but long lease maturities limit valuation declines.
- 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 offset the increase in supply.
- December supply was moderate, leaving valuations intact.
- The Federal Reserve announced it would reduce monthly purchases of U.S. Treasuries and agency mortgages by $30 billion a month beginning January 2022. New buyers need to emerge.

Valuations and Implementation

- The lack of new issue supply the last two weeks of December coupled with monthly principal amortization payments should drive demand for the new issue market in January.
- 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.

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