Securitized Product Market Update

DECEMBER 2022: OUTLOOK AND IMPLEMENTATION

	December 2022	YTD Change
ABS Returns	0.66%	-4.30%
Yield	5.14%	4.42%
CMBS Returns	0.04%	-10.91%
Yield	5.30%	3.42%
MBS Returns	-0.44%	-11.81%
Yield	4.71%	3.34%

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

► Although interest rates backed up in December, credit spreads tightened for the majority of securitized product, which translated into positive total returns for ABS and CMBS. In fact, it was a complete 180 degree turn from November as investors put dollars to work to capture the spread widening from the previous month. The relative value in certain areas of the structured security sector has been recognized by the broader investor base. We continue to invest in high-quality securitized assets to take advantage of these wider spread levels and higher yields.

Fundamentals

- A low unemployment rate of 3.7% and current job openings, still at an elevated ten million-plus, mitigate the effects of higher rates on the consumer.
- Workers continued to benefit from wage gains across the board, especially lower quintile earners.
- Delinquencies have begun to normalize, with delinquency rates on the rise across consumer asset classes – but remember that we are coming off historic lows.
- Housing prices are slowing as sharply higher mortgage rates raise affordability questions.
- CMBS fundamentals are challenged due to rising financing costs and shrinking deal activity. Higher interest rates do not bode well for CRE valuations.

Technicals

- Negative fixed income mutual fund flows continue to put pressure on spread product overall.
- Regarding 2023 issuance, reduced volumes are expected for ABS, CMBS and RMBS, which is a positive technical for those asset classes.

Valuations and Implementation

- High-quality securitized assets are now yielding 5.5% to 7.50%. We continue to emphasize short average life securitized paper within our portfolios due to its relative value versus corporates.
- We are investing in investment grade amortizing assets and in deal structures that benefit from de-leveraging.
- We continue to prefer non-agency residential exposure as credit performance remains stable, prepayments are muted, and the structures provide greater opportunity versus their agency counterparts.
- In CMBS, we prioritize liquidity over marginal spread pickup and recommend names with large deal sizes and well-capitalized sponsors in CMBS SASB investment grade securities.

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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.

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