

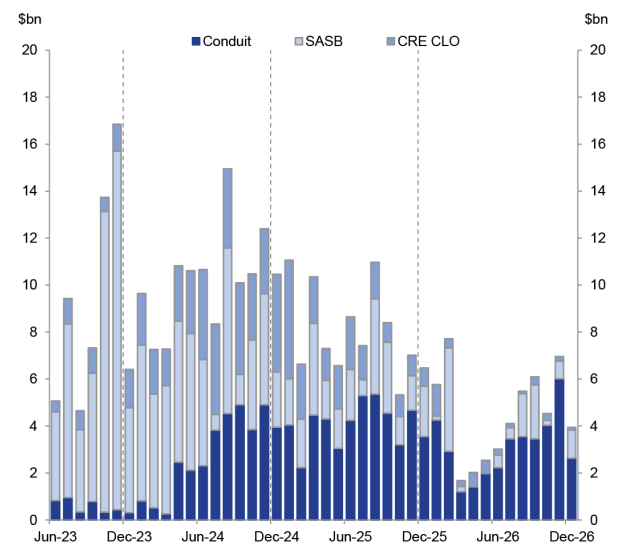
# Three Securitized Debt Trends We're Watching

Securitized debt sectors have seen a lot of action this year: U.S. consumer and office property delinquencies are on the rise, while mortgage rates soared to a 22-year high as investors reconcile themselves to “higher for longer” interest rates. So, what’s our outlook for securitized debt? Here are three trends we’re following.

- While we think commercial mortgage-backed securities (CMBS) are still in the early innings of their credit cycle and that the troubled office space sector will likely take years to play out, we expect to see more interesting opportunities to invest in high-quality single-asset single-borrower (SASB) and conduit deals as foreclosures start to tick up.
- Tighter lending standards within the asset-backed securities (ABS) autos sector first implemented in 2023 are beginning to bear fruit, as we believe subprime auto deterioration has reached its peak.
- Even with spiking mortgage rates, record low levels of housing inventory and low levels of mortgage delinquencies have bolstered this market. We think non-agency residential mortgage-backed securities (RMBS) demonstrate the best opportunity within housing due to their stable performance and attractive spreads.

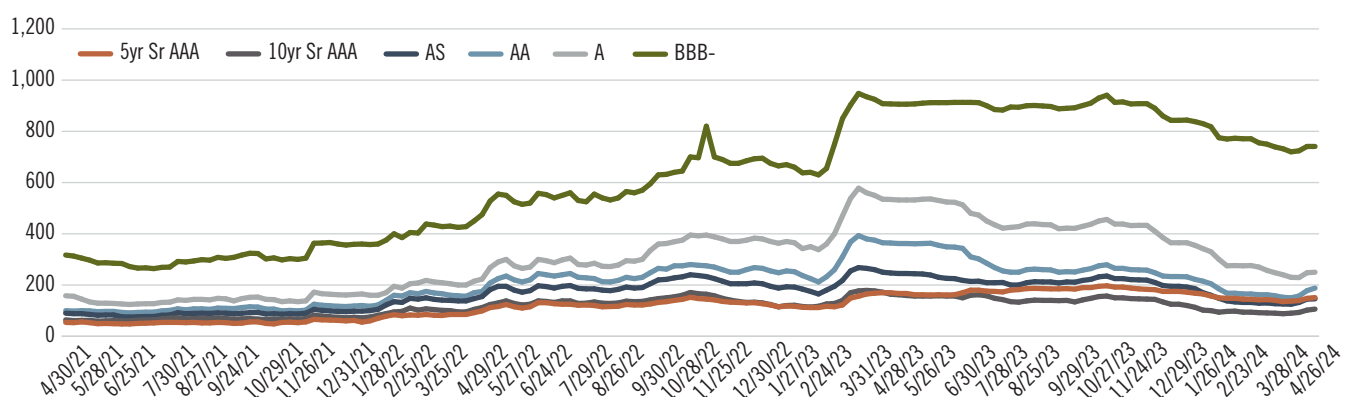
**1 The CMBS sector continues to face challenging headwinds, including a looming maturity wall, reduced office demand driven by the work-from-home trend, and an excess supply of multifamily housing in the Sun Belt.** Per Real Capital Analytics, peak-to-trough valuations for office and multifamily are down 47% and 19%, respectively. That said, CMBS market valuations have rallied while spreads have compressed dramatically from year-end 2023. This signals that a floor may have been set on commercial real estate (CRE) valuations, and that CRE losses may not be as high as initially expected. On a year-to-date basis, new issue supply is up 184% as investors are comfortable putting dollars to work in conservatively underwritten deals.

**CRE LOANS MATURITY SCHEDULE BY PROPERTY TYPE (\$ BIL)**



Source: Mortgage Bankers Association, Goldman Sachs Global Investment Research. Data as of April 10, 2024.

**CMBS 2.0 SPREADS VERSUS U.S. TREASURIES**



Source: JP Morgan Research CMBS Weekly Dataset; Newfleet Asset Management. Data as of April 26, 2024.

## THREE SECURITIZED DEBT TRENDS WE'RE WATCHING

**Our Outlook:** Expect to see a lot of extension modifications for maturing loans due to tighter credit conditions. In addition, look for an increase in downgrades as rating agencies evaluate current negative fundamentals.

**Our Strategy:** Look for one-off opportunities from forced sellers to put run-off dollars to work. Selectively add exposure to seasoned conduit deals and floating rate high-quality, single-asset, single-borrower positions. Floating rate coupons are extremely attractive in this higher-for-longer environment.

### 2 U.S. consumer fundamentals remain strong.

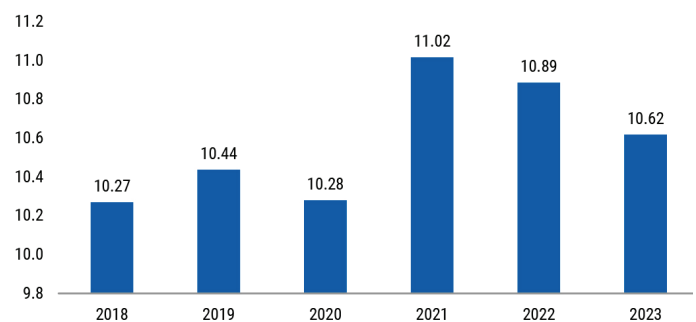
Unemployment (3.9%) remains near-all time lows, job openings (8.9 million) are near all-time highs, employment wage growth (4.2%) is nearly double the pre-pandemic growth rate, housing data remains robust, and the stock market is near all-time highs. Tighter underwriting for lower FICO borrowers also commenced in 2023. As a result, we think newer underwritten loans with lower debt-to-income ratios should produce lower losses going forward.

Though delinquencies are worsening for all types of borrowers, the increase is more pronounced for lower-scoring FICO borrowers who are more likely to sustain direct impact from the rising costs of essentials. That said, unemployment is still historically low at 3.9%.

**Our Outlook:** We're seeing a return to more normal credit metrics. However, we believe consumer credit should still perform well in a high 4% or even low 5% unemployment rate scenario.

**Our Strategy:** Favor the more conservative parts of the capital structure within ABS that will be accretive to performance as consumer performance worsens for the rest of the year. Selectively move down the capital stack if there's an opportunity to find better pricing and a better deal structure. Continue to favor off-the-run deleveraging assets that offer better relative value than corporate counterparts.

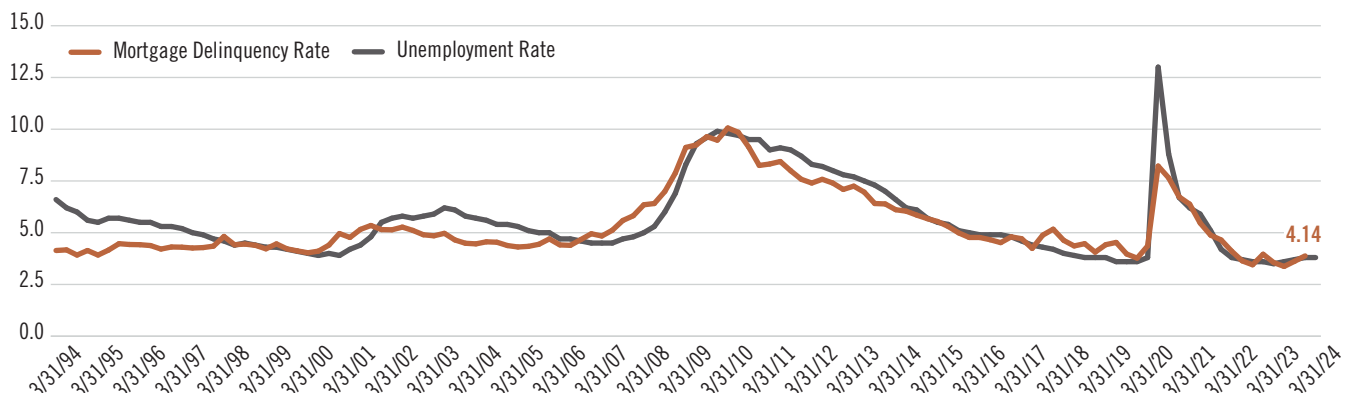
### DEBT-TO-INCOME (DTI) RATIOS WITHIN SUBPRIME DEALS HAVE BEEN COMING DOWN



Source: Intex, Morgan Stanley Research. Note: Only includes deals that release loan level data. Data as of April 24, 2024.

**3 Housing is holding strong.** Despite affordability headwinds from higher rates, mortgage credit fundamentals still look solid, in our view. Though mortgage rates spiked from generational lows, threatening to dampen a hot housing market, the fallout has been relatively mild due to the ongoing housing supply shortage, which remains historically low and creates a floor for any potential price declines. Additionally, most homeowners were able to lock in rates over the last couple of years, creating low mortgage debt service levels.

### MORTGAGE DELINQUENCY RATE AND UNEMPLOYMENT RATE (SEASONALLY ADJUSTED, PERCENT)



Source: Mortgage Bankers Association's National Delinquency Survey, Bureau of Labor Statistics. Data as of December 31, 2023 for the mortgage delinquency rate, and March 31, 2024 for the unemployment rate.

## THREE SECURITIZED DEBT TRENDS WE'RE WATCHING

Meanwhile, mortgage delinquency rates are staying low. Homeowner equity levels have ballooned to nearly \$30 trillion, and stringent underwriting has helped bolster performance. That, coupled with expected low levels of supply, makes RMBS valuations look attractive as a result.

**Our Outlook:** Higher mortgage rates and a subsequent fall in housing activity bode well for fundamentals and technicals for this sector. Credit quality remains healthy, while the non-qualified-mortgage market is issuing enough paper to remain stable. Overall, RMBS issuance is expected to be up 40% from 2023, allowing for many opportunities. RMBS spreads should track agency mortgage-backed securities with additional carry, allowing for outperformance.

**Our Strategy:** Maintain our overweight to the housing sector. Favor non-agency residential exposure as credit performance remains stable, prepayments stay muted, and credit spreads are still wide of averages.

### About Newfleet Asset Management

Newfleet Asset Management, distinguished by its longstanding multi-sector approach, dynamic structural integration, experience, and culture of collaboration, has a proven track record of successfully navigating the fixed income markets to consistently generate excess returns over full market cycles.



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### DEFINITIONS

The **Bloomberg U.S. MBS Index** covers agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) issued by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The **Bloomberg U.S. ABS Index** measures ABS with the following collateral type: credit and charge card, auto, and utility loans. The **Bloomberg U.S. CMBS Index** measures the market of conduit and fusion CMBS deals with a minimum current deal size of \$300M. **Collateralized Loan Obligations** are securities backed by a pool of assets, often low-rated corporate loans.

### IMPORTANT RISK CONSIDERATIONS

**ABS/MBS:** Changes in interest rates can cause both extension and prepayment risks for asset- and mortgage-backed securities. These securities are also subject to risks associated with the non-repayment of underlying collateral, including losses to the portfolio. **Credit & Interest:** Debt instruments are subject to various risks, including credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt instruments may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **Sector Focused Investing:** Events negatively affecting a particular industry or market sector in which the portfolio focuses its investments may cause the value of the portfolio to decrease. **Market Volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Local, regional, or global events such as war or military conflict, terrorism, pandemic, or recession could impact the portfolio, including hampering the ability of the portfolio's manager(s) to invest its assets as intended.

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