Agency Mortgage-Backed Securities

Strategic Coupon Adjustments Amid Economic Shifts

This report is excerpted from the Second Quarter 2025 Fixed-Income Sector Views.

A favorable balance of stable spreads and appealing current yields.

The Agency MBS outlook is sensitive to macroeconomic factors: If economic data worsens due to federal austerity measures, Agency MBS is expected to outperform Treasury benchmarks. A 5.5 percent coupon MBS provides a favorable balance of stable spreads and appealing current yields.

Sector Commentary

- Premium coupon Agency MBS (6 percent and above) led first quarter performance in the coupon stack, driven by a steeper Treasury curve, reduced prepayment speeds, and strong demand for collateralized mortgage obligations (CMOs). This outperformance may stall, however, as prepayments rise, with mortgage rates 50 basis points below their first quarter peak. We recommend par coupon MBS (5.5 percent) for their attractive yield and spread, with reduced short-term prepayment risk.
- CMOs saw more than $100 billion in production in the first quarter. Recent CMO deals have focused on floating-rate tranches structured from premium coupon MBS, enhancing performance despite declining mortgage rates.
- We do not expect a slowdown in CMO floater issuance until the lower yield on fixed-rate MBS—such as front sequential CMOs or passthroughs—normalizes to CMO floater yields.

Investment Themes

- Up-in-coupon migration is ongoing among domestic banks and overseas accounts, as they shift from deep discount bonds (2–2.5 percent) to production coupons (5.5 percent), realizing losses but increasing current income.
- This trend offers an opportunity to add positively convex, index coupons as a duration hedge against potential underperformance of par coupon MBS during an extended risk-off rate rally.
- Comments from Treasury Secretary Scott Bessent and Federal Housing Finance Authority (FHFA) Director William Pulte indicate a serious effort to move government-sponsored enterprises out of conservatorship. Critical details remain speculative, however, and require further clarification.
- Current pricing suggests the market expects that GSE-issued MBS will retain government backing.

By Louis Pacilio

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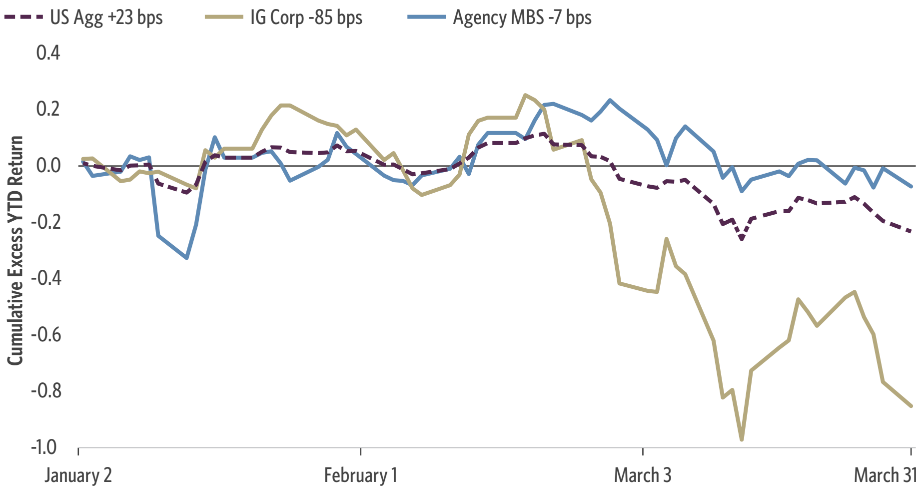
Agency MBS Outperformed Investment Grade and Treasurys in Q1



Source: Guggenheim Investments, Bloomberg. Data as of 3.31.2025.

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One **basis point** is equal to 0.01%.

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Investing involves risk, including the possible loss of principal. In general, the value of a fixed-income security falls when interest rates rise and rises when interest rates fall. Longer term bonds are more sensitive to interest rate changes and subject to greater volatility than those with shorter maturities. During periods of declining rates, the interest rates on floating rate securities generally reset downward and their value is unlikely to rise to the same extent as comparable fixed rate securities. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility. Investors in asset-backed securities, including mortgage-backed securities and collateralized loan obligations ("CLOs"), generally receive payments that are part interest and part return of principal. These payments may vary based on the rate loans are repaid. Some asset-backed securities may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity and valuation risk. CLOs bear similar risks to investing in loans directly, such as credit, interest rate, counterparty, prepayment, liquidity, and valuation risks. Loans are often below investment grade, may be unrated, and typically offer a fixed or floating interest rate.

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