

Par Coupons Offer Compelling Value Amid Market Uncertainty

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

Dovish Fed policy path supports long-duration Agency MBS demand.

Agency mortgage-backed securities (MBS) delivered positive total and excess returns in the third quarter of 2.43 and 0.35 percent, though emerging refinance concerns suggest the outperformance of higher coupon MBS earlier in 2025 may be waning. Prepayment risks and convexity hedging have shifted investor flows toward deep discount coupons (2–3 percent) and par coupons (4.5–5 percent). Nevertheless, borrowers' potential response to lower rates is uncertain, making it prudent to position in par coupon MBS with limited prepayment risk.

Sector Commentary

- 30-year 5 percent or par coupon MBS offer attractive spreads and yields relative to the Bloomberg Aggregate Bond Index. Short-term spread widening is likely due to increased supply, but longer-term support may come from limited investment alternatives, a dovish Fed, and potential government-sponsored enterprise (GSE) backing.
- Lower coupon MBS (30-year 2–3 percent) outperformed as 10-year Treasury yields neared 4 percent in mid-September, driven by a supply-demand imbalance. We expect these under-allocated securities to outperform Treasuries during future rate rallies.
- Premium-priced MBS coupons face limited support as primary rates fall. With October prepayment data pending, attractive to-be-announced (TBA) carry is unlikely to return soon, favoring continued investor flows into lower coupon MBS.

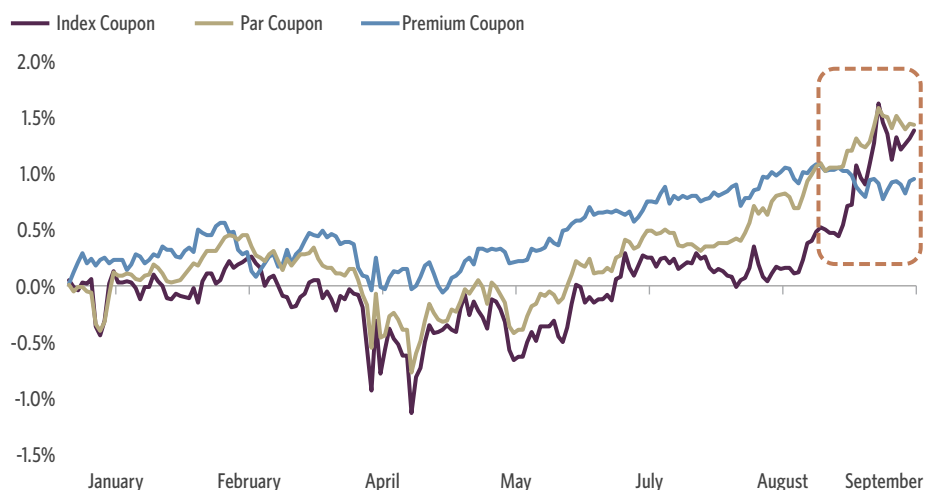
Investment Themes

- Speculation around the return of GSE MBS portfolios has grown following an increase in their MBS holdings. Reinstating these portfolios could provide income and attract equity investors, while opportunistic additions during risk-off periods may help stabilize spreads by reintroducing a buyer of last resort.
- The rates market is pricing in a dovish Federal Reserve path through 2026, which is necessary for banks to re-engage with longer-duration, fixed-rate securities. However, regulatory uncertainty and persistently above-target inflation remain key obstacles to a bullish case for Agency MBS.
- Par coupon MBS currently offer the widest spreads and highest yields, presenting a compelling opportunity for investors amid ongoing market uncertainties.

By Louis Pacilio

Premium-priced MBS coupons face limited support as primary rates fall. With October prepayment data pending, attractive to-be-announced (TBA) carry is unlikely to return soon, favoring continued investor flows into lower coupon MBS.

Par and Discount Coupons Outperformed in Q3 as Premium Coupons Faltered



Source: Guggenheim Investments, Bloomberg. Data as of 9.26.2025. Index (30yr 3%), Par (30yr 5%), Premium (30yr 6.5%) coupons.

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

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