Commercial Mortgage-Backed Securities

Opportunities in Higher Quality Bonds

Select higher quality CRE CLOs and SASB bonds continue to offer attractive risk-adjusted returns.

CMBS moved in step with broader fixed-income markets. Institutional investors accounted for over 40 percent of CMBS buying in recent years, and renewed demand from this investor base has been substantial. Insurance demand also increased, and other players, including dealers and hedge funds, have supported primary and secondary markets. Behind this technical rally, however, fundamental challenges remain. We remain cautious in the CMBS sector, finding select opportunities but generally preferring risk-adjusted returns in other sectors.

Sector Commentary

- Commercial real estate (CRE) fundamental data broadly continue to deteriorate. A BofA study of 2023 conduit CMBS data found that only 65 percent of loans with balances over $100 million successfully refinanced on time.
- Commercial real estate transaction volumes remain depressed (down roughly 50 percent year over year), and many pressures persist, including the structural reduction in office demand.
- Some $19 billion in CMBS was issued in the first quarter, compared to $7 billion over the same period in 2023, driven by higher investor demand for the product.
- Given still-elevated interest rates and tightening lender credit standards, issuance has been mostly limited to higher quality single asset/single borrower (SASB) deals financing high quality industrial portfolios, and other performing retail and hotel properties. SASB represents 63 percent of issuance.

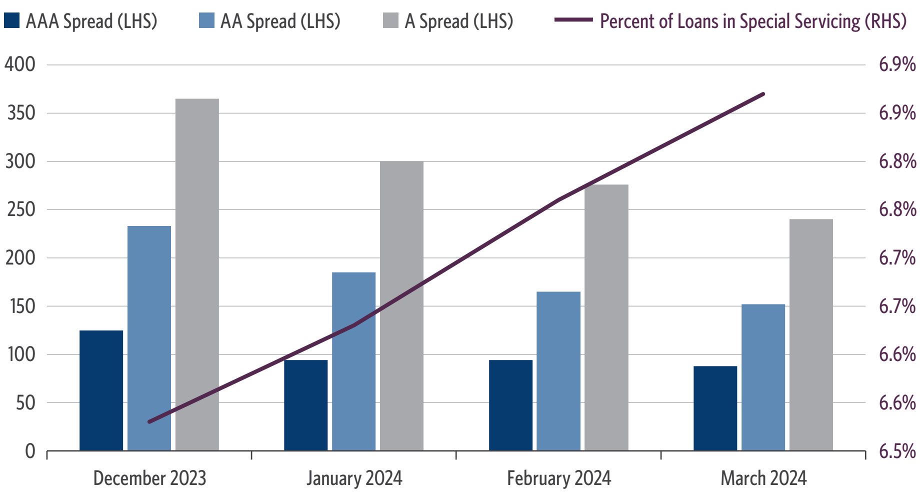
Investment Themes

- We favor select senior securities with higher credit enhancement, capable sponsorship, and limited office exposure. Select AAA, AA, and A-rated CRE CLOs and SASB bonds continue to offer attractive risk-adjusted returns.
- Conversely, we find that most mezzanine and junior bonds across CMBS subsectors fail to appropriately compensate investors at current levels.

By Tom Nash and Hongli Yang

The combination of structural protections and improving market refinancing conditions support investment in credit-enhanced, investment-grade CMBS bonds, but a Bank of America study of 2023 conduit CMBS data found that only 65 percent of loans with balances over $100 million successfully refinanced on time.

CMBS Credit Spreads Have Improved, but Select Credit Indicators Are Showing Increasing Rates of Stress



Source: Guggenheim Investments, Bloomberg. Data as of 3.31.2024. Past performance does not guarantee future results.

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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