

Agency Mortgage-Backed Securities

Outperformance Expectations Come to Fruition

This report is excerpted from the *First Quarter 2026 Fixed-Income Sector Views*.

Improved funding dynamics and GSE portfolios to backstop Agency MBS valuations going forward.

One of our largest overweights, Agency MBS delivered 8.61 percent total returns and 1.71 percent excess returns for 2025, outperforming investment-grade corporate excess returns by 52 basis points and leading the Bloomberg U.S. Aggregate Index. Gains were driven by strong 30-year MBS performance, particularly 3–5 percent coupons priced at \$90–\$100, while higher prepayment expectations weighed on coupons above 6 percent in late 2025. Avoiding exposure to GNMA securities further supported relative outperformance within the MBS Index.

Sector Commentary

- Spreads tightened steadily throughout the quarter, with December delivering exceptionally strong performance. However, elevated valuations for lower coupon securities may require sustained investor inflows to maintain current levels.
- Par coupon MBS in the 30-year 5 percent range offer reasonable valuations and improving income potential, making them a preferred allocation for new investments. These securities are well-positioned to benefit from the anticipated return of bank buyers and the expansion of government-sponsored enterprise (GSE) portfolios in 2026.
- The Fed's shift to reserve management in December enhanced to-be-announced funding levels, increasing the sector's attractiveness to levered investors such as hedge funds and mortgage real estate investment trusts. This dynamic provides additional technical support for Agency MBS valuations, as these investors continue to exert growing influence on mortgage spreads.

Investment Themes

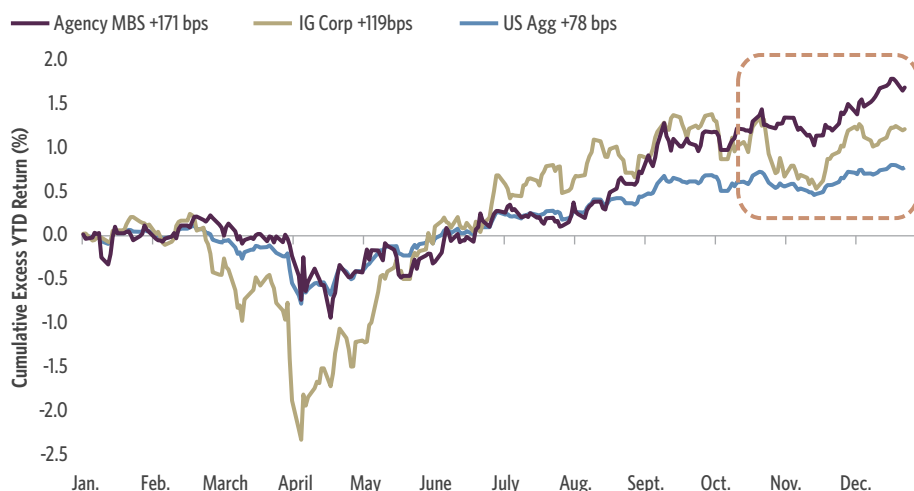
- Housing policy risk remains elevated ahead of anticipated reforms in 2026. However, the Trump administration's focus on mortgage rates and the expansion of the GSE portfolio provide downside protection against adverse policy impacts on the convexity profile of existing mortgages.
- Multiple supportive factors—including uncapped Standing Repo Facility access, the GSE portfolio backstop, the Trump administration's emphasis on housing affordability, and a dovish incoming FOMC chair—establish a strong policy framework that mitigates significant downside risk for Agency MBS.
- In the event of sector weakness, we expect a robust policy response, with intervention likely preempting meaningful spread widening. This asymmetric risk profile underscores the defensive nature of Agency MBS while preserving upside potential for investors.

By Louis Pacilio

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Agency MBS Was the Best Performing Agg Subsegment in 2025

Cumulative Excess Returns (2025)



Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2025.

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

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