GUGGENHEIM

Non-Agency Residential Mortgage-Backed Securities

Finding Value Amid High Rates

Elevated mortgage rates should suppress supply and support performance.

As the average 30-year mortgage rate reached 7.79 percent in October 2023, its highest level in 20 years, home purchase activity contracted to its lowest level on record, and mortgage refinancing activity declined dramatically. Consequently, mortgage loan originations decreased significantly, and non-Agency RMBS new-issue volume closed 2023 at $66 billion, almost 50 percent lower than 2022. New-issue transactions for 2024 are expected to be only marginally higher than the totals seen in 2023, which should be constructive for non-Agency RMBS valuations.

Looking ahead, we expect non-Agency RMBS issuance to remain low across a range of economic scenarios. The rates on most outstanding mortgages remain lower than the prevailing market rate: only 3 percent of outstanding 30-year conventional mortgages have a meaningful refinancing incentive (greater than 50 basis points) at a 6.60 percent mortgage rate, and only 10 percent have such an incentive at a 5.50 percent mortgage rate. Furthermore, subdued housing activity and tepid home price gains will likely prevent meaningful expansion in purchase loan volume. Against this backdrop, RMBS credit spreads will have limited potential to widen, and the market will likely take near-term cues from changes in valuations in the larger Agency MBS market.

We continue to favor non-qualified mortgage, or non-QM, RMBS 2.0 senior and mezzanine tranches with loss-remote, stable-weighted average life profile. We also prefer RMBS 1.0 and re-performing loan deals backed by loans with significant home equity. While carrying a low likelihood of principal loss, current RMBS valuations reflect spreads wider than the long-run averages and routinely trade at discounted dollar prices, which may provide investors additional protection from both collateral losses and prepayments. These subsectors offer 5.5–6.0 percent yields.

By Karthik Narayanan and Roy Park

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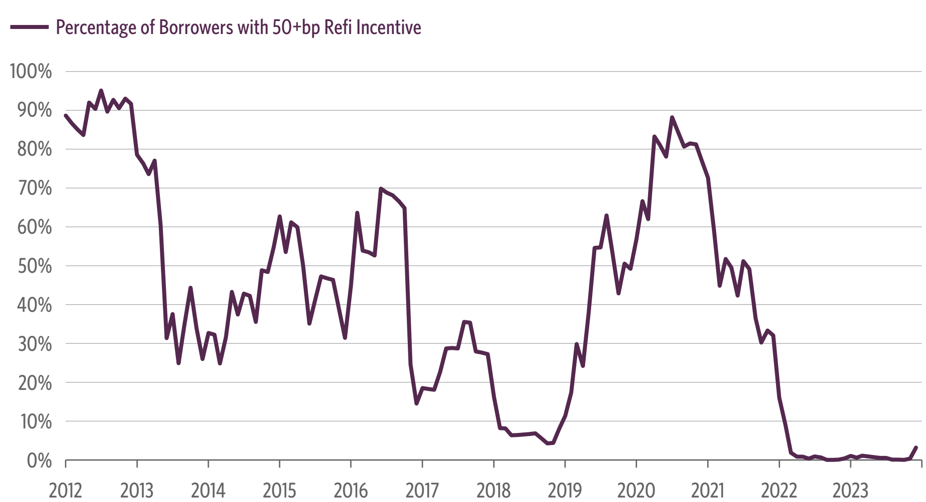
Just 3 Percent of Borrowers Have Incentive to Refinance

Percentage of Borrowers with 50+ Basis Points Refi Incentive



Source: Guggenheim Investments, eMBS, Goldman Sachs. Data as of 12.31.2023.

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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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