GUGGENHEIM

## Non-Agency Residential Mortgage-Backed Securities

# Technical Market Conditions Are Supportive of Valuations

Housing market and labor fundamentals add to our long-term constructive outlook.

Limited supply should provide a positive technical tailwind for the non-Agency RMBS sector in the second half of 2023. Net new issuance is expected to be $5–10 billion for the rest of 2023 as low origination volumes for purchase and refinance mortgage loans are expected to persist, limiting the amount of loans to be securitized. These factors, as well as the combination of a stabilizing housing market and relatively strong labor conditions, support our constructive outlook for the sector.

New issue volume totaled $30 billion as of mid-August, a decline of 67 percent year over year as elevated rates caused refinancing activity to stall. Additionally, high mortgage rates have discouraged current homeowners with historically low rates on their mortgage loans from selling their homes. Despite inflationary pressures abating, the average 30-year fixed mortgage rate was greater than 7.5 percent in mid-August, its highest level since 2000. As a result, the inventory of existing homes for sale fell to 1.08 million units in May 2023, a record low for the month, and activity slowed significantly in the residential housing market.

Non-Agency RMBS valuations benefited from the low new-issue volume as the housing market and the broader banking system showed signs of stabilization. However, they lagged the spread tightening experienced in more liquid credit markets. For instance, the five-year Bloomberg U.S. Investment-Grade Corporate Bond Index retraced three-fourths of its credit spread widening in the wake of the Silicon Valley Bank collapse, but non-qualified mortgage (QM) AAA RMBS retraced less than half of their credit spread widening over the same period, leaving potential for positive total return over time in a normalizing spread environment.

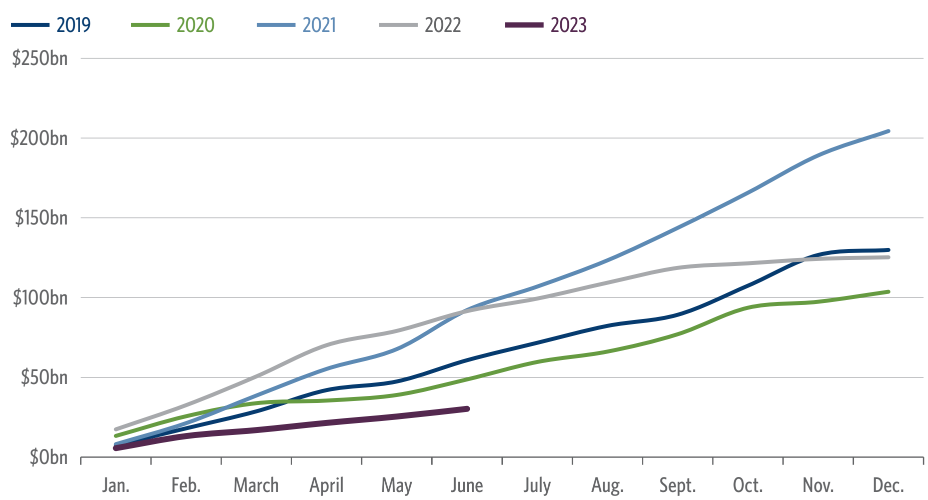
Current RMBS valuations reflect spreads wider than the long-run averages. We prefer AAA–A rated non-QM RMBS 2.0 mezzanine and senior tranches with stable weighted average life profiles, and RMBS 1.0 backed by loans with significant home equity. These subsectors have offered yields in the 6–6.5 percent range and have routinely traded at discounted dollar prices, which is rare for the sector and improves their total return profile.

*By Karthik Narayanan and Roy Park*

Faced with the prospect of higher mortgage rates, current homeowners with low rates are largely unmotivated to refinance and sell their homes, which has contributed to a significant slowdown in activity in the residential housing market, and in turn, a decline in home loan issuance.

**Non-Agency RMBS New-Issue Volume Is at Historic Lows**

Yearly Cumulative Non-Agency RMBS Bond Issuance Volume




Source: Guggenheim Investments, Bank of America, Bloomberg. Data as of 6.30.2023.