

Agency Mortgage-Backed Securities

Agency MBS Spreads Normalize from Historical Wides

Fairly valued in the short-term but offering long-term value.

Agency MBS spreads narrowed relative to benchmark Treasuries in the fourth quarter of 2022 from historically wide levels in the third quarter as the market formed a consensus on the terminal fed funds rate for the hiking cycle, which lowered interest rate volatility and stabilized long-term Treasury yields. Option-adjusted spreads ended the quarter at 51 basis points, 19 basis points tighter quarter over quarter, helping the Bloomberg U.S. MBS Index post a total return of 2.14 percent. Demand for MBS improved, with inflows for both passive index-tracking funds and active fixed-income managers more than offsetting mortgage supply entering its typical winter lull. Agency CMBS posted fourth quarter total and excess returns of 1.29 percent and 0.14 percent, respectively. With full-year excess returns of -0.33 percent, the sector continued to benefit from reduced supply and a superior convexity profile compared to single-family mortgage MBS.

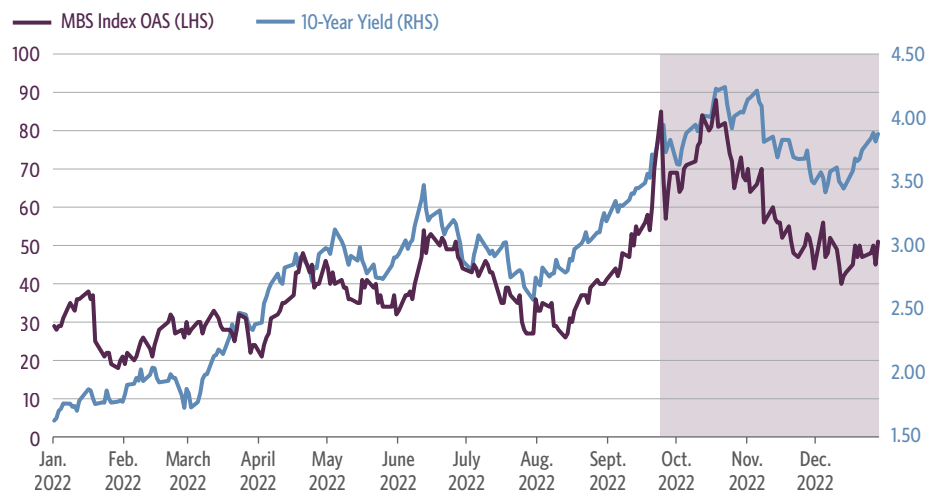
Agency MBS, which appear fairly valued in the short term given their recent spread tightening, continue to offer long-term value. Spread levels are generally in line with the 2018-19 period of Fed

quantitative tightening but remain higher than the averages since the Global Financial Crisis. In addition, with virtually the entire MBS universe well out of the money for refinancing, the sector exhibits low callability and prepayment risk and a higher certainty of cashflows than is typical. We expect cashflow stability to continue and the sector to outperform as the real economy cools and rates move lower. The long-term value proposition in the sector arises from both spread tightening and a reduction in option costs, which remain at elevated levels. We expect this to be achieved by either a steepening of the yield curve, a drop in interest rate volatility, or both. Agency RMBS passthroughs and low pay up-specified pools appear attractively priced in such an environment. In contrast, valuations in the supply-constrained Agency CMBS sector appear rich. Instead, we see better value in the long-duration space from collateralized mortgage obligation (CMO) structures with lockout periods for principal payments, which offer both wider spreads and higher all-in yields.

By Aditya Agrawal and Louis Pacilio

Agency MBS spreads narrowed relative to benchmark Treasuries in the fourth quarter of 2022 from historically wide levels in the third quarter as the market formed a consensus on the terminal fed funds rate for the hiking cycle, which lowered interest rate volatility and stabilized long-term Treasury yields.

Mortgage Spreads Tightened in the Fourth Quarter of 2022



Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2022.

This material is distributed or presented for informational or educational purposes only and should not be considered a recommendation of any particular security, strategy or investment product, or as investing advice of any kind. This material is not provided in a fiduciary capacity, may not be relied upon for or in connection with the making of investment decisions, and does not constitute a solicitation of an offer to buy or sell securities. The content contained herein is not intended to be and should not be construed as legal or tax advice and/or a legal opinion. Always consult a financial, tax and/or legal professional regarding your specific situation.

This material contains opinions of the authors, but not necessarily those of Guggenheim Partners, LLC or its subsidiaries. The opinions contained herein are subject to change without notice. Forward-looking statements, estimates, and certain information contained herein are based upon proprietary and non-proprietary research and other sources. Information contained herein has been obtained from sources believed to be reliable but are not assured as to accuracy. Past performance is not indicative of future results. There is neither representation nor warranty as to the current accuracy of, nor liability for, decisions based on such information.

Investing involves risk, including the possible loss of principal. Investments in fixed-income instruments are subject to the possibility that interest rates could rise, causing their values to decline. 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.

Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Distributors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Partners Advisors, LLC, Guggenheim Corporate Funding, LLC, Guggenheim Partners Europe Limited, Guggenheim Partners Japan Limited, GS GAMMA Advisors, LLC, and Guggenheim Partners India Management.

©2023 Guggenheim Partners, LLC. All Rights Reserved. No part of this document may be reproduced, stored, or transmitted by any means without the express written consent of Guggenheim Partners, LLC. GPIM 56246