Notes From The CIO

16 March 2022

- Today was the first of several hikes by the Fed. Our view is that the Fed's decision was appropriate, and believe they will be vigilant in trying to navigate known and unknown risks. It remains to be seen what the Fed's plan will be for their balance sheet unwind later this year and whether they will have to move to a neutral rate of mid-2's next year or move higher above neutral. We believe that mortgage credit, especially 2.0 structures, is best positioned to outperform other risk assets:
    - Housing has historically been a very good inflation hedge
    - Despite geopolitical and inflation uncertainty, home prices are still projected to rise mid-to-high single digits over the next year. Importantly, mortgage delinquencies are now running at their lowest rate since 1999. The combination of HPA and borrower credit quality will lead to continuing bond delevering, credit buildup and rating upgrades
    - The large portion of floating rate coupons in the sector will begin to see higher yields from higher coupon resets next week. One month LIBOR had risen from 10 bps in January to 44 bps today before the Fed announcement Many of these bonds also have low effective durations with structures relatively insensitive to rising rates

- We are less confident of the direction of corporate credit, much of which has long fixed rate duration. Levered loans, a popular corporate sector with floating rate coupons and short effective durations, have been falling in price since their runup late last year/early this year driven by strong sector inflows – we believe this is a reflection of credit risk recognition

- Within the RMBS sector, Freddie Mac issued a $1.6 billion deal this week, their final underwriting of the quarter. After next week's Fannie Mae new issue, supply is expected to begin slowing from this quarter's record pace. This spurt of supply which began last fall was the initial source of spread widening in CRT and then RMBS more broadly, until inflation, Fed and geopolitical concerns accelerated the risk-off sentiment. While all fixed income risk assets have widened this year, many RMBS profiles have widened much more and in our view are now extremely attractive from a relative value standpoint