Non-Agency Residential Mortgage-Backed Securities

Opportunities in an Elevated Rate Environment

Higher rates for an extended period should benefit securities that offer income potential.

We find the non-agency RMBS sector attractive due to its positive credit fundamentals and potential to provide robust investment income. Tight lending standards, significant home equity gains, and a stable labor market provide favorable conditions for mortgage credit performance. The reversal in mortgage rates makes a refinance wave and pickup in prepayment activity unlikely in the near future. Additionally, higher-for-longer interest rates should benefit higher coupon, income-producing securities.

Sector Commentary

- New issue volume for 2024 was $155 billion—almost double 2023's $80 billion—and the second highest since 2007, according to JP Morgan. Spread performance was strong, with most subsectors ending the year at or near their tightest levels of the year.
- The most recent Case-Shiller Index reading in October 2024 showed 3.6 percent year-over-year home price growth, continuing a slowing trend since March. Favorable demand and supply dynamics, however, combined with stable consumer credit should support steady mortgage credit performance.
- The average 30-year fixed mortgage rate declined to 6.1 percent in September, 1.2 percentage points off its May 2024 peak, before rising nearly 0.8 percentage points by year end. The backup in rates raised concerns that interest rates will remain high longer than expected and limit prepayment activity even for mortgages originated in 2023 and 2024.

Investment Themes

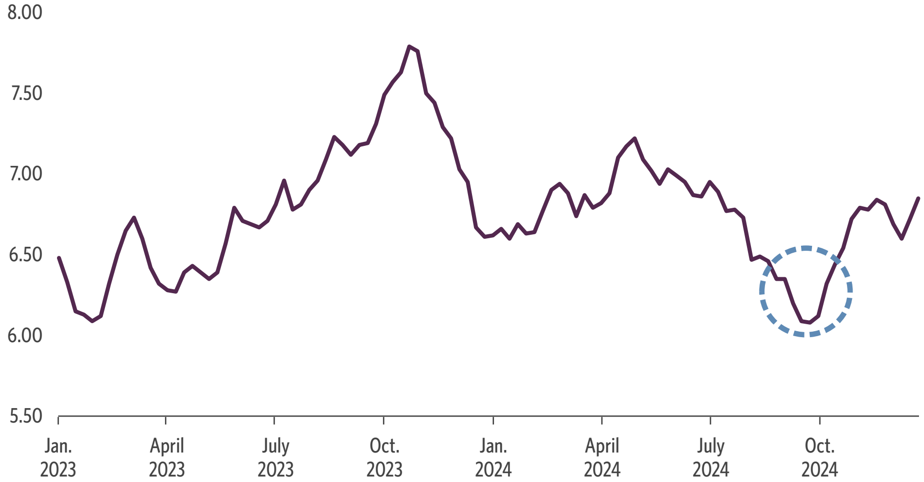
- Should rates remain elevated for an extended period, income is expected to take precedence over price movement. High coupon securities that offer wider spreads and higher yields should benefit in an elevated rate environment with low prepayment expectations.
- We favor those transactions that offer solid carry income with structures that limit extension risk and can withstand a wide range of credit stresses.
- Opportunities include investment-grade securities from non-qualified mortgage (non-QM) transactions and senior securities from closed-end second (CES) lien and home equity line of credit (HELOC) transactions, which offer attractive valuations relative to their credit risks.

By Karthik Narayanan and Roy Park

The average 30-year fixed mortgage rate declined to 6.1 percent in September, 1.2 percentage points off its May 2024 peak, before reversing course and rising nearly 0.8 percentage points by year end, tempering expectations of a refinance wave.

Average 30-Year Fixed Mortgage Rate Closed 77 Basis Points Higher in 2024 Than Its Year Low

Cumulative Percentage of Outstanding Balance



Source: Guggenheim Investments, J.P. Morgan, Freddie Mac, and Bloomberg. Data as of 12.31.2024.