

Strategic Coupon Adjustments Amid Economic Shifts

A favorable balance of stable spreads and appealing current yields.

The Agency MBS outlook is sensitive to macroeconomic factors: If economic data worsens due to federal austerity measures, Agency MBS is expected to outperform Treasury benchmarks. A 5.5 percent coupon MBS provides a favorable balance of stable spreads and appealing current yields.

Sector Commentary

- Premium coupon Agency MBS (6 percent and above) led first quarter performance in the coupon stack, driven by a steeper Treasury curve, reduced prepayment speeds, and strong demand for collateralized mortgage obligations (CMOs). This outperformance may stall, however, as prepayments rise, with mortgage rates 50 basis points below their first quarter peak. We recommend par coupon MBS (5.5 percent) for their attractive yield and spread, with reduced short-term prepayment risk.
- CMOs saw more than \$100 billion in production in the first quarter. Recent CMO deals have focused on floating-rate tranches structured from premium coupon MBS, enhancing performance despite declining mortgage rates.
- We do not expect a slowdown in CMO floater issuance until the lower yield on fixed-rate MBS—such as front sequential CMOs or passthroughs—normalizes to CMO floater yields.

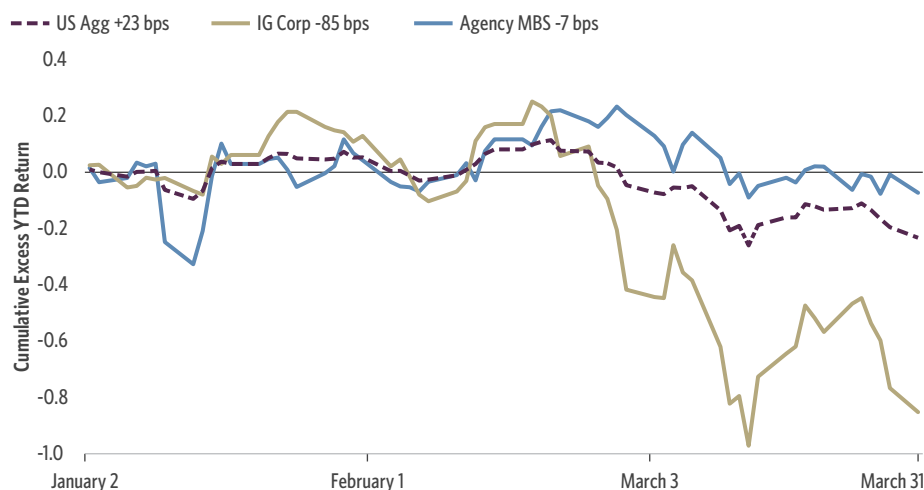
Investment Themes

- Up-in-coupon migration is ongoing among domestic banks and overseas accounts, as they shift from deep discount bonds (2-2.5 percent) to production coupons (5.5 percent), realizing losses but increasing current income.
- This trend offers an opportunity to add positively convex, index coupons as a duration hedge against potential underperformance of par coupon MBS during an extended risk-off rate rally.
- Comments from Treasury Secretary Scott Bessent and Federal Housing Finance Authority (FHFA) Director William Pulte indicate a serious effort to move government-sponsored enterprises out of conservatorship. Critical details remain speculative, however, and require further clarification.
- Current pricing suggests the market expects that GSE-issued MBS will retain government backing.

By Louis Pacilio

Premium coupon Agency MBS (6 percent and above) led first quarter performance in the coupon stack, driven by a steeper Treasury curve, reduced prepayment speeds, and strong demand for CMOs.

Agency MBS Outperformed Investment Grade and Treasuries in Q1



Source: Guggenheim Investments, Bloomberg. Data as of 3.31.2025.

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One **basis point** is equal to 0.01%.

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