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INSIGHT

MONTHLY COMMENTARY

June Agency MBS Update

JAE LIM | 3 JULY 2019

Relative agency MBS performance barely inched out a positive excess return this month as low interest rates continue to brew prepayment concerns despite the general risk-on sentiment. In June, the Fed gave what the market wanted with a dovish statement dropping the word "patient" and stating that it is "closely monitoring" and ready to "act as appropriate to sustain the expansion." The target range for the funds rate was unchanged at 2.25% - 2.50%, as largely expected, but eight out of 17 officials called for interest rate cuts with seven suggesting 50 basis points (bps) of cuts by year-end, which was a meaningful shift from the March statement that called for zero interest rate cuts. Everyone seemed to be a winner from the dovish Fed as both risk assets and U.S. Treasuries (UST) rallied. The S&P 500 briefly hit all-time highs, ending the month up 7.2%, while the 2yr UST and 10yr UST rallied 16.7bps and 12bps respectively. For Agency MBS, the dovish statement was met with mixed reactions as the risk-on sentiment initially helped Agency MBS performance, which then dwindled as mortgage rates declined with broader market rates. The Freddie Mac Primary Mortgage Market Survey (PMMS) 30yr fixed mortgage rate breached 4.00% falling to 3.73%, its lowest level since November 2016. With heightened prepayment concerns heading into peak summer seasonals, the Bloomberg Barclays MBS Index posted excess returns of just 2bps versus benchmark USTs in June, bringing year-to-date (YTD) excess returns to negative 11bps. The market rally, however, aided total returns which stand at 4.17% for 2019.

Conventional coupon stack performance was similar to that of last month's as higher coupon MBS underperformed lower coupon MBS. Fannie Mae 30yr (FNCL) 3.0s and 3.5s ended the month flat to Treasuries while FNCL 4.5s and 5.0s posted negative 12bps and negative 23bps of excess returns, respectively. As conventional TBAs struggled, specified pool payups marched up as the persistent theme of faster speeds and TBA deterioration continued to worry investors. Specified pool supply was robust throughout the month in secondary BWICs, coming in the form of profit taking, but was digested well from dealers and end accounts. Stronger call protection stories, including lower loan balance premium coupons, performed especially well on strong demand from CMO desks.

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Mr. Lim is a member of the Fixed Income group who specializes in agency mortgage-backed securities. Prior to joining TCW in 2017, he was at Citigroup where he covered institutional investors specializing in money market securities, investment grade corporate bonds, and securitized products. Mr. Lim earned a BA in Economics from University of California, Berkeley.

Ginnie Mae MBS (G2SF) had another month of outperformance relative to their 30yr conventional counterparts despite the move to lower yields. In fact, all tradable G2SF coupons except G2SF 5.0s had positive excess returns, with G2SF 4.0s being the best performer at 25bps of excess return. Ginnies started the month on par with conventionals as the May speed print showed that VA loan speeds remained elevated. By mid-month, however, Ginnie Mae MBS were well supported especially after the Ginnie Mae Summit where Mark Calabria, the director of the FHFA, stated that if Congress were to create an explicit guarantee it should be a limited one. This statement did not align with Treasury Secretary Steven Mnuchin's statements earlier in June where Mnuchin made it clear that he would prefer a full explicit guarantee on MBS issued by the GSEs. Nonetheless, Ginnnie Mae MBS saw healthy demand and outperformed its conventional counterparts. Other news supportive of Ginnie Mae MBS included the House passing a bill to remove the MIP (Mortgage Insurance Premium) for life on FHA loans when the balance goes to below 78 LTV. The bill does not seem likely to pass but if it were to go through, seasoned FHA speeds would likely slow down. On the VA front, Ginnie Mae announced that it would allow LoanDepot back into the Ginnie Mae II multi-issuer program starting in July. Loan Depot will be the third servicer to be allowed back into the program after being banned from the program for churning military veteran borrowers. Although it is unclear how LoanDepot will change their churning practices, its VA loans constitute less than 3% of most Ginnie Mae II multi-issuer pools so the impact of the company's reinstatement is likely to be muted in the multi-issuer program.

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Coupon Stack Performance

30 Yr FNMA	June Month End Price	May Month Price	Monthly Price Change (points)	Monthly Performance vs. Benchmark UST (%)	Current	Libor OAS Monthly Change (bps)
2	$99.27	$98.48	0.78	0.17	22.6	-3.5
3	$100.80	$100.39	0.41	-0.01	33.9	1.8
3.5	$102.20	$101.95	0.25	0.00	36.7	1.5
4	$103.33	$103.20	0.13	-0.03	42.00	1.5
4.5	$104.48	$104.45	0.03	-0.12	78.1	3.7
5	$105.70	$105.52	0.19	-0.23	120.4	5.4
5.5	$106.64	$106.95	-0.31	-0.20	150.7	10.0
15 Yr FNMA						
2.5	$100.64	$100.05	0.59	0.04	29.5	0.7
3	$101.95	$101.45	0.50	0.02	31.9	0.4
3.5	$103.20	$102.70	0.50	0.07	39.5	2.1
4	$103.83	$103.33	0.50	0.06	53.3	9.0
4.5	$102.23	$101.98	0.25	-0.04	164.2	18.3

Source: TCW, Bloomberg, Barclays

Benchmark Performance

	June Month End Price	June Month End Yield	May Month End Yield	Change (bps)
2 Yr Treasury	$99.74	1.75%	1.92%	-16.72
5 Yr Treasury	$99.92	1.77%	1.91%	-14.46
10 Yr Treasury	$103.29	2.01%	2.12%	-11.95
30 Yr Treasury	$107.20	2.53%	2.57%	-3.94
2/10 Curve		24.82	20.02	4.80
2 Yr SWAP Spread		4.94	5.44	-0.50
10 Yr SWAP Spread		-4.25	-4.25	0.00
1y*10y Swaption Vol		63.62	66.47	-2.85
5y*10y Swaption Vol		62.32	65.16	-2.85

Source: TCW, Bloomberg, Barclays

Issuer Performance (ticks)

	June GNMAII/FNMA	May GNMAII/FNMA	Monthly Price Change
3	42.50	35.25	7.25
3.5	33.50	25.75	7.75
4	10.25	7.25	3.00
4.5	-8.25	-15.25	7.00
5.0	-36.00	-34.25	-1.75

Source: TCW, Credit Suisse

Specified Pool Pay-up Grid (ticks)

Coupon	June 28, 2019	May 31, 2019	April 30, 2019
FN 3% LLB	29	17	17
FN 3% MLB	25	14	14
FN 3% HLB	21	11	11
FN 3.5% LLB	69	46	37
FN 3.5% MLB	58	39	33
FN 3.5% HLB	48	30	26
FN 4% LLB	116	80	66
FN 4% MLB	100	67	57
FN 4% HLB	84	54	46
FN 4.5% LLB	152	115	100
FN 4.5% MLB	132	100	86
FN 4.5% HLB	100	76	72

Source: TCW, Citi

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