

MONTHLY COMMENTARY

September Agency MBS Update

JAE LIM | 3 OCTOBER 2019



Jae Lim
Vice President
Fixed Income

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.

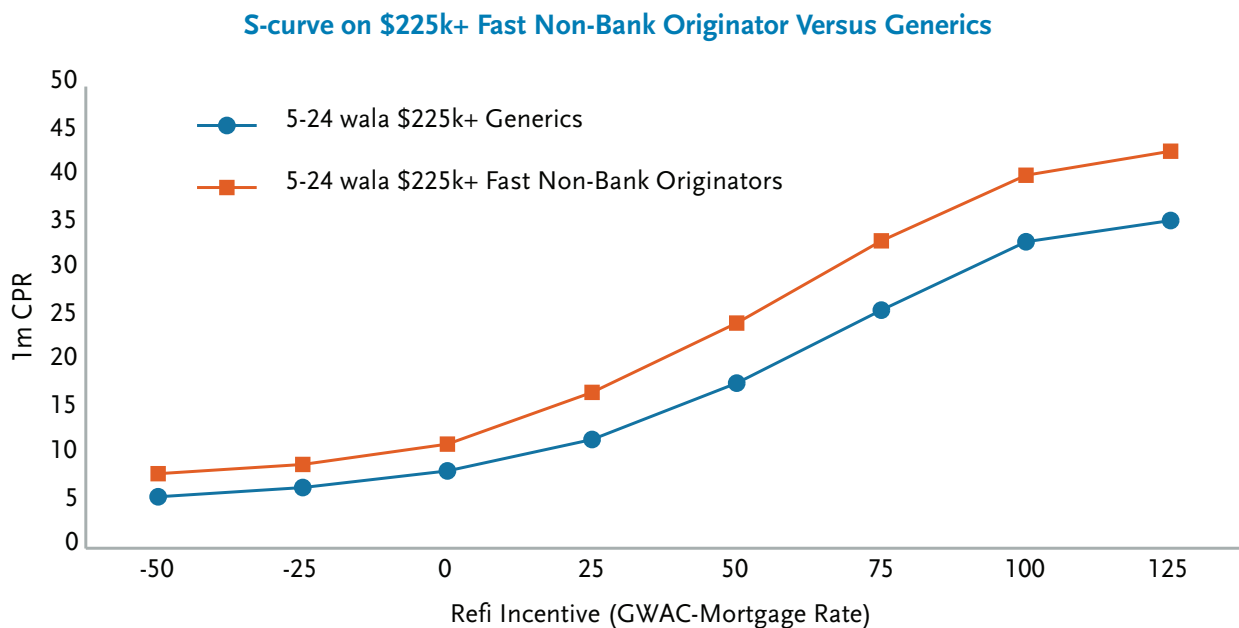
Agency MBS performance was rather benign this month as it recovered from its secular wide levels despite heightened volatility in markets. September was a month full of headline risk with geopolitical tensions, repo market concerns, and an FOMC meeting, all of which caused rates to whipsaw. In the opening days of the month, prepayment speeds ramped up 6% to 9% faster than the previous month but were still slightly slower than expectations. Speeds were projected to be faster with lower mortgage rates and increased refinancing activity but were rather on the tamer side. During mid-month, repo funding rates spiked higher as a result of reserve scarcity which caused the Fed to intervene for the first time since the crisis. The repo funding chaos initially resulted in some weakness in TBAs and TBA rolls, but the Fed's repo injection alleviated much of the damage. Unscathed by some volatile events during the month, the Bloomberg Barclays MBS Index posted a positive excess return of 24 basis points (bps) over benchmark USTs in September. Year-to-date total return remained strong at 5.56%, but excess return to benchmark USTs was still negative at -5bps.

Coupon stack performance was skewed towards better performance in higher coupons with higher interest rates bringing temporary relief to prepayment concerns while supply continued to weigh on the lower coupons. The Freddie Mac Primary Mortgage Market Survey (PMMS) 30yr fixed mortgage rate ended the month 6 bps higher, mirroring the interest rate selloff, and ended the month at 3.64%. Despite higher rates, supply continues to be robust at over \$4bln a day as supply tends to lag the interest rate rallies. On the coupon stack, FN 2.5s were the worst performer, falling below par dollar price and posting 29bps of negative excess returns over benchmark USTs. The rest of the conventional 30yr coupon stack posted gains over benchmark USTs with FN 3.0s, 3.5s, 4.0s posting an excess return of 21bps, 40bps,

September 2019 Agency MBS Update

and 30bps respectively. The best performer in the coupon stack was FN 5.0s which posted a whopping 102bps of excess returns. GNMA MBS underperformed its conventional counterparts as supply continued to weigh in while usual buyers, including Asia, were quiet into quarter end. The one exception was G2 2.5s where we did see some buying as it was only down 7bps, which was 17bps better than its conventional counterpart FN 2.5s. Overall, most G2 coupons ended the month close to flat to benchmark USTs with G2 3.0s ending the month up 4bps.

Specified pool pay-ups, especially in call-protected pools, were generally down as the prospect for additional Fed cuts became unclear and rates soared higher. Despite some overall weakness in specified pools, seasoned specified pools held up well with pay-ups remaining stable month to month. In recent months, servicer efficiency has been at the forefront of investors' minds. In last month's commentary, we touched upon conventional multi pools displaying a similar prepayment ramp to G2 multi pools where loans would display a large prepayment spike after 6-8 months of issuance. This phenomenon used to be unique to G2 pools, which displayed the ramp because of the streamline refi program and VA churning practices. In conventional space, however, those phenomena are nonexistent and the prepayment spike can simply be attributed to servicer efficiency. As technology enables servicers to be more effective, there is a further deterioration of the deliverable stemming from servicer efficiency. It is important to note that not every mortgage originator displays these large prepayment spikes. Bank servicers are typically known to be slow while some non-bank originators have historically been faster. In recent months, we saw several non-bank originators paying much faster than their cohorts. With most TBA coupons currently trading at a premium, this prepayment efficiency hurts MBS investors because these fast originators can affect overall prepayments materially. As shown in the S-curve below, with the rise of efficiency and technology, investors will have to be more selective in terms of servicer allocation when finding value in the agency MBS universe.



Source: CPRCDR, Robert W. Baird

September 2019 Agency MBS Update

Coupon Stack Performance

30 Yr FNMA	September Month End Price	August Month Price	Monthly Price Change (points)	Monthly Performance vs. Benchmark UST (%)
2.5	\$99.58	\$100.48	-0.91	-0.24
3	\$101.55	\$101.92	-0.38	0.21
3.5	\$102.64	\$102.83	-0.19	0.40
4	\$103.80	\$103.92	-0.13	0.30
4.5	\$105.33	\$105.39	-0.06	0.37
5	\$107.14	\$106.92	0.22	1.02
15 Yr FNMA				
2.5	\$100.89	\$101.33	-0.44	0.09
3	\$102.23	\$102.55	-0.31	0.13
3.5	\$103.45	\$103.70	-0.25	0.15
4	\$104.11	\$104.17	-0.06	0.11

Source: TCW, Bloomberg, Barclays

Benchmark Performance

	September Month End Price	September Month End Yield	August Month End Yield	Change (bps)
2 Yr Treasury	\$99.76	1.62%	1.50%	11.77
5 Yr Treasury	\$99.79	1.54%	1.39%	15.75
10 Yr Treasury	\$99.63	1.66%	1.50%	16.85
30 Yr Treasury	\$103.05	2.11%	1.96%	14.79
2/10 Curve		3.88	-1.39	5.28
2 Yr SWAP Spread		0.94	0.60	0.34
10 Yr SWAP Spread		-11.63	-10.25	-1.38
1y*10y Swaption Vol		69.36	71.92	-2.56
5y*10y Swaption Vol		66.47	67.32	-0.86

Source: TCW, Bloomberg, Barclays

Issuer Performance (ticks)

	September GNMAII/FNMA	August GNMAII/FNMA	Monthly Price Change
2.5	47	34	13
3	35.5	37.25	-1.75
3.5	33	36	-3
4	7.25	13.25	-6
4.5	-24.75	-20.5	-4.25
5	-54	-57	3

Source: TCW, Credit Suisse

Specified Pool Pay-up Grid (ticks)

Coupon	Sept. 30 2019	Aug. 31 2019	July 28 2019
FN 3% LLB	54	63	29
FN 3% MLB	48	56	25
FN 3% HLB	37	48	21
FN 3.5% LLB	103	112	64
FN 3.5% MLB	92	98	57
FN 3.5% HLB	72	81	46
FN 4% LLB	142	170	111
FN 4% MLB	122	140	93
FN 4% HLB	83	108	77
FN 4.5% LLB	164	175	150
FN 4.5% MLB	126	155	129
FN 4.5% HLB	89	108	95

Source: TCW, Citi

This material is for general information purposes only and does not constitute an offer to sell, or a solicitation of an offer to buy, any security. TCW, its officers, directors, employees or clients may have positions in securities or investments mentioned in this publication, which positions may change at any time, without notice. While the information and statistical data contained herein are based on sources believed to be reliable, we do not represent that it is accurate and should not be relied on as such or be the basis for an investment decision. The information contained herein may include preliminary information and/or "forward-looking statements." Due to numerous factors, actual events may differ substantially from those presented. TCW assumes no duty to update any forward-looking statements or opinions in this document. Any opinions expressed herein are current only as of the time made and are subject to change without notice. Past performance is no guarantee of future results. © 2019 TCW