

Opportunities in Asset-Backed Fixed Income

Published August 5, 2022

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On the latest episode of the *Behind the Markets* podcast, we had a fascinating conversation with Don Kohn, former Federal Reserve vice chair, and Dave Goodson, Head of Securitized Fixed Income and Senior Portfolio Manager at Voya Investment Management. We discussed:

- **A Policy Debate:** In the first half of the episode, Professor Jeremy Siegel and Don Kohn debated the inflationary impulse in the economy and the appropriate path for the Federal Funds Rate. Kohn is more hawkish than the interest rate curve priced into the market, and Professor Siegel is more dovish. Given Kohn's prior role at the Federal Reserve (Fed), this was an important conversation about how the Fed might approach policy over the coming meetings and into 2023. We are starting to see Fed speakers push back on market pricing that implies rate cuts in 2023 quickly after this hiking cycle, and Kohn's commentary reflects that thinking.
- **Quantitative Tightening (QT):** Goodson talks about the opportunities in the securitized credit space and how quantitative tightening could impact the mortgage-backed securities market. Fed transparency and guidance has helped market participants assess quantitative tightening and price in concessions to compensate for perceived risk to securitized debt. But the pace of balance sheet runoff will double in two months, and it is hard to know how an already jittery market will react.
- **Attractive Valuations/Opportunities:** Currently, the spreads across most of the securitized debt markets Goodson invests in are at levels that reflect outlier scenarios that have occurred less than 1% of the time. Essentially, a lot of bad news has been priced into spreads already. This over-discounting reflects good value for the securitized debt market, in Goodson's opinion, even though there are many uncertain elements.
- Goodson highlighted two corners of the non-agency residential mortgage-backed market where this over-discounting was pronounced
 - Credit Risk Transfer securities – a new type of security in which Fannie Mae and Freddie Mac compensate institutional investors to bear some of the credit risk of their portfolio
 - The non-qualifying mortgage-backed market, which pools mortgages from lenders that do not meet specific criteria demanded for mortgages pooled by the government-sponsored enterprises (GSEs)
- For commercial mortgage-backed markets, Goodson sees opportunity in the multi-family space but remains leery of the office space given the trends in work-from-home mindsets

- **Diversifying Fixed Income Portfolios:** In Goodson's view, the securitized bond market is under-appreciated by investors, leading to sub-optimal allocations. If you consider the entire range of securitized debt (agency MBS, commercial MBS, non-agency MBS, asset-backed (ABS) and collateralized loan obligations (CLOs)), it totals more than \$12 trillion (more than \$9T in agency MBS and \$3T outside of it). The securitized market dwarfs the high-yield market, emerging market bonds and bank loans and starts to compete in total size with the investment-grade corporate bond market.
- **With the Fed moving aggressively to tighten policy, Goodson notes** some signs of stress from less experienced borrowers and lower income consumers, as reflected in firming default levels for unsecured loans, despite very low levels of unemployment and high wage levels.

Goodson is the portfolio manager for [WisdomTree's Mortgage Plus Bond Fund \(MTGP\)](#). For more details on the Fund, please visit the Fund's page.

You can listen to the full conversation with Kohn and Goodson below:

Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. In addition, when interest rates fall, income may decline. Fixed income investments are also subject to credit risk, the risk that the issuer of an investment will fail to pay interest and principal in a timely manner or that negative perceptions of the issuer's ability to make such payments will cause the price of that investment to decline. Investing in mortgage- and asset-backed securities involves interest rate, credit, valuation, extension and liquidity risks and the risk that payments on the underlying assets are delayed, prepaid, subordinated or defaulted on. Liquidity risk may result from the lack of an active market or a reduced number and capacity of traditional market participants to make a market in fixed income securities and may be magnified in a rising interest rate environment and/or with respect to particular types of securities, such as securitized credit securities. Non-agency and other securitized debt is subject to heightened risks as compared to agency-backed securities. High yield or "junk" bonds have lower credit ratings and involve a greater risk to principal. Derivative investments can be volatile, and these investments may be less liquid than other securities and more sensitive to the effects of varied economic conditions. Unlike typical exchange-traded funds, the Fund is actively managed using proprietary investment strategies and processes, and there can be no guarantee that these strategies and processes will be successful or that the Fund will achieve its investment objective. Due to the investment strategy of the Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.