Securitized Credit Quick Hits

Much of the securitized credit market displays improving fundamentals and is benefiting from encouraging economic growth—but expect some turbulence as overly optimistic Fed predictions are brought down to earth.

Macro drivers

- **Interest rates:** The market's optimistic outlook is at risk if the Fed fails to meet expectations for five rate cuts in 2024. **We expect volatility to return,** and markets that outperformed at the end of 2023 are particularly vulnerable.
- **Asset class performance:** As disinflation continues, **we anticipate a more traditional negative correlation between equity and fixed income returns will resume.** Positive economic growth will broadly benefit holders of credit risk—specifically investors in securitized credit sectors, and especially underlying borrowers in ABS, CMBS and RMBS.
- **Issuance: Lower rates and less restrictive monetary policy are expected to drive greater activity,** especially in mortgage sectors. Volumes in non-agency CMBS and RMBS fell significantly in 2023 but should pick up in the months ahead. ABS and CLOs have already seen a surge in new issuance in 2024 and will be a large source of actionable supply.

Sector views

CMBS: Back to life, back to reality

The commercial mortgage-backed securities (CMBS) sector is early cycle and very cheap. Sentiment has shifted due to lower rates and the pricing in of a Fed pivot. Spreads have tightened significantly from their peaks but remain elevated, drawing investors back into the market. While the sector still faces fundamental challenges, lower rates help commercial real estate as a whole, and **a slow healing process has begun,** significantly reframing opportunities in the sector.

U.S. ABS: Steady as she goes

We expect the asset-backed securities (ABS) sector to provide a stable `return experience. In our view, prime consumer ABS offers compelling risk/reward opportunities, benefiting from a strong labor market, easing rates and moderating inflation. However, lower-income consumers appear to be struggling due to higher borrowing costs, and inflationary pressures.

Non-agency RMBS: Golden handcuffs

The non-agency residential mortgage-backed securities (RMBS) sector had perhaps the most durable setup entering 2024. Given a large cohort of mortgage holders with affordable loans, **we view defaults as unlikely, and we believe homeowners will work to defend their equity.** Rising prepayment speeds should de-lever structures and drive higher total returns across a broad range of economic scenarios.

CLOs: The double-edged sword

Collateralized loan obligations (CLOs) were the stars of 2023, but there are now concerns in the sector. Exposure to CCC and lower credits has become problematic, as CLO managers are struggling to cover their liabilities. **Many older CLOs are exiting their reinvestment periods, which limits maneuverability and increases risk for investors.**

VOYA® INVESTMENT MANAGEMENT

Positioning

	Love	Leave
CMBS	■ Non-office fixed-rate investment grade (IG) single-asset single-borrower (SASB) securities ■ Seasoned interest-only (IO) securities ■ Higher-rated seasoned conduit loans	■ Office and mall credit ■ Transitional multi-family ■ Conduit BBB rated issues ■ BBB–A rated commercial real estate CLOs ■ Sub-IG bonds
U.S. ABS	■ Discount private student loans ■ Benchmark new-issue offerings	■ Subprime consumer loans ■ Solar subordinates ■ Buy now/pay later
Non-agency RMBS	■ Prime jumbo passthroughs ■ High–weighted avg. coupon (WAC) prime IG subordinates ■ Prime senior-support ■ GSE investor passthroughs	■ Lower-end RMBS sectors, such as debt service coverage ratio (DSCR) loans and non-qualifying mortgages (non-QM) ■ Equity share ■ Seasoned credit risk transfer (CRT) B2s
CLOs	■ Select post-reinvestment BBBs	■ BBs ■ Tier II/III BBB–AAA rated issues, equity, and middle market deals

While securitized credit is often seen as an opportunistic, tactical trade, it can also be a strategic allocation within a fixed income portfolio. The market offers diversification and alpha opportunities across the full economic cycle. At Voya, our team of securitized specialists can shift attention to the most attractive subsectors at any given time—an approach we believe is well suited to a through-the-cycle allocation.

Click here to read our complete 2024 outlook on securitized credit.

A note about risk

The principal risks are generally those attributable to bond investing. Holdings are subject to market, issuer, credit, prepayment, extension, and other risks, and their values may fluctuate. Market risk is the risk that securities may decline in value due to factors affecting the securities markets or particular industries. Issuer risk is the risk that the value of a security may decline for reasons specific to the issuer, such as changes in its financial condition. The strategy invests in mortgage-related securities, which can be paid off early if the borrowers on the underlying mortgages pay off their mortgages sooner than scheduled. If interest rates are falling, the strategy will be forced to reinvest this money at lower yields. Conversely, if interest rates are rising, the expected principal payments will slow, thereby locking in the coupon rate at below market levels and extending the security's life and duration while reducing its market value.

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