A Unique Opportunity in Structured Credit

Today, the structured credit markets, which include consumer credit, corporate credit, residential and commercial real estate credit, offer higher yields, lower interest rate risk and lower loss rates than most comparable rated unsecured corporate credit. In fact, investors can enjoy high single-digit yields in a secured investment while still maintaining an investment grade credit rating (Figure 1).

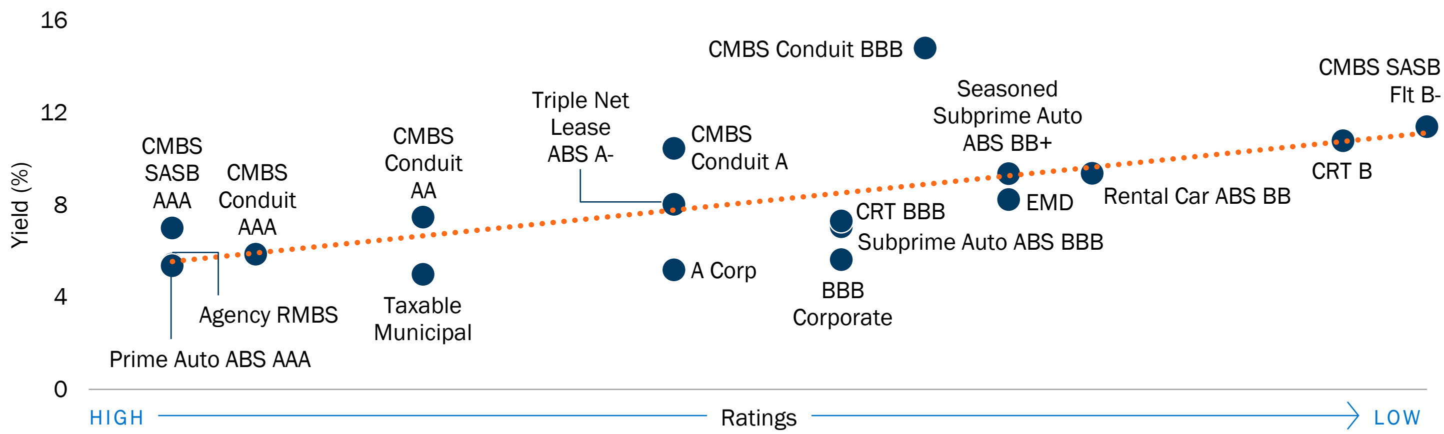
What Is Structured Credit?

Structured credit involves the packaging of cash flows from different sources including mortgages, credit cards, auto loans, aircraft leases, corporate loans and other types of receivables into marketable securities. These securities offer many benefits to fixed income investors who are seeking to diversify their traditional unsecured credit risk exposure and source alternative forms of income and total return. Some of these benefits include degrees of structural protections such as subordination, over-collateralization and excess spread.

Why Invest in Structured Credit?

We view structured credit as an attractive alternative to traditional unsecured credit. The sector, which varies greatly across collateral types, can offer investors diversification benefits, higher ratings, predicable cash flows and in some cases, lower interest rate sensitivity. Broadly speaking, we maintain fundamentals remain sound across the structured credit market, where the US consumer's balance sheet is strong, incomes are rising and unemployment sits near all-time lows. Moreover, the floating-rate features of some securitizations benefit from a "higher for longer" policy environment.

FIGURE 1: AGGREGATE YIELD AGAINST CREDIT RATING



Source: Bloomberg, JPMorgan, and MacKay Shields.
CRT = Credit Risk Transfer; RMBS = Bloomberg Mortgage Backed Index (30Y FNCL Par Coupon Yield); CMBS SASB = New Issue Pricing sourced by MacKay Shields; Prime Auto ABS = New Issue Pricing sourced by MacKay Shields; CMBS AAA = Bloomberg Non-Agency Investment Grade CMBS: Aaa; CMBS AA = Bloomberg Non-Agency Investment Grade CMBS: Aa; Taxable Muni = Bloomberg Municipal Index Taxable Bonds; A Corp = Bloomberg A Corporate; CMBS A = Bloomberg Non-Agency Investment Grade CMBS: A; Triple Net Lease ABS = New Issue Price sourced by MacKay Shields; IG Corp = Bloomberg US Corporate; BBB Corp = Bloomberg Baa Corporate; Subprime Auto ABS = New Issue Price sourced by MacKay Shields; CRT BBB = New Issue Price sourced by MacKay Shields; CMBS BBB = Bloomberg Non-Agency Investment Grade CMBS: BBB; EMD = J.P. Morgan - EMBIG Diversified; Seasoned Subprime Auto ABS = New Issue Price sourced by MacKay Shields; Rental Car ABS = New Issue Price sourced by MacKay Shields; CRT B = New Issue Price sourced by MacKay Shields; CMBS SASB Flt = New Issue Price sourced by MacKay Shields.
It is not possible to invest directly in an index. Please see disclosures for information related to comparisons to an index and index descriptions.
Past performance is not indicative of future results.

In the mortgage market, forced selling by banks and the FDIC has driven spreads to near historical wides while commercial real estate has been tainted by concerns over office properties. It is worth noting that office-related financing accounts for less than 20% of commercial real estate debt. Even within this sector, certain properties are able to retain tenants and sustain rents. Outside of the office sector, our research indicates fundamentals remain very strong. Continued growth in e-commerce is driving demand for warehouse space while higher mortgage rates are driving demand in the multi-family sector. Accordingly, we believe opportunity exists to take advantage of the considerable yield and total return potential.

Key Takeaways for Investors

- High quality structured credit spreads are trading at or near historical wides and we believe absolute yield levels are very compelling;
- Quantitative Tightening (QT) and FDIC selling from its acquisition of failed banks is driving spreads wider, particularly for residential mortgage-backed securities;
- Higher interest rate volatility is weighing on the sector in the near-term;
- The shift to remote work has led to lower values for office properties; however, office properties account for less than 20% of outstanding commercial real estate debt;[1]
- Select high quality office space continues to retain its value;
- We see significant opportunity in multi-family and warehouse space; and
- Residential mortgage credit, including credit risk transfer securities, are enjoying upgrades as they de-lever over time.

Why MacKay Shields?

MacKay Shields has deep expertise in the structured credit markets and maintains it is uniquely positioned to capitalize on market opportunities. The team operates with a disciplined top-down and bottom-up investment process. For more information on MacKay Shields' structured credit capabilities, please reach out to steven.buckley@mackayshields.com.

1. Source: Moody's, as cited in Reuters, "Office CRE in US at risk from rising interest rates, work from home", June 20, 2023.

SOURCE INFORMATION

COMPARISONS TO AN INDEX

Comparisons to a financial index are provided for illustrative purposes only. Comparisons to an index are subject to limitations because portfolio holdings, volatility and other portfolio characteristics may differ materially from the index. Unlike an index, individual portfolios are actively managed and may also include derivatives. There is no guarantee that any of the securities in an index are contained in any managed portfolio. The performance of an index may assume reinvestment of dividends and income, or follow other index-specific methodologies and criteria, but does not reflect the impact of fees, applicable taxes or trading costs which, unlike an index, may reduce the returns of a managed portfolio. Investors cannot invest in an index. Because of these differences, the performance of an index should not be relied upon as an accurate measure of comparison.

The following index may be referred to in this document:

BLOOMBERG US MORTGAGE BACKED SECURITIES INDEX

The Bloomberg US Mortgage Backed Securities (MBS) Index tracks fixed-rate agency mortgage backed pass-through securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.

BLOOMBERG US CORPORATE BOND INDEX

The Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers. Bonds must have a $300 million minimum par amount outstanding. Callable fixed-to-floating rate bonds are eligible during their fixed-rate term only. Bonds that convert from fixed to floating rate, including fixed-to-float perpetual, will exit the index one year prior to conversion to floating-rate.

BLOOMBERG BAA CORPORATE INDEX

The Bloomberg Baa Corporate Index measures the Baa-rated, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

BLOOMBERG NON-AGENCY INVESTMENT GRADE CMBS INDEX

The Bloomberg Non-Agency Investment Grade CMBS Index measures the market of conduit and fusion CMBS deals with a minimum current deal size of $300 million that are rated investment grade or higher using the middle rating of Moody's, S&P, and Fitch after dropping the highest and lowest available ratings.

J.P. MORGAN EMBI GLOBAL DIVERSIFIED INDEX

The J.P. Morgan EMBI Global Diversified Index (EMBIG) tracks liquid, US Dollar emerging market fixed and floating-rate debt instruments issued by sovereign and quasi-sovereign entities.