MANAGER INSIGHT

SECURITIZED ASSET UPDATE:

Performance & Collateral Fundamentals

WRITTEN BY
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In August 2023, the Loomis Sayles Mortgage & Structured Finance Team published "Technicals Create Opportunities," an analysis that discussed how we thought negative demand technicals in securitized assets over the prior year had cheapened valuations despite resilient collateral fundamentals. Here, we provide an update on how securitized assets have performed since that time and fundamental collateral changes.

Recap of Negative Demand Technicals

We believe the poor demand technicals were in large part due to two factors. First, during 2022, interest rates spiked as the Federal Reserve (Fed) hiked aggressively to combat inflation and began quantitative tightening (QT), which reduced the central bank's agency mortgage-backed securities (MBS) purchases. Second, in early 2023, a regional banking crisis caused some failed banks to liquidate their large agency MBS holdings and other banks to pull back demand for agency MBS as a way to reduce their asset-liability mismatches.

These worsening technicals in agency MBS also spilled over into securitized credit, as banks pulled back their participation in sectors such as collateralized loan obligations (CLO) AAAs and asset-backed securities (ABS). The negative technicals in securitized assets caused valuations to cheapen, despite the consumer and housing fundamentals remaining strong. As a result of this dynamic, our team believed securitized assets presented an attractive buying opportunity for investors.

Performance and Collateral Fundamentals Since 2023

As shown in **Figures 4-6** at the end of this document, portfolios of securitized assets as represented by the Loomis Sayles Investment Grade Securitized Credit and Opportunistic Securitized Credit Composites have performed strongly since June 2023 relative to the Bloomberg IG Corporate and Bloomberg High Yield Indices, respectively. This is also the case over longer time periods (past five and 10 years).

KEY DEVELOPMENTS:

CONSUMER ABS

The average delinquency rate of prime ABS collateral has remained relatively unchanged since June 2023. However, some near-prime and non-prime borrowers have become more challenged over the past year and performed slightly worse than pre-COVID levels. These lower-income consumers are now under more financial stress and facing reduced credit availability due to a combination of tighter underwriting standards and higher loan interest rates. However, stricter underwriting and higher rating agency loss assumptions have contributed to new issue consumer ABS coming to market with stronger structures and lower risk collateral.

RMBS

Within residential mortgage-backed security (RMBS), housing fundamentals remain strong with year-over-year home price appreciation in the mid-single digits. Historically low inventory, a "lock-in" effect in which borrowers with low mortgage rates choose not to move, and affordability challenges have supported house prices.

US ECONOMY AND INTEREST RATES

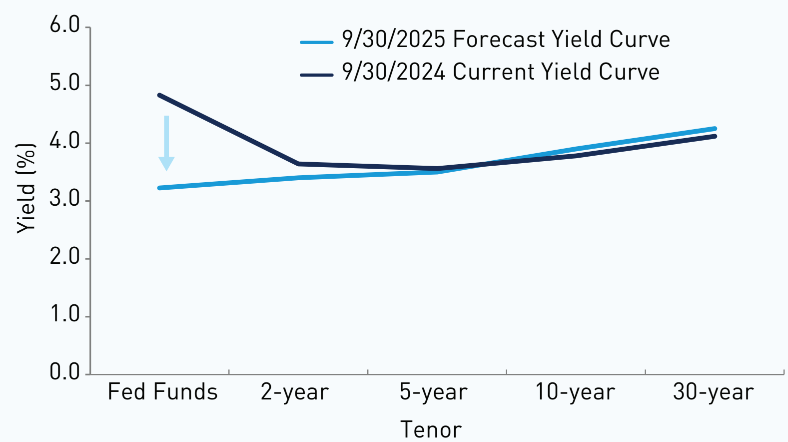
On the economic front, US inflation (CPI) has eased from 3.0% in June 2023 to 2.4% in September 2024 (US CPI Urban Consumers YoY NSA, Bloomberg: CPI YOY Index) and the labor market has started to soften, with the unemployment rate moving up 0.70% from 2023's low to 4.1% in September 2024 (U-3 Unemployment Rate, Bloomberg: USURTOT Index). To help ease the tightening in macroeconomic conditions, the Fed reduced interest rates by 50 basis points in September 2024 and the market expects it to continue lowering interest rates into 2025.

We believe lower interest rates should be a tailwind to securitized asset performance and provide investors with a continued opportunity for near-term attractive returns. From a collateral standpoint, lower interest rates should decrease financing costs of consumer purchases and provide strong fundamental tailwinds to hard asset values, such as residential real estate, containers, fiber assets and cell towers.

Looking Forward

According to the Loomis Sayles Macro Strategies Team, with the Fed expected to continue cutting interest rates into 2025, the US Treasury yield curve is likely to bull steepen with short-end rates falling faster than long-end rates (see **Figure 1** below).

FIGURE 1: LOOMIS SAYLES MACRO STRATEGIES TEAM PROBABILITY WEIGHTED YIELD CURVE FORECAST VS. CURRENT YIELD CURVE

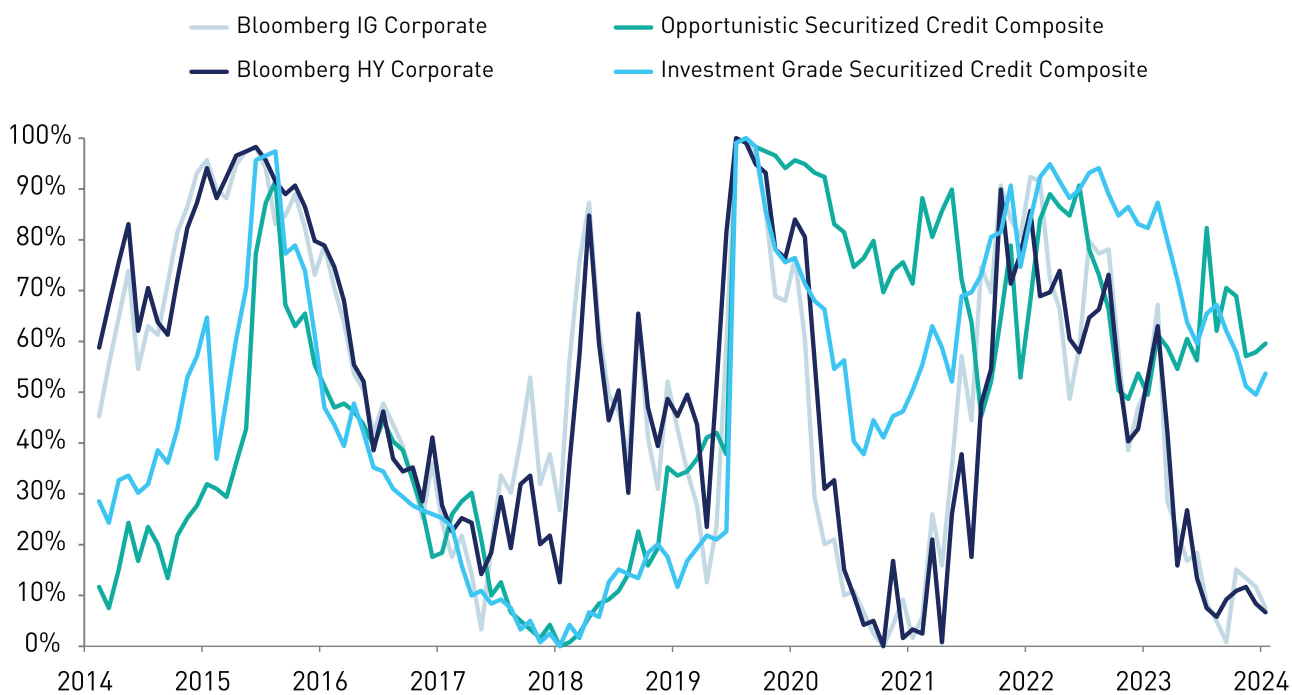


Source: Loomis Sayles, as of 04 October 2024.
The charts presented above are shown for illustrative purposes only. Some or all of the information on this chart may be dated, and, therefore, should not be the basis to purchase or sell any securities. The information is not intended to represent any actual portfolio. information obtained from outside sources is believed to be correct, but Loomis Sayles cannot guarantee its accuracy. This material cannot be copied, reproduced or redistributed without authorization

Past performance is no guarantee of future results.

In such an economic environment, securitized asset total return performance should benefit from the securities' typically shorter duration. In addition, we believe securitized asset carry still looks attractive relative to investment grade corporates and should help provide strong excess returns even if spreads stay roughly unchanged over the next year (see **Figure 2** on the following page).

FIGURE 2: 10-YEAR HISTORICAL SPREAD OVER US TREASURYS, PERCENTILES



Source: Loomis Sayles, as of 31 October 2014 - 30 September 2024.
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See **Figure 3** below for the current spread level and other characteristics of the Investment Grade Securitized Credit and Opportunistic Securitized Credit Composites.

SPREAD LEVEL & CHARACTERISTICS		
	INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE	OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE
QUALITY	A3	BAA3
YIELD (%)	6.71	9.06
OAS (BP)	295	487
COUPON (%)	4.79	6.11
DURATION (YEARS)	2.46	2.44
AVERAGE LIFE (YEARS)	3.40	3.91

Source: Loomis Sayles, as of 30 September 2024.

Currently, credit curves in more "traditional" securitized asset sectors, such as autos and student loans, are relatively flat on a historical basis, but we have found more value in esoteric sectors like aircraft, data centers and fiber ABS. That said, security selection is key; Loomis Sayles' robust sponsor, collateral, and structural analysis has the potential to help uncover compelling investment opportunities.

For more information on the Loomis Sayles Investment Grade Securitized Credit and Opportunistic Securitized Credit Composites, please request a complete presentation book.

FIGURE 4: ANALYSIS TIME PERIOD: JUNE 2023 - SEPTEMBER 2024

JUNE 2023 - SEPTEMBER 2024						
SUMMARY	ANNUALIZED RETURN	ANNUALIZED STANDARD DEVIATION	SHARPE RATIO	MAX DRAWDOWN	CORRELATION TO INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE	CORRELATION TO OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE
INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE (GROSS)	11.28%	2.73%	2.01	-0.75%	-	-
INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE (NET)	10.73%	-	-	-0.79%	-	-
OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE (GROSS)	15.61%	2.60%	3.59	-0.15%	-	-
OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE (NET)	15.04%	-	-	-0.20%	-	-
BLOOMBERG IG CORPORATE INDEX	8.29%	8.20%	0.36	-5.23%	0.82	-
BLOOMBERG HY CORPORATE INDEX	13.37%	5.47%	1.36	-2.33%	-	0.75

FIGURE 5: ANALYSIS TIME PERIOD: OCTOBER 2019 - SEPTEMBER 2024 [5-YEAR PERIOD]

OCTOBER 2019 - SEPTEMBER 2024						
SUMMARY	ANNUALIZED RETURN	ANNUALIZED STANDARD DEVIATION	SHARPE RATIO	MAX DRAWDOWN	CORRELATION TO INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE	CORRELATION TO OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE
INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE (GROSS)	3.98%	5.60%	0.32	-9.16%	-	-
INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE (NET)	3.59%	-	-	-9.19%	-	-
OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE (GROSS)	5.31%	6.91%	0.45	-13.71%	-	-
OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE (NET)	4.78%	-	-	-13.79%	-	-
BLOOMBERG IG CORPORATE INDEX	1.16%	8.91%	-0.08	-20.46%	0.70	-
BLOOMBERG HY CORPORATE INDEX	4.72%	9.35%	0.30	-14.74%	-	0.68

FIGURE 6: ANALYSIS TIME PERIOD: OCTOBER 2014 - SEPTEMBER 2024 [10-YEAR PERIOD]

OCTOBER 2014 - SEPTEMBER 2024						
SUMMARY	ANNUALIZED RETURN	ANNUALIZED STANDARD DEVIATION	SHARPE RATIO	MAX DRAWDOWN	CORRELATION TO INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE	CORRELATION TO OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE
INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE (GROSS)	4.18%	4.10%	0.62	-9.16%	-	-
INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE (NET)	3.83%	-	-	-9.19%	-	-
OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE (GROSS)	5.64%	4.98%	0.80	-13.71%	-	-
OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE (NET)	5.12%	-	-	-13.79%	-	-
BLOOMBERG IG CORPORATE INDEX	2.93%	6.92%	0.22	-20.46%	0.69	-
BLOOMBERG HY CORPORATE INDEX	5.04%	7.58%	0.47	-14.74%	-	0.61

FIGURE 6.1: APPENDIX: TRAILING REURNS

TRAILING RETURNS				
SUMMARY	1-YEAR	3-YEAR	5-YEAR	10-YEAR
INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE (GROSS)	13.93%	3.65%	3.98%	4.18%
INVESTMENT GRADE SECURITIZED CREDIT COMPOSITE (NET)	13.37%	3.21%	3.59%	3.83%
OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE (GROSS)	18.67%	6.22%	5.31%	5.64%
OPPORTUNISTIC SECURITIZED CREDIT COMPOSITE (NET)	18.08%	5.70%	4.78%	5.12%
ICE BOFAML ABS & CMBS INDEX	9.91%	1.13%	1.81%	2.37%

**Benchmark for the Loomis Sayles Investment Grade Securitized and Opportunistic Securitized Credit Composites is the ICE BofAML ABS & CMBS Index. Bloomberg Corporate Indicies are shown for informational purposes only.*

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Disclosure

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Any investment that has the possibility for profits also has the possibility of losses, including the loss of principal.

Market conditions are extremely fluid and change frequently.

Past performance is no guarantee of, and not necessarily indicative of, future results.

Indices are unmanaged and do not incur fees. It is not possible to invest directly in an index.

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