MBS Mantra MBS High Income/Absolute Return Strategy Oct 2018 returns: +0.1% net, +0.2% Gross, +2.09% YTD

Hello. Please find attached the October 2018 Fact Sheet for our flagship MBS High Income/Absolute Return Strategy. This can be accessed from our website as well.

Our return for the month was positive, unlike the returns of all of our benchmarks, and outperformed them all by 0.7% to 7%! We are also outperforming all our bond benchmarks YTD, including outperforming the AGG by +4.5% net YTD and +5.9% gross YTD.

Our combined portfolio cashflow in September was within our expected range at ~1.7% of portfolio basis. Our aggregated portfolio Income also performed within expectations. The stability of the Income from cashflow received mitigates the volatility in the pricing of MBS, resulting in uncorrelated returns.

I was in Napa for the Opal Family Office and Private Wealth Management Forum West at the end of October to participate on the 'Fixed Income in a Rising Rate Environment' panel, where I described our MBS High Income Strategy. Our strategy is uniquely suited for such an environment, as our High Income MBS portfolios generate a significant amount of cashflow, inherently keeping portfolio duration short, that is reinvested into more MBS with high income, resulting in returns that are dominated by the compounding of income over time, that should increase in a rising rate environment. This return profile is unlike that of most asset classes, including other Fixed Income Assets (including real estate), where price changes have the greatest impact on returns, and high returns and income require leverage. Since we are not constantly trading to manipulate portfolio duration, I suspect that our strategy should also have a lower tax impact than other fixed income strategies (I am not a tax expert, and cannot give tax advice – please discuss this with your accountant). We believe that our strategy is an all-weather strategy that maximizes risk-adjusted returns, and is the correct way to invest in bonds.

We purchased 11 unique bonds in in the first week of October, but stopped investing and reinvesting as volatility picked up in the markets, hoping to encounter knee-jerk selling and to purchase bonds cheaper. No such luck – the legacy bonds that we like appear to have gone up in price in the market, with FINRA TRACE reported prices on some matchers showing trades at prices higher than our purchase prices, in spite of the pricing service marks still being lower than our costs.

As we have been saying for many years to potential investors, the marginal buyers in bonds are the leveraged funds and leveragable funds (ETFs), that have driven down yields and spreads on new issue fixed income bonds (that are leveragable). As funding costs rise, and such funds delever, we expect yields on such leveragable bonds to widen. Legacy MBS typically are not leveragable, due to size and ratings, and their yields on average reflect their fundamental value and possibly a liquidity discount, without being artificially rich. They should not be significantly impacted by deleveraging, as they are typically held by real money cash investors that do not need to sell. Our opinions about market structure appear to have been corroborated in October. With deleveraging, we expect the yield spread between new bonds and legacy bonds to converge, with the widening occurring on the new-bond side.

We did not sell any bonds in October, but did have 2 small positions 'called', resulting in small losses and offsetting some of the income for those accounts.

We welcome your questions and comments.

Regards, Samir

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