



March 2019 - MBS Mantra MBS High Income/Absolute Return Strategy returns:

- **Aggregated SMAs:** +1.72% Net, +1.80% Gross; 2019 YTD: +2.72% Net
- **Founder's Portfolio:** 1.94% Net, +2.02% Gross; 2019 YTD: +1.98% Net

- Feb 2019 Income - Aggregated SMAs: @ recent marks: 0.86%; Annualized: 10.8%

Hello.

The average income rates for March remain in our target ranges, with some bonds outperforming and others underperforming, as is typical, highlighting the need for diversification and position sizing. The pricing services delivered some positive performance as well, marking up a number of our bonds, resulting in monthly total returns greater than the 0.86% Income for the month.

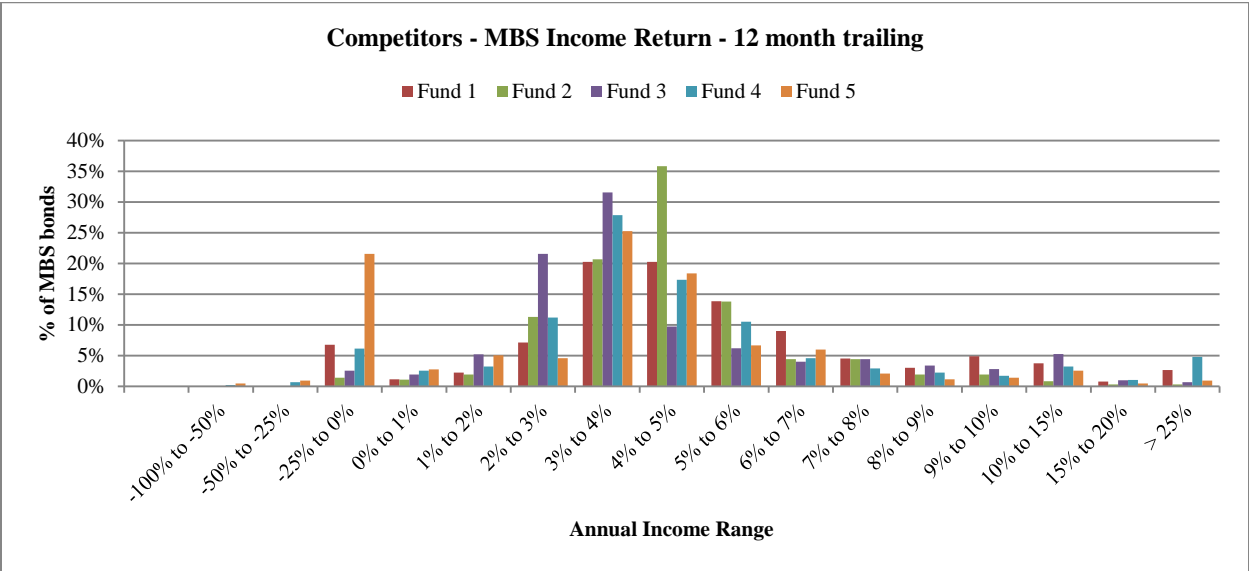
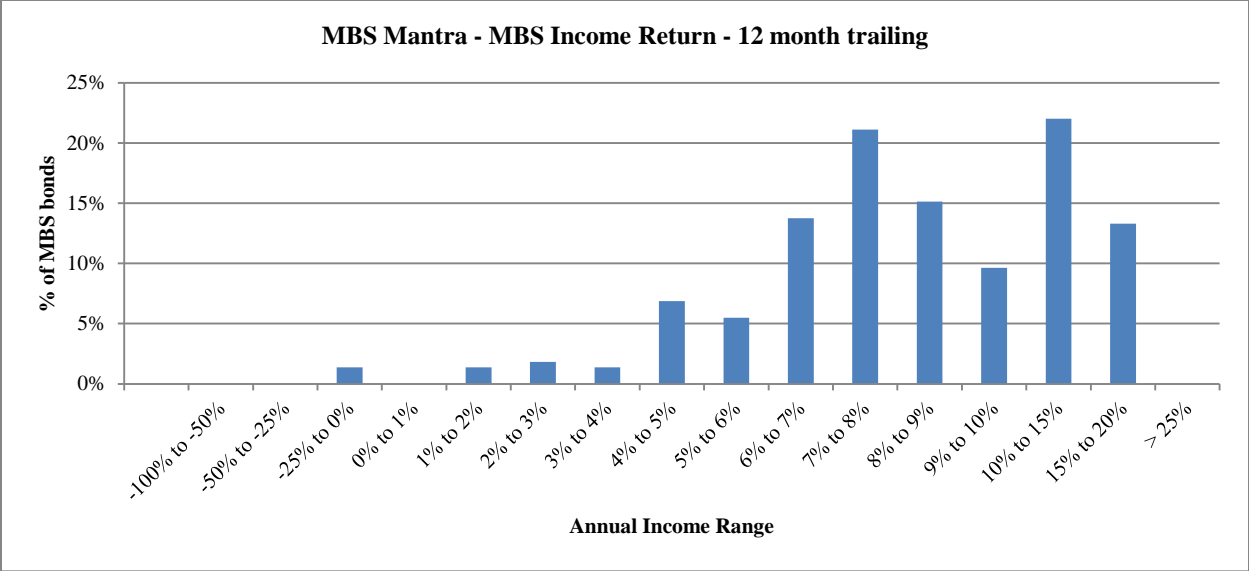
Competitor Income Analysis

This month, we have conducted, and share some competitor analysis. This is part of our regular routine, as we track what other managers are doing – we are not averse to finding new sources of Alpha or identifying risk from market activity.

As you know, we manage MBS in separate accounts, with a unique fee structure. Our unconventional structure has been created from first principles, with the goal of addressing flaws in the market structure and improving fairness to client investors. We manage with the unique insight that MBS are variable income securities and produce a wide distribution of income that is available in the market.

Our competitors are conventional structured-products/MBS hedge funds and other fixed income funds that investors seek out for 'Income' or 'Total/Absolute Return'. Due to the private nature of hedge funds, we do not have access to their portfolios. Some hedge funds managers however do have public funds that likely have similar holdings as their hedge funds. Some traditional 'Income' or 'Total Return' funds also have significant Non-Agency MBS and Asset Backed holdings. We have selected a few such public funds for analysis. Most of the managers are either friends or former clients, and for that reason, I am not going to identify the funds by name.

The following graphs summarize the analysis and show the distribution of trailing 1-year trailing Income for the bonds in MBS Mantra's portfolio as well as in the fund portfolios of five competitors. Each column (and Y axis) shows the number of bonds in each income bucket, as a percentage of the total bonds in the portfolio. This is not weighted by position size, to demonstrate the success of security selection for Income.



In previous newsletters, we have shown the [distribution of Income in the Non-Agency MBS market](#). Most of the competitor funds replicate the market distribution.

We use data about portfolio holdings from Bloomberg – some are from Dec 2018, and some are from Mar 2019. To compute the data for the graphs above, we made a number of adjustments to the portfolios. All non-MBS (cash, corporate bonds, US Treasuries, money market funds, currency futures, etc.) are removed. Agency CMOs and MBS pools have relatively defined low Income levels ~ 2% to 3.5%, and we have removed those. The analysis is not perfect – to compute Income we need a price estimate for each of the holdings and we attempt to collect these from multiple sources that might be different from the marks used by the funds. Bloomberg does not price many of the bonds, and in many cases the prices implied from ‘market value’ of the holdings do not make sense (eg Interest Only bonds at \$100). We therefore remove all IOs from the analysis (including from our portfolios), and only analyze the subset of each fund’s holdings where there is an estimate of price. We also do not know purchase dates for each position, and compute 12 month (annualized to compensate for when a bond has not existed for 12 months) trailing cashflows and income for each bond.

The next table summarizes the estimated income and cashflow characteristics of each portfolio. These averages are weighted by the investment in each bond over a trailing 12 month period.

	12mo Weighted Avg Income	Cashflow	Principal	Interest	Losses	Avg Coupon
MBSM Agg Ports	10.1%	23.1%	17.1%	6.0%	1.1%	4.9%
Fund 1	5.6%	8.9%	4.9%	4.0%	0.6%	5.7%
Fund 2	4.3%	9.9%	6.5%	3.4%	0.3%	4.4%
Fund 3	4.3%	16.0%	12.6%	3.4%	0.5%	3.9%
Fund 4	3.4%	15.8%	11.8%	4.0%	1.9%	4.0%
Fund 5	2.1%	4.7%	0.7%	3.9%	5.4%	3.7%

The table shows how we generate higher income than our competitors - we identify securities that generate a significant amount of cashflow and principal, and keep the ratio of losses to principal returned low. This also keeps our effective duration low.

We also have a significant position in IOs, that is not reflected here, and we avoid subprime and leveraged credit bonds like Mezz and Subs, that our competitors are drawn to for 'yield'.

	Total AUM \$mm	MBS \$mm	% port analyzed	# MBS	% Mezz	% Subs
MBSM Agg Ports	\$ 7.60	\$ 5.46	71.9%	252	0.0%	0.8%
Fund 1	\$ 1,181.24	\$ 1,129.00	95.6%	272	21.0%	34.8%
Fund 2	\$ 1,999.14	\$ 1,596.24	79.8%	369	23.1%	35.8%
Fund 3	\$ 118,368.80	\$ 22,476.41	19.0%	2,823	12.0%	1.2%
Fund 4	\$ 717.67	\$ 553.58	77.1%	589	50.1%	15.1%
Fund 5	\$ 2,616.95	\$ 2,312.12	88.4%	436	85.5%	9.5%

If you have a specific fund or portfolio you would like us to analyze, we would be happy to do so.

T-Leaf Reading

Thank you for the comments about last month's [T-Leaf Reading](#) white paper. Based on reader requests, I have created a new 'Predictions' section on our website, in the right column of the 'Viewpoints' tab, where I will periodically post our interpretation of market movements using the MBS Mantra Market-Macro Framework.

<http://mbsmantrallc.com/viewpoints.shtml>

The new buzzword in the market and in the news is '*Japanification*', with regard to low growth and low inflation in western economies - both Europe and US. I will send out a white paper on this topic during the month or in next month's newsletter.

Travel

I will be in Dallas, and possibly Austin this coming week (April 10-12), if you would like to meet.

We welcome your questions and comments.

Regards, Samir

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