MBS Mantra, LLC

Dear Investor

I am reaching out to provide you with an update on the performance of our portfolio and to share some market information.

**The last three days of last week (3/18/2020 to 3/20/2020) have been amongst the most volatile in Bond Market history.** In three days, we saw declines in prices that would normally take months of grinding down to accomplish, such as between 2007 and 2009. These violent moves resulted in a massive race for cash, and any asset class that could be sold was sold by many, often at a steep discount. US T-Bills are currently offered at negative yields!

**MBS aggregated portfolios were down -10.8% in March through Friday 23th, and -8.4% YTD. We appear to have outperformed many MBS and Corporate/High Yield bond funds, as well as most equities, over the past week, MTD and YTD, most of which are down between -12% and -81%.** The table at the end of this document shows these returns as well as recent daily returns.

**The key to this has been our unique High Income MBS strategy, which has allowed us to generate attractive Income and returns without resorting to either explicit leverage to boost returns, or owning subordinated bonds with credit leverage, unlike most MBS funds.**

**Numerous news outlets have blamed the breakdown of "Risk-Parity" strategies for the volatility and declines**, resulting in massive selling in both equities and bonds that overwhelmed the ability of dealer balance-sheets to absorb the sales. Fixed Income as a volatility reducer and hedge for equities broke down last week.

**Both US Treasuries and S&P Equity futures, normally the two most liquid assets, showed terrible liquidity as a result, leaving other asset classes including MBS hanging, begging for bids that did not materialize.** Most bid lists over the last week did not get many bids. The few bonds that traded were at much lower prices, with everything else being marked down by the pricing services. Any fund or product with explicit leverage, such as REITs, or levered Credit exposure, such as High Yield bonds and levered MBS Credit (subordinate and mezz bonds), took massive -50+% dives and many got margin calls. Large bond ETFs, like the AGG, ended up at significant discounts to NAV, as investors sold and shorted ETFs to sell the risk of the bonds they could not sell. (See "AGG Equity NAV <GO>" on Bloomberg).

**Over the weekend, there were multiple liquidation bid lists for MBS and CMBS.** One $4B mutual fund, AlphaCentric's IOFIX, without financial leverage but with over 90% in levered MBS Credit (much of it subprime, typical of holdings of many MBS funds and hedge funds), had redemptions and tried to sell over $1B in bonds. Two "brand-name" MBS REITs from large managers also got margin calls and attempted to sell bonds over the weekend. There will be more – most REITs are in freefall. There is also talk of the CMBS market having collapsed, with one large well known CMBS REIT investor begging for a bailout. (MBS sales on weekends surprised many of the members of a Macro chat group I belong to. This is nothing new – during times of stress, we've had bond sales on weekends since the early 1990s. During the 2007-2010 financial Crisis, when I ran the desk at MF Global, it was a 24/7/365 job for 2.5 years. During that period, for example, I provided liquidity to a client in China, who represented the portfolio of a large(st) Chinese bank, usually at 3am EST, and on weekends, with regularity, with very large LA based money managers who were buying, also awake on the other line.)

**Even though our portfolios have been marked down due to overall illiquidity in the market, our portfolios are very different from the portfolios of the MBS firms with the extreme drawdowns. We have actively avoided the types of credit levered bonds that will be very exposed to a recession, and also shunned financial leverage to boost returns. In the near term, we continue to expect our portfolios to continue to generate attractive income.**

Our bonds are of predominantly of two types: discount Non-Agency MBS with Alt-A borrowers from the 2005-2007 vintages, and Agency MBS derivatives with prepayment protection of some kind, either from low loan balances or high LTVs. With rates having declined and the MBS Refinancing Index at a high, our discount Non-Agency MBS should benefit from faster prepayments, as many of the borrowers have significant equity in their homes. The Agency MBS derivatives should, on the other hand, exhibit slower prepayments, as the prepayments on many of the Agency MBS we own derive from defaults. With many banks agreeing to President Trump's proposal to withhold foreclosure actions, we expect defaults and thus prepayments to decline for our agency MBS derivatives, increasing income. Return from Income will defray some of our paper losses for the month. We will see how these expectations for our Non-Agency MBS pan out later this week, when cashflows arrive on the 25th. Of course, prices and marks could decline further, too.

**Today, March 23rd, the Fed announced QE Infinity**! The only asset class that responded was Investment Grade corporates (the Fed will buy them), and to a smaller extent Agency MBS. Banks continued to collapse.

**Looking forward, I am expecting further declines in all markets, in spite of the heroic and often counter-productive efforts by the Fed and other central banks. Spooked investors will continue to sell, resulting in further deleveraging of assets and funds. Illiquidity will continue into April, and attempting to sell MBS is a mistake in this environment, unless you are forced to sell (REITS and hedge funds will continue to get margin calls), are willing to take a serious discount, or are expect deteriorating credit performance for your credit-levered bonds.**

**It is also too early to be bottom fishing.** Many hedge funds have monthly or quarterly redemption notice periods – March 31st is both month end and quarter end. Retail investors will get their brokerage statements for March in the first week of April. I expect further selling from both institutional investors and retail investors in April. I would not be surprised if this spirals out of control, as it did in late 2008. Just like in 2007-2010, there is not enough balance sheet and capital available to hold these assets. As leverage vanishes, prices need to decline to meet the smaller balance sheet and available capital. See my first few Crisis Notes from 2007 and 2008 for the parallels.
https://mbsmantrallc.com/analysis.shtml

The blame for the lack of liquidity that exists in the market can be party attributed to the misguided and flawed Dodd-Frank Wall Street Reform and Consumer Protection Act, which crippled the ability of even well capitalized banks to provide liquidity through market making, as it would be viewed as 'prop-trading', which Dodd-Frank effectively outlawed. Banks now reach out to their customers for bids, which does not work in times of deleveraging, as the majority of their clients are sellers. This has created massive risk for the consumer's portfolios, instead of protecting him or her. **We are currently in a buyer's market.**

**However, the fundamental problem remains leverage.** Central banks continue to use their balance sheets to re-leverage economies after the every crisis . Every time a central bank responds to a crisis by providing the balance sheet to replace lost leverage, facilitating re-leveraging, the next crisis becomes larger. While this can lead to long periods of "good times", when they end, the crash is mighty! Our current crisis is a result of the cumulative central bank leverage growth in response to LTCM (1997-98), 2002, GFC (2007-2011), and Taper Tantrum (2013), plus the ECB (2012-present) and Japan's (1998-present) growing QE and balance sheets, with each subsequent crisis requiring an even larger bailout and debt and leverage creation.

This central bank derived money supply has supported asset inflation in every asset class that can be leveraged, most notably equities, corporate bonds, and real estate, creating expectation of bailouts (the Fed "Put") and impunity in risk taking. Just like in 2007, a deleveraging has started, triggered by the rate cuts of our central bank in response to COVID-19. Powell, just like his predecessors, continues the tradition of not understanding how interest rate policies work in a world of free capital movements, and how they impact asset prices and leverage. I can send you a reading list if you would like to understand more about this issue.

**As asset prices spiral out of control due to deleveraging, the stage will be set for the greatest money maker of this decade, as it was post GFC - distressed MBS investing. We are adding a Distressed MBS Investing Strategy to our offerings for clients. I have significant experience trading and investing during Crises, and in the identification of deep value in MBS, having traded billions of MBS during the GFC and in prior crises.**

Below is the table of some of the returns over the past week and also from the start of the year.

| Ticker | Name | Strategy/Type | 12/31/19<br>02/29/20 | 02/29/20<br>03/23/20 | 12/31/19<br>03/23/20 | 02/29/20<br>03/16/20 | 03/16/20<br>03/17/20 | 03/17/20<br>03/18/20 | 03/18/20<br>03/19/20 | 03/19/20<br>03/20/20 | 03/20/20<br>03/23/20 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | MBS Mantra Aggregated SMAs | MBS High Income | 2.7% | -10.8% | -8.4% | -2.5% | -0.5% | -2.5% | -1.7% | -2.6% | -1.6% |
| SPY | SPDR S&P 500 ETF TRUST | Equity Benchmark | -8.0% | -24.3% | -30.3% | -19.0% | 5.4% | -5.1% | 0.2% | -4.3% | -2.6% |
| AGG | ISHARES 3-7 YEAR TREASURY BO | Bond Benchmark | 3.8% | 2.1% | 6.0% | 1.8% | -1.1% | -0.6% | 0.2% | 1.2% | 0.7% |
| IEI | ISHARES 3-7 YEAR TREASURY BO | Bond Benchmark | 3.8% | 2.1% | 6.0% | 1.8% | -1.1% | -0.6% | 0.2% | 1.2% | 0.7% |
| TLT | ISHARES 20+ YEAR TREASURY BO | Bond Benchmark | 14.8% | 7.0% | 22.9% | 5.7% | -6.7% | -5.6% | 2.7% | 7.5% | 4.1% |
| MBB | ISHARES MBS ETF | Bond Benchmark | 1.6% | -0.5% | 1.0% | -0.2% | -0.4% | -0.7% | -1.2% | 1.2% | 0.7% |
| LQD | ISHARES IBOXX INVESTMENT GRA | Bond Benchmark | 3.6% | -13.0% | -9.9% | -8.0% | -4.1% | -5.0% | -4.9% | 1.6% | 7.4% |
| HYG | ISHARES IBOXX HIGH YLD CORP | Bond Benchmark | -1.7% | -19.9% | -21.3% | -11.7% | 0.9% | -4.4% | -2.2% | -2.2% | -1.6% |
| MITT | AG MORTGAGE INVESTMENT TRUST | MBS REIT | -2.9% | -81.2% | -81.8% | -45.6% | -16.8% | -51.8% | 45.3% | -4.0% | -38.4% |
| RWT | REDWOOD TRUST INC | MBS REIT | 3.3% | -74.5% | -73.7% | -44.2% | -22.1% | -9.8% | -1.5% | -24.6% | -12.6% |
| CLNY | COLONY CAPITAL INC | CMBS REIT | -16.6% | -64.4% | -70.3% | -50.3% | -1.5% | -24.2% | 0.0% | 3.4% | -7.2% |
| EFC | ELLINGTON FINANCIAL INC | MBS REIT | -8.3% | -67.5% | -70.2% | -44.8% | -20.0% | -24.9% | 19.2% | 4.1% | -21.0% |
| BDKAX | BRADDOCK MULTI-STRAT INC-A | MBS Fund | 1.4% | -67.7% | -67.2% | -3.4% | -2.4% | -2.6% | -14.6% | -33.8% | -37.7% |
| NRZ | NEW RESIDENTIAL INVESTMENT | MBS REIT | -3.4% | -66.0% | -67.2% | -32.1% | -6.7% | -41.8% | 17.8% | 3.9% | -24.5% |
| WMC | WESTERN ASSET MORTGAGE CAPIT | MBS REIT | -3.0% | -65.0% | -66.0% | -45.5% | -9.7% | -33.9% | 19.3% | -4.9% | -5.1% |
| MFA | MFA FINANCIAL INC | MBS REIT | -5.5% | -62.7% | -64.7% | -29.5% | -16.7% | -14.1% | 0.0% | -1.4% | -25.0% |
| CIM | CHIMERA INVESTMENT CORP | MBS REIT | -4.4% | -56.5% | -58.5% | -23.4% | -18.9% | -18.3% | -5.1% | 0.8% | -10.6% |
| NLY | ANNALY CAPITAL MANAGEMENT IN | MBS REIT | -5.9% | -46.4% | -49.6% | -25.3% | 0.6% | -20.1% | -1.3% | 1.1% | -10.5% |
| PRRSX | PIMCO REALESTATEREALRET-I | Real Estate | -6.2% | -38.0% | -41.8% | -28.4% | 4.5% | -10.7% | -0.7% | -3.6% | -3.0% |
| IOFIX | ALPHACENTRIC INCOME OPP-I | MBS Fund | 2.9% | -42.2% | -40.5% | -5.1% | -1.9% | -2.7% | -10.7% | -17.2% | -13.7% |
| AGNC | AGNC INVESTMENT CORP | MBS REIT | -1.9% | -38.7% | -39.9% | -30.7% | 0.0% | -17.6% | -3.6% | 4.8% | 6.2% |
| VNQ | VANGUARD REAL ESTATE ETF | Real Estate | -5.9% | -34.3% | -38.2% | -24.6% | 5.8% | -9.5% | 0.4% | -5.0% | -4.6% |
| URTLX | JPMORGAN REALTY INCOME-L | Real Estate | -6.0% | -33.7% | -37.7% | -23.8% | 5.2% | -10.1% | -0.6% | -2.9% | -4.7% |
| DMO | WESTERN ASSET MORTGAGE OPPOR | MBS Fund | -1.9% | -32.6% | -33.9% | -12.6% | -4.0% | -25.0% | 15.3% | 4.7% | -11.2% |
| DPFNX | DEER PARK TTL RTRN CRED-I | MBS Fund | 2.0% | -19.2% | -17.6% | -3.1% | -0.6% | -2.0% | -6.2% | -7.7% | -1.3% |
| SEMMX | SEMPER MBS TOTAL RETURN-INST | MBS Fund | 1.8% | -16.2% | -14.6% | -3.0% | -1.4% | -1.7% | -5.3% | -4.4% | -1.4% |
| ANGLX | ANGEL OAK MULTI-STR INC-A | MBS Fund | 1.1% | -13.9% | -13.0% | -1.2% | -0.7% | -1.8% | -4.4% | -3.0% | -3.6% |
| PIMIX | PIMCO INCOME FUND-INS | High MBS % Fund | 0.3% | -12.4% | -12.1% | -5.9% | -1.1% | -2.3% | -2.5% | -0.7% | -0.6% |
| VSCFX | VOYA SECURITIZED CREDIT-P | MBS Fund | 1.9% | -13.8% | -12.1% | -4.0% | -1.2% | -1.3% | -4.7% | -2.8% | -0.6% |
| BA | BOEING CO/THE | Equities | -15.0% | -61.6% | -67.4% | -52.9% | -4.2% | -17.9% | -4.1% | -2.8% | 11.2% |
| GE | GENERAL ELECTRIC CO | Equities | -2.5% | -43.8% | -45.2% | -38.7% | 6.3% | -6.8% | -1.8% | 0.6% | -6.3% |
| BRK/A | BERKSHIRE HATHAWAY INC-CL A | Equities | -9.0% | -22.4% | -29.3% | -13.3% | 4.6% | -8.5% | 2.1% | -1.7% | -6.7% |

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| AAPL | APPLE INC | Equities | -6.7% | -17.9% | -23.4% | -11.4% | 4.4% | -2.4% | -0.8% | -6.3% | -2.1% |
| MSFT | MICROSOFT CORP | Equities | 3.0% | -16.1% | -13.5% | -16.4% | 8.2% | -4.2% | 1.6% | -3.8% | -1.0% |
| AMZN | AMAZON.COM INC | Equities | 1.9% | 1.0% | 3.0% | -10.3% | 7.0% | 1.2% | 2.8% | -1.9% | 3.1% |
| QVPIX | AQR VOLATILITY RSK PREM-I | Equity Quant | -6.5% | -16.0% | -21.4% | -13.1% | 2.5% | -4.0% | 0.7% | -1.4% | -1.0% |
| QRHIX | AQR RISK PARITY II HV-I | Equity Quant | -3.7% | -13.7% | -16.9% | -11.2% | -2.3% | -4.7% | 0.9% | 2.0% | 1.4% |
| AQRIX | AQR MULTI-ASSET FUND-I | Equity Quant | -4.2% | -8.4% | -12.3% | -8.8% | -0.1% | -2.1% | 0.4% | 0.8% | 1.4% |
| QRMIX | AQR RISK PARITY II MV-I | Equity Quant | -2.4% | -9.0% | -11.2% | -7.4% | -1.5% | -3.1% | 0.7% | 1.4% | 0.9% |
| C | CITIGROUP INC | Financial | -20.0% | -44.2% | -55.4% | -35.1% | -2.3% | -9.5% | 8.8% | -4.0% | -7.0% |
| WFC | WELLS FARGO & CO | Financial | -23.3% | -38.2% | -52.6% | -35.1% | 11.8% | -5.1% | 0.6% | -6.3% | -4.7% |
| BAC | BANK OF AMERICA CORP | Financial | -19.1% | -36.1% | -48.3% | -27.8% | 7.5% | -5.4% | 2.0% | -7.2% | -8.1% |
| MS | MORGAN STANLEY | Financial | -11.3% | -38.2% | -45.2% | -29.7% | 6.8% | -9.0% | 0.6% | -4.0% | -6.3% |
| GS | GOLDMAN SACHS GROUP INC | Financial | -12.1% | -32.8% | -40.9% | -23.0% | 2.6% | -11.8% | 6.8% | -7.4% | -2.5% |
| BLK | BLACKROCK INC | Financial | -7.9% | -28.8% | -34.4% | -22.3% | 8.3% | -3.5% | 6.4% | -10.7% | -7.7% |
| APO | APOLLO GLOBAL MANAGEMENT INC | Private Equity | -11.0% | -42.9% | -49.2% | -25.2% | 0.2% | -3.8% | -0.4% | -10.2% | -11.3% |
| CG | CARLYLE GROUP INC/THE | Private Equity | -10.6% | -36.0% | -42.8% | -34.6% | -1.6% | -6.8% | 17.0% | -3.0% | -6.1% |
| KKR | KKR & CO INC -A | Private Equity | -1.6% | -35.3% | -36.3% | -23.5% | -0.8% | -10.0% | 5.4% | -7.4% | -3.0% |
| BX | BLACKSTONE GROUP INC/THE-A | Private Equity | -2.8% | -33.1% | -34.9% | -24.7% | 2.2% | -1.6% | 3.0% | -10.3% | -4.3% |

**Regards, Samir Shah**

**sshah@mbsmantrallc.com**

**3/23/2020**

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