May 2020 – MBS Mantra MBS High Income/Absolute Return Strategy returns:

	% Net Return	% Gross Return	2020 YTD Net	2020 YTD Gross	Trailing 1 year Net
Aggregated SMAs	**+2.35%**	**+2.42%**	**-4.5%**	**-4.1%**	**-3.2%**
Founder's Portfolio	**+2.08%**	**+2.16%**	**-3.3%**	**-2.9%**	**-1.0%**

May 2020 Income: +1.62%; Annualized: ~22.8% (Aggregated SMAs @ recent marks)
May 2020 Cashflow % of invested value: 2.9% (~ 35% annualized rate)
May 2020 Loss rate: -0.3%

Hello.

Our Aggregated SMA's portfolio had a total return of 2.35% in May 2020.

The Income performance was solid, returning 1.62% in Income, 22.8% annualized, from 2.9% in cashflow for the month, with only 0.3% in losses. Income was higher than in April, with total return augmented by positive price change of 0.9% on average.

As we had hoped, our discount Non-Agency bonds benefited from refinancing prepayments due to lower rates, while our premium Agency derivatives with more impaired borrowers did not get fast prepayments. It does not appear that forbearance is negatively impacting our portfolio, and there is some anecdotal evidence that people might have taken out forbearance as insurance, but have not used it or do not intend to use it.

While I continue to monitor the forbearance risk, we will resume reinvesting our cashflows into seasoned MBS that have demonstrated their resiliency.

We are finally beginning to see some CMBS subordinated bonds trade at distressed levels. We've analyzed a few of them, but do not think they are cheap enough yet, nor is there enough clarity about the business model post-COVID to make the bets implied by the current prices. In the meantime, private equity funds are diving into the CMBS space with direct investments/bailouts of CMBS REITs, which is preventing supply from flooding the market.

There were some interesting articles in the WSJ at the end of May regarding the CLO market.

https://www.wsj.com/articles/japanese-farmers-foray-into-risky-u-s-debt-leaves-3-7-billion-hole-11590582336

https://www.wsj.com/articles/japan-warns-its-banks-about-risky-u-s-debt-11591174886

"Japan's banks collectively hold nearly 20% of the $750 billion global market for corporate debt packaged into securities called collateralized loan obligations".

"More than half the Japanese portion belongs to a single bank, Norinchukin Bank, which manages assets on behalf of farming and fishing cooperatives." Mitsubishi UJF and Japan Post Bank are the second and third largest Japanese holders of US CLOs.

I believe this has huge implications for the private equity markets as well as for corporate merger activity going forward. CLOs are to financial markets what Samurai bonds were in the early 2000s – they provided the capital and leverage to boost US money supply and the prices of financial assets. The days of covenant- light loans may be behind us if the largest buyer has exited the market. However, we've said this before, and bond covenants have gotten worse – central bank 'easing' and negative rates always leads to investor desperation in carry trades, so maybe another bank will step up.

As always, we welcome your questions and comments. Please stay safe.

Regards, Samir Shah

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