



August 2021 – MBS Mantra MBS High Income/Absolute Return Strategy returns:

	% Net Return	% Gross Return	Since 3/31/2020 Net %	2021 YTD Net %	2021 YTD Gross %	Trailing 1 year Net %
Aggregated SMAs	+0.75%	+0.83%	+21.7%	+6.9%	+7.5%	+10.6%
Founder's Portfolio	+0.61%	+0.69%	+22.2%	+7.3%	+7.9%	+11.4%

Annualized 2021 net returns to date: 10.54%

Annualized Income since 3/31/2020: 13.9%

August 2021 Income: +1.21%; Annualized: ~15.5% (Aggregated SMAs @ recent marks)

August 2021 Cashflow % of invested value: +2.3% (~28% annualized rate)

August 2021 Loss rate: -0.08%

Hello.

Another positive month, making it 17 in a row since March 2020. Cashflows, and Income, were slightly lower than in previous months at 1.21%, but still high when compared to prior years. Marks were down slightly on average reflecting volatility in the bond markets, resulting in a +0.75% average total return.

Once again, our High Income (+1.21% in Aug, +16% annualized) allowed us to significantly outperform our fixed income benchmarks in spite of slightly lower marks (B-AGG -0.20%; B-MBS -0.16%; B-HY +0.51%).

YTD, at +7.3% net return, 10.5% annualized, we are outperforming High Yield as well the MBS and AGG benchmarks (B-HY +4.5%, B-AGG -0.8%, B-MBS -0.3%). **Since March 2020's deleveraging selloff our net return has been 21.7%.** By comparison, over the same period, the B-AGG has returned 3.5% while B-MBS has returned 1.2%.

In our [Sep 2020 newsletter](#), where we had updated returns performance for various funds and benchmarks since April 2020, we stated that **'Fixed Income has run its course'**. This seems to be well validated, leaving our unique MBS investment strategy as one of the few still standing in the bond markets, primarily as it is a Variable Income, and not a Fixed Income, strategy.

We will reiterate that we are NOT a Fixed Income strategy, as the returns comparisons above demonstrate. Our research has demonstrated that MBS is a Variable Income bond product, and we therefore focus on the 'right tail' of the MBS Income distribution, creating a unique High income strategy and product. Our current high Income allows us to overcome significant price declines and creates self-healing portfolios, as the breakeven prices of our

holdings continually decline monthly with realized MBS income. This allows us to reinvest and compound over long periods – a very old-school investing process.

While we are acutely aware of MBS credit and opportunities, unlike typical MBS Credit strategies that invest in low income/low yield bonds with leverage, we mostly invest in senior bonds and have very low loss rates with High Income, creating an unlevered portfolio with lower volatility that most other MBS and credit portfolios (see our [March 2019 newsletter](#) for a comparison to the credit risk of other MBS funds).

Adjusting Correlations, Beta, and Alpha

March 2020’s Risk-Parity-driven across-the-board deleveraging caused substantial drawdowns in almost every strategy and asset class, causing correlations to spike and overwhelm all fundamental correlations and betas from the normal price and return behavior of various strategies. With drawdowns in many cases greater than a year of returns, this jump in correlations dominated all long-term time series, making almost all historical correlations and betas to become meaningless for the purposes of portfolio construction and risk management.

MBS Mantra’s Correlations and Betas from 11/2014.

Note the changes in March 2020 that have persisted, primarily due to the magnitude of the March 2020 drawdowns that, in my opinion, have distorted the statistics.

MBSM Correlations to:

	Barc AGG	Barc MBS	Barc HY	S&P-500
Feb-20	35%	26%	8%	10%
Mar-20	27%	5%	63%	32%
Apr-20	30%	7%	65%	38%
Aug-21	30%	6%	63%	36%

MBSM Betas to:

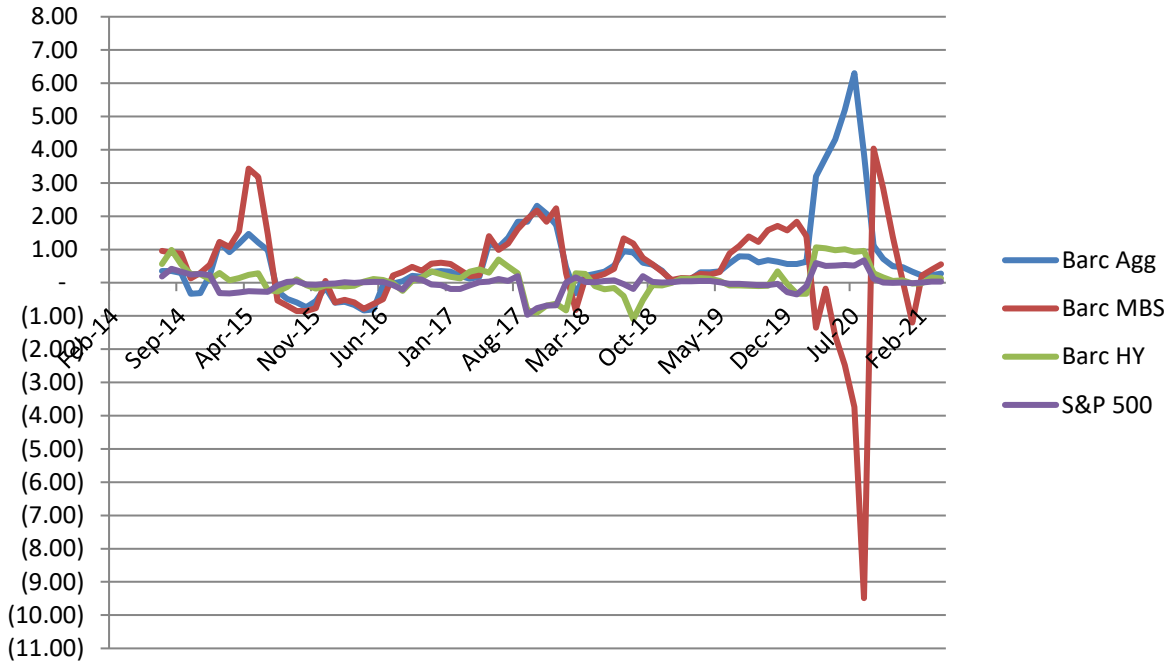
	Barc AGG	Barc MBS	Barc HY	S&P-500
Feb-20	0.37	0.42	0.05	(0.03)
Mar-20	0.56	0.16	0.57	0.16
Apr-20	0.63	0.23	0.59	0.18
Aug-21	0.57	0.20	0.54	0.16

This has also distorted other measurements of risk/reward such as Sharpe ratios, as standard deviations have also been impacted.

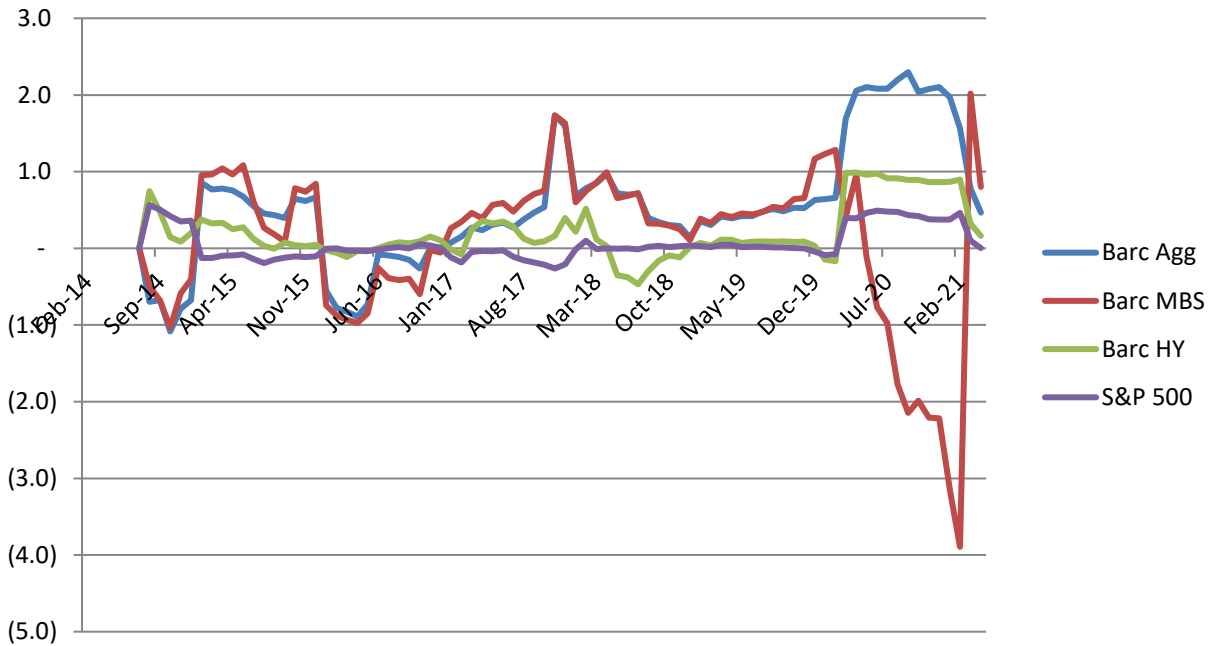
There are 2 ways to correct for this. We have added both computations to our Fact Sheet.

One is to use rolling short term betas (3-mo, 6-mo, 12-mo), and use them once the 3/2020 data point rolls out of the time series. We have been [using this method for many years](#) to assess the stability of our betas to benchmarks, and to determine if our strategy is hedgeable. Our 6-mo and 12-mo rolling Beta data is now back on track.

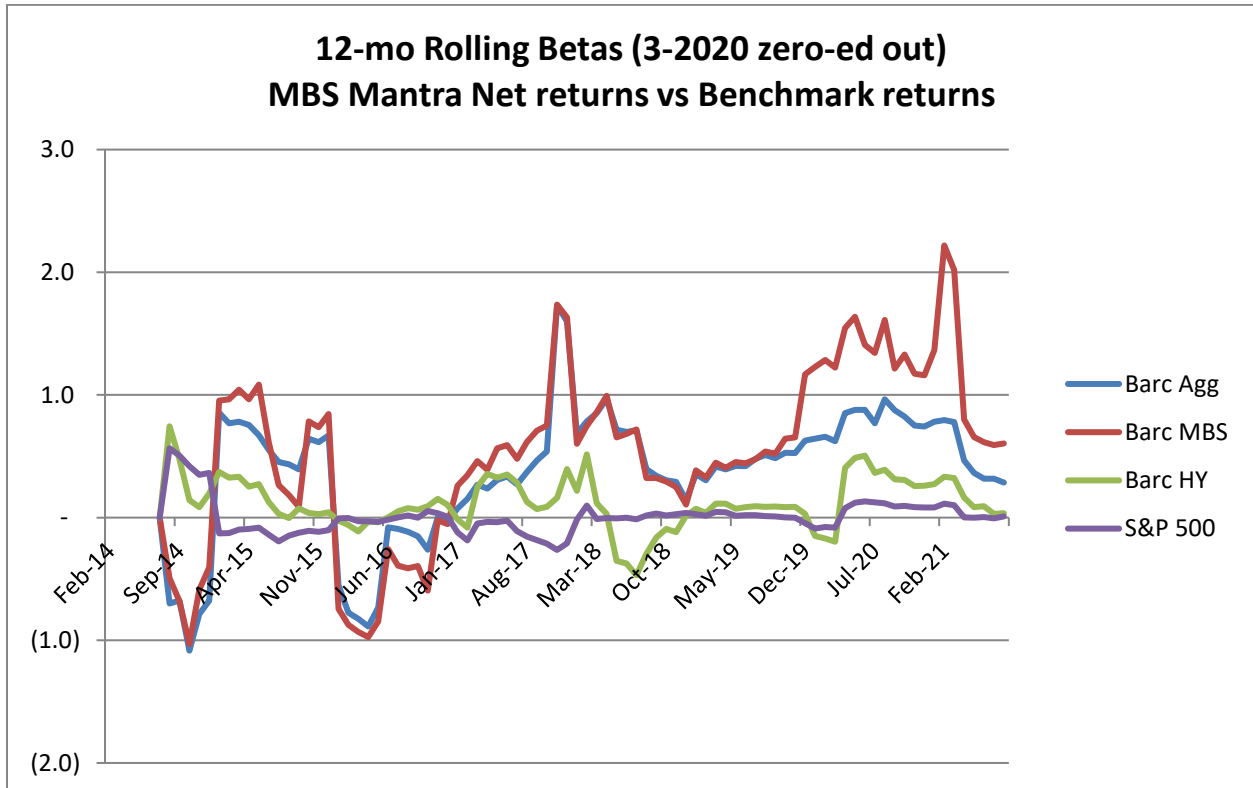
6-mo Rolling Betas MBS Mantra vs Benchmarks



12-mo Rolling Betas MBS Mantra Net returns vs Benchmark returns



Another method is to simply remove or zero out the 3/2020 returns from the data series. While most correlations and betas will have still changed and risen compared to pre-3/2020 computations, as most ‘boats rose’ due to the Fed’s cash-flooding of the markets, the numbers will be more “normal” and allow you to differentiate between strategies and permit more appropriate portfolio construction, weighting, and hedging with data based on recent returns.



Adjusted MBS Mantra Net Returns Betas and Correlations

		Barc Agg	Barc MBS	Barc HY	S&P 500
3/2020 RP deleted	Beta	0.42	0.46	0.15	0.03
	Correlation	16%	7%	6%	1%
12mo Rolling	Beta	0.29	0.60	0.04	0.01
	Correlation	55%	51%	9%	8%

Please stay safe, and wishing you good health.

Regards, Samir Shah

September 3, 2021

Samir Shah
President and CIO
MBS Mantra, LLC (a CT Registered Investment Advisor)
"Alpha Through Analysis"®

203-388-8356 P

203-273-0360 C

sshah@mbsmantrallc.com

<https://www.linkedin.com/in/samir-shah-6a9096a>

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