MBS
MBS Mantra, LLC

Dec 2022 – MBS Mantra MBS High Income/Absolute Return Strategy returns

	% Net Return	% Gross Return	2022 YTD Net %	2021 YTD Net %	Trailing 1 year Net %
Aggregated SMAs	**+1.22%**	**+1.29%**	**-3.8%**	**+10.0%**	**-3.8%**
Founder's Port	**+0.52%**	**+0.59%**	**-1.7%**	**+10.1%**	**-1.7%**
BB Barc Agg	-0.87%		-13.0%	-1.8%	-13.0%
BB Barc MBS	-0.40%		-11.7%	-1.0%	-11.7%
BB Barc HY	-0.62%		-11.2%	5.3%	-11.2%
S&P 500	-5.76%		-18.2%	28.7%	-18.2%

Dec 2022 MBS Income: +1.18%; Annualized: +15.0% (Aggregated SMAs @ month end marks)
Dec 2022 MBS Cashflow: +1.3% (~15.3% annualized rate)
Dec 2022 MBS Loss rate: -0.04%

Hello, and Happy New Year! Most mailboxes will by now have been inundated with Year End Reviews and Forward Looks at 2023. With that in mind, this newsletter will be short.

We ended the year demonstrating uncorrelated returns once again: our total return for Dec was up +1.2%, while all the other benchmark markets were down between -0.4% for MBS to -5.7% for the S&P500.

Our positive returns were driven by MBS Income of 1.2% (15% annualized), with some drag from cash. Our legacy High Income MBS bond prices were mostly unchanged on average for the month, with some up and some down, unlike the Fixed Income markets. Income was slightly higher than last month's MBS Income of +0.96%, and still higher than our historical target of 0.75% per month. Losses from credit, as usual, were negligible.

Year to date, this was our third highest outperformance over the MBS benchmark ETF ("MBB") since our "inception" in Nov 2014.

Cumulatively, since inception, we have outperformed MBB by 48.3%. Statistically, this has translated into annualized "Alpha" of 5.3% and a Beta of 0.37, with a 24% correlation.

	YTD MBSM	**YTD "MBB"**	**MBSM Outperformance**
2022	-3.8%	-11.7%	7.8%
2021	10.0%	-1.0%	11.0%
2020	2.0%	4.2%	-2.1%
2019	5.6%	6.4%	-0.9%
2018	3.1%	1.0%	2.2%
2017	7.5%	2.5%	5.0%
2016	8.0%	1.8%	6.3%
2015	11.6%	1.5%	10.2%

Our boilerplate: MBS is a Variable Income asset class and product, and not Fixed Income, as it is widely viewed and categorized. Unlike traditional managers that understand MBS as Fixed Income and do not differentiate between Low-Income and High-Income MBS, we systematically identify and harvest High-Income MBS to construct portfolios that generate total returns with low correlations to Fixed Income as well as with other assets. High Income MBS add to returns in periods with positive price changes, and buffer declines in periods where price changes are negative, creating positive Skewness compared to normally distributed returns that are largely driven by price changes. High Income MBS can be an Absolute Return component of a portfolio, or a diversifier. This is explained in detail in our white paper, The MBS Income Factor.

Risk in 2023

I put forth my views for 2023 in my October newsletter, in which I laid out the Distressed Opportunities for 2023. In short, the risk of a risky event, like Risk Parity ("RP") rebalancing in March 2020, is high. (I've been accumulating cash for the past few months.) If my expectations come true, there will be another opportunity for Distressed Investing in 2023, and this time I want to be ready.

Why do I expect riskiness in 2023? To me, it's about the Risk Parity Strategy rebalancing. I did a forensic analysis of the Role of Risk Parity in March 2020's drawdown events, in the March 2020 newsletter, and I am concerned about a similar rebalancing occurring again. Don't forget, Risk Parity is mostly automated and systematic.

The following table shows the returns for a generic RP strategy index (10% vol) and various asset classes that might be used by RP strategies. While I don't have access to the weightings used by specific RP firms, I suspect that the instability of returns and the greater than +-10% returns of these different asset classes in 2022 could lead to a RP rebalancing, upsetting markets.

Asset Class	Ticker	2018	2019	Jan20-Feb20	Mar20	Apr20-Dec20	2020	2021	2022
Risk Parity Index 10% vol	**SPRP10T**	-4.3%	22.8%	-3.3%	-10.7%	29.2%	11.5%	15.0%	-16.2%
US Large Cap Eq	**B500T**	-4.4%	31.8%	-7.8%	-12.2%	50.2%	21.6%	27.3%	-19.8%
US Bonds Agg	**AGG**	0.1%	8.5%	3.6%	-0.5%	4.2%	7.5%	-1.8%	-13.0%
7-10yr UST	**UST**	-1.1%	13.3%	12.9%	7.2%	-1.8%	18.8%	-7.8%	-30.2%
Dollar	**BBDXY**	3.1%	-0.9%	2.1%	3.1%	-10.2%	-5.4%	4.7%	6.2%
Yen	**FXY**	2.3%	0.4%	0.6%	0.3%	3.7%	4.6%	-10.9%	-12.8%
Oil	**USO**	-19.6%	32.6%	-26.2%	-55.4%	-2.0%	-67.8%	64.7%	29.0%
Commodities	**DBC**	-11.6%	11.8%	-14.7%	-17.3%	30.7%	-7.8%	41.4%	19.3%
Gold	**GLD**	-1.9%	17.9%	3.8%	-0.2%	20.5%	24.8%	-4.1%	-0.8%
Dev Markets	**VEA**	-14.8%	22.6%	-10.4%	-15.1%	44.4%	9.7%	11.7%	-15.4%
Emerging Mkts	**EEM**	-15.3%	18.2%	-9.7%	-15.8%	53.9%	17.0%	-3.6%	-20.6%

In March 2020, the rebalancing was caused by the massive swing in energy returns from 2019 to Feb 2020. This rebalancing (and subsequent bailout by the Fed) led to the recovery in the total return of the RP strategy from April to Dec 2020.

2022 has some very large drawdowns in most asset classes, resulting in a RP Strategy return that is negative in a large way (-16%), especially for a strategy that is meant to be stable. The anti-correlations between bonds, stocks and commodities have broken down, and therefore RP has not worked, similar to early 2020.

There should be a RP rebalancing coming. Will the result be like 2019 for stocks and bonds? Or like March 2020?

Regards, Samir Shah

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