MBS Mantra, LLC

Alpha Research & Management

November 2023 – MBS Mantra/ARAM Strategy Returns and newsletter

	% Net Return	**2023 YTD Net %**	**Trailing 1 year Net %**	2022 YTD Net %	2021 YTD Net %
MBSM Aggregated SMAs	**+1.73%**	**+9.0%**	**+10.3%**	-3.8%	+10.0%
ARAM AGG+ Alpha - ETFs – Baseline ModelPort20	**+2.31%**	**+9.4%**	**+8.7%**	-9.2%	-0.05%
BB Barc Agg	+4.59%	+1.9%	+1.0%	-13.0%	-1.8%
BB Barc MBS	+5.02%	+0.8%	+0.4%	-11.7%	-1.0%
BB Barc HY	+4.53%	+9.4%	+8.7%	-11.2%	5.3%
S&P 500	+9.13%	+20.7%	+13.7%	-18.2%	28.7%

"Plus Alpha" Systematic Strategies and Portfolios will be getting their own newsletter, in which I will be discussing Active Fixed Income Management and Fixed Income Market Structure, and the performance of additional Model Portfolios using our new Risk Algorithms. "Agg Plus Alpha" used to have its own newsletter, which I stopped writing in 2018; this will be a continuation and expansion of the product using our new Active Systematic Portfolio Construction technology. A collection of other Model Portfolio Fact Sheets is found here.

MBSM High Income Strategy:

Nov 2023 MBS Income: +1.00%; +12.0% annualized (Aggregated SMAs @ month end marks)
YTD 2023 MBS Income: +13.6%, 14.6% annualized (current portfolio, excluding bonds no longer in portfolio)
YTD 2023 Loss Rate: 0.36%

Nov 2023 MBS Cashflow: +1.2%. ~14% annualized (implying a short weighted average life/duration)
Nov 2023 MBS Loss rate: 0.08% (a negative loss rate is a gain from subsequent recoveries)

November's returns reflect the continuing turnaround in the bond markets, as expectations increase that Powell will cut rates numerous times next year. Both our strategies are in shorter duration bonds and ETFs, with all the longer duration benchmarks outperforming for November. **For the year, our steady risk-adjusted-return maximization MBS portfolio construction has outperformed our primary benchmarks by 7% to 8%!** The benchmarks finally broke into the black thanks to the recent rally.

Similarly, the Agg Plus Alpha portfolios have all outperformed benchmarks by similar amounts.

Regarding Inflation

I find it fascinating when the markets are startled when the expected happens.

Here is an update of the Real GDP/Deferred Demand model and explanation that I came up with in the Jan 2022 newsletter, which had an extensive discussion about the causes of the inflation. **The Foregone GDP Gap is now positive, so Deferred Demand has been satiated.**

Jay's Transition had been completed; it was time for inflation to decline.

This data was known in September. I had updated 2022 in the August newsletter.

	Actual Real GDP						
	2019	2020	2021	2022	2023 Q1	2023 Q2	2023 Q3
GDP Growth		-2.8	5.9	2.1	2.2	2.1	5.2
Non Annualized					0.55	0.525	1.3
GDP index	100.0	97.2	102.9	105.1	105.7	106.2	107.6
	Real GDP Target						
	2019	2020	2021	2022	2023 Q1	2023 Q2	2023 Q3
Hist GDP growth		2.24	2.24	2.24	0.56	0.56	0.56
GDP index Target	100.0	102.2	104.5	106.9	107.0	107.2	107.3
Foregone GDP Gap	0.0	-5.0	-1.6	-1.8	-1.3	-0.9	0.3

No rigorous macro talk this month - I'm doing some research.

People who have known me for many years know that I rarely have opinions. I take a scientific and forensic approach to economic events, follow the money, and come to conclusions about how economics works and is currently working, and what has happened. I use that to build models to determine what is likely to happen, no matter what the popular opinions might be, or how unpopular my conclusions are.

However, I'll offer this opinion based on my past research, and make the comment that Powell cutting rates next year will likely be the worst thing this economy will have ever endured, eclipsing the damage done by Bernanke cutting rates in August 2007.

While cutting rates might appear to bail out certain levered sectors of the market, the economy-level deleveraging that will likely ensue will make the 2007 GFC seem benign, primarily due to multiples more leverage now than in 2007, thanks to QE from Bernanke, Yellen and Powell, Draghi, Lagarde, Hayami, and Kuroda, and many negative rate experiments. The US is the only scalable economy for investment, so while US QE remains in the US, all other global injected money supply ends up here.

I'll encourage readers to start re-reading my Crisis Notes, and some of the papers and macro models I've created since 2016. Here is a link to the first one. https://mbsmantrallc.com/cn-2007-1.shtml. This anticipated the consequences of Bernanke's actions in 2007, and yes, I was called 'Crazy' at the time. Maybe also try 'All Roads Start with Paul Volcker'.

In case you are wondering, Greenspan's actions after LTCM in 1998 (Tiger blew up, $5b loss from Yen Carry), and dotcom in Jan 2001 also had the same effect – selloff in assets due to deleveraging, capital used for leverage flowing back to Japan, with the Yen strengthening. This could have warned anyone that investigated the past about what would happen in 2007, ($1.5T in US leverage repatriated back to Japan, stocks declining 35+%, Yen going from 125 to 80).

Here is another example from Aug 2019, when Powell cut rates, and stocks sold off. Yen went from 109 to 106 over the next few days.

The world of macro changed in 1996 with Japan's Big Bang, and central bankers and economists have not yet figured this out.

I know that my views on interest rate policy are the polar opposite of the consensus. When facts don't align with the consensus, they do not make the events resulting from flawed interest rate policy Black Swan events. So far, these events have been very predictable, as they are driven by the micro economic decisions of savers.

Raising rates has resulted in capital inflows into the US, driving up asset prices, which have flowed through into our GDP. The 78% of GDP that is services is driven by consumption as wealth increases. This is what has led to the 'Soft Landing' we are experiencing. Powell should have been taking advantage of this by aggressively pursuing QT.

I will be updating my research and models and will report results once I have done so. There is time to be rigorous, before Powell blows up the world and creates the shorting opportunity of a lifetime.

I'm not celebrating; however, this will not be good for people globally.

Sure, it will also mean lower rates, as Powell, knee-jerking in response to his training, will no doubt cut rates even more as asset prices snowball downwards, and ultimately resort to QE after hitting a liquidity trap again, and buy more USTs, MBS, and everything else. So bonds, in general, will be a good place to position, along with Yen.

The end result will be yet more QE to replace the leverage that Powell will chase away with interest rate cuts, leaving our grandchildren and great grandchildren with more debt that they won't be able to ever pay off. And, of course, more "income inequality". (The US Navy needs to get its act together and increase production of Air Craft Carriers and Carrier groups in order to preserve the dollar as global measure of value).

The fundamental problem with economics and finance in general is that the training is based on an apprenticeship model. (This was also the underlying theme of my ***Connecting the Dots*** talk.) There is very little training to think scientifically, problem solve, and determine causality. Within banks, traders are paid to mis-hedge as the capital does not belong to them and they have upside from gains, so they ignore new science. Economists will not admit that their training and legacy research and papers might not be relevant anymore.

Economics is stuck in a Flat Earth belief period, where the central bankers and profession in general thinks that their actions only impact their localized economy, local GDP, local inflation, local asset prices. The rest of the world, and the massive global flows of capital that result from interest rate policy are ignored by the entire profession – central bankers, central bank watching economists, asset managers, journalists. They have not noticed that Japan's Big Bang changed the world, and the shadow cast on Japan's GDP was offset by the sunshine that was global growth from Japan's export of capital to leverage other economies.

The world is round, and money flows globally. Economists need to admit this and adjust their models. If they want economics to be viewed as a science, they should take a scientific approach to understanding prices and risk.

The Greeks had proved that the world was round by 500 B.C. However, it was still debated till the 15^{th} century. We are only 30 years into the fundamental change in economics.

Energy and weather markets understand the global nature of activity and results. Coal burning elsewhere can result in acid rain in the US, etc. I'm not opining on Energy science or the UN here, but Economics needs its COP28 moment, where global impact is acknowledged and solutions found (I suggested a solution in my Crisis Notes).

Here is my prior model from 2016 using global central bank actions: Understanding Beta – Determinants of the US Stock Market

The conclusion from 'The Failure of Macro Economics' in 2016) is still relevant:

Conclusion Section 3: The Failure of Macro Economics

In a global market for capital, where capital can move between economies, management of the economy through Interest Rate Policy no longer works for a country attempting to boost investment, money supply, and inflation. The traditional monetary policy models, as exemplified by the ISLM concepts, cannot achieve their desired results to increase domestic money supply, and thereby inflation, as money supply flees overseas to seek higher returns. Such Policy Management results in stagnation and deflation in the domestic economy.

When a large Economy enters a Liquidity Trap, its citizens rationally export much of their available capital to seek higher yields, thus linking Micro-economic decisions with Macro-Economic implications. Recipient Countries of this Carry-driven money supply lose control of their domestic interest rate policy, and their attempts to control money supply result in outcomes that are the opposite of what is desired. Economic output in these countries rises to the point of saturation of needs (a subject for further research), after which the money supply results in Asset Price Inflation, Bubbles, and creation of excess assets to meet the need for investment. Traditional financial valuation models cease to be useful and rationalizations abound for investing in assets with inflated prices.

Quantitative Easing is not well understood. While QE, as executed by Central Banks, is a special type of asset purchase to inject Money into the Banking System in order to increase Money Supply, QE is more simply understood as a form of Carry that is unrelated to interest rate differentials.

Domestic QE can perform the same function as a higher interest rate (which would attract traditional Carry), as it can cause Asset Inflation. Even without an Interest Rate differential between two countries, Asset Inflation leading to positive total return performance will attract foreign money for those asset classes. Thus, recent US QE has led to Yen weakening and SFM-Japan going down, in spite of no rate differential between the 2 countries, and thus the high correlation between US Stocks and Yen persists.

Any form of foreign asset purchases from a creator of money is a form of Carry, serving the same function as domestic QE to the Recipient Economy. An example would be the purchase of US Treasuries by a Foreign Central Bank, such as the BOJ, but if the BOJ purchased US stocks, or US Real Estate, or took a US company private, that would count as well.

Failures of Macro Economic Policy occur due to the failure of Central Bankers to fully comprehend the global nature of Finance and Economics. Economists appear to be too specialized to look up at the world and see how it has changed since they studied the theory. This results in misuse of Economics, at the expense of the world. Until there is a dramatic rethinking of currencies, asset flows, trade imbalances, price levels, and interest rates, the world is headed into a quagmire that it will not easily be able to extricate itself from.

Anyway, stand by – this updated research will come out in the next few months as I dodge Bloomberg's data limits while updating models.

In the meantime, I'll encourage people to stay liquid, and not tie up capital in the illiquid flavors of the day like 'Private Credit' or PE. However, convex deep discount MBS should rock it in such an environment – so I'm still enthusiastic about the MBS High Income Strategy.

The Agg Plus Alpha Systematic portfolios are liquid, outperform the bond market, and would be a good place to remain invested and liquid – please take a look at them, and call if you'd like me to walk you through the strategy and what it can offer for overall portfolio construction.

To learn about the ARAM portfolios, read the last 2 newsletters (however, they don't incorporate our latest technology). If you would like to learn more, please request the latest presentation deck.

The Oct 2023 newsletter and Nov 2023 newsletter both discuss the Systematic Active Fixed Income Strategy.

I've previously mentioned the talk I gave at NYU in November – Connecting the Dots. Request the presentation via the contact page on my website (compliance reasons).

https://mbsmantrallc.com/contact.shtml

Put this in the Subject Line: "***Connecting the Dots PW***", and the presentation and password will be emailed to you.

Let me know if you have problems.

Have a Happy Holiday and here's wishing you a Happy New Year in advance.

Regards, Samir Shah

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