

# Securitized fixed income Q&A: A decade after the financial crisis, is the trade over?

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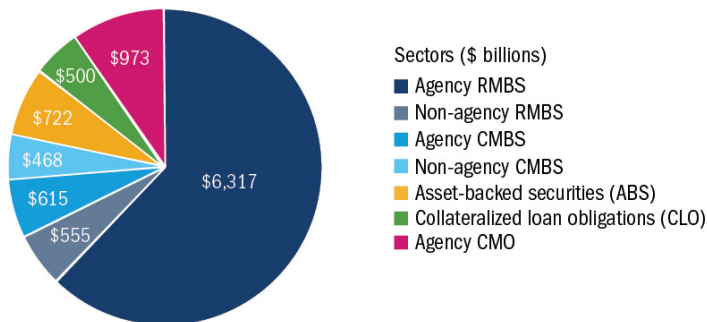
*Securitized fixed income is almost unrecognizable from 10 years ago. A structured asset veteran who's been part of the transformation weighs in.*

**Q: How has the structured product market changed in the last decade?**

**Jason:** The investable universe for structured products is over \$10 trillion, which is more than investment-grade, high-yield and floating-rate bonds combined. To talk about how an investment universe this large has changed, we need to drill down into the different areas. And the biggest, and most obvious, area that has undergone a transformation is structured mortgage products.

▶ **Total structured product universe: \$10.15 trillion**

Structured products allow investors to invest in a bundle of underlying securities, such as mortgage loans.



Source: Columbia Threadneedle Investments as of March 31, 2018.

The supply dynamics, or the volume and types of investable structured mortgage products, are very different from what they were before the financial crisis. Everything you watched and read about mortgages before the financial crisis was true: those “no doc” loans were basically issued with a file folder and a single piece of paper inside — an affidavit that the person taking the mortgage would pay back the loan. These mortgages were at the heart of the financial crisis in



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2008, and a lot of regulation was implemented since then. The new regulations changed the dynamics of mortgage issuance, resulting in credit quality being much higher than it was before.

Before the financial crisis, the market for non-agency and agency mortgages was about equal size. After the crisis, most of it shifted to agency mortgages, which includes Ginnie Mae, Fannie Mae and Freddie Mac. These [agency mortgages](#) are of very high quality and backed by the U.S. government.

Additionally, since the financial crisis we've had new markets develop like marketplace lending, single-family rentals and single-asset commercial mortgage-backed securities (CMBS). Another new market is government-sponsored enterprise (GSE) credit risk transfers, which were created as a way for Fannie Mae and Freddie Mac to transfer some mortgage credit risk to the private sector.

### **Q: Where does the non-agency market stand today?**

**Jason:** While the non-agency market has been slow to come back, it's returning with a greater standardized capital structure than before. One of the things we always highlight about structured assets is there are multiple ways to make a safe investment, because you can accomplish it through either good underlying loans or a strong capital structure. Today, both sides of this coin are in a better position than they were before the financial crisis.

What protects us as bondholders are triggers in the capital structure (like credit enhancements) that have been put in place to make sure we have protection on the principal of the bonds. And there's now a lot more transparency and consistency into the capital structure of these structured products, so we're able to better analyze those protections and assess the level of risk in any non-agency investment. Lenders became a lot more responsible because of regulation, but the improvement to the capital structure came about because of natural market forces. This standardization and transparency is a good thing for investors.

### **Q: Is the recovery after the financial crisis done? Is the trade over?**

**Jason:** No. Partly because investing in structured assets isn't just a housing-recovery story. The investment universe is much broader than that. If you're flexible and look at all sectors of the market, the trade isn't over, and there are good and evolving investment opportunities.

Some of the same dynamics that improved the mortgage market have improved other types of securitized assets. The American consumer is in a much financially healthier spot than they were before the financial crisis, thanks in part to low unemployment, modestly higher wages and low interest rates. The level of household debt payments as a percentage of income is at the lowest point since the '80s. The different market segments that can benefit from a healthy U.S. consumer include everyday financing vehicles like credit cards, student loans and auto loans, all of which are securitized and available for us to invest in.

## Q: What has become the most exciting part of the market?

**Jason:** I'd highlight marketplace lending because it's kind of new, and it's interesting how it has evolved over the last few years. Marketplace lending is a form of peer-to-peer lending, obviously different from the more traditional model we think of where banks loan the money. To try to give you a real example, SoFi is a company that got its start in securitized products by offering student loans to graduate students with expected six-figure salaries upon graduation, and it's moving into marketplace lending as the area grows. It still isn't a huge part of the market, but it's growing and gives us a newer way to diversify portfolios and access investments driven by the U.S. consumer.

You can't get to marketplace lending in a passive ETF. Non-agency mortgage loans and single-borrower mortgage loans aren't part of the Bloomberg Barclays U.S. Aggregate Index or the Bloomberg Barclays U.S. MBS Index. In fact, they aren't in any index. Certain sectors that allow us to fully use our research capabilities and find the good opportunities aren't included in passive investment vehicles. Investors who are relying on passive fixed-income options for their mortgage exposure are missing out on a lot of areas of the structured product universe.

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The **Bloomberg Barclays Mortgage-backed Securities Index** is a market value-weighted index which covers the mortgage-backed securities component of the **Bloomberg Barclays U.S. Aggregate Bond Index**. The index is composed of agency mortgage-backed pass through securities of the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac) with a minimum \$150 million par amount outstanding and a weighted-average maturity of at least 1 year. The index includes reinvestment of income.

It is not possible to invest directly in an index.



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