INVESTOR **EDUCATION**

AN INTRODUCTION TO AGENCY MORTGAGE-BACKED SECURITIES

What are pass-through mortgage-backed securities?

A residential mortgage-backed security (MBS) is a bond or debt secured by a collection of home loans. MBS investors get a share of principal and interest payments from a pool of underlying mortgages.

The majority of MBS are issued by one of two government-sponsored enterprises (Fannie Mae or Freddie Mac) or guaranteed by Ginnie Mae, a government-owned agency. In each of these cases, the security is generally referred to as agency MBS. While only Ginnie Mae securities are backed by the full faith and credit of the U.S. government, all three types of MBS are considered to be among the safest investments from a credit risk perspective. Agency MBS provide stability, liquidity and affordability to the mortgage market.

How do they work?

When a bank makes a home loan, it typically sells the loan in order to free up funds so it can finance additional home loans. If the loan meets certain guidelines, it can be sold to Fannie Mae or Freddie Mac, who will then bundle it with other loans with similar interest rates and maturities. This is when the MBS is issued. If the loan qualifies for a Government National Mortgage Association guarantee, it can be sold to an eligible investment bank that acts as an MBS issuer. In either case, the homeowner will most likely continue to send monthly mortgage payments to the bank that gave the original loan, and that bank sends the payments along to the MBS issuer.

When is the best time to consider MBS?

The best time to consider MBS funds is when home prices and employment are strong, and interest rates are relatively stable.

How might an MBS fund complement a portfolio?

Agency mortgage-backed securities can provide attractive income with low credit risk because of the implicit/explicit backing of the U.S. government. They may provide your portfolio with an added element of diversification and help buffer volatility during periods of heightened credit and equity market swings.

Reasons to consider agency mortgage-backed securities:

- **They offer the implicit or explicit backing of the U.S. government and can offer protection in volatile credit or equity markets**
- **They have historically provided higher yields than U.S. Treasuries**
- **They provide additional diversification to your portfolio**

To learn more about how this asset class might complement your portfolio, speak with your financial advisor. For additional investor education materials, please visit **columbiathreadneedleus.com.**

Why consider agency mortgage-backed securities?

Added portfolio diversification

Agency MBS have a negative correlation to the S&P 500 Index and low correlations to high yield. This helps buffer against market volatility associated with things like negative news headlines on global growth and geopolitical events.

Liquidity

Agency MBS are liquid investments with hundreds of billions of dollars trading in the market daily.

Higher yields

Agency MBS have historically offered higher yields than U.S. Treasury bonds that have a similar duration and interest rate sensitivity. This is to compensate investors for the risk of prepaying underlying mortgages.

Limited credit risk

Because of their relationship with the U.S. government and U.S. Treasury, agency MBS carry limited credit risk and may offer a safe haven for investors during periods of volatility.

Interest rate shocks

MBS are less susceptible to unexpected interest rate shocks compared with U.S. Treasuries.

What are some of the risks associated with mortgage-backed securities?

Typically an MBS investment offers a conservative risk profile. As interest rates change, owners have the options to refinance, pay down their mortgages early or purchase a new home. Prepayment risk occurs as interest rates fall and owners refinance or purchase a new home at a lower rate. Extension risk occurs when higher interest rates prompt mortgage holders to hold on to lower rate mortgages for a longer period.

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Mortgage- and asset-backed securities are affected by interest rates, financial health of issuers/originators, creditworthiness of entities providing credit enhancements and the value of underlying assets.

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The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization U.S. stocks. It is not possible to invest directly in an index.

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