Overweight Current Coupon Agency MBS/Underweight Investment-Grade Corporates

Recommended since October 31, 2025

Investment thesis: US current coupon agency MBS—more recently issued, higher-yielding securities—represent a high-quality, attractively valued segment within the investment-grade bond universe. With yields now above those of US corporates, they offer compelling relative value and are well positioned to outperform, providing defensive characteristics without sacrificing yield—especially as both credit and equity valuations appear stretched.

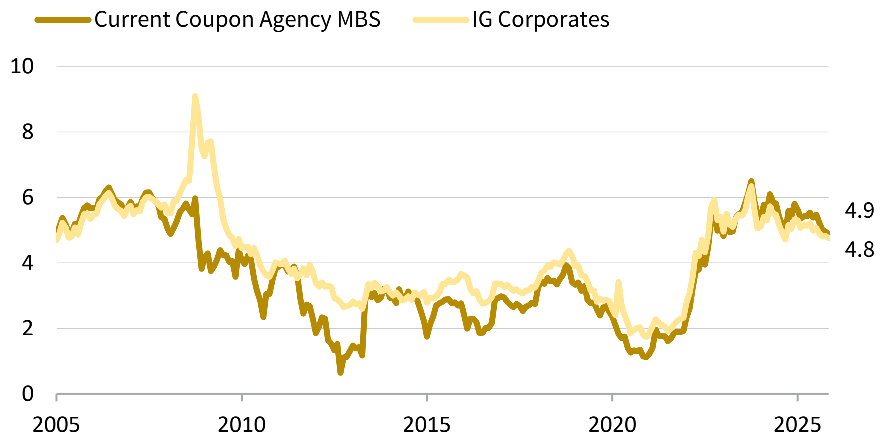
Key support 1: For the first time since 2007–08, current coupon yields exceed those of corporates, creating an attractive entry point. From these levels, current coupons have outperformed corporates 62% of the time over the next two years, with returns ranging from -3% to 11%. Meanwhile, corporate spreads are unusually tight and vulnerable to widening, given elevated risk asset valuations and early signs of labor market and low-end consumer weakness. As a AAA-rated sector, agency MBS provide additional spread and hedge against negative shocks.

Key support 2: While corporate spreads are near historical tights, current coupon MBS spreads to Treasuries are less extreme—currently in the 42nd percentile over the past 20 years—leaving room for further tightening as rate volatility subsides. Although volatility has declined since its 2022 peak, it remains somewhat elevated. With quantitative tightening ending and further rate cuts likely once tariff-related inflation pressures ease, there is scope for volatility and MBS spreads to compress further, supporting returns.

Key risks: Fundamentals for MBS are not a major concern. The main risk is a resurgence in rate volatility, which, while still elevated, appears unlikely. Prepayment risk for recently issued, higher-yielding current coupons is limited, as Treasury and mortgage rates are expected to remain rangebound. The Fed's ongoing MBS portfolio reduction has been a headwind but is likely priced in. The key uncertainty is potential privatization; however, the administration aims to limit market disruption, with a partial sale that preserves the government guarantee the most likely outcome.

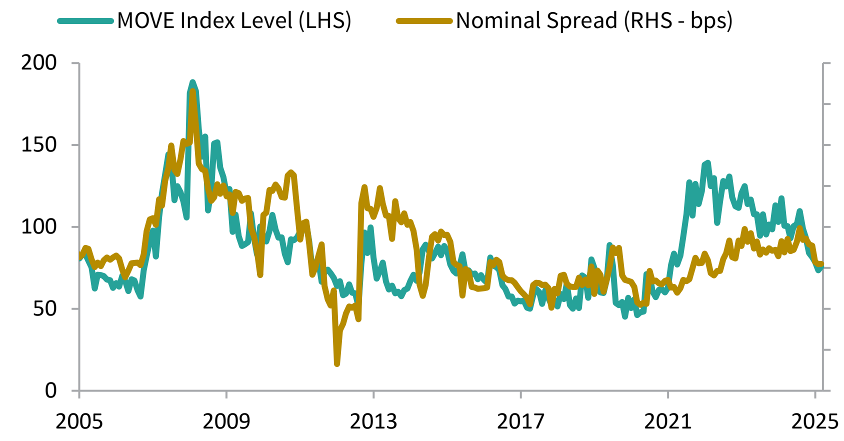
US bond yields

January 31, 2005 – November 30, 2025 • Percent (%)



Rate volatility and US Treasury nominal yield spread

January 31, 2005 – November 30, 2025



Sources: Bloomberg Index Services Limited, Intercontinental Exchange Inc., and Thomson Reuters Datastream.
Notes: The MOVE Index is a key indicator of expected volatility in the US Treasury market. Yield spread is calculated versus the Bloomberg US Treasury Index.