



Taking Another Look at Securitized Credit

Fundamental research can reveal opportunities in the asset class.

February 2023

KEY INSIGHTS

- Securitized credit can be a useful fixed income allocation for institutional investors who focus on book yield or those trying to match future pension liabilities.
- The asset class typically provides a meaningful credit spread advantage over corporate bonds with similar credit quality, as well as diversification benefits.
- Building a customized securitized credit portfolio is an iterative process in which we work closely with the client to refine investment guidelines.

Securitized credit can be a useful fixed income allocation for institutional investors who focus on book yield or those trying to match the cash flows of future pension liabilities. The asset class, which broadly consists of asset-backed securities (ABS), non-agency mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and collateralized loan obligations (CLOs), typically provides a meaningful credit spread advantage over corporate bonds with similar credit quality. Although bonds in the asset class are often complex, this complexity can work to an investor's advantage as thorough fundamental research can often uncover attractive opportunities in securitized credit.

While liquidity can be limited in some segments of securitized credit, particularly versus high-grade corporate and government bonds, it is meaningfully better than in some

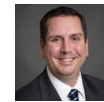
alternative pension fund allocations, such as private credit. Also, book yield-focused investors are generally reluctant to realize gains or losses on their holdings because of unfavorable tax treatment, so they can largely be considered buy and hold investors. This makes them less sensitive to mark-to-market price fluctuations and less focused on returns relative to a benchmark. Because of their longer-term horizon, they may also be more comfortable holding less-liquid assets.

Typical Spread Premium to Similar-Quality Corporates

We have found that many investors focusing on book yield have historically had relatively concentrated exposure to corporate credit, both investment grade and high yield. Because of its relative complexity and more limited liquidity, securitized credit generally offers a spread premium to comparable corporate credit, a factor that has historically helped generate relatively attractive risk-adjusted returns (i.e.,



Jean-Marc Breaux, CFA
Securitized Credit Analyst



Ramon de Castro
Securitized Credit Portfolio Manager



Evan Shay
Securitized Credit Analyst

“T. Rowe Price’s focus on deep fundamental research...allows us to concentrate on identifying attractive book yields from securities that have robust fundamental underpinnings.”

Sharpe ratios). The securitized credit asset class also offers diversification benefits for portfolios with large corporate credit exposure because securitized performance is driven by different risk factors, such as consumer and real estate fundamentals, and can diverge from corporate performance at different points of the credit cycle.

Another advantage of securitized credit for some institutional investors is that there are also meaningfully more AAA rated bonds available in securitized credit than in other fixed income asset classes such as corporate bonds, where top-rated issuers are increasingly rare. Regulations require some investors to hold less reserves against these high-quality securities than against lower-quality bonds, freeing up assets and reducing their cost of capital.

Focus on Identifying Attractive Book Yield and Robust Fundamentals

T. Rowe Price’s focus on deep fundamental research, which seeks to identify credit deterioration ahead of the rating agencies, allows us to concentrate on identifying attractive book yields from securities that have robust fundamental underpinnings. As long as we have a high degree of confidence that a security will mature at par, permitting the investor to capture the full book yield over the life of the investment, we—and more importantly, the end investor—can be somewhat indifferent to day-to-day price fluctuations related to market risk sentiment or liquidity conditions.

We pride ourselves on partnering closely with our book yield-focused investors, tailoring their portfolios to maximize book yield given each client’s unique credit quality constraints, risk tolerance, and return targets. The heterogeneous nature of the securitized credit sectors and subsectors, combined with our deep research capabilities, allows us to find yield from a variety of sources, including both traditional and more esoteric areas of the securitized markets.

Iterative Process to Build Customized Portfolio

Building a customized portfolio for a book yield-focused investor is typically an iterative process in which we work closely with the client to fine-tune the investment guidelines over time. This is particularly true for investors that may have had limited exposure to securitized credit in the past. In these instances, we focus on educating the client through conversations with our portfolio managers and credit analysts.

Once the portfolio is established, we communicate regularly with the client to maximize book yield and manage portfolio credit quality by integrating cash inflows resulting from the client’s business growth. We also reinvest interest income and security paydowns to minimize cash drag. Because the asset class lacks a comprehensive benchmark, we can collaborate with the client to create a custom benchmark to measure the portfolio’s relative performance over time.

Updates on Evolving Securitized Credit Markets

We provide regular updates on account performance and the factors that drove returns, and our investment and client relationship teams keep clients informed of our market outlook and new developments as securitized markets evolve. We also analyze the potential costs or benefits of realizing a gain or loss on a security where our analysts have concerns around its credit quality trajectory or see better opportunities in other areas of the market.

Book yield-focused investing also requires unique recordkeeping capabilities given the tax-sensitive nature of these types of portfolios. To assist in that regard, we have partnered with Clearwater Analytics to provide our clients with seamless, real-time access to all the requisite portfolio accounting data. As of December 31, 2022, clients had entrusted more than USD 17 billion in securitized credit assets to our management, demonstrating our expertise in the asset class.

General Fixed Income Risks

Capital risk—the value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the portfolio and the currency in which you subscribed, if different.

ESG and Sustainability risk—May result in a material negative impact on the value of an investment and performance of the portfolio.

Counterparty risk—an entity with which the portfolio transacts may not meet its obligations to the portfolio.

Geographic concentration risk—to the extent that a portfolio invests a large portion of its assets in a particular geographic area, its performance will be more strongly affected by events within that area.

Hedging risk—a portfolio's attempts to reduce or eliminate certain risks through hedging may not work as intended.

Investment portfolio risk—investing in portfolios involves certain risks an investor would not face if investing in markets directly.

Management risk—the investment manager or its designees may at times find their obligations to a portfolio to be in conflict with their obligations to other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably).

Operational risk—operational failures could lead to disruptions of portfolio operations or financial losses.

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

T.RowePrice®

Important Information

This material is being furnished for general informational and/or marketing purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

Australia—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. For Wholesale Clients only.

Brunei—This material can only be delivered to certain specific institutional investors for informational purpose only. Any strategy and/or any products associated with the strategy discussed herein has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd which is regulated by the Dubai Financial Services Authority as a Representative Office. For Professional Clients only.

EEA—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Hong Kong—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Indonesia—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

Korea—This material is intended only to Qualified Professional Investors. Not for further distribution.

Mainland China—This material is provided to qualified investors only. No invitation to offer, or offer for, or sale of, the shares will be made in the mainland of the People's Republic of China ("Mainland China", not including the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the Mainland China. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the Mainland China. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the Mainland China that are expressly authorized under the laws and regulations of the Mainland China to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the Mainland China. Potential investors who are resident in the Mainland China are responsible for obtaining the required approvals from all relevant government authorities in the Mainland China, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the Mainland China, or nationals with permanent residence in the Mainland China, or to any corporation, partnership, or other entity incorporated or established in the Mainland China.

Malaysia—This material can only be delivered to specific institutional investor. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

New Zealand—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

Philippines—ANY STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING DISCUSSED HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

Singapore—Issued by T. Rowe Price Singapore Private Ltd. (UEN: 201021137E), 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

South Africa—Issued in South Africa by T. Rowe Price International Ltd (TRPIL), 60 Queen Victoria Street, London, EC4N 4TZ, is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (Financial Services Provider (FSP) Licence Number 31935), authorised to provide "intermediary services" to South African Investors. TRPIL's Complaint Handling Procedures are available to clients upon request. The Financial Advisory and Intermediary Services Act Ombud in South Africa deals with complaints from clients against FSPs in relation to the specific services rendered by FSPs. The contact details are noted below: Telephone: +27 12 762 5000, Web: www.faisombud.co.za, Email: info@faisombud.co.za

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

Taiwan—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

Thailand—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

UK—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

USA—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2023 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.