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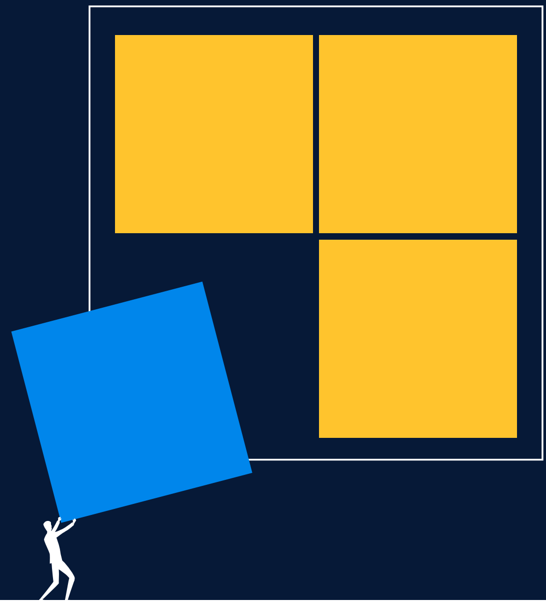

Perspectives on securitized credit

From the Field
Q1 2025

Key Insights

- Securitized credit delivered relatively resilient excess returns in the first quarter, outperforming corporate bonds despite rising rates and volatility.
- Demand remained solid across securitized sectors, but supply pipelines began to rebuild, especially in CLOs and troubled office CMBS deals.
- Valuations are broadly neutral, but dispersion remains elevated. We see relative value in select RMBS with strong structural protections at the expense of CLOs and CMBS.

Christopher Brown, CFA
Head of Securitized Products and Portfolio Manager, Fixed Income

Ramon de Castro
Portfolio Manager, Agency and Non-agency Mortgages

Jean-Marc Breaux, CFA
Sector Portfolio Manager, Securitized Credit

Securitized credit markets posted relatively resilient performance in the first quarter of 2025, outperforming U.S. investment-grade corporates, high yield bonds, and bank loans on an excess return basis. The quarter began with a continuation of the late-2024 risk rally, but sentiment shifted as investors reassessed the macroeconomic and policy outlook amid persistent inflation risks and renewed geopolitical uncertainty.

Investor optimism carried into early January, supported by moderating inflation data and expectations for continued monetary easing following the Federal Reserve's (Fed's) 50 basis points of cuts in late 2024. (A basis point is 0.01 percentage point.) However, stronger-than-expected services inflation, wage growth, and labor market strength challenged that narrative. The new administration's tariff and immigration policies were also perceived as inflationary.

The Fed held its policy rate steady at the 4.25% to 4.50% range but signaled a more cautious stance on future cuts. Treasury yields moved higher, and the curve steepened as easing expectations moderated. Geopolitical tensions, including conflict in the Middle East and deteriorating U.S.-China trade relations, added volatility, although fixed income markets remained underpinned by solid growth and favorable technicals.

Mixed results across securitized sectors[1]

Collateralized loan obligations (CLOs) delivered the strongest performance among securitized sectors, generating six basis points of excess returns.[2] AAA rated CLO[3] tranches widened modestly amid volatility in the secondary market and exchange-traded fund (ETF) outflows but outperformed their lower-quality counterparts.

Agency mortgage-backed securities (MBS) produced modestly positive excess returns of four basis points, with performance led by production and higher coupon pools (5.0% and higher). Dealer inventories rose, though overall supply pressures remained manageable.

Asset-backed securities (ABS) posted a small negative excess return of four basis points.[4] Credit spreads[5] widened early in the quarter on tariff-related concerns but stabilized by March. Whole business, dealer floor plans, and equipment-backed securitization underperformed auto leases and credit cards during the quarter; however, the trend reversed in April amid investors' concerns of the impact of tariffs on the consumer.

Non-agency residential mortgage-backed securities (RMBS) underperformed with negative 13 basis points of excess returns. Nonqualified mortgage (QM) bonds and credit-risk transfer (CRT)[6] securities faced pressure from higher rate volatility and money managers demanding wider spreads to take RMBS risk amid elevated supply.

Commercial mortgage-backed securities (CMBS) posted the weakest returns, delivering negative 15 basis points of excess returns.[7] Structural challenges persisted in the office sector, while agency CMBS backed by multifamily properties remained more resilient.

Solid demand amid shifting technicals

Issuance across the four major securitized sectors moderated from late 2024's heavy pace but remained healthy relative to historical averages. Investor demand stayed resilient despite increased market volatility. Following the quarter's end and the accompanying market volatility, issuance across subsectors ground to a near halt. Only toward the end of April did we see green shoots for a rebound in supply, which was met with solid demand from dedicated securitized investors.

CLO issuance remained robust, with USD 160 billion of U.S. CLOs priced year-to-date through mid-April, a 44% increase over the prior year.[8] Refinancings and resets dominated, as issuers prioritized reducing liability costs on existing deals over locking in substandard returns in new issues. Issuance has slowed considerably since the end of March, as the arbitrage is more challenged at clearing levels for AAAs. Demand has improved post "Liberation Day," with active buying from banks and insurance companies, but flows into CLO ETFs have turned negative.

Agency and non-agency RMBS issuance held up better than feared, with gross issuance totaling approximately USD 248 billion and USD 58 billion, respectively, through mid-April. Demand was strong among money managers and insurance companies, although bonds backed by lower-credit-quality borrowers saw more pressure amid expectations for heavier spring issuance.

[1] **Past performance is not a guarantee or a reliable indicator of future results.**
[2] Excess returns measure the performance of a bond relative to a similar-duration U.S. Treasury security.
[3] Source: J.P. Morgan CLOIE Post-Crisis Index.
[4] Source: Bloomberg US Aggregate ABS Index.
[5] Credit spreads measure the additional yield that investors demand for holding a bond with credit risk over a similar-maturity, high-quality government bond.
[6] CRTs are a type of RMBS issued by Fannie Mae and Freddie Mac but with credit risk borne by private investors. They can incur losses if enough homeowners in a pool of mortgages default on their loans.
[7] Source: Bloomberg Non-Agency CMBS Index.
[8] Source for ABS, CLO, CMBS, and RMBS issuance totals: J.P. Morgan.

ABS gross issuance totaled about USD 98 billion, led by prime auto, credit card, and equipment deals. Tariff-driven inflation concerns briefly widened spreads in February, but senior AAA tranches from high-quality sponsors remained well supported. Demand for consumer-facing issuers weakened in April.

CMBS issuance has been robust at USD 82 billion year-to-date relative to the start of 2024. Sentiment and liquidity improved—especially during the first half of the quarter, and spreads for higher-quality conduit and single-asset/single-borrower (SASB) deals tightened modestly. Concerns persist for many office-backed transactions as property fundamentals remain challenged.

In CLOs, loan default and distressed exchange activity ticked higher, with the loan default rate reaching 3.9% by quarter-end. Downgrade activity moderated, but CCC rated loans remained under pressure. CLO equity distributions declined slightly due to elevated loan refinancings. Senior tranches remain well insulated from deterioration in credit fundamentals.

In RMBS, credit performance remained broadly stable, supported by homeowner equity and labor market strength. However, prepayment volatility and rising Ginnie Mae delinquency rates created some dispersion, particularly among lower-FICO or high loan-to-value (LTV) collateral. Investors remained focused on seasoned and higher-quality deals.

Fundamentals mixed but largely stable

Fundamentals across securitized sectors were broadly stable in the first quarter of 2025, though early signs of stress were more visible in lower-rated tranches and consumer-linked collateral.

In ABS, delinquencies and losses in subprime auto and private student loans trended higher but remained within historical ranges. Credit normalization continued, particularly among lower-income borrowers. Credit curves remained unusually flat, suggesting markets are not fully pricing in fundamental stress. Whole-business ABS tied to discretionary sectors like restaurants bear close monitoring.

CMBS fundamentals remained bifurcated. Office sector delinquencies and transfers to special servicing remained elevated, while multifamily and industrial properties performed steadily. Lodging sector cash flows showed early softening after a post-pandemic rebound, and the sector is most exposed to macroeconomic uncertainty. The fundamental divergence between trophy assets and transitional properties remains stark.

Valuations largely neutral, but pockets of value exist

Credit spread movements across securitized sectors were mixed during the quarter. CMBS and lower-rated ABS widened modestly, while agency MBS and CLO spreads proved more resilient. Overall, valuations screened broadly neutral versus historical norms, but dispersion remained elevated, creating targeted opportunities.

- In ABS, spreads widened early in the quarter but recovered into March. We favor discount-priced whole-business securitizations, floorplan ABS, and off-index equipment-backed ABS, which lagged the broader recovery. Credit curves remained flat, suggesting attractive asymmetry for high-quality off-benchmark names.

- In CLOs, valuations remained moderately expensive versus history and corporate bonds, but AAA new-issue spreads widened slightly and remain attractive. We prefer higher-rated (AAA and AA) CLOs, and refinancing of shorter-maturity transactions provides an ABS-like profile with enhanced carry.

- In CMBS, valuations became incrementally more attractive late in the quarter as pipelines grew. We

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favor select seasoned, discount-priced conduit bonds with stable cash flows and a shorter weighted average life (WAL) and selectively target well-leased SASB office bonds where valuations imply punitive extension scenarios but impairment risk appears manageable.

- In RMBS, valuations appear broadly fair. Fundamentals remain stable, but limited near-term catalysts for spread tightening warrant a selective approach. We remain focused on liquidity and structural protections, favoring seasoned single-family rental and hybrid ARM bonds with strong credit profiles.

We maintain a selective and cautious outlook for securitized credit heading into the remainder of 2025. While fundamentals across most subsectors remain stable, we expect macro volatility and pockets of consumer and commercial real estate stress to persist, reinforcing the importance of portfolio construction that prioritizes liquidity and security selection.

In this environment, we are focused on leveraging our strong credit research and trading platforms to identify fundamentally sound, reasonably priced opportunities across high-quality RMBS and CLO tranches, selective conduit CMBS, and off-index ABS sectors. A disciplined, research-driven approach will be critical as dispersion across structures and issuers could remain elevated.

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