

Defensive Carry Amid a More Symmetric Setup

This report is excerpted from the [Fourth Quarter 2026 Fixed-Income Sector Views](#).

Risks remain, but the entry level is far more attractive than earlier in the year.

Agency MBS posted its weakest quarter of 2026 as rates sold off to multi-decade highs, the yield curve flattened, and volatility increased, pressuring the sector with volatility not seen since March/April 2025. Spread underperformance relative to U.S. Treasuries worsened in late September as the Fed's rate hike failed to stem rising Treasury yields. Higher rates have created the more symmetric range of future spreads that we favor as an entry point for the longer-term investment horizon, where the current-coupon MBS spread sits well above the year-to-date average.

Sector Commentary

- Current coupon Agency MBS spreads now sit well above the year-to-date average. With the Merrill Lynch Option Volatility Estimate Index well off its recent lows, the distribution of spread outcomes from here is becoming far more symmetric than it was at the start of the quarter with the opportunity for spread compression now back on the table.
- Primary mortgage rates have moved above 7 percent, which will channel new production primarily into 6 and 6.5 percent coupons. Only two premium coupons remain among actively traded MBS—6.5s and 7s—and together they account for less than 3 percent of the Bloomberg U.S. MBS Index.
- 30-year 5–5.5 percent coupon MBS are now out of the production window and are approaching full duration extension as prepayment speeds slow. Short-duration subsectors outperformed relatively despite the front end leading the selloff, while index coupons (2s–3s) were buoyed by passive inflows chasing higher all-in yields and a more favorable convexity profile.

Investment Themes

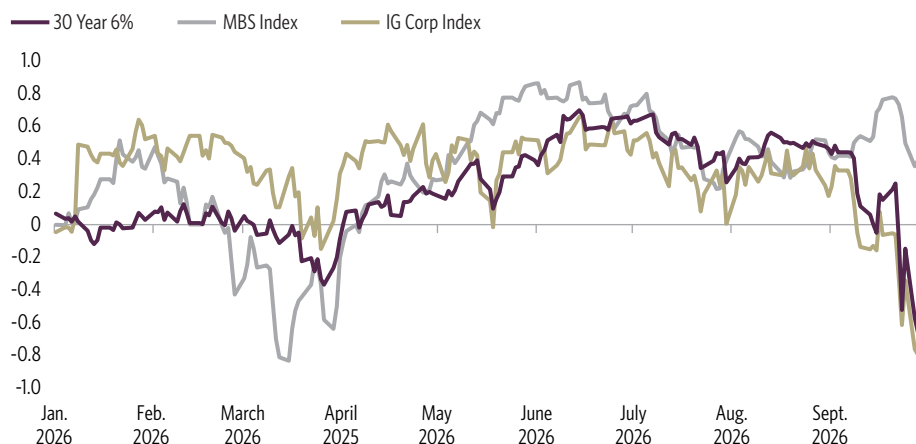
- We currently favor buying MBS on weakness in production coupons (6s/6.5s) for higher spreads and better To-Be-Announced (TBA) carry. Underperformance of MBS relative to investment-grade corporates is notable, and valuations should attract sector rotation from crossover buyers.
- Risks remain, but the entry level is far more attractive than earlier in the year. We are selectively seeking defensive carry trades that maximize carry per unit of spread duration to withstand further widening events and limit partial duration to the long end.
- We prefer production coupons (6s/6.5s) in both conventional (Fannie Mae and Freddie Mac) and Ginnie Mae form—trading at or below parity—in addition to front-sequential collateralized mortgage obligation (CMO) structures off this collateral.
- TBA contracts offer implied financing levels well inside SOFR, which could persist given the smaller float versus 5s and 5.5s, the CMO takeout and limited supply at current primary mortgage rates.

By Louis Pacilio

Higher rates have created the more symmetric range of future spreads that we favor as an entry point for the longer-term investment horizon, where the current-coupon MBS spread sits well above the year-to-date average.

Spread Widening Has Driven Excess Returns Negative Year to Date

Year-to-Date Excess Return



Source: Guggenheim Investments, Bloomberg. Data as of 9.30.2026. Indexes used include the Bloomberg U.S. Mortgage Backed Securities Index and the Bloomberg U.S. Corporate Bond Index.



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One **basis point** is equal to 0.01%.

Carry is the difference between the cost of financing an asset and the interest received on that asset.

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