GAM Star Fund Plc - GAM Star MBS Total Return

Marketing material for professional / institutional / accredited investors only

Tom Mansley
Investment Director

Chien-Chung Chen
Investment Director

Gary Singleterry
Investment Director

Market environment

October was a tough month for equity and fixed-income assets. Bond markets experienced a sell-off as stronger US economic data lowered expectations that the Federal Reserve would cut interest rates more aggressively. In addition, there was increased macroeconomic volatility due to the November US election.

The S&P 500 lost 0.92% during the month and the US 10-year Treasury rate finished the month 50 basis points (bps) higher at 4.29%. During the month, the 30-year fixed mortgage rate in the US rose 64 bps, finishing at around 6.7%.

US housing prices experienced a 0.1% month-over-month decrease and grew 4.2% on a year-over-year basis at the end of August, which was the most recent Case-Shiller Home Price Index release.

Performance

GAM Star MBS Total Return (USD, Inst) achieved a net performance of 0.2% during October.

Performance contributors

The main contributor to the fund's performance during the month was the interest income generated by the fund's holdings.

Performance detractors

Given the low but positive duration, the rise in US interest rates during the month detracted from performance.

Positioning

The majority of the fund is invested in non-agency residential mortgage-backed securities issued prior to the 2008-2009 credit crisis (Legacy RMBS), resulting in a more substantial home equity buffer than recently issued mortgages. Approximately 10% of the fund is invested in commercial mortgages. These investments focus on apartment complexes that are currently benefiting from low vacancy rates. We continue to avoid large retail shopping malls and office buildings, anticipating further market adjustments due to unresolved problem loans in these areas.

Over 95% of the securities in the fund hold the most senior position in the capital structure. We feel that this defensive positioning is appropriate given that we can still achieve an attractive yield even with a conservative portfolio. In terms of duration, we continue to maintain a low effective duration of around one year.

Outlook

Our outlook for the US housing market remains positive. Stronger economic data in October show the resilience of the US economy and the US consumer. Home prices continue to be stable due to the persistent lack of supply. Mortgage credit is still fundamentally sound, as mortgage foreclosure rates are still low and the increase in home prices gives homeowners a cushion of additional equity in their houses. We believe that US housing prices will be stable going forward.

In the non-agency RMBS space, we continue to see relatively stable spreads during October, despite the sell-off in US interest rates and the increase in volatility. We continue to believe that non-agency RMBS spreads remain attractive given the strength of the housing market, especially relative to other markets such as corporate credit in the US. We believe that the portfolio yield is attractive relative to the low credit risk in the portfolio.

The portfolio has a significant allocation to senior bonds backed by mortgages that have been outstanding for over 15 years, in which the homeowners have substantial equity in their houses. We believe that this large home equity in combination with low unemployment rates and low household debt levels should ensure the creditworthiness of the securities in the portfolio, even in the event of a recession.

GAM Investments

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