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Andrew Davidson launches CRT index as market uncertainty rises

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Andrew Davidson & Co. on Wednesday launched a total return index that will help investors better evaluate their holdings in the USD 40bn mortgage credit risk transfer debt market, according to company president Andrew Davidson.

The AD&Co CRT Index, developed partly in response to clients of the mortgage research and analytics firm, is one of at least three either active or on the drawing board, according to the firms involved. Investors are looking for greater transparency, with the market expected to grow to USD 100bn, the company said in a report to clients.

As CRT structures change, the index will also evolve, Davidson said.

The Davidson index, another announced by mortgage strategist Mark Fontanilla's MF & Co. last month and a two-year old pilot from Vista Capital Advisors are coming at a time of greater uncertainty over CRT performance. Higher-risk CRT securities led returns among mortgage credit debt in 2017, but the outlook has clouded recently as rising volatility and a correlation with junk-rated corporate debt have capped the market's rebound, as reported.

The AD&Co. CRT Index data show that total returns for "Tier 4" CRT (seasoned M1s) have been roughly equal to the BBB Corporate Index, but much less volatile, according to the report. Similarly, total returns for "Mid-Tier" CRT (B1-M2) beat the High Yield Corporate index and are less volatile.

The Mid-Tier index may be useful as the first benchmark for an investable index, according to the report. "It excludes first loss and the most senior bonds, providing a fairly long duration and enough spread to be an interesting investment," it said.

The index uses data from bond pricing services, Davidson said. The Vista index was getting pricing from dealers when it began its pilot in early 2016, as reported.

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Vista in 2015 envisioned an index that could provide the basis for a correlated hedging vehicle, potentially developed by Intercontinental Exchange, or ICE, as reported. A hedging product could let dealers offset cash positions and reduce capital charges that have chilled secondary market liquidity (see article, 15 September 2015). An index would be run by Vista Data Services.

But the GSEs have been cautious about backing indexes that could conceivably be used to develop financial derivatives that might destabilize the cash market, according to sources familiar.

by Al Yoon