Accrued Interest

CMLS mortgage fund

April 2025

cmls asset management

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We are pleased to bring you Accrued Interest, April 2025 issue. This will also be included in our upcoming first quarter report. More detailed and up-to-date portfolio information can be found in our monthly Fund Facts, available on our website here.

What a wild start to 2025. With a tripling of market volatility (as measured by the VIX) from its YTD low to its high on April 8, and peak to trough S&P 500 drop of 19%, many have been comforted by the perceived safety and stability of private market investments. There are certain features of our fund, for example, that avoid incessant daily fluctuations of value. Some are observable characteristics of our permitted investments, some result from choices we make as manager, and importantly, none represent anything special or unique at the underlying asset level, only with regard to the method of delivery.

First, our targeted investments represent short duration credit provided to real estate owners. Changes in the value of the real estate do not affect the value of our investments 1-to-1. Consistent with public fixed-income securities, the value of an investment in our fund is mainly influenced by current market interest rates for similar investments. We regularly update these valuations using objective benchmarks and third party opinions. This is notably different than choosing to ignore the value of underlying investments for the benefit of stable NAV. However, because our investments are short term, changes in market rates have only a limited impact on their value.

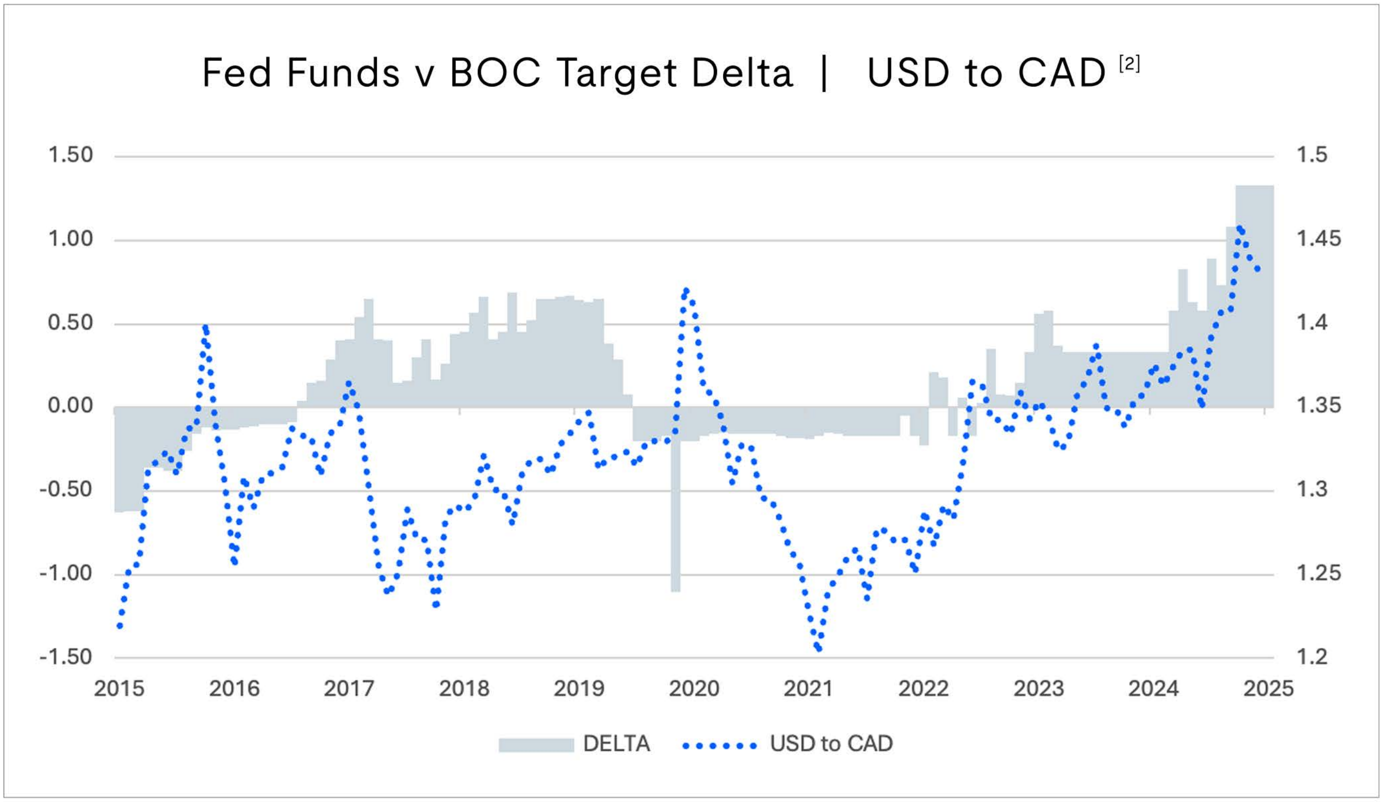
Second, we choose to value monthly, not daily, and we permit our investors to trade units of the fund on the same schedule.

And third, we are an open-ended fund. An imbalance of buy (subscription) versus sell (redemption) trades does not move a "clearing price" of our units as it would if structured as a closed-ended fund and traded on an exchange. Over 2% of our AUM can trade on a single day as it did on March 31, with buy orders 2x sells, with no effect on price. For reference, the average daily trading volume of AAPL shares in Q1, as a percentage of market capitalization, was 0.3%.

As a result, our fund exhibits limited correlation to public markets and significantly lower volatility. We delivered a steady 6.8% annualized return through the first quarter of the year. But we should not look away when markets tank. It is rather a healthy prompt to investigate why the markets tanked, and how the fund might be impacted in the future (e.g. interest rate trajectory, inflation, unemployment).

Why indeed. The volatility in public markets has mirrored the volatility of communication from the US administration. It is difficult to ascertain the presence of a core principle or primary objective among broad-based reshoring, building negotiating leverage, or alleviating the pressure of national debt. By extension, uncertainty remains around our relationship with our southern neighbours, how the Canadian economy will be impacted and where the Bank of Canada policy rate is headed.

The Bank of Canada held steady at 2.75% in April after having made seven consecutive cuts. They continue to deal with the prospect of opposing tariff-induced pressures of economic strain and inflationary impacts. We also wonder if currency concerns stemming from the divergence of Canada and US central bank rates will limit BoC flexibility (although broader USD weakness may alleviate these concerns – see chart below). This interest rate and economic uncertainty and the general strain on consumers have kept real estate transaction activity low. In March, home sales in Canada fell 9.3% year-over-year, and the average sale price was down 3.7% over the same period[1].



Among elevated market risks, we are placing a greater emphasis on underwriting and positioning the portfolio defensively. Specifically, this quarter, we decreased our maximum LTV in geographies most vulnerable to cross-border trade. We also increased the magnitude of pricing differential between higher and lower risk lending opportunities (e.g. rewarding those with LTVs below 50% and borrower credit scores above 800). Our continued focus on low leverage loans to strong borrowers in core markets has served us well. Arrears have remained low (2.0% at the end of Q1) and we have continued our record of zero losses of principal since fund inception.

During a time when public markets can swing massively in response to posts on social media, we look to provide consistency in our approach as manager. Our focus remains on sustainable returns driven by well-underwritten real estate debt investments. We thank our investors for their continued trust and are excited for the quarter ahead.

[1] https://stats.crea.ca/en-CA/
[2] Federal Reserve Economic Data, Federal Reserve Bank of St. Louis; Bank of Canada