

**To:** [REDACTED]  
**From:** Ike Groff  
**Sent:** Fri 1/24/2014 3:07:39 PM  
**Subject:** RE: Gundlach Counting Rotting Homes Makes Subprime Bear: Mortgag

That is a long time, I think it will be fun to take ty

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**From:** [REDACTED]  
**Sent:** Friday, January 24, 2014 10:00 AM  
**To:** Ike Groff  
**Subject:** Re: Gundlach Counting Rotting Homes Makes Subprime Bear: Mortgag

Oh my. Sounds difficult to get to. June of 2015. Ok

Sent from my iPhone

On Jan 24, 2014, at 9:54 AM, Ike Groff <[REDACTED]> wrote:

Looks like we are going back to Cali, cali, cali, going back to cali.

**From:** Will Ford [mailto:[REDACTED]]  
**Sent:** Friday, January 24, 2014 9:44 AM  
**To:** Evan & Ingrid Wax; Ike Groff; David & Waverly Smith; Seth & Alison Hoenig; Rich & Val Steiner  
**Subject:** Re: Gundlach Counting Rotting Homes Makes Subprime Bear: Mortgag

By the way, tentative date for wedding is 6/27/15 on the Ford Family ranch in Arcata, CA

<https://www.google.com/maps/preview/place/2185+liscom+hill+mckinleyville/@40.9110733,-123.9628893,820m/data=!3m2!1e3!4b1!4m2!3m1!1s0x54d1592d22554a6f:0x833572509251b11d>

You would either fly United via SFO into ACV (which often has issues with fog), or fly to SFO and drive 5 hrs north (how I usually get there).



A measure of losses on mortgage debt rose last quarter for the first time since 2011, Fitch Ratings said in a report yesterday. The reversal was driven by an aging pool of loans in the foreclosure process, particularly in states such as Florida and New Jersey which give added legal protections to homeowners against repossessions.

About 32 percent of seriously delinquent borrowers, those at least 90 days late, haven't made a payment in more than four years, up 7 percent from the beginning of 2012, according to Fitch analyst Sean Nelson.

"These timelines could still increase for another year or so," Nelson said, leading to even higher losses because of added legal and tax costs, and a greater potential for properties to deteriorate.

Loss severities on subprime debt, tied to risky mortgages that inflated the housing bubble, increased to 75.9 percent from 74.1 in the last three months of the year. The severities -- a measure of losses suffered on a liquidated loan -- peaked at 77.1 percent in early 2012 from 12.8 percent at the end of 2006, during the property boom.

### Keeping Pace

Improvements in loss severities have failed to keep pace with the 24 percent gain in house prices since the 2012 trough. Real-estate values have been recovering for about two years, with prices climbing in October at the fastest pace since 2006, according to a Case-Shiller index of 20 cities.

"You see Case-Shiller price data showing strong markets, and you expect in a certain logical way that these loss severities should be coming down as home values are increasing," said Gundlach, who started Los Angeles-based DoubleLine Capital in December 2009 and built it into the fastest growing mutual-fund firm ever in its first year. "Unfortunately, that's being trumped or neutralized by this rotting away problem."

Investors including Blackstone Group LP and Colony Capital LLC have been central to the rebound, buying more than 366,200 single-family homes in cities such as Phoenix, Las Vegas and Atlanta, since January 2011 to turn into rentals, according to Port Street Realty and RealtyTrac data. Federal Reserve policies that reduced borrowing costs and increased homeowner refinancing also lifted the market.

### Improving Economy

While rising prices, and an improving economy have resulted in a steep drop in foreclosures, there are more than 1.2 million properties in the repossession process or owned by banks that the market is absorbing, according to RealtyTrac.

“With the average timeline for foreclosure increasing, these properties are sitting in limbo for a longer period,” said RealtyTrac Vice President Daren Blomquist.

Florida had the highest foreclosure rate last year, with more than 3 percent of households receiving a filing. It’s one of about 20 judicial states including New Jersey, New York and Connecticut, requiring a court review of home repossessions, and lengthening the time it takes to seize a property.

There are about 8 million borrowers still underwater, who owe more on their mortgages than their homes are worth, which increases the probability of default, Deutsche Bank AG wrote in a report this month. Florida and California have the highest concentration, each with more than one million single-family houses in negative equity.

### Negative Equity

Subprime and option adjustable-rate mortgages originated at the peak of the market, with weaker underwriting standards, have the highest exposure to negative equity, Deutsche Bank analysts led by Steven Abrahams wrote in the report. Defaults and losses to bondholders are expected to decline as home prices continue to rise, with estimated gains of about 6.8 percent this year, the report said.

An index tied to subprime bonds created in the second half of 2006 that were issued with AAA ratings rose to 59.5 cents on the dollar this month from a low of 31.1 cents on the dollar in October 2011, according to London-based administrator Markit Group Ltd. The debt last year outpaced returns for less risky non-agency mortgage debt, such as Alt-A, which is backed by borrowers who often qualified with limited documentation.

### ‘Very Bullish’

“In 2013, we were very bullish on subprime,” said Anup Agarwal, head of mortgage-backed and structured products at Pasadena, California-based Western Asset Management. “It was overall a big winner and you saw that reflected in prices.”

Agarwal, whose firm managed \$443 billion in fixed-income assets as of Sept. 30, has in the past six months turned more negative on subprime and started shifting money into Alt-A securities.

One William Street Capital Management LP, a hedge fund firm

with \$2.7 billion in assets, is expecting reduced losses as home prices continue to rise, according to a letter sent to investors this month. The investment firm said increased regulations have added to costs for firms that deal with troubled mortgages.

For subprime prices to make sense, recoveries must improve but won't because of the backlog of loans, Gundlach said.

The money manager has cautioned investors before about avoiding subprime. In 2012, he said investors can't assume the "lines will head south" speaking about loss severities for loans and then last year, referred to the debt as being stubborn.

### Brash Pronouncements

Gundlach has a history of making contrarian and brash pronouncements. After a conference in April 2012, he said he thought the Federal Reserve should be abolished, and that same month that investors should short Apple Inc., after it had risen more than sevenfold from January 2009.

Most of DoubleLine's assets are in the \$31 billion Total Return Bond Fund, which as of last year had 31 percent, the highest allocation, in residential mortgage-backed securities not backed by the U.S. government.

Gundlach has traditionally favored higher quality non-agency debt in the fund rather than subprime. He balances those securities with bonds that are backed by the government and adjusts the mix to help the fund weather different scenarios in the housing market and changes in interest rates.

Gundlach's fund returned 6.3 percent over the past three years, ahead of 93 percent of peers, according to data compiled by Bloomberg. Last year was the fund's worst absolute and relative returns since opening in April 2010, with it gaining just 0.02 percent and beating 80 percent of peers. Investors pulled \$6 billion, according to estimates from Morningstar Inc., its first year of net withdrawals.

During a webcast this month Gundlach said that he's "re sculpted" DoubleLine Total Return Bond Fund, decreasing its holdings of agency mortgages and adding holdings of non-agency and commercial mortgage debt. This year through Jan. 22, the fund returned 1.5 percent, moving it ahead of 99 percent of similarly managed funds, Bloomberg data show.

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