DYNAMIC CREDIT

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European ABS market Update

ABS Trading in Stable Range, CLOs Weaken on back of Rating Agency Downgrades...

Global equity markets continued the recent upward trend amid optimism that the economy in some parts of Europe and the US were beginning to reopen. We continue to cheer news of flattening of COVID-19 curves coupled with hopeful announcements coming from pharmaceutical companies developing potential treatments. Unfortunately, a vaccine allowing for a return to "normal" likely remains at least 12 months away. As shown in Japan, Singapore, and now Germany, premature easing of lockdown restrictions can result in secondary infection clusters and transmission rates reversing the downward trend. On a more positive note, New Zealand announced that COVID-19 has been "eliminated" in the country and moved to ease into a less restrictive lockdown. Energy continues to experience elevated volatility as optimism over reopening conflicts with dwindling storage capacity, with June WTI settling in the low double digits and international benchmark Brent around $20.

In terms of fundamental credit performance, we continue to see credit rating agencies reacting significantly faster this time around compared to the financial crisis as they downgrade ABS transaction citing worse than expected performance or reflecting counterparty exposure following servicer downgrades. Having received a number of post-March investor reports from a wide cross-section of country and asset types, we see an increase in arrears. Risker deal types, including non-performing loan and subprime auto transactions, are likely to experience more material deterioration in credit performance which can result in impairments to mezzanine positions. In CLO markets, over 1,000 mezzanine CLO tranches have been placed on watch for ratings downgrade by multiple rating agencies, which contributed to more negative sentiment relative to other asset classes.

While equity markets rallied last week, most ABS traded in a stable range with senior and shorter duration bonds trading better and more credit sensitive and longer duration positions were flat to wider on low trading volumes. The ABS primary market is still technically on hold with only one VW Bank auto deal closed via private placement. In the CLO primary market, banks are trying to sell existing warehouse exposures from their balance sheet. The first CLO deals were placed since the beginning of the COVID-19 outbreak, including some without non-investment grade tranches. In the secondary market, CLOs weakened after rallying the previous two weeks as the market digests the elevated risks of loan defaults and rating downgrades amid heavier selling volume.

Below is an overview of the one week spread change in various ABS segments, compared to investment grade and high yield corporate credit as of April 24, 2020:

	20-2	13-3	20-3	27-3	3-4	10-4	17-4	24-4	1 Week Change	Ytd	Peak 2007-2009
Iboxx Eur Corporate	100	186	247	256	251	235	210	205	-5 bps	101 bps	470 bps
Iboxx EUR HY	338	661	895	802	770	712	645	649	4 bps	298 bps	1930 bps
Prime/Auto Senior ABS	16	25	50	60	60	55	49	48	-1 bps	32 bps	400 bps
Spanish Senior RMBS	38	85	200	215	215	190	175	165	-10 bps	52 bps	750 bps
Auto ABS Mezzanine	60	140	250	275	275	260	260	240	-20 bps	164 bps	1150 bps
CLO AAA	105-125	210-225	300-400	200-300	200-300	150-200	150-200	175-200	25 bps	55-80 bps	550 bps
CLO BBB	265-375	575-600	600-800	750-850	800-1050	700-900	650-850	700-850	50 bps	315-465 bps	2300 bps

Source: Bloomberg

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