

European ABS market Update

Muted Activity in ABS Primary Market, DNTs Up on Thin Secondary Trading, First Euro Credit Default...

Last week saw both global equity and corporate debt markets take a breather from the rally observed over the past 6 weeks. We remain early in the current crisis - monetary policy support has provided a floor but the market awaits more clarity on direction from here. This week started off with a bang following an announcement from Moderna, a US-based biotech company, about promising results in the first testing phase for a potential COVID-19 vaccine, along with comments from Chairman Powell that the Fed is "not out of ammunition by a long shot." In Europe, first quarter preliminary GDP numbers project contractions on both a quarterly and annual basis at country and eurozone (-3.8%) levels. On the fiscal policy front, Germany and France announced talks on the creation of a EUR 500 billion recovery fund with the aim to help EU countries and industries hit the hardest by the COVID-19 pandemic.

In terms of fundamental credit performance, as pointed out last week, we are starting to see the first visible effects of the pandemic crisis. The first significant exposure in European CLOs, Apax Partners (owned German discount retailer Takko Fashion) was downgraded to "defaulted" after suspending interest payment on one of its bonds. While European CLOs currently remain in better shape than US deals, where almost a quarter of deals are failing overcollateralization tests, many highly-leveraged companies in Europe have been blocked from state-backed loan programs due to EU state-aid rules limiting support to companies with limited equity capital. Combined with an ECB that has thus far been less aggressive than the Fed in terms of supporting high yield credit, private sources of capital are likely to remain constrained in the wake of rising defaults. On the ratings front, this week S&P highlighted expectations of negative rating momentum globally across asset classes throughout 2020, including investment grade bonds in an adverse scenario.

In the Euro secondary space, we continued to see relatively thin supply. Spreads were stable week-over-week, with elevated levels of DNT on low trading volumes. On the more positive side, we saw two BWICs with Mezzanine ABS positions and. The ABS primary market continues to see muted activity with a few more deals coming to market. Senior bonds were well received by investors but mezzanine bonds were either not offered or preplaced. Reflecting this trend, we saw a new STS-compliant German Auto deal from Mercedes-Benz this week with strong demand for the A tranche while the B tranche was fully retained by the originator. In the CLO primary market, a few low leverage deals with short non-call and reinvestment periods are currently being marketed. One deal that was pulled in March is back on the market at a dramatically smaller size (EUR 202.5m vs. EUR 400m).

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 May 15, 2020:

	20-2	13-3	20-3	27-3	24-4	1-5	8-5	15-5	1 Week Change	Ytd	Peak 2007-2009
Iboxx Eur Corporate	100	186	247	256	205	193	195	205	10 bps	102 bps	470 bps
Iboxx EUR HY	338	661	895	802	649	645	657	665	8 bps	314 bps	1930 bps
Prime/Auto Senior ABS	16	25	50	60	48	46	44	44	0 bps	28 bps	400 bps
Spanish Senior RMBS	38	85	200	215	165	155	150	150	0 bps	37 bps	750 bps
Auto ABS Mezzanine	60	140	250	275	240	230	215	210	-5 bps	134 bps	1150 bps
CLO AAA	105-125	210-225	300-400	200-300	175-200	175-200	175-200	175-200	0 bps	55-80 bps	550 bps
CLO BBB	265-375	575-600	600-800	750-850	700-850	650-800	600-750	600-750	0 bps	215-365 bps	2300 bps

Source: Bloomberg



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