

European ABS market Update

ABS Secondary Market Grinds Tighter as Countries and Economies (Begin to) Reopen

What a difference two weeks has made on the pandemic front. The epicenter of the COVID-19 crisis has shifted to Latin America and other developing countries. Case numbers continue to flatten in much of the developed world as countries continue to reopen their economies alongside plans to reopen some national borders in the form of “travel bubbles” and “air bridges”. To be clear, concerns about a second wave of infections in the second half of the year remain, especially in light of recent mass protests in the US and around the world. Nevertheless, the combination of a lack of reopening setbacks thus far and optimism that initial doses of a vaccine could be available by the end of the year have effectively alleviated a health crisis driven depression. This has been combined with effectively unlimited monetary policy support, putting a convincing floor under prices for equity markets and quality assets. Barring another unexpected event (e.g. a second wave of infections, a spiraling trade conflict between the US and China, or simply a monetary or fiscal policy mistake of withdrawing support too early), we have likely already seen the bottom for high grade assets. Still, it remains clear that the global economy is at risk of a more garden variety downturn lead by persistent high unemployment, wage declines, and some likely permanent changes in consumer spending behavior, all of which indicate a likely slow and uncertain recovery process which will result in significant stress on overleveraged companies and other credit sensitive assets which don't benefit from direct monetary policy support.

While continued monetary policy support is largely expected, such as the recent expansion in size and duration of the ECB Pandemic Emergency Purchase Program, broader fiscal support has largely been tabled as the initial urgency from early stages of the crisis has subsided. In the US, little progress on an additional stimulus package following March's \$2 trillion CARES Act has been made. At the same time, the European Commission has unveiled a plan for a EUR 750 billion recovery fund based on an initial initiative by France and Germany, but the road to its implementation remains uncertain due to opposition by some members of the EU. However, there remains a convincing case for additional fiscal support, due to historic worldwide unemployment. Although unemployment levels in the Eurozone has been significantly lower (7.3% in April) than the estimated 20% level in the US due to wage subsidy programs, estimates of over 40 million on furlough schemes highlight similar levels of potential stress in the European labor force. In ABS markets, primary market flow continues to be very slow. Aegon recently closed a fully retained Dutch prime RMBS while the German auto loan ABS sold by Mercedes Bank at the end of May highlighted weak end-investor demand as almost 75% of bonds were placed with banks and central banks. At the same time, secondary markets have continued to grind tighter on light volume. However, we are beginning to see increased selling appetite in more credit sensitive “story bonds” as the market continues its upward trend. Additionally, we have seen an uptick in activity in asset classes such as in European CMBS, where trading had previously ground to a halt following the outbreak. While we remain wary towards CMBS exposure, it does offer pockets of value for investors with a positive outlook. A renewed rally in European high yield credit also extended to the CLO space, despite worsening fundamental performance. Issuance in CLOs remains negligible with only four deals done in May, marked by lower leverage, small deal sizes, and large amounts of preplacement.

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 29, 2020:

	20-2	20-3	27-3	24-4	1-5	8-5	15-5	29-5	2 Week Change	Ytd	Peak 2007-2009
Iboxx Eur Corporate	100	247	256	205	193	195	205	176	-29 bps	72 bps	470 bps
Iboxx EUR HY	338	895	802	649	645	657	665	569	-96 bps	218 bps	1930 bps
Prime/Auto Senior ABS	16	50	60	48	46	44	44	42	-2 bps	26 bps	400 bps
Spanish Senior RMBS	38	200	215	165	155	150	150	150	0 bps	37 bps	750 bps
Auto ABS Mezzanine	60	250	275	240	230	215	210	200	-10 bps	124 bps	1150 bps
CLO AAA	105-125	300-400	200-300	175-200	175-200	175-200	175-200	175-200	0 bps	55-80 bps	550 bps
CLO BBB	265-375	600-800	750-850	700-850	650-800	600-750	600-750	500-650	-100 bps	115-265 bps	2300 bps

Source: Bloomberg



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