

European ABS market Update

Global Markets Rally on Back of Monetary and Fiscal Policy Intervention, Credit Showing Signs of Deterioration...

Global markets rallied last week on the back of monetary and fiscal policy intervention and a wave of optimism that outweighed continuing negative macro developments. Announcements of selected economic re-openings as a result of flattening COVID-19 curves and news of promising treatment findings (e.g. remdesivir) drove the positive sentiment.

Negative headlines included secondary outbreaks in countries thought to have achieved containment (i.e. Singapore, Japan), unprecedented US and Norwegian unemployment numbers, and May contracts for West Texas Intermediate (WTI) oil delivery trading as low as negative(!) \$37 a barrel, highlighted just how far real economic activity has fallen. On the opposite (positive) end of the spectrum, with the number of new cases declining in large parts of Europe, the conversation has turned towards exit strategies. Austria and Italy have gradually allowed small shops to open this week, some Danish students will start returning to school on Wednesday and selected non-essential Spanish factories have reopened. However, a return to somewhat normal business activities remains far from clear without a vaccine. While France has presented an ambitious plan to lift all restrictions by August, the UK extended its lockdown by "at least" 3 weeks and suggested that some restrictions could remain in place until a vaccine is found.

In terms of fundamental credit performance - although some April ABS transaction reports showed mild signs of credit deterioration in the form of higher delinquency rates, it remains too early to make broad judgements. Only after we have received quarterly reports from a wide cross-section of country and asset types can we assess the impact of both economic conditions on borrowers and judge how well social safety nets are functioning. In the CLO space the feedback loop has been significantly faster, as CCC rated loans in European CLO portfolios increased 3x-4x in March to 6%-9% (a.o. 01.04.20), while rating agencies have put over 1,000 CLO tranches on watch for rating downgrade. As credit performance unfolds, fiscal policy support dominated sentiment in the last two weeks, as the Federal Reserve announcement that it would start buying high yield bonds triggered a modest rally in both US and EUR loan and CLO markets. Even though neither European paper nor leveraged loans is eligible for Fed purchase, there was a pronounced trend of US CLO buyers crossing over to EUR market driven by perceived relative value given exposure of US CLOs to the battered energy sector.

Last week we saw again most asset classes trading stable to slightly better compared to last week, though spreads have flattened off (with this week noticeably weaker) as real money account selling picked up. With the primary ABS market on hold and the primary CLO market consisting of banks trying to sell existing warehouse exposures from their balance sheet, trading activity is confined to secondary BWICs. As the relief rally lost steam in the face of buyers failing to meet selling demand, we saw DNTs increase into the 30-40% range. 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 10, 2020:

| | 20-2 | 13-3 | 20-3 | 27-3 | 3-4 | 10-4 | 17-4 | 1 Week Change | Ytd | Peak 2007-2009 |
|-----------------------|---------|---------|---------|---------|----------|---------|---------|---------------|-------------|----------------|
| Iboxx Eur Corporate | 100 | 186 | 247 | 256 | 251 | 235 | 210 | -25 bps | 106 bps | 470 bps |
| Iboxx EUR HY | 338 | 661 | 895 | 802 | 770 | 712 | 645 | -67 bps | 295 bps | 1930 bps |
| Prime/Auto Senior ABS | 16 | 25 | 50 | 60 | 60 | 55 | 49 | -6 bps | 33 bps | 400 bps |
| Spanish Senior RMBS | 38 | 85 | 200 | 215 | 215 | 190 | 175 | -15 bps | 62 bps | 750 bps |
| Auto ABS Mezzanine | 60 | 140 | 250 | 275 | 275 | 260 | 260 | 0 bps | 184 bps | 1150 bps |
| CLO AAA | 105-125 | 210-225 | 300-400 | 200-300 | 200-300 | 150-200 | 150-200 | 0 bps | 50-80 bps | 550 bps |
| CLO BBB | 265-375 | 575-600 | 600-800 | 750-850 | 800-1050 | 700-900 | 650-850 | -50 bps | 215-415 bps | 2300 bps |

Source: Bloomberg



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