DYNAMIC CREDIT

22 July 2020

European ABS market Update

European ABS issuance remains subdued while credit performance is starting to be impacted COVID-19

With the number of COVID-19 cases passing 13 million, the world continues to adjust to life with the pandemic in the background for the foreseeable future. While Western Europe and parts of Asia progress toward a semblance of normalcy, we continue to see an acceleration in the number of daily new cases in many areas like (Latin) America, Eastern Europe, and India. This aligns with the easing of lockdown measures we continue to see across Europe since the beginning of July as some countries have now opened external borders. However, the macroeconomic picture remains difficult as ECB President Lagarde described expectations of a complicated economic recovery using the words “sequential and restrained.” This aligns with our continuing view that the global recovery will be halting and uneven, with potentially a very long path towards pre-pandemic levels of economic activity.

On the monetary policy side, the ECB has increased the Pandemic Emergency Purchase Program (PEPP) to EUR 1.35 trillion, which may be upsized even more given the long road to recovery. The impact of this support has led to investment grade bonds within the scope of the program that have seen significant growth in volume as companies continue to raise cash in the most active quarter for primary issuance on record. While high yield spreads have also benefitted, the fundamental credit story is challenged as we continue to see deterioration with two new major European defaults: Hema, the Dutch retail chain and Matalan, a British retailer. We also observed the first broadly publicized European case of a (high yield) borrower shifting pledged assets away from creditors into a separate uncovered entity under control of the private equity sponsor. While it remains to be seen if this is the beginning of a trend, it highlights the disparity in the ability of high yield versus investment grade borrowers to raise cash as we remain in a challenging period for corporates (and individuals).

European ABS issuance remains subdued with only two deals in the pipeline. European issuance is 30% below June 2019 YTD levels. While the pace of primary supply could partially recover in the second half of 2020, as spreads have recovered significantly from the depths of March, this is unlikely to happen before September and subject to COVID-19 developments over the next 2 months. In the absence of new issue supply, European ABS secondary spreads ground slightly tighter over the last few weeks on the back of the current supply/demand imbalance. BWIC activity has remained healthy and trade execution remained robust with most bonds trading. The level of DNTs has been in the low single digits for core European bonds, with peripheral bonds somewhat higher between 10 and 20 percent.

In terms of fundamental credit performance, we see more and more transactions reporting on the impact that COVID-19 has had on the collateral pool. We have begun to observe significant dispersion across jurisdictions (and even between originators). Dutch RMBS have reported less than one percent of loans on payment holiday on average, Spain is close behind at less than 2 percent, while UK RMBS levels are significantly higher at just above 15% on average. To be fair, this is partially due to the discrepancies in loan hardship documentation requirements, but it highlights the need for detailed credit analysis and a conservative approach towards credit selection despite strength in bond prices.

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 July 10th, 2020:

	20-2	20-3	27-3	24-4	1-5	15-5	29-5	12-6	26-6	10-7	2 Week Change	Ytd	Peak 2007-2009
Iboxx Eur Corporate	100	247	256	205	193	205	176	151	155	151	-4 bps	47 bps	470 bps
Iboxx EUR HY	338	895	802	649	645	665	569	534	542	520	-22 bps	170 bps	1930 bps
Prime/Auto Senior ABS	16	50	60	48	46	44	42	40	38	34	-4 bps	18 bps	400 bps
Spanish Senior RMBS	38	200	215	165	155	150	150	140	138	135	-3 bps	22 bps	750 bps
Auto ABS Mezzanine	60	250	275	240	230	210	200	182	180	177	-3 bps	101 bps	1150 bps
CLO AAA	105-125	300-400	200-300	175-200	175-200	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	500-650	500-600	500-600	500-600	0 bps	115-215 bps	2300 bps

Source: Bloomberg



Tim Jansen
Portfolio Manager

Vlad Olteanu
Portfolio Manager

Mike Li
Portfolio Manager