LOOMIS | SAYLES

THREE QUESTIONS ON CREDIT: CONSUMER ABS

FEATURING GREG WARD AND JENNIFER THOMAS

HOW IS THE CURRENT ENVIRONMENT AFFECTING THE CONSUMER-RELATED SECURITIZED SECTOR?

Consumer asset-backed securitized (ABS) sectors should continue to face headwinds as consumers feel the full impact of the dramatic economic slowdown ignited by the COVID-19 outbreak. Unemployment has increased, which could impact the ability of borrowers to make loan payments on everything from autos to credit cards, and will have implications for the securitizations underpinned by these obligations. We may not see these impacts manifest in the numbers until remit reports for March are available in late April, but we are already hearing anecdotal evidence from our issuer relationships that consumers are reaching out to discuss payment extensions and other potential remedies. Lenders have curtailed the extension of new credit in some areas while simultaneously communicating the options available to some borrowers through active outreach, special advertising and web-based resources. On the plus side, US consumers were largely in decent financial shape going into the crisis, which may help provide some cushion. One difference between now and the global financial crisis is that house prices have been rising and there's a lot less leverage in the housing market, which may help alleviate some pressure on borrowers. However, an important distinction to consider is that all of this is less true for lower-income or subprime borrowers who tend not to own homes. The consumer ABS space is broad and the impacts of this crisis will not be felt evenly across all sectors. In this environment, given the uncertainty, we favor staying higher in the capital structure in bonds from high-quality issuers.

CAN THESE STRUCTURES WITHSTAND THE STRESSES?

We believe that the investment-grade-rated tranches of most securitizations can withstand the stresses created by extensions, deferrals and outright defaults. Credit enhancements, such as overcollateralization, reserves, early amortization provisions and cash-trapping performance metrics embedded in these structures, can provide a good level of protection in a severe recession scenario. The strength of the sponsor and servicer is also an important factor—those with more financial strength and flexibility should be able to better handle issues as they arise. Finally, it is also important to bear in mind that the $2 trillion federal stimulus package, which provides for extended unemployment benefits, one-time checks to some, personal tax cuts and other provisions, may help soften the blow.

WHAT OPPORTUNITIES ARE YOU SEEING NOW?

Beginning in the second half of March, credit markets, including securitized sectors like consumer ABS, sold off significantly. As the government stepped in, sentiment improved and some sectors partially rebounded, though not to pre-crisis levels. In securitized credit, spreads remain wide. However, recognizing that we are in uncharted territory in terms of the ultimate impact on consumers, we believe investors should be cautious. The next few weeks will be key in understanding the magnitude and duration of the economic fallout and we generally favor awaiting more clarity. Patience is warranted in areas like consumer credit and transportation-related assets. However, there are pockets of the consumer ABS market that we are watching, such as refinanced student loans, which tend to have a borrower base with more stable income and are attractive from a valuation perspective. We are also watching consumer ABS sectors like auto loans that could potentially tighten as a result of government support programs like TALF. As noted, we continue to favor staying up in quality and avoiding significant credit risk until there is more visibility. Away from the consumer space, we see opportunities in the RMBS sector, which saw forced selling as some investors needed to deleverage.

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