GUGGENHEIM

Asset-Backed Securities and CLOs

Commercial ABS Remains Attractive

Declining primary market issuance helps support spreads.

In the CLO sector, primary market issuance slowed significantly in the second quarter to $22 billion—a 47 percent year-over-year decline—as elevated CLO tranche spreads and rising bank loan prices reduced the economic incentive for sponsors to issue new CLO deals. We expect issuance to remain tepid into year-end and for spreads to remain rangebound. Our preference is to focus on senior CLO tranches given the attractive carry profile and higher credit quality of the tranches. The tiering between top and bottom quartile AAA spreads for new-issue CLOs has increased to 37 basis points compared to less than 10 basis points historically, making it more punitive for lesser-followed managers to issue new deals. Underlying loan fundamentals remain challenged in a higher interest rate environment—net downgrades to CCC and defaults in CLO portfolios in the first half of the year have exceeded 2022 full-year levels. Importantly, recovery rates have trended lower, which could lead to increased volatility for junior CLO tranches. Exposure to healthcare companies and software companies—two of the largest sector weights in CLO portfolios—remain a key focus area due to the elevated level of stress in these industries.

Commercial ABS yields are notably more attractive than similarly rated corporate bonds. The spread differential between commercial ABS and corporate bonds stood at 120 basis points in mid-July, versus a 10-year median of 58 basis points, which ranks in the 89th percentile relative to history. Commercial ABS is a smaller niche market with less liquidity than the corporate bond market, and this lower liquidity means structured credit tends to lag rallies in corporate credit. Since this spread is driven by liquidity rather than fundamentals, we believe it presents an attractive opportunity to increase exposure to certain categories of the ABS market.

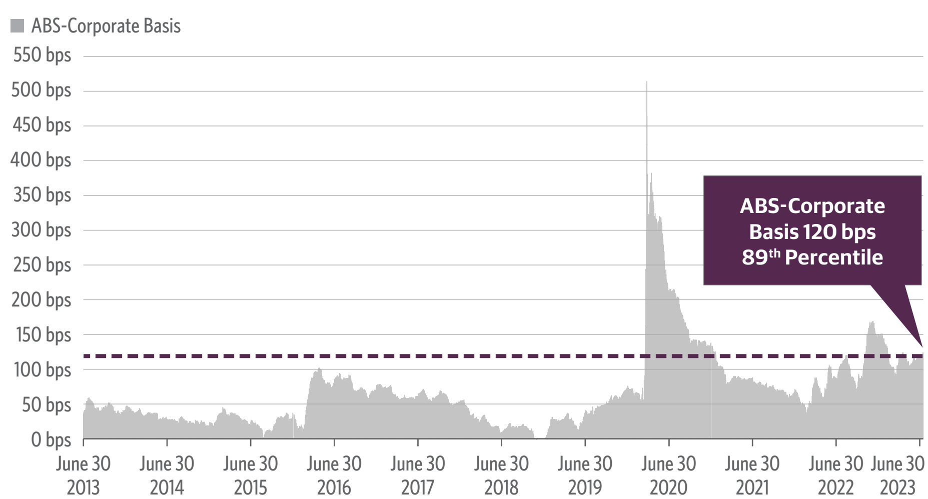
Commercial ABS primary market issuance declined 28 percent year to date as issuers avoided borrowing at higher rates. While opportunities in new issue have been modest, investors who have high credit conviction and stepped up to anchor deals were able to achieve favorable allocations. We have been active in data center, fiber, and triple net lease sectors, where we have seen senior investment-grade rated tranches at 6–6.5 percent yields. We expect to see a similar rhythm of issuance over the rest of the year as issuers can no longer defer refinancings or takeouts of non-ABS warehouse debt. Credit performance across ABS is beginning to show differentiation, as some subprime auto and consumer unsecured issuers sustain underlying collateral defaults. Our focus in ABS remains on capturing the complexity premium in commercial subsectors with an emphasis on selecting stronger sponsors and investor-friendly structures.

By Michael Liu, Scott Kanouse, and Dominic Bea

The spread differential between investment-grade commercial ABS and corporate bonds stood at 120 basis points in mid-July, putting it at the 89th percentile relative to history. This spread is largely driven by liquidity rather than fundamentals, presenting an attractive opportunity to increase exposure to ABS.

Commercial ABS/Investment-Grade Spread at 89th Percentile

Commercial ABS and Investment-Grade Corporates Spread Differential



Source: Guggenheim Investments, ICE BofA, Bloomberg. Data as of 7.14.2023.