

## Asset-Backed Securities and CLOs

# Esoteric ABS Goes Mainstream



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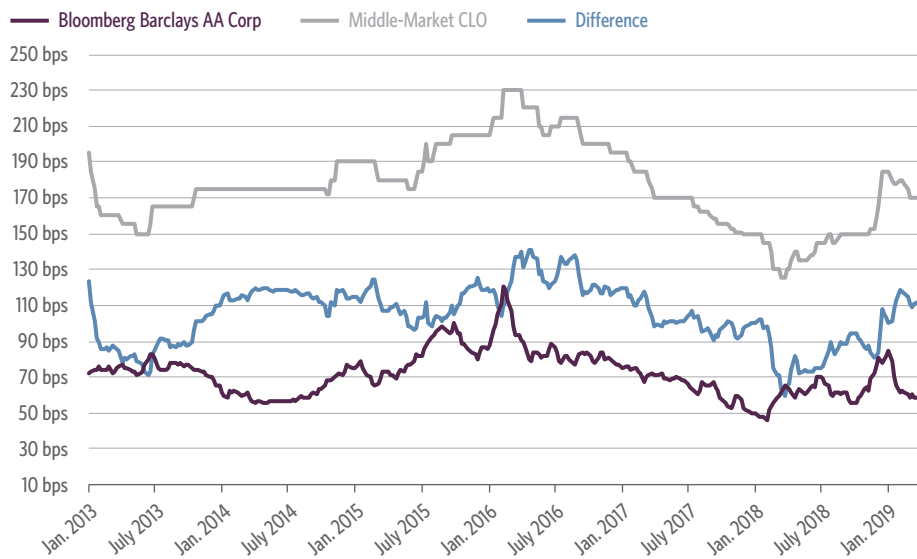
Investor demand for high-quality credit is increasing competition for whole business ABS.

Rising market expectations of a Fed rate cut (which hurt demand for floating-rate assets), ongoing negative headlines for leveraged lending, and uncertainty regarding new Japanese risk retention regulation all weighed on CLO markets in the first quarter. AAA CLO spreads drifted around 10 basis points wider, erasing the economic incentive to refinance or reset existing CLOs. As a result, refinance and reset volumes dropped by around 75 percent from the same period in 2018. New issuance volume of \$29 billion kept pace with first quarter 2018 levels. CLO spreads began to rally later in the second quarter, and we note that AAA CLO spreads look attractive relative to corporate credit (see chart, top right). We have found compelling investments in shorter-tenor AAA broadly syndicated loan and middle-market CLOs.

Esoteric ABS spreads rallied sharply in the first quarter. Limited supply and strong investor demand drove spreads tighter across ABS subsectors. The few esoteric transactions marketed during or shortly after the first quarter saw voracious investor demand. First-time issuers enjoyed substantial investor support for securities, and bellwether whole business ABS issuers such as Dunkin' Brands were able to upsize their original bond offerings and price them well through initial price guidance.

The strength and breadth of the bid in whole business ABS has recently caught our eye. The whole business ABS market has grown from \$16 billion to \$25 billion in the last two years, and as investor acceptance and sponsorship of whole business ABS has grown, the spread pickup to BBB corporates has evaporated. While whole business traded at a 50-100 basis point spread concession to BBB corporate bonds since 2015, there has been little to no spread concession since the middle of last year (see chart, bottom right). We are still able to find unique opportunities within this space, but it seems the word is out. Demand has increased as other investors now understand the high-quality credit of this esoteric investment space. In the immediate term, we remain focused on senior CLO, esoteric commercial ABS, and aircraft finance.

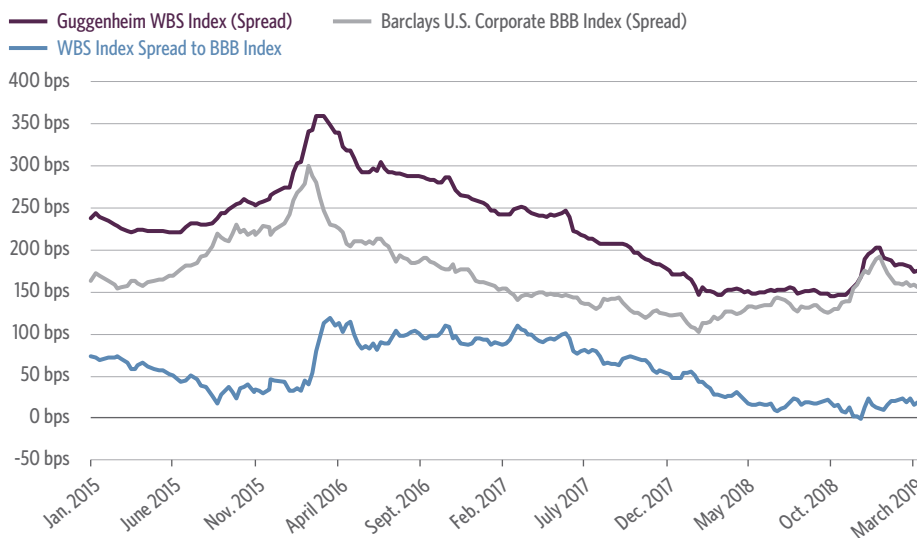
### AAA Middle-Market CLOs Have Cheapened Relative to Corporates



Source: Guggenheim Investments, Bloomberg Barclays, Wells Fargo. Data as of 4.5.2019.

AAA-rated CLOs have cheapened relative to corporates since the middle of last year. AAA-rated broadly syndicated CLOs and middle market CLOs currently offer 69–106 basis points of spread concession relative to AA-rated corporates (there are too few AAA corporates to create a meaningful sample). These are attractive spread concessions for securities that have no historic example of ever defaulting or taking a loss.

### Whole Business ABS Spreads Continue to Grind Tighter, Offering Little Concession



Source: Bloomberg, TRACE. Guggenheim WBS Index includes the following fixed rate term notes, weighted by original principal balance: Driven Brands 2019-1, Driven Brands 2018-1, Driven Brands 2015-1, Taco Bell 2018-1, Taco Bell 2016-1, Wingstop 2018-1, FOCUS 2018-1, FOCUS 2017-1, Planet Fitness 2018-1, Coinstar 2018-1, Coinstar 2017-1, CKE 2018-1, CKE 2013-1, Domino's 2018-1, Domino's 2017-1, Domino's 2015-1, Domino's 2012-1, Sonic 2018-1, Sonic 2016-1, Sonic 2013-1, Wendy's 2018-1, Wendy's 2015-1, Dunkin' Brands 2017-1, Dunkin' Brands 2015-1, Jimmy John's 2017-1, Church's 2017-1, Church's 2011-1, Five Guys 2017-1, TGI Friday's 2017-1, Arby's 2015-1, Dine Brands 2014-1, Miramax 2014-1, and Hooters 2014-1. US Corporate BBB and BB indices per Bank of America Merrill Lynch. Data as of 3.15.2019.

As the popularity and investor acceptance of whole business securitization has grown, the spread pickup to BBB corporates has generally evaporated. We are still able to find unique opportunities within this space with new issuers and differentiated business concepts.

Investing involves risk. In general, the value of fixed-income securities fall when interest rates rise. High-yield securities present more liquidity and credit risk than investment grade bonds and may be subject to greater volatility. Asset-backed securities, including mortgage-backed securities, may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity risk. Investments in floating rate senior secured syndicated bank loans and other floating rate securities involve special types of risks, including credit risk, interest rate risk, liquidity risk and prepayment risk. Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Funds Distributors, LLC, GS GAMMA Advisors, LLC, Guggenheim Partners Europe Limited and Guggenheim Partners India Management. ©2019, Guggenheim Partners, LLC. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission of Guggenheim Partners, LLC.