GUGGENHEIM

Asset-Backed Securities and CLOs

Sound Fundamentals Counter External Pressures

Pent-up demand for long-term ABS financing will likely result in increased issuance over 2023–2025.

Credit fundamentals remain sound across most of commercial ABS, but we expect higher borrowing costs and recession-related reductions in consumer spending and corporate investment to pressure asset values and debt coverage parameters on certain deals. Certain commercial ABS sectors, such as triple net lease and data centers, continue to offer discounted dollar prices and higher spread versus similarly rated corporate credit alternatives. Whole business quick service restaurant franchises (QSR), also currently offer income enhancement opportunities compared to investment-grade corporate bonds.

The drop-off in commercial ABS issuance has been a major market dynamic year-to-date, but we expect this trend to change course. Issuance declined by 15.8 percent in the first quarter, but excluding resurgent issuance of utility ABS, commercial ABS issuance declined by 31.4 percent year over year. The decline is due in large part to issuers having access to alternative sources of financing, such as warehouse lines and revolvers, and being strategic about issuance timing. While we expect high all-in costs of debt to keep commercial ABS issuance subdued for the short-term, pent-up demand for long-term ABS financing will likely result in increased issuance over 2023–2025. This could provide an attractive opportunity to add to exposure in more meaningful size.

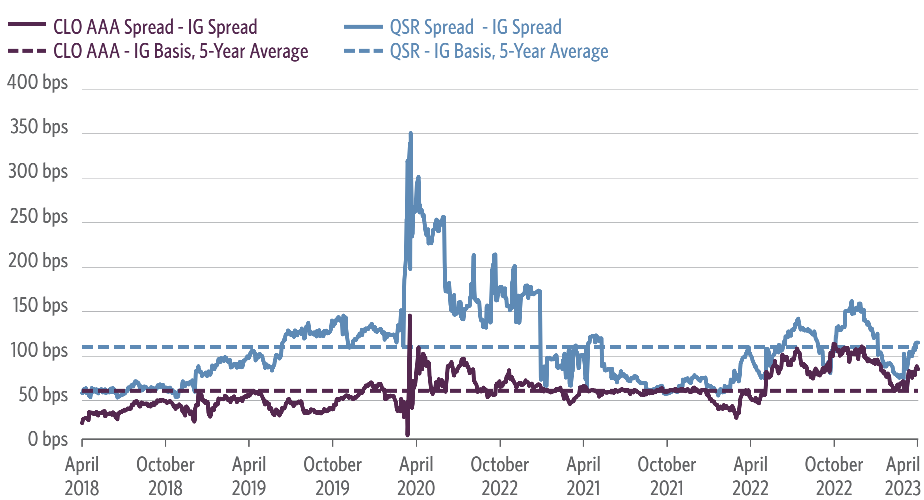
The indirect effects of tighter bank lending standards may result in tighter credit conditions in CLOs, particularly for smaller-sized borrowers typically outside the scope of inclusion as CLO collateral. New issuance in the first quarter was the second-highest on record with $33.4 billion of supply. We expect issuance to slow as macroeconomic uncertainty lingers, warehouse balances are pared, and CLO creation economics are challenged. Managers have been focused on upgrading portfolio quality and trading out of CCC and weaker B- names. We believe that there will be increasing dispersion in performance as managers who can avoid credit losses outperform. CLO spreads remain historically elevated, which means existing deals are unlikely to be called in the near term. AAA–A CLOs offer attractive income potential with less risk. Junior debt tranches are more susceptible to credit losses and we anticipate that there will be better entry points.

By Michael Liu, Scott Kanouse, and Dominic Bea

Whole business quick service restaurant (QSR) franchises currently offer income enhancement opportunities compared to investment-grade corporate bonds. AAA–A CLOs offer attractive income potential with less risk.

Whole Business QSR and Senior CLO Tranches Look Attractive

CLO and QSR vs. IG Corporate Spreads



Source: Guggenheim Investments, J.P. Morgan, Barclays. Data as of 4.9.2023. Note: QSR = quick service restaurant.

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