

Asset-Backed Securities and CLOs

Focus on High Quality, New Issue



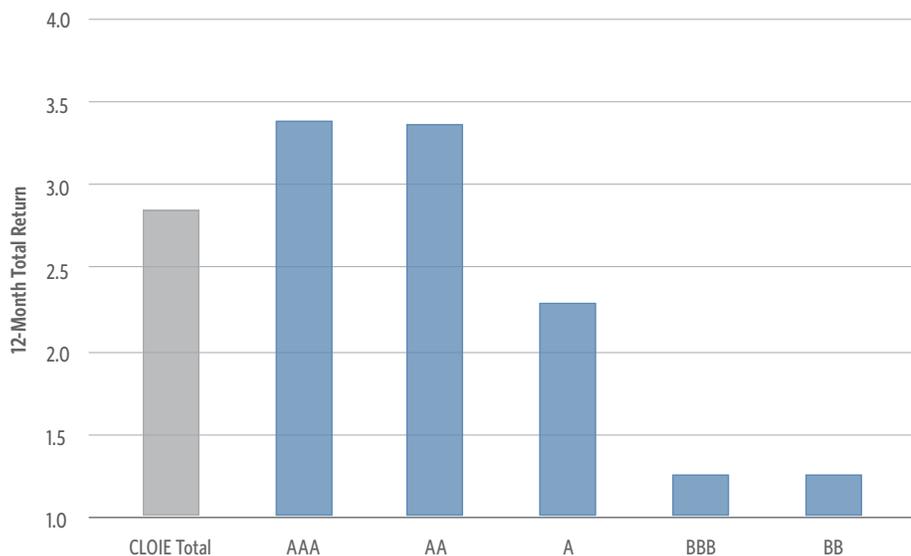
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We prefer short, senior CLO tranches and new-issue commercial and aircraft ABS.

Ongoing concerns about the longevity of the current credit cycle, memories of the sharp fourth quarter 2018 selloff, and reduced investor interest in floating-rate securities all weighed on CLO spreads during the third quarter. Our thesis over the last 12 months to favor short, senior CLOs has worked as expected: Pricing generally remained steady, but pricing for riskier subordinated tranches weakened by 10–45 basis points in the third quarter. Over the last 12 months AAA CLO tranches returned 3.52 percent, while subordinated BBB and BB securities returned just 2.83 percent and 2.72 percent, respectively (see chart, top right). Investors have not been adequately compensated to assume the additional credit and spread duration risk of subordinated CLO securities. While weakening spreads did not materially impact new issuance volumes in the third quarter (\$25 billion) refinance and reset volumes were anemic. We remain cautious on subordinated CLO investments, and believe short, senior CLO tranches have a superior investment profile for the remainder of the year.

Meanwhile, 2019's sharp rate rally (see chart, bottom right) has presented new risks for and meaningfully impacted our investment strategies in esoteric ABS. With relatively long open periods, or timeframes in which borrowers can refinance existing ABS without any prepayment penalty, esoteric ABS are prone to call and reinvestment risk in sharp interest rate rallies. These risks were particularly acute in 2019. Seasoned esoteric ABS have drifted toward premium dollar prices over the year, and when combined with short non-call periods and long open periods, the spread and yield profiles vary widely on a yield-to-call and a yield-to-maturity basis. To address these concerns, we have focused our investment activity on new issuance and shied away from premium-priced secondary offers. Par-priced new issuance avoids the skewed return profiles and offers extended call protection compared to more seasoned premium priced securities. Our investment focus remains on bespoke opportunities and new issue commercial ABS and aircraft ABS.

Senior CLO Tranches Outperformed Subordinate Tranches in the Past Year



Source: Guggenheim Investments, JP Morgan. Data as of 10.31.2019.

Senior CLO tranches have outperformed subordinate tranches on a nominal basis (and especially on a risk-adjusted basis) over the last 12 months.

Nominal Yields Have Fallen Since the Beginning of the Year

ABS Overview	Rating	WAL	12.31.2018		11.5.2019	
			Spread	Yield	Spread	Yield
Whole Business	BBB	5	168	4.25	175	3.3
Aircraft	A	4.5	160	4.17	200	3.55
Aircraft	BBB	5	285	5.42	310	4.65
Container	A	4.5	160	4.17	185	3.4
Triple Net Lease	AAA	5	95	3.52	110	2.7
Triple Net Lease	A	5	165	4.22	170	3.3

Source: Guggenheim Investments. Data as of 11.5.2019.

Credit spreads for certain ABS subsectors have widened. The underperformance of ABS credit spreads is owing to those securities' weak call protection, not credit concerns. As interest rates declined, prices rose and investors increasingly focused on yield to call analytics.

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.