## Asset-Backed Securities and CLOs

# Capturing the Information Premium

**Peter Van Gelderen**
Managing Director

**Michelle Liu, CFA**
Director

**Josip Zdrilic, CFA**
Director

Supply weighs on CLO markets, but opportunities abound in commercial ABS.

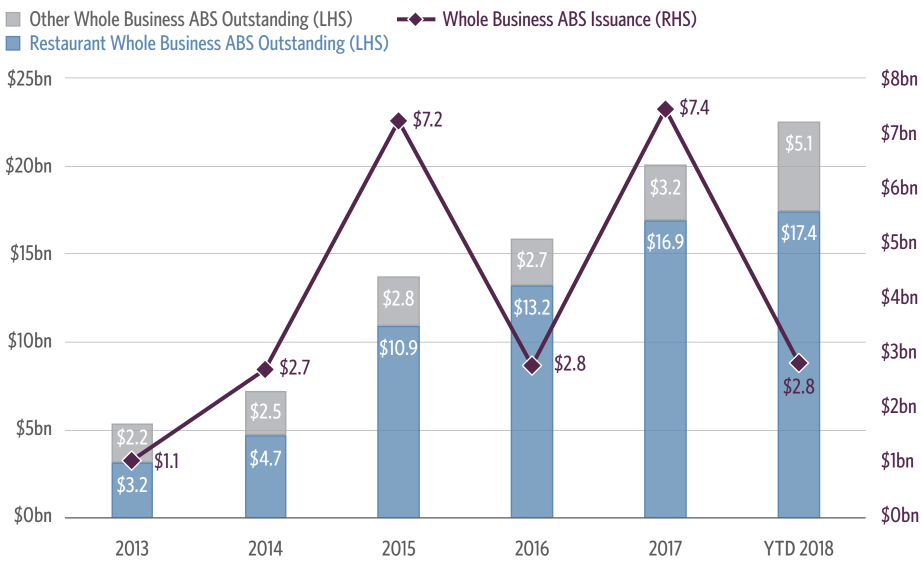
CLO spreads sagged in the second quarter as a torrent of primary market supply exhausted market participants. Year-to-date CLO issuance is trending at 1.3 times the volume of 2017, itself the second largest year of post-crisis CLO issuance. This overwhelming supply has empowered CLO debt investors to push back on weakening documentation terms that proliferated in the first quarter and created technical pricing distortions within the term structure of the CLO market. Despite this pressure in broadly syndicated CLO markets, middle-market CLOs continue to find favor with investors hungry for yield, causing spreads to tighten significantly. Spread concessions at these tight levels do not offer sufficient compensation to investors for the limited collateral transparency and lower liquidity profile.

Esoteric commercial ABS issuance was particularly strong in the second quarter (see chart, top right). Franchise finance, aircraft, cell tower, data center, insurance receivables, and university trademark licensing financing all offered new ABS issuance in the second quarter. Dominant franchise systems continue to take market share from smaller competitors, global aircraft travel has increased at a compound annual growth rate of 5.5 percent over the last 10 years, cellular data usage continues to explode with smart phones and mobile video, and other negotiated ABS transactions all offer uniquely strong credit profiles for credit investors. Our work in these sectors continues to uncover considerable value, fueling higher yields by capturing information premiums, as opposed to taking additional credit or leverage-based risk.

Per the JPM CLOIE indexes, the post-crisis index returns in the second quarter were 0.49 percent for AAA-rated securities, 0.63 percent for AA, 0.78 percent for A, 0.80 percent for BBB, 2.06 percent for BB, and 0.65 percent for B grades.

We currently find value in short-tenor CLOs, AA CLOs, and select esoteric ABS. CLO supply pressures have flattened the term curve for CLOs to the point where defensive short-spread duration CLOs are now comparably priced to riskier longer-spread duration CLOs. We also believe AA CLOs are mispriced and represent compelling value (see chart, bottom right). Esoteric commercial ABS will remain a focus in the third quarter.

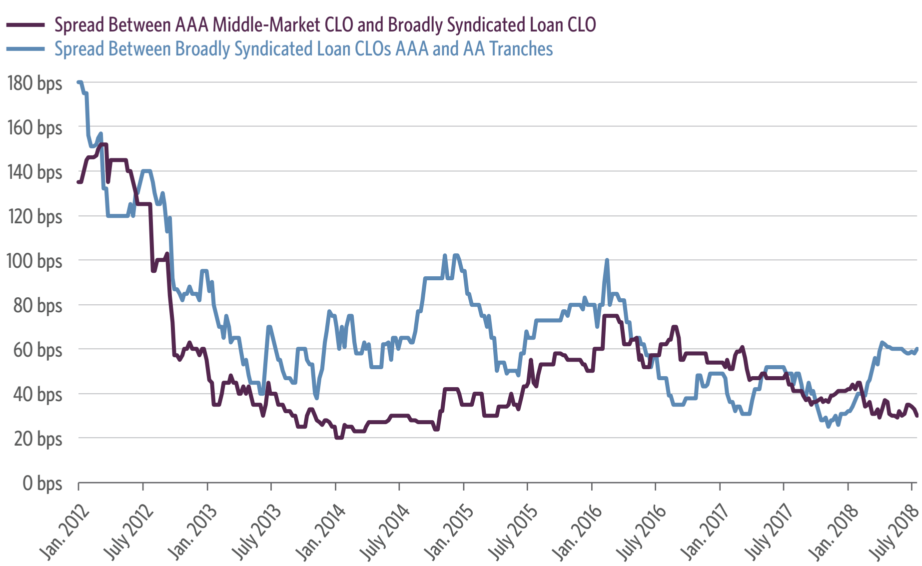
## Strong Issuance Keeps ABS Whole Business Supply Growing




Source: Asset-Backed Alert, Bloomberg, Guggenheim Investments. Data as of 7.20.2018.

Whole business securitization, which finances franchised restaurant businesses, has enjoyed robust new issuance, increased investor sponsorship and growing outstanding market size since the financial crisis.

## Relative Spread Movement Spells Opportunity and Caution




Source: Wells Fargo, Guggenheim Investments. Data as of 7.20.2018.

The recent basis widening between broadly syndicated AAA and AA loan tranches has caused AA to look very compelling on a risk-adjusted basis. However, investors' recent appetite for middle-market CLOs has caused the basis between middle-market CLOs and broadly syndicated loan CLOs to collapse. Middle-market CLOs do not currently offer investors sufficient compensation relative to broadly syndicated loan alternatives, considering their lower data transparency and liquidity.