RBC BlueBay
Asset Management

High supply creating attractive opportunities in ABS

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Securitized Credit team

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> "European auto loan ABS bonds have long had the attractive characteristics of strong fundamentals, fast de-levering, likely upgrade potential, and short spread duration."

European auto loan ABS bonds have long had the attractive characteristics of strong fundamentals, fast de-levering, likely upgrade potential, and short spread duration. In recent times an increase in supply has made the asset class even more appealing, with wider spreads and more deals to choose from. Technical opportunities such as this typically offer strong risk-adjusted value and now that supply/demand has re-balanced, we believe it's an attractive entry point for Auto ABS across our strategies.

Why are we seeing high supply?

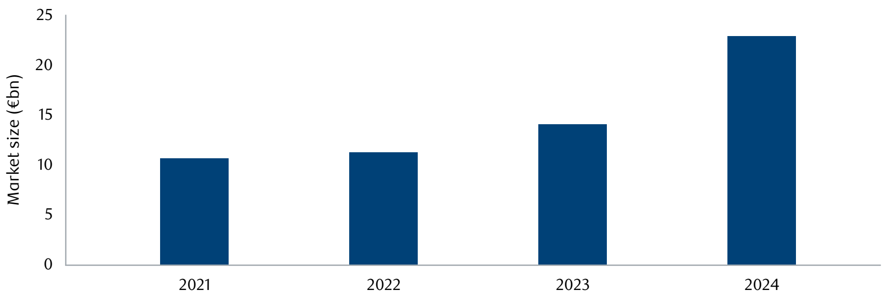
The increase in volume has been driven by four main factors:

1. Banks have had to move away from reliance on central banks for funding, and ABS markets need to fill the gap.
2. Beyond the need for funding, banks are seeking capital relief, which can be achieved by issuing ABS.
3. New non-bank lenders looking to diversify funding and enter the ABS market for the first time.
4. Consistent demand for loans from consumers despite continued strong lending standards.

What's the impact?

The technical backdrop for the European ABS market has shifted, causing spreads to widen on new deals and creating attractive investment opportunities that we have already been taking advantage of. Looking at historic European consumer ABS supply, given the short-dated nature of the bonds (2-3 years), net supply is typically relatively low. However, elevated new issue volumes has shifted this dynamic and caused a softening in spreads.

Figure 1: Consumer ABS market size (€bn)



Source: Chart Consumer Loan ABS Market Size. Morgan Stanley, 4 October 2024.

Looking at a snapshot of the capital structure in new issue ABS and comparing to recent tights and similarly rated corporates, the attractive risk adjusted value on offer in European ABS is evident, with shorter WAL and higher spreads versus both recent tights and corporates.

Asset class	Rating	Current spread (bps)	2021 spread tights (bps)	Basis to tights (bps)	Spread duration
European ABS	A	160	95	+65	2.8 yrs
	BBB	200	135	+65	2.8 yrs
European Corporates	A	78	28	+50	4.8 yrs
	BBB	104	55	+49	4.4 yrs

Source: RBC BlueBay, Bloomberg, representative deal for European ABS, Indices for European Corporates ER30, ER40.
Spread vs swaps, at 30 September 2024.

What are we doing?

This backdrop is attractive for our strategies as we are focused on seeking the best risk-adjusted returns and when issuance is high, it gives us a real opportunity to find bonds that are mispriced and offer attractive total returns, but without taking undue credit risk. We are always looking for technical dislocations, as opposed to fundamental deterioration, and as such we are positioned for it. We expect to see further opportunities in European ABS in the final quarter, as well as other areas of Securitized Credit which are experiencing similar trends.

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Reminder: the key features of ABS

- Yield pick-up and attractive risk adjusted spreads: ABS typically offer a higher yield versus similarly rated corporates alongside shorter spread duration.
- Limited exposure to single names: ABS have diversified asset pools, thus have extremely low sensitivity to single name credit risk.
- Default protection: ABS bonds are structured into layers of credit risk, with robust structures that absorb losses creating very high quality investment opportunities.
- Diversification: ABS offer exposure to differing types of risk; for example, consumer risk, which provides a diversifier versus common government and corporate risk.

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