April 15, 2024

Securitized Credit Market Update

My opening last month: "After YEARS of elevated volatility, are things actually "settling in"?" An emphatic "No!" has been the answer since our last note. Thankful I phrased it as a question.

So, this month I'll ask another question: are the 'ides of April' a thing? The legendary 'ides of March' didn't manifest in markets, but April has been a different story.

Volatility jumped back in this month, reacting to a third consecutive upside surprise in the CPI and renewed geopolitical concerns.

Risk markets continued to move higher through *March*, reflecting that same constructive calm identified that guided markets to a strong first quarter (SPX +10%, HY -24bps OAS).

Market conditions in April, in stark contrast, have seen volatility re-emerge across equity and bond markets (VIX +6pts to 19, MOVE +35pts to 121) and valuations move lower (SPX -3.7%, Agg -1.76%).

- Commodities have been a punctuated bright spot, although reflecting the inflationary and geopolitical challenges pushing broader markets lower.

Zeroing in on the inflation data, the CPI report for March again surprised to the upside, stacking up 3 straight upside surprises to start 2024.

- Headline CPI was +0.4% MoM and +3.5% YoY; was +0.4% and +3.2% in February's report. Much of the move came from core components (Core CPI +0.4% MoM, +3.8% YoY), with core services accounting for much of the surprise by most accounts.
    - Core goods deflation continued (-0.15% MoM), albeit at a modest pace (used cars, notably, -111bps MoM).
    - Also of note, the shelter component held steady at +0.4% MoM. While not reflective of the sustained downward momentum we have observed in the pace of multifamily rent increases, the lack of upward volatility is somewhat reassuring from an inflationary standpoint.

We'd also be remiss if we didn't briefly highlight the March labor market report. In an echo of recent reports, the data almost perfectly supported a soft or no landing growth outlook (+303K jobs, unemployment ticked +0.1% lower to 3.8%, average earnings growth slowing to +4.1% YoY).

On the follow, real time GDP trackers are solidly positive (Atlanta real GDPNow tracker +2.8% through 4/15).

In response, credit markets have started to crack, despite the generally improved outlook for economic growth, clearly fearing a rate backdrop that seems increasingly likely to stay restrictive/high for longer.

Accordingly, we'd point to rates as leading the down-trade.

- US Treasury rates have sold off sharply over the last month (2yr +22bps, 10yr +35bps) and the number of projected rate cuts by the Fed reducing to 1-2 this year.

- Excess returns in fixed income credit sectors have been more resilient, but have begun to roll over in recent days, correlating directionally with the drawdown in equities.
    - MTD: HY -34bps, Agg -13bps, IG Corps -1bps, Agency MBS -53bps (a familiar underperformer).

- Securitized credit-oriented sectors have been slower to react, in keeping with our expectations and typical patterns. CLOIE (CLO index) +44bps, CMBS +16bps, ABS +9bps are reflective of the lack of selling pressure endured in this market cycle.

So, turning more specifically to securitized markets, conditions remain constructive with liquidity still deep and primary markets open with robust investor interest. Activity levels remain elevated, at a similar pace as experienced in Q1.

As such, the virtuous cycle that we observed materializing in last month's note remains intact even as rates push higher and volatility returns.

Our updated issuance table continues to reflect YoY growth in issuance, experienced across each of the major sectors:

	2016	2017	2018	2019	2020	2021	2022	2023	YTD 2023	YTD 2024	%YTD
ABS	195	239	244	242	183	285	253	274	86	102	19%
CMBS	72	96	93	121	64	161	107	50	9	21	133%
CLO	75	119	130	123	84	187	130	117	41	55	34%
RMBS	34	90	126	130	105	204	127	66	22	27	23%
Total U.S. new issue	366	505	540	582	452	782	617	507	158	205	30%

Source: VOYA IM, BofA Global Research as of 4/12/2024

While not delineated above, April MTD issuance has remained active into the volatile backdrop (CMBS $4B, CLOs $7B, ABS $9B) with strong subscription levels continuing to evidence deep investor appetite.

If/as the volatile backdrop continues, we'd eventually expect to see weakness emerge in securitized credit. However, the sectors that have typically displayed relatively higher beta have the potential to rotate given a different mix of technical and fundamental drivers.

- Long time readers may have guessed CRT and CLOs as the usual culprits, as elevated issuance and leverage components (CRT structures, CLO borrowers) promoted more active trading and correlated spread moves.

- More recently, these sectors have benefited directly from the stronger economic growth backdrop (CLOs) and constrained net supply (CRT) and may continue to prove resilient in the near term.

- Conversely, in this cycle, CMBS is levered to rates and while elevated issuance is far from an issue, fundamentals are vulnerable to the recent retracement of the Q4 2023 rate rally. We'd expect some weakness to re-emerge, particularly if the rate backdrop remains subject to upward volatility.

For now, as intimated above, securitized credit market performance has remained resilient, as indicated in our trusty spread chart found on the next page (updated through 4/15):

	12/30/2022	3/31/2023	6/30/2023	9/30/2023	12/29/2023	3/31/2024	4/15/2024	Change (YTD)	Change (1M)
ABS									
Benchmark ABS									
2Y credit card AAA	45	60	55	50	50	42	44	-6	7
3Y prime auto AAA	75	85	90	85	70	70	68	-2	-2
3Y subprime auto BBB	340	260	250	215	225	155	155	-70	-5
Non-Benchmark ABS									
Private student loan AAA				170	165	120	120	-45	0
Senior consumer loan	225	130	110	100	115	85	80	-35	-5
CMBS									
Conduit									
3Y AAA	118	140	145	134	115	86	92	-23	3
5Y AAA	127	165	180	184	175	135	140	-35	-3
10Y last cash flow AAA	130	179	160	134	125	88	95	-30	4
Junior AAA	205	265	214	211	195	126	135	-60	5
AA	265	380	310	251	233	152	160	-73	-2
A	380	560	480	421	365	240	233	-132	-24
BBB-	720	970	933	932	878	742	740	-138	-15
XA IO (to UST)	315	350	301	275	225	168	167	-58	-15
Residential Mortgage Credit									
Jumbo 2.0									
Pass through	164	198	177	211	196	173	160	-36	-19
Credit risk transfer									
M1	228	223	182	149	126	113	118	-8	13
M2	488	423	358	257	206	163	184	-21	11
B1	591	554	485	336	325	219	203	-122	-31
CLO									
AAA	189	183	196	170	153	144	136	-18	-8
AA	263	249	260	232	214	200	197	-17	-3
A	349	345	337	291	270	253	248	-22	-6
BBB	522	524	527	458	411	383	382	-29	-9
BB	992	985	986	925	835	778	770	-65	-31

Looking forward, we are more cautious given the volatility that is again apparent in financial markets, particularly in rates. Securitized credit-oriented risk premiums have continued to richen since our last note, mostly in line with expectations and at a pace that properly reflects new information received and evolving market conditions. While the space has ‘room to run’ when taking into account the solid economic growth backdrop, higher rates and related uncertainty should eventually ‘creep’ into market pricing.

If/as that emerges, we will remain positioned as consumers of securitized credit risk, with our mostly constructive views in resi-mortgage sectors as well as consumer-oriented ABS go to places to continue to take risk.

Best of luck to all in the markets!

Voya Securitized Team

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