10 years of securitized credit outperformance

February 2024

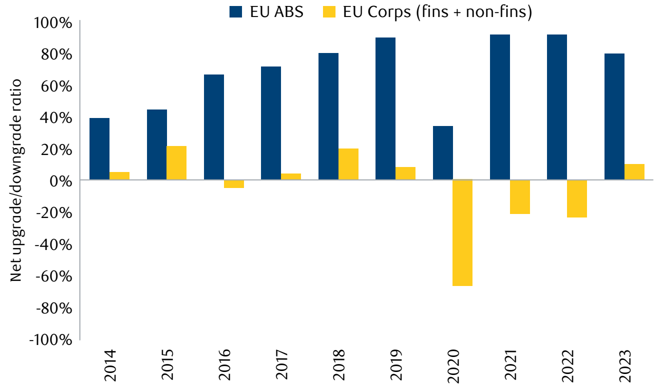
Securitized Credit Team

BlueBay Fixed Income Team

"Over the past 10 years, European ABS has consistently had a higher net upgrade ratio, even during periods of volatility such as Covid."

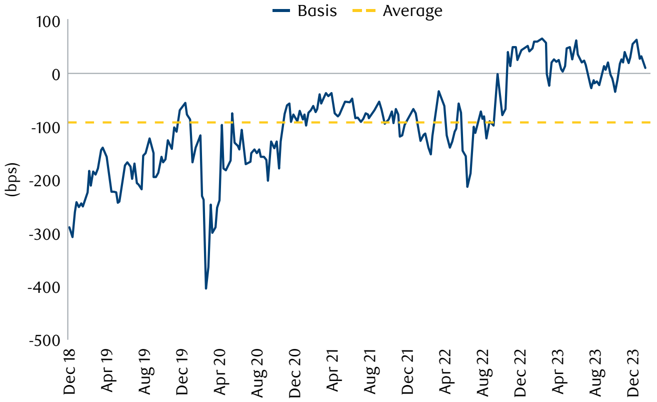
- **Strong fundamentals:** securitized credit markets continue to display stronger fundamentals than corporate bond markets (due to both conservatively underwritten collateral and high structural protection from defaults). Over the past 10 years, European ABS has consistently had a higher net upgrade ratio, even during periods of volatility such as Covid (Chart 1). This has not been the case for EU corporates where the net ratio has been below 0%, which indicates more rating downgrades then upgrades (a reading of 100% would mean all upgrades and no downgrades).
- **Benefit from de-leveraging:** one key reason for the outperformance is that securitized credit transactions typically de-lever over time as the principal balance is paid back. This results in reducing credit risk in the mezzanine bonds, which has led to more rating upgrades than downgrades.
- **Higher spreads and better risk-adjusted return:** at the same time, spreads and returns are higher in securitized credit for the same or better rating. In particular, high grade and investment grade securitized credit continues to offer very high credit quality and attractive spreads. Currently, BBB CLO spreads are higher than single B corporate spreads, when historically the reverse has been the case (Chart 2).
- **Floating rate back in vogue:** at the beginning of 2024, we have already seen Fed rate cut expectations reduce from six to four cuts on the back of strong jobs data and a CPI print on the upside. Securitized credit bonds will continue to benefit from higher rates for longer. They should be a consideration for client allocations for the diversification benefit, alongside the higher yields and strong credit quality.

Chart 1: Consistent trend of more upgrades than downgrades in ABS due to strong and de-leveraging structures



Source: Morgan Stanley, as at 31 December 2023.

Chart 2: Basis between CLO BBB and Single-B HY corps credit spreads has increased dramatically over the past 5 years



Source: Wells Fargo, Bloomberg, as at 31 January 2024.

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