Structured Finance Sees a New Tone as Spreads Reset in 3Q

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By Christopher DeReza

(Bloomberg) -- U.S. ABS and CMBS sectors saw mostly steady issuance in 3Q, while CLO volume fell notably, according to data compiled by Bloomberg; Talmage, Palmer Square, Invesco and a NYC-based ABS syndicate shared the following comments on U.S. structured finance trends:

* CMBS
* Macro volatility during the quarter, particularly in August, pushed spreads wider; more volatility should be expected around liftoff, Talmage CEO Edward Shugrue said during phone interview on Sept. 29
* Spreads blew out by ~40% to levels not seen since 2013; nearly the same percentage change as during the "taper tantrum," Shugrue said
* Buy and hold, or "real money," investors were able to take advantage of dips spurred by "hot money," or hedge funds, who were active sellers during the qtr, likely rebalancing due to equities sell-off or raising cash for redemptions: Shugrue
* "With underlying CMBS fundamentals healthy, we were able to take advantage of wider spreads during the quarter driven by global or macro volatility," he said
* Expecting more issuance between now and year-end, as issuers take advantage of the relative calm; liftoff is likely to bring more volatility until a new normal is established

* CLO
* U.S. CLO issuance slowed both vs earlier this year and relative to 2014, partly because deals from non-risk retention compliant managers were pulled forward into early part of the yr, Kevin Egan, senior PM at Invesco, said in e-mail Sept. 25

* Issuance is being slowed by a challenging equity arb and an inflection point for investors, who now want to know about plans for risk retention; those without plan may be refraining from issuing, Christopher Long, president of Palmer Square Capital Management, said during phone interview yday
* "Almost no" tolerance for deals from managers without a retention plan: Long
* "Given these factors, many market participants don't believe some of the rosy new issuance projections," Long said
* Credit deterioration in underlying portfolios started to materialize in 3Q
* Driven by oil and gas exposure in some CLO loan pools and "contagion sections," which might have second order effects to oil and gas, Long said
* "Even though you can stress test the CLO structure from a fundamental credit perspective, and they hold up under very challenging conditions," investors have unduly penalized BB debt "pretty much across every CLO," Long said
* Presents opportunity for a discerning investor to buy lower priced securities with tremendous convexity, Long said
* BBs are 50bps wider vs start of 2015, Long said

* ABS
* ABS market faced sell-off in Aug. and a choppy Sept. riddled with equity mkt volatility, on top of a calendar that held a late Labor Day, the FOMC, ABS East conference and religious holidays, said NYC-based syndicate, who asked not to be identified because not authorized to speak publicly
* Equities mkt volatility loomed large: of 18 trading days in Sept., 12 of those days had Dow moves up or down of 100 or more; 7 had moves of 200 or more
* Depth of participation by buyer base was OK, though avg order sizes were smaller than typical
* Sign of investors being more cautious
* Issuers also more cautious, may lead to smaller deals; trend of issuers asking if they should do smaller deals
* As for potential for broader mkt volatility to continue in 4Q, ABS issuers tend to be less sensitive, as they typically lay out a funding plan for the yr and stick to it

* Card ABS slower than some expected; credit card issuance seen as occasional opportunistic financing, which is contrary to current environment
* Recent pricings show levels are much more expensive, which may deter issuers
* Even though spreads are wider, benchmarks have stayed low, mitigating overall impact on all-in financing cost

* RMBS
* Investor interest is growing in NPL/RPL space, Wells Fargo analysts Greg Reiter, Anish Lohokare, Randy Ahlgren and Neil Delap wrote in Sept. 30 note
* “Issuance has already surpassed 2014 levels and a steadily increasing buyer base should be positive for the sector,” Well said
* New forms of agency credit risk transfer “attractive” for 1st loss risk in conforming collateral
* “Fannie Mae’s L street securities shelf should help expand the investor base in Credit Risk Transfer (CRT) deals to REITs and other buyers looking for secured interests in mortgage credit risk”
* Recommends “selectively adding” legacy non-agency; investor preference for short IG paper provides opportunities for credit, duration buyers