



Dresner & Cie – Die Fondsplattform

January 2023

Marketing Communication for investment professionals only.



Focus on Residential Mortgage Backed Securities (RMBS)

A reminder about Asset Backed Securities

Investments backed by visible collateral issued in a floating rate format

Pool of assets are 'security' for a range of bond issues with different risk/reward characteristics



Tranches

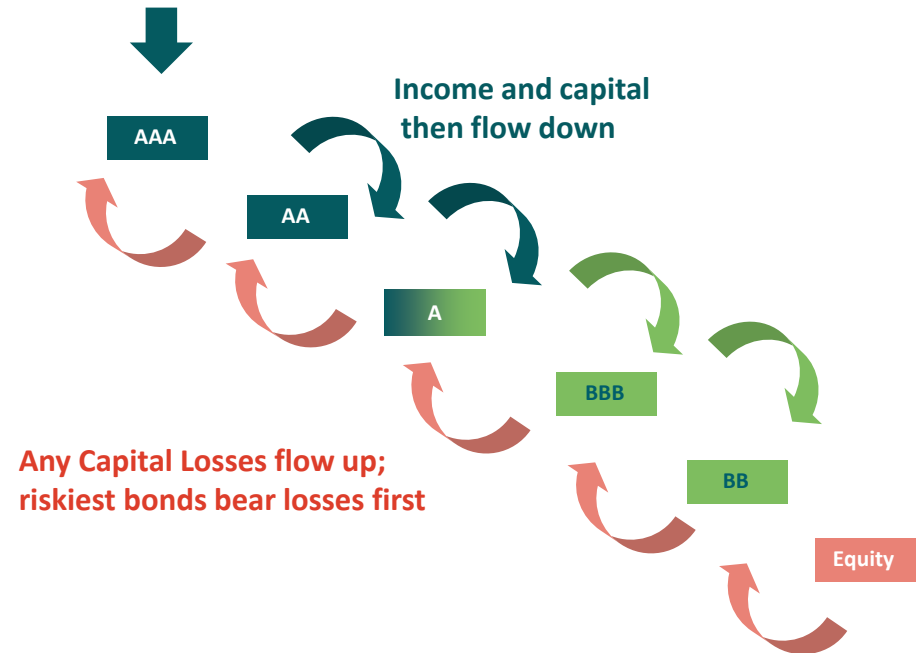
AAA
AA
A
BBB
BB
Equity

European ABS can offer :

- **Robust Structures** – ability to withstand major economic shocks
- **Floating Rate Coupons** – protection against rising interest rates
- **Consistent income** – access to amortising cash flows

Capital Structure

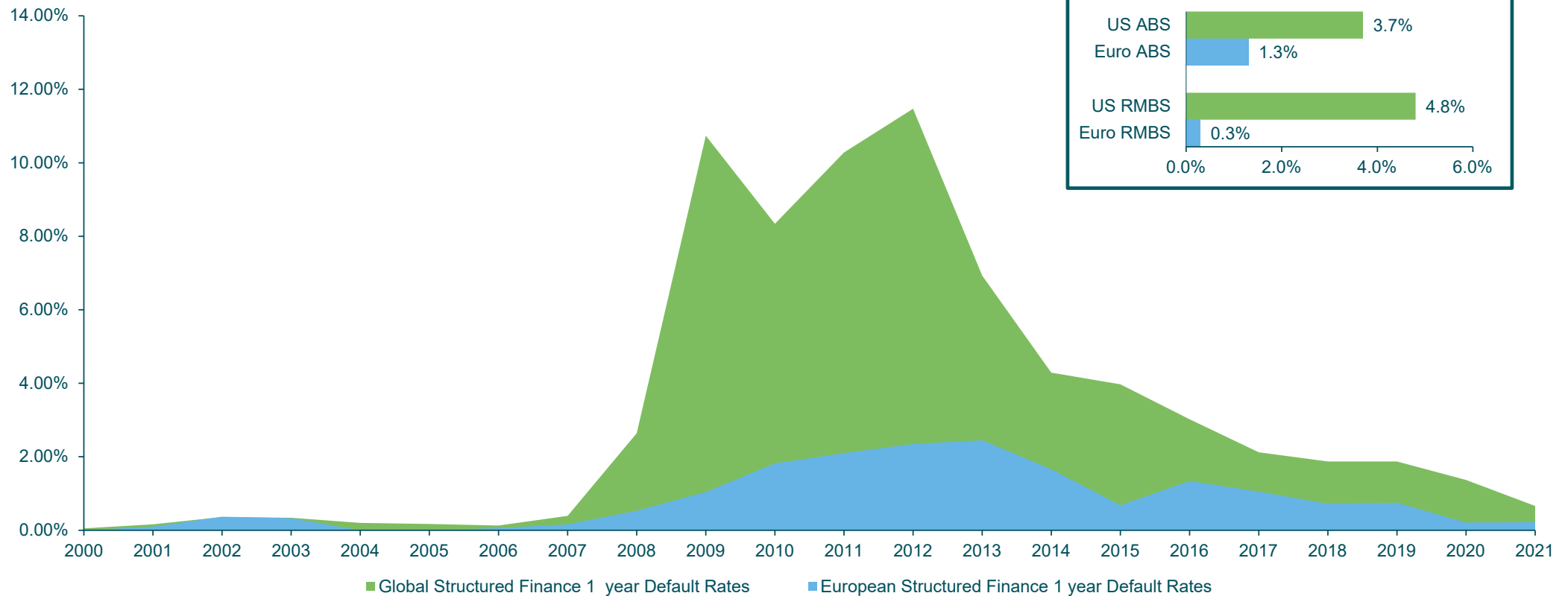
Returns on the Assets repay the low risk bonds first



How has European ABS performed?

Misconception that Euro ABS is the same as U.S. sub-prime persists

Rolling 1 year default rates for all rated ABS debt



S&P data December 2021. Rolling 1 yr default rate since 2001 (Global structured finance default study and rating transitions).

Source: M&G.

Why haven't European ABS spreads normalised?

Disagreement between regulators and the ECB

European regulators have been severely penalising the ABS market

- Introduced Solvency II for European insurance companies, which made **owning ABS extremely expensive** – removing large natural buyer from the market
- Made investors responsible for confirming compliance with retention requirements - rather than issuers

Whilst the European Central Bank has been broadly supportive

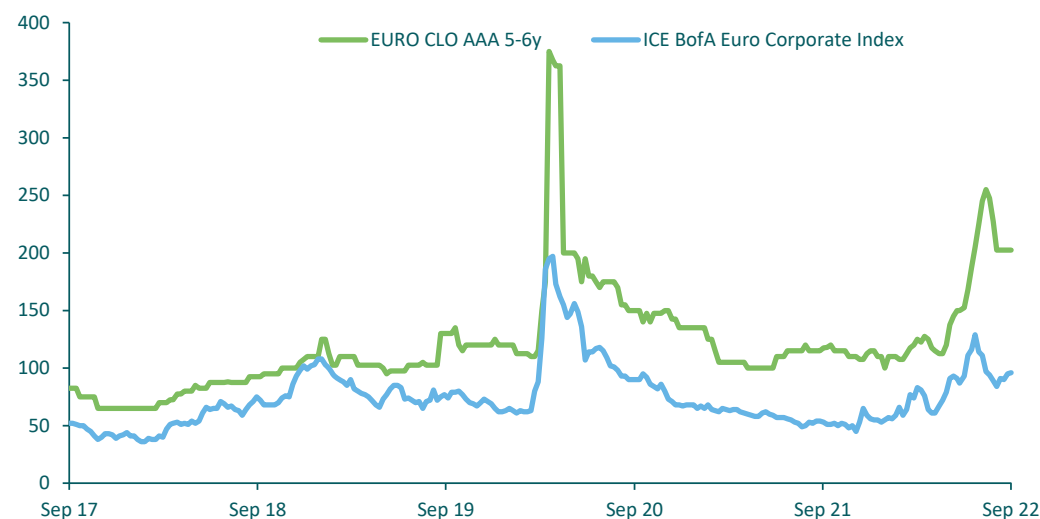
- Argued publicly for “need to level (regulatory) field” for ABS compared to other asset classes*
- Purchased ABS as part of QE to help stimulate real economy and revive the securitisation market

The outcome

- **High barriers to entry for new investors** – monitoring, stress testing, ensuring risk retention compliance
- **ABS remains a poorly understood asset class** – jargon, acronyms, underserved association with U.S subprime

*ECB and Bank of England – May 2014
Source: M&G, September 2022

CLO AAA spreads continue to trade wider than Euro IG Corps (average rating A/BBB+)

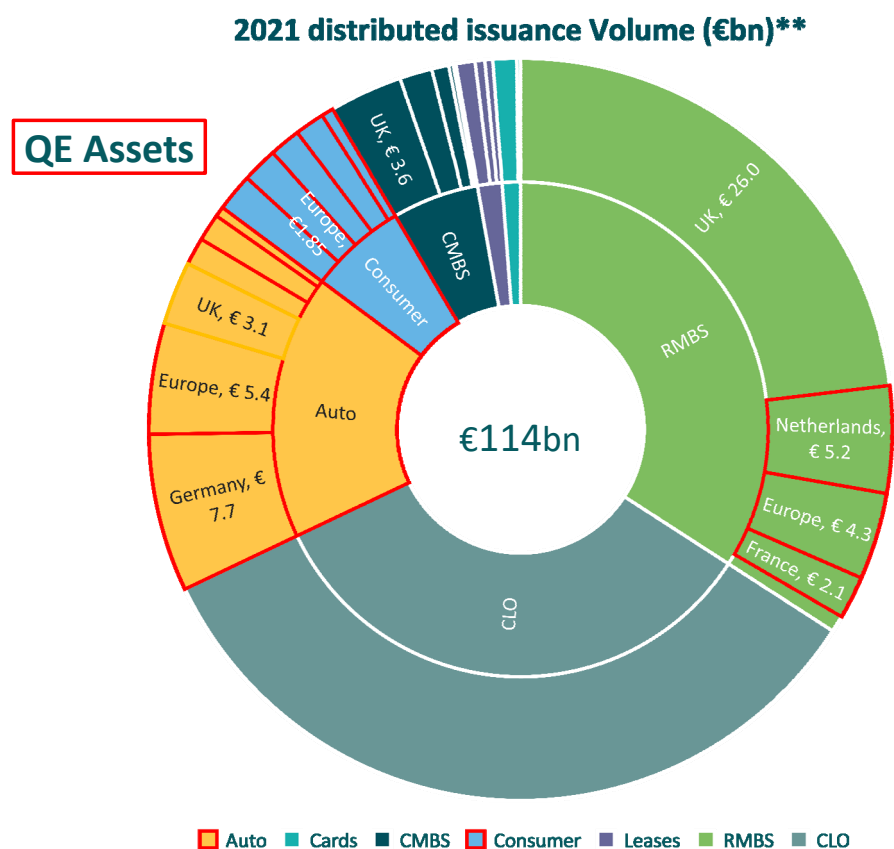


In our view ABS spreads levels are a function of harsh regulatory treatment and the complexity/lack of understanding of the asset class rather than a reflection of elevated credit risk

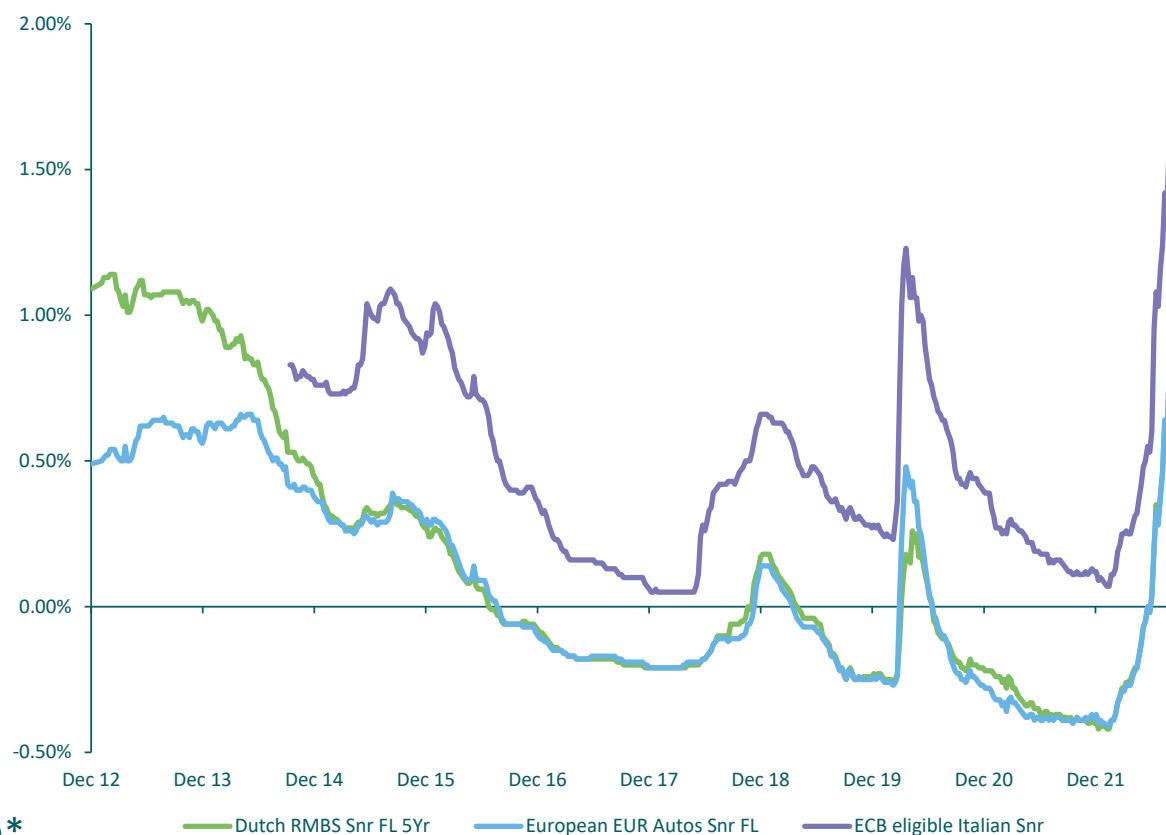
This creates an opportunity

The ABS market is sizeable and relative value is ever changing

The end of ECB purchases can present opportunities



All-in EUR Senior ABS Yields

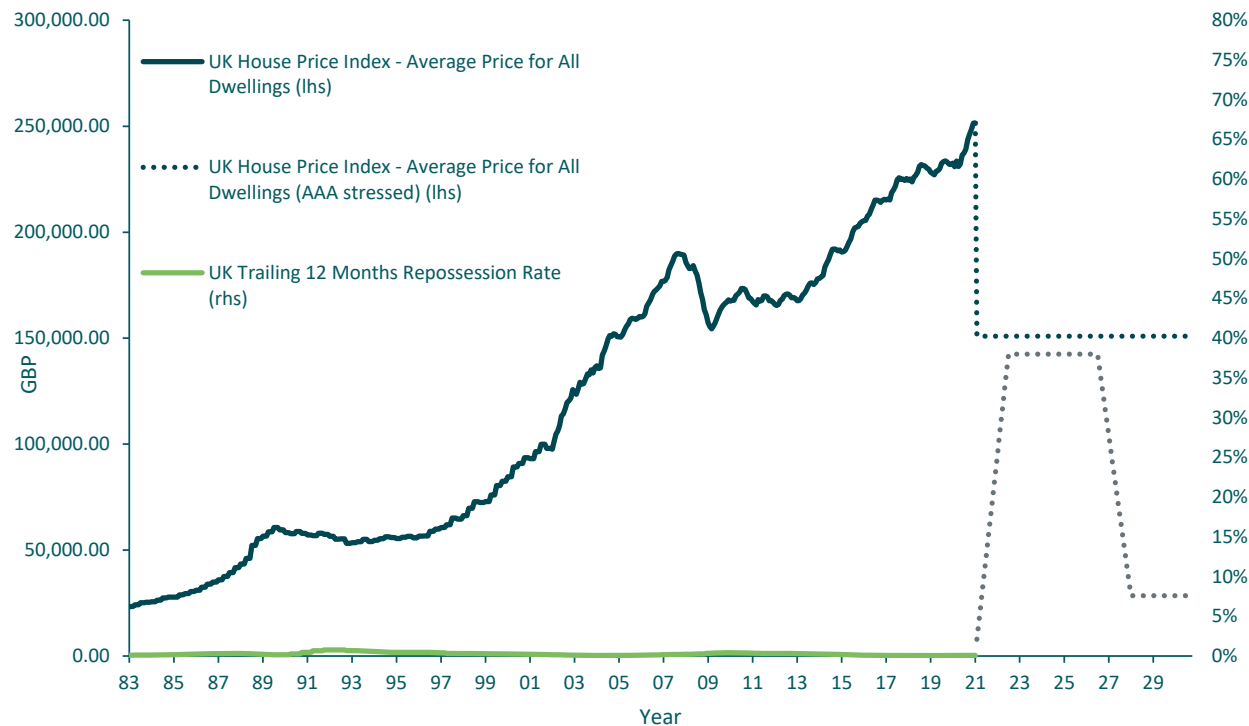


Total Outstanding European ABS Market: c.€550bn*

Source: Citi Velocity, M&G, *Deutsche Bank ABS outlook 2022. ** J.P Morgan International ABS Spreadsheet (excluding CLOs) August 2022

The opportunity: Asset Backed Securities have very robust structures

AAA U.K RMBS stress example



What needs to happen **before the first cent of principal loss** is imposed on this AAA RMBS:

1. A 40% fall in house prices with no recovery **ever**
2. Prepayment to drop to 5%
3. **Over 70%** of homeowners would need to default cumulatively

Worst historic observation – U.K

18% house price fall between 1989 and 1993

10%+ annual prepayment rates seen even during GFC

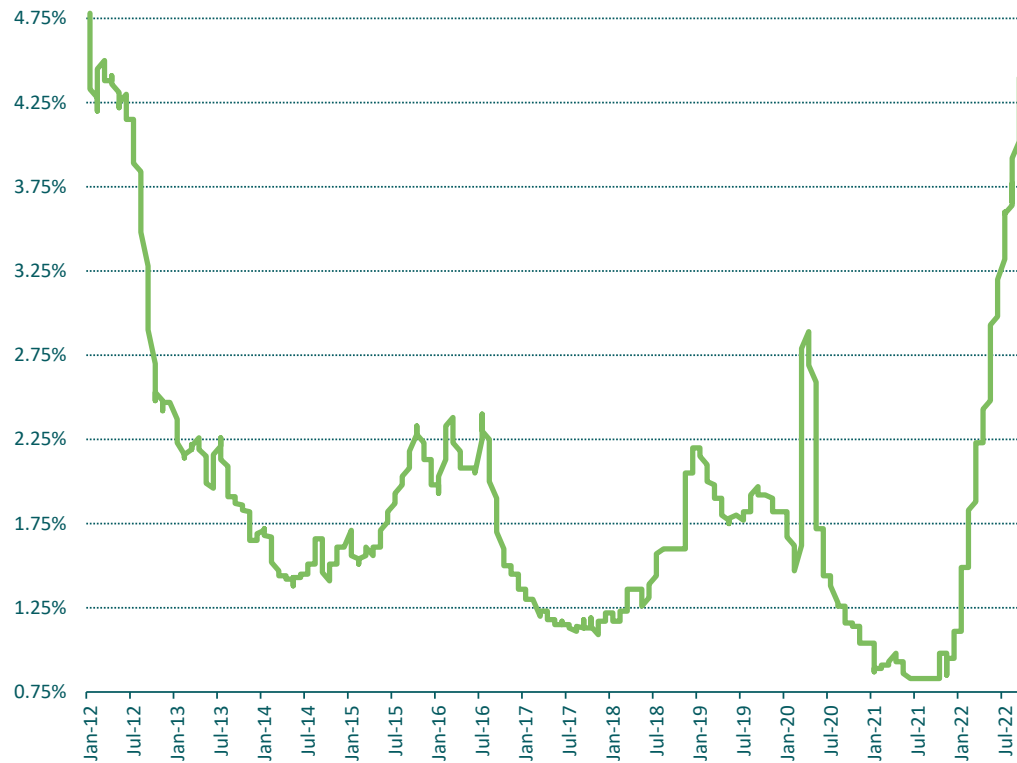
0.79% peak annual mortgage default rate in 1992

Despite significant credit resilience this instrument trades at more than 4% yield in € today

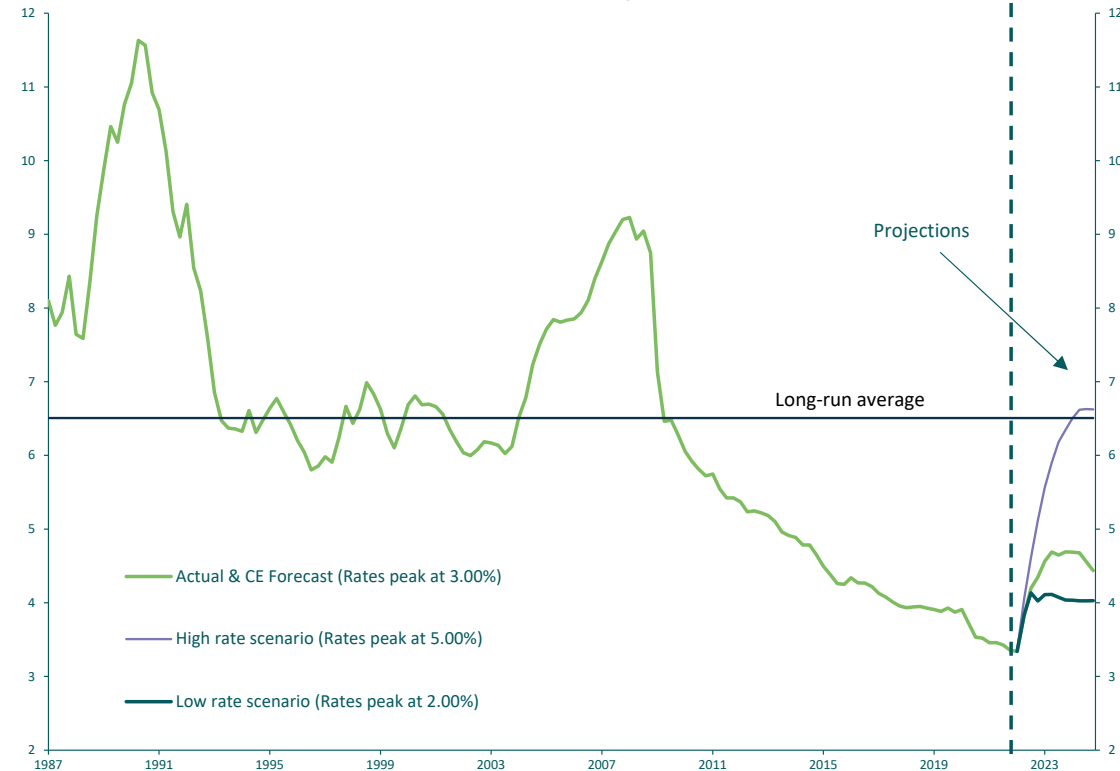
AAA U.K RMBS has widened significantly in 2022

Yields are back to 2012 levels while debt servicing is projected to remain manageable

AAA U.K non-prime RMBS yield (in £)



Household Interest Payments (% of Income)



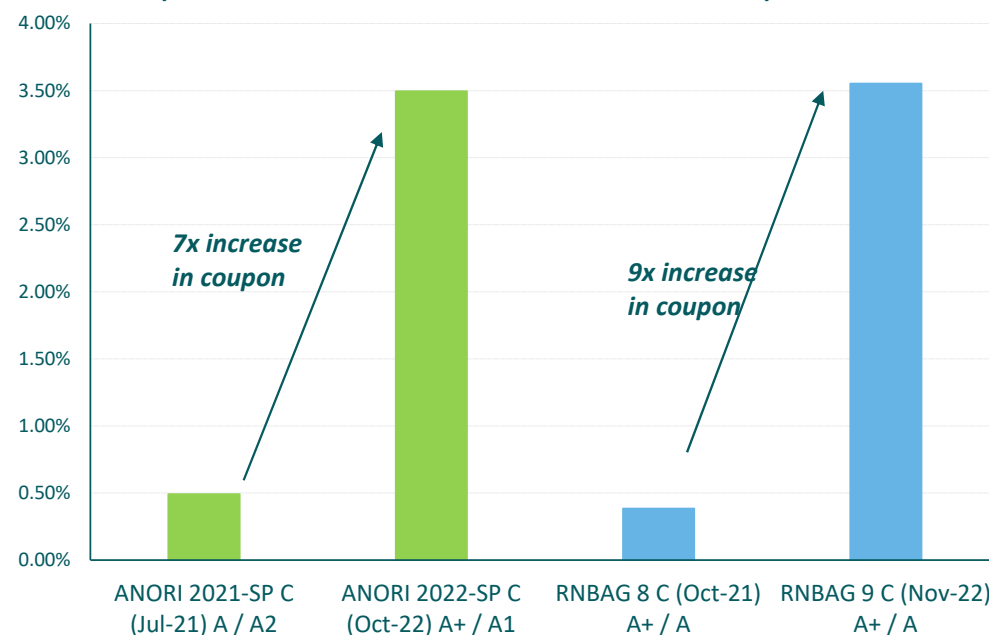
European consumer paper has become investable following period of poor value

Spreads have widened noticeably, credit remains defensive

- Continental ABS paper has **re-priced significantly** during 2022 following a long period of trading at expensive valuations – thanks in part to ECB purchases
- Wider spreads and positive EURIBOR have combined to provide a much more **favourable relative value** backdrop for the asset class – **M&G ABS funds purchased German and Spanish auto ABS transactions for the first time in 5+ years during H2 2022**
- These transactions provide granular, geographically diversified consumer loan exposure **originated by tier one financial institutions**

Summary metrics	ANORI 2021-SP C (A / A2)	ANORI 2022-SP C (A / A2)
Jurisdiction & Sector	Spanish Autos	
Originator	BNP Paribas	
Obligors / Average balance	97,911 / €14,662	39,918 / €14,933
Class C pricing margin	E+105	E+280

Spanish and German auto ABS – Class C new issue coupon 2021 - 2022



Summary metrics	RNBAG 8 C (A+ / A)	RNBAG 9 C (A+ / A)
Jurisdiction & Sector	German Autos	
Originator	Societe Generale	
Obligors / Average balance	81,532 / €12,265	41,549 / €14,440
Class C pricing margin	E+95	E+270

Why consider ABS?

Defensive, diversification, yield

Why is there an opportunity?

- High investor barriers to entry limit new entrants in the market
- Complexity means high returns are available for those who are suitably resourced
- Insurance companies are still virtual absent from the market due to high capital charges under Solvency II

ABS provides:

- Robust Structures – ability to withstand significant, prolonged economic downturns
- Credit resiliency - No AAA European ABS bond has ever defaulted (including through the 2008 and 2020 crisis)
- Floating Rate Coupons – protection against rising interest rates

The benefit for investors:

- Diversification away from conventional fixed income
- Provides exposure to hard to source areas – e.g. consumer credit
- Offers higher returns than other asset classes without sacrificing liquidity

Market outlook

Attractive valuations and healthy primary supply can provide a compelling entry point

- ABS portfolios offer an appealing combination of **high credit quality, attractive relative value and floating rate** instruments whose yields increase with interest rates
- UK LDI debacle has led to significantly lower demand from what was previously a large investor base for the asset class, which means **new capital can be deployed quickly and at attractive pricing**
- **Valuations look compelling**, higher rates and wider spreads during 2022 have seen **AA portfolio yields rise from 2% to 6%+** over the last 12 months
- **A/BBB portfolios now yield 7-10%** compared to less than 3% in January 2022

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