

# 2019: Back to Fundamentals

## European ABS Market

December 2018

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# **EUROPEAN ABS MARKET**

## *A few words about November*

Just before the year 2018 draws to a close, the ABS primary market has continued to see plenty of new supply in November with deals worth EUR 10 bln pricing during the month, taking YTD supply to EUR 92bln. The relative low subscription amount observed on recent deal placements (deals often ~ 1x done) highlighted the weakened market sentiment at the moment while we are approaching the year-end with still a lot of political uncertainties (Brexit risk, Italian budget, trade war,...) and traditionally low liquidity as this time of the year.

Unsurprisingly, the growing volatility observed in wider credit markets over recent weeks has taken valuations in most European ABS sectors to September/October 2016 levels reversing the gains of nearly two years. All sub-sectors of the European ABS market with no exception have experienced repricing despite good fundamental performance supported by better growth and still low interest rates in Europe. Overall **senior ABS spreads have widened by 10-15bps over the month** and now trade at almost their two-year wides.

## *Looking forward to 2019*

**We expect less new supply next year than this year**, given the pending STS regulation for securitization that will come into force next year. Furthermore, regulation will affect the timing of issuance. New rules, including those affecting STS regulation especially on disclosure obligations, will take effect in January, causing a significant dip in new supply particularly at the beginning of next year, while updated LCR rules are also likely to weigh on ABS demand from banks in the medium term.

In an environment that is likely to be framed by moderating growth in Europe, tighter monetary policy,

withdrawal of liquidity in the market and so late-cycle risks developing in parts of the corporate credit market, we expect European ABS spreads to be rather volatile over the course of next year. Nevertheless, we think that European ABS could potentially outperform but not decouple from the rest of the market.

In terms of spread dynamics, given that issuance volumes are projected to contract especially during the first quarter of next year and the fact that ECB will continue to provide technical support to ABS through reinvestment of redemptions, we think that all these factors are likely to limit any potential spread widening during the course of the year. The rumored prolongation of the TLTRO program from the ECB could also contribute to weigh on ABS issuance next year, particularly on peripheral issuers but also on ABS spreads dynamics over the second part of the year.

From a fundamental standpoint, **there are still some pockets of value left in the European ABS and CLO markets after this significant repricing in 2018**. While risks to the economic outlook in Europe are rising, we do not expect this to translate into a substantial decline in the credit quality of ABS. From our point of view vulnerabilities within the ABS asset class remain limited especially at the top of the ABS capital structure.

## *In a nutshell*

According to us **2019 will be more about fundamentals and finding value bottom-up rather than directional conviction**. In 2019, we will continue to see an extension of the weakness but we expect more spread tiering among sub-sectors, jurisdictions and ABS issuers. **In a volatile market our recommendation for investors is to position defensively and favor securitized risk over unsecured corporate risk.**

Source : Ostrum AM. Written in 06.12.2018. The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change without prior notice. There can be no assurance that developments will transpire as may be forecasted in this material.

# ADDITIONAL NOTES

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