TCW

INSIGHT

Securitized Products
Notes From the Desk (September)

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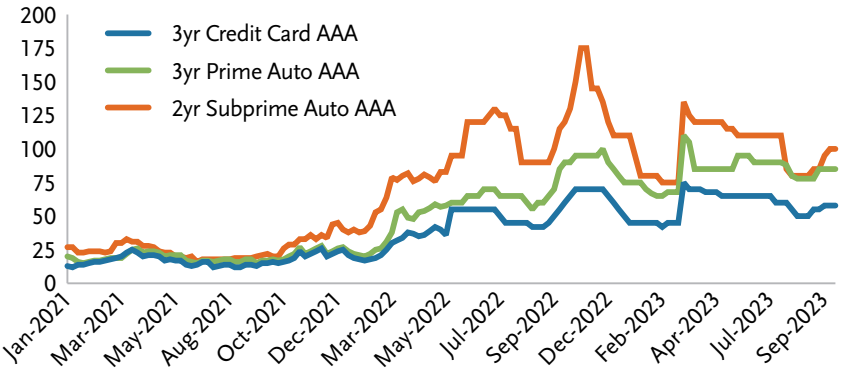
Asset-Backed Securities (ABS): Adam August, CFA

The ABS market began to show signs of fatigue in September. Elevated front-end rates and an inverted yield curve continued to draw investor focus to the sector, but this focus was met with a deluge of primary issuance as sponsors rushed to bring deals amid economic uncertainty and rising interest rates. The net result was that ABS spreads widened in an orderly manner over the course of the month as investors began to demand incremental spread and yield to absorb the supply.

Spreads on AAA-rated Senior ABS were generically 5-20 basis points (bps) wider in August. Subprime auto senior spreads experienced the largest spread widening (+20 bp MoM), reversing most of the gains seen in July. Spread widening was less pronounced in AAA-rated prime auto and credit card bonds, with spreads drifting around 5 bps wider in September. ABS subordinate bond spreads were roughly flat over the month, outperforming AAA seniors. This outperformance was principally driven by lower relative primary issuance supply in subordinate bonds.

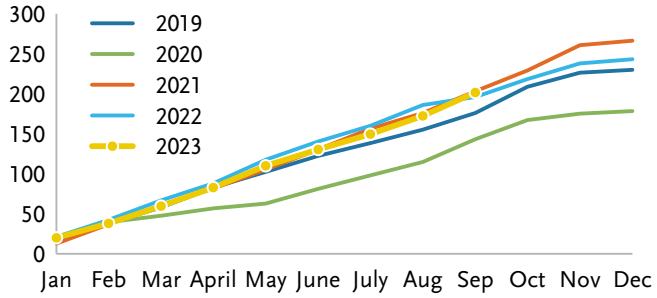
Investment Grade ABS Spreads to Treasury (bp)



Source: JP Morgan

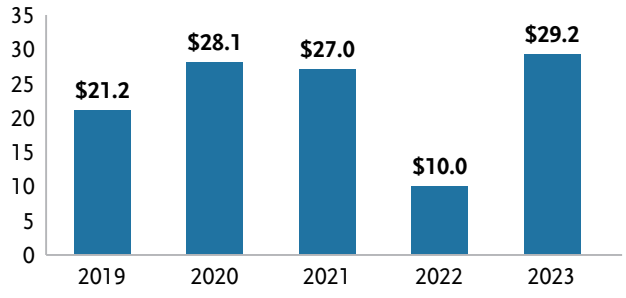
The pace of new issuance accelerated significantly in September as market participants returned from their summers ready to engage. Over the course of the month, sponsors priced $29.2 bn of new bonds across 39 separate deals. Through September, YTD primary issuance volume is running at 103% of that seen last year. Supply continued to be dominated by auto ABS, with $14.4 bn pricing across 17 deals. September was also the most active month for credit card issuers YTD, with $5.4 bn pricing across five deals. As noted above, the majority of the debt sold in September was senior risk, with only roughly 11% ($3.3 bn) of the supply being subordinates.

YTD ABS Issuance ($bn)



Source: JP Morgan

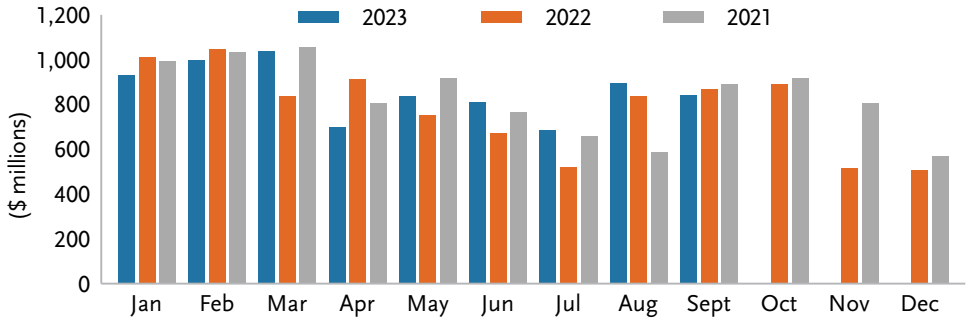
ABS Primary Issuance in September ($bn)



Source: JP Morgan

Despite the heavy primary supply in September, secondary trading remained active. Average secondary ABS trading volumes in September were roughly in line with historical levels (averaging approximately $844 mm per day, according to TRACE).

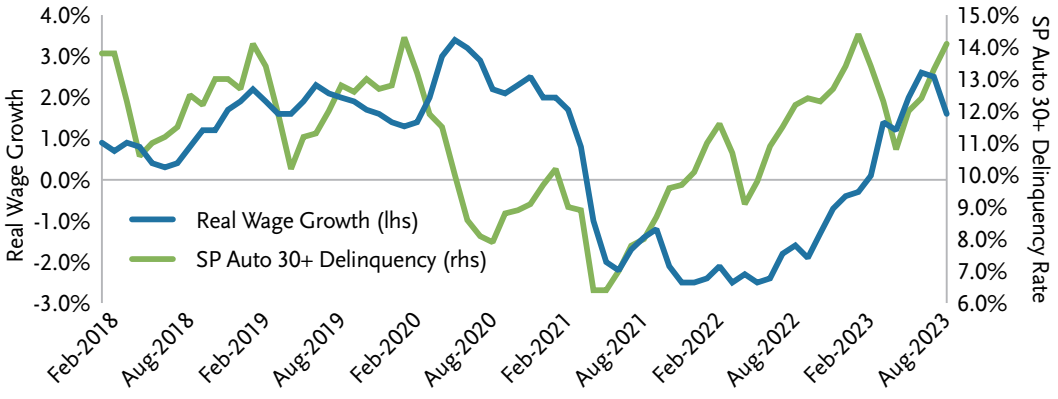
Average Daily Trading Volume - Secondary ABS



Source: TRACE, TCW

Looking at collateral performance, consumers continue to come under stress with lower-income subprime borrowers impacted the most. For instance, subprime auto borrower delinquency rates are now close to levels last seen during the Global Financial Crisis (GFC). On a seasonally adjusted basis, subprime auto delinquency rates are actually higher than they were during the GFC. It is clear to us that high inflation and negative real wage growth has had an outsized impact on the marginal borrower. The chart below illustrates the rise in subprime auto borrower delinquencies concurrent with the negative real wage growth seen in 2021 and 2022. With real wages once again in positive territory, we believe that incremental credit performance deterioration will be driven by job losses (should they occur).

Real Wage Growth vs. Subprime Auto DQ



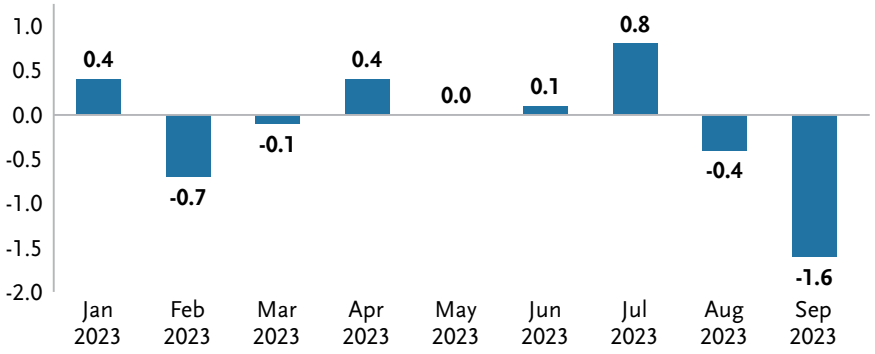
Source: Standard and Poor's

Residential Mortgage-Backed Securities (RMBS)

September saw non-qualified mortgages (QM) and prime jumbo RMBS spreads widen around +10-30 bps in sympathy with agency MBS weakness as well as elevated supply in primary and secondary markets. New issue non-QM AAAs widened the most, by +30 bps (+175-180), on heightened supply which included lower-coupon collateral. Prime jumbo AAAs widened around +10-20 bps (+175-185), with lower coupon pass-throughs trading around 3.25-3.5 ticks back of agency.

Re-performing (RPL) RMBS and Credit Risk Transfer (CRT) held in better – with RPL RMBS spreads largely flat (i+135a), insulated by its shorter duration. CRT spreads also remained roughly flat (M1s roughly +160 Discount Margin (DM), M2s +250 DM), with spreads supported by technicals given zero primary supply and another $1.3 bn Freddie tender offer during the month, which gave investors cash to put back to work.

CRT New Issuance YTD 2023



Sources: BofA Global Research, Intex, FN, FH, GN, Bloomberg

Fundamentals

While we continue monitoring delinquency trends across RMBS, the fundamental story around residential mortgage credit remains strong on housing supply-demand mechanics. Moreover, multiple research houses predict positive home price appreciation (HPA) for the full year 2023 and into 2024.

JPM Model for Case-Shiller Home Price Appreciation

Scenario	FY 2022	2023 YTD	2023E	2024E
Bullish			10.0%	7.5%
Positive			5.0%	5.0%
Base	6.5%	5.2%	3.0%	2.5%
Negative			-5.0%	0.0%
Crisis			-9.9%	-17.1%

Source: JP Morgan, CoreLogic, NAR, BLS
Note: 2023 and 2024 HPA forecasts are YoY % change of Q4 HPI. Projections for Case-Shiller YoY Home Price Appreciation (SA) for various scenarios.

Commercial Mortgage-Backed Securities (CMBS): Alexandra Crenshaw

With summer now in the rearview mirror, the Street got back into the saddle with renewed focus in CMBS. Historically, September is known to be a busy month for secondary trading in CMBS relative to the rest of the year, and this rang true this year. Secondary trading took place against the backdrop of several news events, including the Fed's pause on rate hikes and CMBS news events such as Blackstone's $308 mm defaulted 1740 Broadway loan (BWAY 2015-1740) being marketed for sale. A pervasive theme through the summer was credit bifurcation between Tier 1, high-quality, liquid names versus frothier, more nuanced credit stories, the majority of which are office credits. Generally, high quality AAA SASB names, such as One Vanderbilt (SLG 2021-OVA) traded in the mid-160s spread context (fixed-rate) while credit profiles on the cusp continued to be evaluated by the street on a name-by-name basis with careful consideration given to where in the capital stack bonds sat. While bids wanted in competition (BWIC) lists did come out for these weak/distressed credit assets, the bid/ask spreads on these lists were often too wide for parties to transact. Given that the Street's sentiment is "higher for longer" with respect to rates, and conservative credit underwriting remains a consistent trend, secondary markets are often still working to digest levels for these hairier credits.

Risk sentiment to close out September was divided. With new issue deals clearing and Tier 1 bonds trading, there was appetite for the right CMBS profiles; however, the lack of price transparency on distressed assets left traders feeling mixed about the sector as a whole.

CMBS Spreads (bps)	9/29/2023	9/22/2023	9/15/2023	9/8/2023	Year Start 2022
10yr conduit LCF AAAs (fixed)	137	138	137	137	76
10yr conduit BBB (fixed)	710	705	705	710	379
SASB fixed AAA	175	175	165	160	89
SASB fixed BBB	500	500	475	475	199
SASB floater AAA	165	165	155	150	90
SASB floater BBB	260	260	240	225	160
10yr Freddie K A2 (fixed)	71	67	67	70	34
10yr FN DUS 10/9.5 (fixed)	79	72	72	75	39

Source: Wells Fargo

New issuance was light in September and down 40% from August with a total of $2.56 bn pricing across single-asset single-borrower (SASB) and conduit. A much larger post-Labor Day pipeline was expected, however much of this new issue pipeline has been postponed to later in the fall subject to market conditions. Two fixed-rate SASB deals ($1 bn) priced along with two conduit deals ($1.56 bn), one of which was a traditional 10-year deal while the other was a 5-year deal. Additionally, September observed the pricing of two managed commercial real estate (CRE) CLO's, totaling $1.8 bn in aggregate.

Of note, one of the SASB deals to print this month was BPR 2023-BRK2. The 5-year, fixed-rate cash-out refinance loan was written to a joint venture between Brookfield and CalPERS and is collateralized by Oakbrook Center, a 2.61 mm square foot open-air, retail shopping destination in Oakbrook, IL. The Green Street Class A++ mall was 90% occupied and generated $1,285 sales per SF ($1,027 sales per SF excluding Apple and Lucid Motors) at new issue. The deal saw strong interest and priced in line with initial talk at J curve +250 for the A tranche (Fitch/Kroll: AAA/AAA) and J+400 for the C tranche (Fitch/Kroll: A+/A).

CMBS Issuance	September	Count	YTD
SASB + Conduit	2,565,327,263	4	49,693,188,886
All	**13,952,277,314**	**9**	95,376,602,056
Freddie K	11,386,950,051	5	45,683,413,170
Conduit	1,565,327,263	2	38,063,688,886
SASB	1,000,000,000	2	11,629,500,000

Source: Well Fargo Deal Comp Sheet

CMBS performance continued to observe an uptick in delinquency rates. According to figures published by CMBS data provider Trepp, the September delinquency rate for CMBS rose to 4.39%, representing a 14 bps increase from the prior month. The largest driver for the increase in September's delinquency rate was the office sector, which observed a 51 bps increase in delinquent loans compared to August's figures. Year-over-year (YoY), the overall CMBS delinquency rate is up 147 bps as the high interest rate environment, along with other factors, continued to present CMBS borrowers with exit challenges on their current financing and little respite from these challenges is expected in the short term.

CMBS Delinquency Rates

	Trend	Sep-2023	Aug-2023	Jul-2023	3 MO.	6 MO.	12 MO.
Overall		**4.39**	**4.25**	**4.41**	**3.90**	**3.09**	**2.92**
Industrial		0.30	0.33	0.31	0.42	0.37	0.43
Lodging		5.27	5.31	5.85	5.35	4.41	5.18
Multifamily		1.85	1.84	1.83	1.59	1.91	0.93
Office		5.58	5.07	4.96	4.50	2.61	1.58
Retail		6.92	6.87	6.86	6.48	6.23	6.97

Source: Trepp

CMBS Delinquency (September 2023)	
Current	94.82%
30 Days Delinquent	0.30%
60 Days Delinquent	0.13%
90 Days Delinquent	0.60%
Performing Matured Balloon	0.78%
Non-Performing Matured Balloon	1.18%
Foreclosure	1.39%
REO	0.79%
Total	5.17%

Collateralized Loan Obligations (CLOs): Palak Pathak, CFA and Madison Perry

CLOs continued their strong August performance into September as floating rate asset classes continued to be in favor amid the rate volatility. CLOs returned 0.6% in September, setting YTD returns at +7.64%. CLOs are outperforming high yield (HY) credit and investment grade (IG) credit and underperforming loans on a monthly and YTD basis. YTD returns in CLOs are the highest they have been in the post-crisis time period as coupon returns via higher carry from rising rates is providing an enormous impact to all-in returns (per the JPM CLOIE Index coupon returns account for 5.12% of total YTD returns of 7.64%).

Secondary CLO 2.0 Total Returns

	September 2023	YTD
CLO Total	0.60%	7.64%
AAA	0.56%	6.36%
AA	0.70%	8.05%
A	0.72%	10.17%
BBB	0.67%	12.43%
BB	0.76%	16.02%
B	1.25%	17.28%
IG Credit	-2.60%	0.03%
HY Credit	-1.18%	5.86%
Leveraged Loans	0.96%	10.16%

Source: JP Morgan CLOIE Index, Bloomberg U.S. Credit Index, Bloomberg U.S. Corporate High Yield Bond Index, Morningstar LSTA U.S. Leveraged Loan Index

The attractive carry that is currently available at the top of the stack kept spreads tight and demand high. As per Bank of America, average AAA current yields of 7% are currently at their 93rd percentile over the past 5 years. As a result, AAA spreads tightened over the month with the most pronounced tightening observed at the shorter end of the curve with short AAA spreads firmly in the 140s discount margin (DM). As demand picked up, so did supply with over $2.3 bn in AAA BWIC volume over the month. Sellers were focused on monetizing high dollar prices and tight spreads to rotate into wider fixed rate bonds as well as re-position portfolios.

AA and single A spreads tightened over the majority of the month, only to give back that tightening as volatility hit CLOs towards the end of September and spreads were a few bps wider as selling picked up with BWIC volume almost double that of August. Single A spreads were flat with limited volatility given the heightened demand from insurance accounts for that tranche.

As rates continued to sell off, BBB tranches felt some weakness, especially given the pronounced tightening experienced over the past couple of months. The BBB basis began to widen again as Tier 1 names widened less than their lower tier counterparts. On average, BBB spreads were 5-15 bps wider with most bonds back into the 400s DM. BB spreads saw less volatility as loan prices remained elevated and Tier 1 names remained firmly in the mid to high 600s/700 DM. Lower market value overcollateralization (MVOC) bonds were wider but we saw very little trading into the month end volatility to get any transparency as to the magnitude of the move.

Equity trading remained elevated with over $500 mm in BWIC activity and longer duration profiles well bid into the mid-teens yield to a base case. Net asset values (NAVs) were flat as the loan market finally experienced some down days after continual rising prices since August 25.

Overall trading activity increased significantly with YTD monthly highs in BWIC volume of $6 bn and TRACE reporting $20 bn in total volume, split between $15.9 bn in IG and $4.2 bn in below IG. Notably, dealers got net longer by $825 mm over the month but are only $225 mm longer over the year.

Secondary CLO 2.0 Spreads

	September 2023 (bps)	MoM Change (bps)
AAA	145-170	-3
AA	210-235	5
A	260-315	0
BBB	375-550	15
BB	700-1000	0
B	1000+	0

Source: TCW

CLO Primary

Primary CLO issuance dropped in September with $9.5 bn in new issue volume versus $11.1 bn in August, although we continued to see strong refi/reset activity as deals that priced at wider levels in 2022 took advantage of tighter current spreads. YTD new issue volume now stands at $81.4 bn, down 23% YoY as issuance continues to lag years prior and the arbitrage remains challenged. Tier 1 broadly syndicated loan (BSL) CLO spreads were flat at the top of the stack, 5-10 bps wider for AA-A, and 25-35 bps tighter for BBB-BB over the month with tier 1 AAAs pricing at +170. Less liquid managers continue to lag with AAA execution in the +200s. Given the move wider in secondary spreads during the last week of the month, we may potentially see some widening in primary spreads in the near-term, although historically, primary spreads tend to move with a lag. Middle-market issuance has remained elevated this year with over $2 bn in new middle-market issuance in September and, notably, accounting for approximately a quarter of new issue deals YTD. Middle-market issuance will likely remain elevated for the remainder of the

year given heightened demand and increased activity in the private credit market.

CLO New Issuance

	September 2023	YTD 2023	YTD 2022	YoY %
New Issue ($bn)	$9.50	$81.40	$106.00	-23%
Refi (#)	6	8	12	-33%
Reset (#)	3	15	35	-57%

Source: TCW

Tier 1 New Issue Spreads (5nc2)

	September 2023 (bps)	MoM Change (bps)	YTD Change (bps)
AAA	170	0	-55
AA	240	10	-70
A	280	5	-105
BBB	425	-25	-140
BB	715	-35	-235

Source: TCW

Fundamentals – CLOs

CLO credit metrics deteriorated marginally in September with weighted average rating factor (WARF) increasing to 2817 and B- and CCC buckets up slightly to 28% and 6.2%, respectively, as downgrades and defaults continue to roll through. Downgrades have outpaced upgrades in the loan market every month since May of 2022, a trend that we anticipate will continue given stress on borrowers' interest burdens. Market value metrics were mostly flat over the month, BB MVOCs remaining at 105% and equity NAVs down just 30 bps to 46.3%. ■

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Mr. August is an Analyst in the Fixed Income group, specializing in securitized products. Prior to joining TCW in 2021, Mr. August was the portfolio manager of Rosebrook Capital Partners, a hedge fund focused on illiquid and complex securities and transactions. Mr. August began his career at Morgan Stanley Investment Management where, as a Vice President on the securitized products investment team, he helped manage and direct client portfolios in a wide spectrum of securitized asset classes. Mr. August graduated magna cum laude from Georgetown University with a BS in Economics and Biochemistry. He is a CFA charterholder.

Alexandra E. Crenshaw
Vice President
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Ms. Crenshaw is an Analyst in the Fixed Income group, specializing in Commercial Real Estate CLOs, single asset single borrower (SASB), and Commercial MBS credit analysis. Prior to joining TCW, Ms. Crenshaw was a Capital Markets Senior Associate at Limekiln Real Estate, part of the MF1 joint venture with Berkshire Residential Investments. At Limekiln, Ms. Crenshaw led the securitization process for the largest programmatic multifamily Commercial Real Estate CLO issuer. Prior to that, Ms. Crenshaw was a Trader and part of the capital markets team at Benefit Street Partners, where she focused on Commercial Real Estate bond investments, conduit loan pricing and hedging, credit analysis, and securitization for both fixed and floating rate Commercial Real Estate debt. Ms. Crenshaw started her career at KPMG, where she focused on Commercial Real Estate CLO, CMBS, and agency transaction due diligence. Ms. Crenshaw holds a BA in Economics from New York University.

Palak S. Pathak, CFA
Managing Director
Senior Portfolio Manager

Ms. Pathak is a Senior Portfolio Manager and Trader in the Fixed Income group, specializing in securitized credit. She also serves as a member of the Fixed Income investment committee. Prior to joining TCW in 2007, Ms. Pathak was an Investment Specialist at Merrill Lynch in their Private Banking and Investments group where she helped manage $4 billion in High Net Worth assets and Co-Managed a proprietary equity derivatives portfolio. Ms. Pathak was previously an Assistant Vice President at the Bank of New York in their Strategic Consulting group. Ms. Pathak graduated cum laude from Barnard College/Columbia University with a BA in Economics and she also holds an MBA in Finance from Columbia Business School. She is a CFA charterholder.

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Ms. Perry is a Trader in the Fixed Income Group, specializing in asset-backed securities. Ms. Perry joined TCW in 2021 following a summer internship in the Securitized Products group. Prior to joining TCW, she was a Real Estate Development summer analyst at Hines. Ms. Perry graduated cum laude from the University of Pennsylvania and holds a BS in Economics from the Wharton School.

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