Jennison

Prime Flex and Subprime Stress

Michael DeFlorio, CFA – Fixed Income Trader

Alex Chansky – Principal, Junior Quantitative Analyst Jennison Fixed Income

Audio Starts

Alex: [00:00:00] Hi everyone, welcome back to Clipping Coupons with Jennison. My name is Alex Chansky, and I'll be your host for the show. Today, I have with me Mike DeFlorio, who is a trader on the securitized desk here at Jennison. Mike, how are we doing today? Good to see you.

Mike: I'm doing well! Thanks for having me on the show today.

Alex: Yeah, thanks so much for coming on! First question I have for you today: looking at ABS, are there any sectors that you're looking at and maybe particularly concerned about within ABS?

Mike: Within the ABS universe that we tend to focus, which for Jennison, is typically top of the stack, we're usually in the AAA classes. I would not say that I personally have any concerns, but I continue to watch and view with caution some areas of the subprime auto sector. There have been a few new issuers to the space post-2008, with a handful taking a good amount of market share away from the more established issuers.

There are different flavors to underwriting to a mix of different subprime borrowers. Personally, I feel like there should be a little more tiering in the sector than currently. Should there be a recession, are all issuers / sponsors going to make it through a cycle? We've already seen one subprime issuer stop origination and run off their portfolio given high losses in their 2022, 2023 vintages. Given, you know, the dynamics in the industry, there could be more to come.

Alex: Got it. Thank you. And what kind of issuance trends are you seeing recently? What issuances are we maybe finding the most or least appealing?

Mike: So the ABS market has seen back-to-back record-breaking years, in 2024 and 2025 for volume. So it was about $340 billion in 2024, followed by $370 billion in 2025.

And [00:02:00] that includes a light month in April 2025 with Liberation Day. Autos are still the lion's share of total volume in the ABS space. It's around 50%. But that's continuing to decline as there's more volume in the esoteric sector, such as whole business and digital infrastructure – and that's split between fiber and data centers.

Within the AAA ABS space, I personally find auto leases attractive. There's lots of credit enhancement up front. The deals amortize and build credit enhancement. The main risk to the auto lease deals is in the back end of the lease. To really take losses, there needs to be high turn-in rates and significant losses on the resale of the vehicles to break the AAA classes.

Given how the deals are structured, it's quite hard to do. And then least appealing, and this is more of just a trader's issue, as opposed to a credit concern, but the least appealing to me is rate reduction bonds. They tend to come to the market quite infrequently. They're usually a bit longer duration with much smaller issue sizes, so they get oversubscribed quite quickly.

And there tends to be a gray area of coverage on these bonds in the secondary. For example, is it covered by an ABS desk or, you know, a credit desk? Uh, al- also with fewer transactions and the split of coverage, there's usually a wider bid-ask, which makes it challenging.

Alex: Oh, that's interesting. I wouldn't have thought about it that way. And then how are you thinking about AI and data center impact on the market? Does it change anything about how we view risk and return for certain structured products?

Mike: So AI data centers is a major talking point in the sector, whether it's research issuance or [00:04:00] different firm uses, our own firm use.

On the issuance side, it's been a major area of growth and a key contributor to overall ABS volume increases the last couple of years. So for example, in 2024 about 8 billion issued, and in 2025 there was about 15 billion issued, with more supply expected in coming years. Primarily, the deals have been single A-rated for the top, class in the stack, but there are now a few triple A-rated deals.

So in Q1 and early Q2, there were a few 5-year triple A deals at price. Compass brought a 5-year deal priced 120 for their AAA class, and Switch brought their deal at 185 over. Within the ABS sector for data center, the structures are typically a master trust with a 5-year ARD, so that's an anticipated redemption date.

The deals can get a bit complicated. For example, cash flows if the bond's not called on the ARD. Plus what are the existing data centers in the master trust? And further, given all the talk about future supply, it does give some caution on wider spreads if the sector can take down all this future supply.

At Jennison, we found some more opportunities in the CMBS space, but that's in the more traditional 5-year and 10-year fixed options.

Alex: Got it, thank you. And then for the last fun question here, is there maybe a recent book or show or movie that you've seen and want to tell anyone about?

Mike: I recently read, "The Glass Castle" by Jeannette Walls. I'm usually biased towards fiction, but my wife recommended this memoir. It was an excellent read. It’s a little sad and as a parent, it's tough to read some of the experiences that Jeannette [00:06:00] and her siblings shared.

But it's amazing to see how that family persevered and they all became successful adults. Highly recommend it.

Alex: Wonderful. Okay. Thank you, Mike. Appreciate it again.

Mike: Thanks for having me.

Audio Ends