Jennison Associates
The Consumer Contradiction
Dmitri Rabin, CFA – Managing Director, Portfolio Manager
Alex Chansky – Principal, Junior Quantitative Analyst Jennison Fixed Income

Audio Begins

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Hey everyone. Welcome back to Clipping Coupons with Jenison Fixed Income. My name is Alex Chansky and I'll be your host for the show. Today I have with me Dmitri Rabin, a portfolio manager overseeing all of our work in structured finance.

So that means working with a variety of securitized products here at Jenison. Thanks so much for listening. Get ready for a great episode. Dmitri, thanks so much for doing this. Good to see you today.

[00:00:30] **Alex:** Alex, very good to see you today as every day. Perfect. if you can start with maybe giving me 30 second introduction about yourself and your role here and, yeah,

[00:00:38] **Dmitri:** my name is Dmitri Rabin. I'm a portfolio manager here at Jenison overseeing our work in structured finance.

I've been here for a little over six years. Before Jenison, I was for 10 years at another money manager in town, was co-head of structured finance there, and before that, portfolio manager and analyst started in the non-agency RMBS world. Before the 2008 crisis. So I've seen the oh one and the oh eight crisis as well as sort of the various cycles we've seen since then.

before that, I'd spent some time at a couple of hedge funds and started my career in consulting.

[00:01:11] **Alex:** Great. Okay. So then as PM in structured products here, the first question I have for you is about

the health of the US consumer. That's been a hot topic recently.

what is your current view on the US consumer? Yeah.

[00:01:23] **Dmitri:** , We spend a lot of time thinking about the companies that we look at, the sectors that we look at, and how that. feed into our macro view. within the structured finance, we have a lot of access to very current data on the consumer, whether it's auto loans, residential mortgage loans, credit cards, other types of, consumer debt.

So when we think about the US consumer, the asset class that we think gives us the best data today is auto loans. And broadly speaking, there are two types of consumers in the us There's a prime consumer more, much more likely to own their house. Higher credit or FICO score, higher income. Those consumers have been performing reasonably well.

You also have the subprime consumer. these are consumers who are more likely to rent. Their income tends to be lower and have higher volatility. Their FICO of Vantage, various credit scores tend to be lower. and these are consumers who have been really hard hit by. Higher inflation, higher prices.

So shelter, transportation, and food are three big categories for them have gone up in price quite a bit. to give you a sense for how different these two consumers are, if we look at a typical auto loan, they expected losses on that auto loan are below 1%. If you look at a typical subprime auto loan, the expected losses on that auto loan are 10 to 25%, meaning that you expect

A third of your pool roughly to default with some pretty significant severity on that. Wow.So, to give you a sense for how we use this data, about two and a half, three years ago, late [00:03:00] 2022. We saw a very sharp deterioration in subprime auto delinquencies and general performance. We're seeing data that was really concerning. and we did not see the same in prime. Our immediate response was to kind of adjust the portfolios and so on.

And think about sort of owning more prime, consumer debt. Really cut out or reduced dramatically what we did to zero, in subprime auto.

[00:03:25] **Alex:** Mm-hmm.

[00:03:26] **Dmitri:** and if you look at the results that we've seen 2022 and really since then in terms of delinquencies and losses, the subprime auto consumers performing at levels, which are pretty similar to 2008.

[00:03:38] **Alex:** Mm-hmm.

[00:03:38] **Dmitri:** Right. And we're in a very different economic environment. Mm-hmm. Versus the prime consumers performing much, much better. It's maybe performing at levels more like 2016. Okay. Which there was some economic stress, but it was not nearly to the same level.

If we look at the consumer today and we think about the types of losses we're seeing, and we are seeing some increases in the prime consumer as well. but still quite well contained. The consumer does not look like a four point a half percent unemployment rate consumer.

[00:04:08] **Dmitri:** I would say that the prime consumers probably performing at maybe five point a half. So about a 1% higher than the actual unemployment rate.

[00:04:15] **Alex:** Mm-hmm.

[00:04:15] **Dmitri:** And the subprime consumers performing as if the unemployment rate is more like oh eight, it's more like an eight or 9%, which is a pretty deep recession.

[00:04:24] **Alex:**

[00:04:24] **Dmitri:** Even versus their own history.

[00:04:25] **Alex:** Right. So for their own history, the prime consumer is performing slightly worse than they should be for this current employment rate.

Yes. And the subprime consumer is performing a lot worse. Yes.

[00:04:34] **Dmitri:** So obviously thinking that the consumer performance is closer to a six or 7% unemployment rate, is somewhat bearish. it gives us a more conservative view on the consumer overall. A relatively more positive view on the prime consumer. Mm-hmm. than the subprime consumer. And we do think about why that might be, and this can get a little geeky, but we think that there's a couple of reasons, the biggest of which that the FICO scores or some of the scoring systems that were historically used for scoring the consumer, we've been in a very long.

Sort of positive economic growth cycle post 2008. the, the FICO scores are probably inflated and there are various ways to measure it, but we think that a

760 FICO consumer is probably performing more like a 730 FICO consumer, which still leaves them within the prime range, but the losses are higher as the FICO goes down.

Whereas a 660 sort of a strong subprime sort of near-prime consumer is performing more like a 600 consumer, which is really pretty deep. sub-prime consumer. And that is some of what you're seeing

[00:05:43] **Alex:** Can you walk me through that just briefly how the FICO scores seem to be reflecting better than people are actually performing?

[00:05:49] **Dmitri:** Yeah, so a FICO score, a traditional credit score, is primarily based on people's payment history and their borrowing capacity. Those are [00:06:00] sort of the two main factors. So one thing is that if you think about a 700 FICO score in 2010. That is a borrower who in their prior three year history survived a very deep recession and maintained a pretty good payment history.

If you think about that today, that is a borrower that has so had a fairly strong economic backdrop Against which it is measured. You've also had a lot of consumer support come in during the Covid and post Covid period, which has significantly boosted borrower's ability to service debt.

[00:06:36] **Alex:** Got it.

[00:06:36] **Dmitri:** you've also had some significant regulatory driven changes where the way FICO is measured in terms of borrowing capacity. So for example, certain debts such as medical debts. Or student loan debts have been deemphasized or removed from the credit file in a way that when you look at the, at the scores, when you look at the overall credit file, the borrower has more borrowing capacity than they might actually be able to handle. So there's a couple of other consumer concerns that we do think about.

probably near the top of that list is a student loan market, a market that's grown to about $1.7 trillion. , And with loan default rates of 5% to 10% of all loans, it'll probably be higher without the multitude of forbearance and extension options that have been available to borrowers.

of that 1.7 billion, almost the entire market is. Various forms of government provided, government guaranteed loans about 1.4, 1.5 trillion of that. is government guaranteed. so we do think that as those loans become payable again, and there have been changes very recently within Department of

Education, that puts a lot of strain on a lot of consumers who may have been able to be in very graduated repayment plans or haven't paid for just a number of years while interest has accrued

that I think is a concern. the other concern we have is that there's a lot of new or relatively new unsecured loan segments that have been created post a great financial crisis, which have not been through the 2008 type cycle. And we do worry about how those types of products will perform when we get sort of a traditional unemployment, um, stress type of recession.

Can you gimme a quick example of that?

Yeah. So if you went into a store today to buy a pair of expensive sneakers as part of the checkout process, you would be offered a loan to pay those sneakers off in installment payments.

Mm-hmm. Um, that, that is a relatively new product. Mm-hmm. If you went to a lot of. Fairly expensive and they have become quite expensive music venues. A lot of the time they'll say, well, you know, the tickets to go to Boston calling is coming up here in Boston. Not a shout out to Boston or anything, but I love Boston.

These are tickets that can cost $2,000, $3,000. all of a sudden there's a lot of financial products available [00:09:00] that sort of let consumers borrow against these types of expenses.

[00:09:05] **Alex:** Yeah.

[00:09:05] **Dmitri:** and there are others that. Have had a number of names sort of initially they're called peer to peer lending.

When that didn't quite work out, they became marketplace lending, and now they're primarily called FinTech. They're more or less the same. They're trying to use new sort of measures of consumer credit availability to lend to consumer beyond the traditional channels

For all sorts of needs from installing swimming pool, to holding a wedding, to buying a pair of sneakers. Um, we're just not sure that those have been underwritten and in a way that, would withstand a higher unemployment rate and will over the next, whenever we do get an economic cycle, a whole economic, cycle, we will see.

[00:09:48] **Alex:** Yeah,

[00:09:48] **Dmitri:** there is some positive, and I should mention that we do think that. the homeowner, and the credit quality around residential mortgages is actually historically very good. And that has to do with both the fact that underwriting post 2008 tightened dramatically in the sector.

So the quality of what's being underwritten, particularly by the private market, as well as Fannie and Freddie is very, very good. And at the same time, a fairly significant increase in home prices means that consumers have a lot of equity in their homes so that they're able to refinance, they're able to sell if they do get into trouble.

and they're also potentially able to tap some of that equity, to help support them, which is probably part of the reason we're seeing such a gap between prime and non-prime, consumers in terms of performance.

[00:10:36] **Alex:** Yeah. Yeah, that makes sense.

what data do you think we should be watching out for to get a good indication of consumer trends?

[00:10:43] **Dmitri:** I think the auto data is probably the most robust because it covers the entire range of consumers. Pretty much anyone in the United States to participate in economic life, you sort of have to own the car in, in most places.

And so people own cars. They borrow against cars, sort of from very prime to very subprime consumers. when we look at that data, the Federal Reserve publishes some decent data on overall delinquencies, autos, but also mortgages, credit cards, and so on. That will include the banking sector and some things which we may not see through the securitization system.

And it's broad. But it doesn't give you the granularity. and then within the auto sector, we think there's a lot of beyond just prime subprime, there's a lot of measures that we look at to think about regional and local trends. So we think about differences by geography. We think about new versus used cars, which have had a very different performance pattern this time around.

Used cars really underperformed and. There's a couple of reasons for that, but we think that the main reason is they were priced more aggressively, much more highly. during the covid period when people needed cars, whereas new cars were kept at or near [00:12:00] MSRP used cars, the prices became much more negotiable and a lot of consumers found themselves in vehicles that they couldn't really refinance.

They couldn't really sell for anywhere near what they paid for them, and that became an issue. So that's a sector that we continue to. Watch and then also thinking about by manufacturer, there's different incentives programs, there's different popularity of different vehicles. So we're tracking all of that to sort of really understand, what are the best places for us to invest.

[00:12:28] **Alex:** Great. And then was there anything you wanted to mention there as well about, home equity lines of credit?

[00:12:32] **Dmitri:** so within the housing sector that I mentioned before, we are watching for additional, issuance of HELOCs or various forms of second lien. We think that can actually be a positive accelerant for the consumer because the consumers have built up a lot of positive equity in their homes.

The amount of this product that has been lent or borrowed is actually smaller than it was in 2008, whereas actually value of the homes, particularly inflation adjusted terms are up by factor of two. as a result, if you are able to tap into some of that equity that gives consumers significant additional borrowing power, we'll see if there are regulatory changes that enable that, but that does give the homeowner and consumer some additional runway, into a more difficult economic environment.

[00:13:21] **Alex:** how does your view of the consumer impact your thoughts on kind of the different sectors within securitized products?

[00:13:28] **Dmitri:** Yeah, so we continue to really like Prime Auto AAAs. That's a sector that, as we talked about, the prime consumer has, in our view, performed well.

The AAA part of the structure is set up sort of with the knowledge of the performance during 2008, we can compare performance and trends to that market. the idea that you would have to exceed that 2008 stress by several times, actually, three to five times generally to have any sort of issues so that serve as a sector that we think very attractive to treasuries, it's relatively short.

You are also. Guaranteed by the vehicle. In addition to the consumer credit, and given some of the headlines around tariffs, we think that loans and leases in this environment struck before prices are likely to have something of a step change increase due to tariffs are quite, quite attractive. we're avoiding subprime auto loans at this time.

Not only the default rates concern us, but also the stability of some of the sponsors. In that space really worries us compared to kind of OEMs and, large banks that tend to lend in the prime space. we are pretty comfortable with loans on leases and equipment, whether it's agriculture or construction loans or office related.

Again, higher prices due to tariffs and other factors actually help you really. Um, yeah, because they, the cost of the equipment goes up. if you bought or leased a John Deere tractor and the tractor now Oh, I see. [00:15:00] Cost 30% more. you are probably gonna want to keep that tractor, you're not gonna want to, default that and buy

[00:15:06] **Alex:** another one.

Does that then make new originations of those types of loans riskier? Like do you look at those less favorably in the future?

[00:15:14] **Dmitri:** Yeah, I think that's, that's a terrific question. When we finally see the new prices come through mm-hmm. We're gonna have to reevaluate every, everything that we do. Yeah. Um, what we buy is on a static pool basis.

So it's loans that are already made, and so they're loans from six or eight months ago in a year. These are gonna be all new loans and we're gonna have to think about, well, could there be a shock in the other way if the tariffs were to come down and prices were to become more competitive? is there any risk for stranded products?

We're not there yet, but that's exactly the way that, we're thinking and analyzing, these things. finally we're conservative around student loans. We think some very prime names are okay and very, very conservative about unsecured consumer.

[00:16:02] **Alex:** Mm-hmm. thanks, Dmitri. And then did you have, a, did you have an opinion on kind of the current environment versus different downturns that you've seen in the past?

Yeah, it's interesting. As you work in this industry longer, you do see some patterns, a little things, never quite repeat.

You see certain similarities in cycles, but each one tends to be new and each one you'll learn something and this surprises you, which is what makes this job fun. But if I think about the ones that I've had the chance to observe, 97 to 98 is world term capital implosion and the Asian financial crisis; 2001, 2003 was the popping of the .com bubble and Enron WorldCom defaults.

[00:16:39] **Dmitri:** 2008 was great financial crisis housing, kind of really global, issues. 2011, 2014, European Sovereign Banking and sort of sovereign banking issues. And then 2016, we had commodity price fall. And 2020, which was Covid. they're all different. They all had different causes. They also had different sectors, which were most levered at the time and which tended to suffer.

if I look at the current cycle, it looks maybe a little less like the great financial crisis. in particular, as we talked about, the prime consumers are in good shape, housing is in good shape. investment grade corporates actually similar in some ways to oh eight are in good shape, but also banks are in much better shape than they were 2008, particularly the large money center banks.

Mm-hmm. So all of all of those look pretty reasonable. where we do think there are some issues is the period post 2008. A lot of these healthy consumer and corporate bank balance sheets have been achieved. Through tremendous government spending. government guarantees that by the 2020 cycle, really sort of looked to fully support the level of consumer spending throughout the downturn.

And so if we look at the US government balance sheet, that looks much worse than those cycles. Mm-hmm. Um, right. You could think about in terms of debt to [00:18:00] GDP, you could look at it in terms of interest serving costs. You could look at it as forward looking. Deficits. all of those variables, um, look pretty alarming.

From our perspective. And so that raises the question, the US government can always tax more and it can always spend less. Right. And it can also print money. But it does raise two questions. One is the question about inflation, and I know you've talked to Sam, and so there's a question about the.

shape of the yield curve and term premium. Which is to say, does the US government, will they have to pay more To borrow further out to term out the debt, which is a concern. And then the second question, will the US government have the fiscal capacity if we have another crisis to spend?

The sorts of sums that we have spent in the past when we're starting at sort of full employment and sort of pretty close to full economic output with a 6% Deficit to GDP ratio that historically has been sort of near peak recession levels. So what does that go to? 10%, 12%, 15% in a recession to fully support, kind of serve the consumer and the corporate sectors.

That makes us pretty cautious. That question as to how much capacity does the government sector, the sovereign sector have in the US to support. an economy, if we hit a, if we hit a recession, that worries us and that informs a more cautious view on the consumer and elsewhere.

[00:19:26] **Alex:** Yeah. Perfect. Thanks so much, Dimitri.

Do you have any good, uh, movies or books that you've, seen or, or read recently that you wanna tell everyone about?

[00:19:35] **Dmitri:** I tend to get really excited about whatever it is that I'm sort watching a reading But probably the thing I'm most excited about is something that's been with me for a long time, which is I love the original Sherlock Holmes novels and I love the shows that have.

Come out one of the reasons you know that the books are great is that there have been hundreds of dramatization, some of 'em truly great. the Sherlock show that came out now close to 10 years ago with Martin Freeman and Benedict Cumberbatch, they're doing a new season that's gonna come out.

So I would recommend anybody who hasn't seen the old ones read the books, see those, because those are really fun. And then I'm really looking forward To the new stuff that they're gonna be coming back with.

[00:20:15] **Alex:** Yeah. they did a, I think it might have just been a couple of movies, maybe just one or two movies with, uh, Robert Downey Jr as well.

I thought that was fun

[00:20:21] **Dmitri:** as well. There. There've been those movies, and if you go back, I mean there's movies and pretty much every, in, pretty much every language, every decade. Wow. People redo the dramatizations because the books and the stories are just very, um.

Con conducive to that. Mm-hmm. They're just a lot of fun.

[00:20:39] **Alex:** Yeah. I believe

[00:20:40] **Dmitri:** that.

[00:20:40] **Alex:** I have one more fun question for you here. this episode won't come out for at least a couple of weeks, but I want your prediction here.

Now, Celtics currently down three, two to the Knicks. what is gonna happen in this series?

[00:20:52] **Dmitri:** So the games have been. Really fun to watch. But fundamentally, the analyst in me looks at it and [00:21:00] says, the Celtics shoot a lot of threes. If they make more than a third of them, which they usually do.

They win every game. And if they make less than a third of 'em, which happen in two of the games, they lost those games by two points each. it seems to me like they're probably gonna make more than a third of them. So I think they come back and win the last two games, not just because I love the Celtics.

Um. I think New York has been a great competitor in this year. Yeah. I think it's been a really great series. I've been so impressed with them. Yeah. It's, it's, it's, it's been great. But because I think that the type of basketball that's played now, just very analytically, it's how many threes can you make?

And the Celtics, so far, they've either been significantly below the average and lost by two or significantly above, and one by 20. Mm-hmm. Well, I think if they just get to the average, they're gonna win the last two games. Even though, see Jason Tatum is out, They're such a team, deep and well coached.

Again, the analyst in me looks at how they've been built, how they've been put together, how thoughtful the team has been about, developing young stars, bringing in players. Super, super impressive. Some, I'm very excited to see the next game in New York and hopefully game seven in Boston.

[00:22:05] **Alex:** Yeah, yeah, absolutely.

Thanks so much Dmitri. Really appreciate your time on all of this.

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