Jennison Associates
Consumer Engine Stalls
Dmitri Rabin – Managing Director, Head of Structured Products
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Audio Starts

Alex: [00:00:00] All right 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 Dmitri Rabin, who's a portfolio manager here, primarily working with structured products. And Dmitri's been on the show a couple of times before, so yeah, excited to have him back. How are you doing Dmitri?

Dmitri: I'm great. Thanks for having me back, Alex.

Alex: Perfect. the first thing I want to talk to you about is the conflict in Iran and the rise in energy costs associated with it, as being a major economic event recently. So how do you think about the impacts of all of that on the US consumer?

Dmitri: So we're recording in mid-April, and so the conflict, the war has gone on for about a month, month and a half. I mean, we think this is a major negative impact to the consumer. Um, and the reason is, especially the subprime consumer, it takes a lot of income out of the consumer that they would've spent on other things.

That's now going to go towards heating, towards gas, and so on. And for the subprime lower income consumer in particular, that's doubly true because their income is lower, and the percentage of their income that they historically spend on energy cost is higher. So it hits them hardest.

Alex: And then how would you compare this shock to the tariff shocks of 2025?

Dmitri: Yeah, so it's right around the one-year anniversary of Liberation Day and when a lot of the tariff policies were announced. I think it's actually quite different.

We were somewhat bullish around the consumer and around Prime Auto after Liberation Day, even though the response from the financial markets was quite negative. And the reason was that there was a potential increase in consumer incomes from some of the protectionist policies, but more importantly, to the degree to which we're investing primarily in secured assets like autos.

An increase in potential auto prices from tariffs making foreign and domestic cars more expensive [00:02:00] is a positive for the assets that we were able to buy at the time, which had been lent against three or six months earlier. So we were quite aggressive during that time. Going out and looking for more auto ABS prime assets.

By comparison, we're very cautious about this crisis because we think the magnitude is greater. There is no positive employment effect. And importantly, this hits right in the transportation part of the consumer balance sheet. So if you have an older car, if you have an internal combustion engine car, and if it's not very energy efficient, right, your costs really increase. So the overall cost of owning a car really goes up, which hits that part of the consumer budget that they used to use to service car payments. And again, much bigger issue for the subprime consumer with older, potentially less energy efficient cars, and lower incomes than for the prime consumer.

Alex: And then tell me a little bit about how you would know if performance is getting better or worse over time here?

Dmitri: So the way we would think about it is look at the data. We have a lot of loan level and pool level data across various prime and subprime originators. And with the additional analytics we can control for credit, we can control for when the loans were made, we can control for the types of car that it is and really see detailed consumer performance and whether it's getting better or worse.

And we've been doing this for many years, but in 2022, we saw the subprime audit performance was starting to really deteriorate. Loans made in 2022 were just performing much, much worse. And we were seeing trends, which turned out to be borne out by time of '22, '23 vintages, where subprime performance was similar to 2007, 2008 performance right before the great financial crisis. And that made us extremely cautious around the subprime consumer because when we think about it today, with an unemployment rate of 4%-4.5%versus back then unemployment rate, [00:04:00] having gone to 9%-10%, you're not supposed to see those types of loss numbers.

And that made us really concerned about what if we did get a recession? What if we did see unemployment rates actually increase? What sort of loss numbers we would get and what would that mean for the originators, for the overall subprime auto ecosystem and for the loans that we could potentially buy.

So we pulled back pretty strongly from the subprime auto sector, at that time and switched entirely to owning Prime Auto Credit, where we felt the performance was and remains much better than it was sort of during the post-08 crisis period.

Alex: Thank you. And then I've also heard that there's been some tightening in underwriting standards recently. Can you tell us a little bit about how that works? What's going on there?

Dmitri: Yeah, absolutely. So when the people making the loans, the originators see that the performance is significantly worse than what they expected. They will typically tighten standards, which means maybe they'll lend a little less against the car, or maybe they will sort of lend it only at slightly higher credit tiers, and that usually improves credit performance.

Unfortunately, when we look at the ‘23 and the ‘24 vintage, kind of into ’25, we saw some tightening in sub-prime underwriting, but we actually did not see much of an improvement. And that again, makes us very cautious. There's marginal improvement in the ‘25 vintage, um, but not commensurate with the supposed amount of tightening.

So that tells us there's continued deterioration that even significant tightening of the credit standards couldn't fully make up for.

Alex: Last big question here -- What does this all mean? What should we do about it? What kind of positioning do we want to take here at Jennison?

Dmitri: So our conclusion is, we'll look at the energy shock from the Iran conflict -- we should be more conservative around consumer assets and particularly assets related to subprime auto in the subprime and the unsecured non-prime consumer.

Those things to us are very, very clear based on the [00:06:00] trends we're already seeing, based on the logic of where an energy shock really hits the economy hardest. Beyond that, we're going to be always looking at data, and we're always ready to be surprised by positive and negative trends. So in the Prime Auto space where we do have more exposure, we're going to be looking very closely at those trends to make sure that the performance remains strong, and continue to go where the data and the events take us.

Alex: Perfect. Thank you. And then actual last question here is a fun one about, if there's been any books or movies or TV shows that you've read or watched recently that you want to tell people about?

Dmitri: Yeah, absolutely, so my reading sort of spans a pretty wide range, but tends to be somewhat geeky.

So there's a book I'm currently reading called *The Land Trap*, which is a very long but super interesting economic history of how people have financed and regulated and speculated on land, which goes back to some of the things I do in mortgages and kind of how I think about that type of history.

And then on the more fun side, we've been watching a show called My Friends and Neighbors, which is on Apple TV, which I highly recommend. It's sort of a super fun, a little bit of a thriller, but really social commentary, comedy of a show, that deals with a lot of things in middle age and kids sort of leaving for college and a lot of other things that we deal with. So my wife and I really love it, and they just started the second season, so we just started that and they're super excited to see the rest.

Alex: Cool, cool. Yeah, I saw, I saw season one last year or something. That was great so I'm excited for season two. Appreciate it, Dimitri, thank you so much for your time.

Dmitri: Thank you.

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