

## US Support for Securitization

Featuring: **David Zhang**, Managing Director and Head of Securitized Products Research

### Adam Bass:

This is MSCI Perspectives, your source for weekly research insights as investors respond to the COVID-19 pandemic. I'm your host Adam Bass, and today is June 4th, 2020. This week: securitized products, mortgage debt, car loans, and packages of other kinds of debt, which have been a major focus for investors as well as the Fed during this crisis, just as they were back in 2008. But how has this market reacted to Washington's moves this time around, and what is it telling us about what to expect going forward? For answers to these questions, we turned to David Zhang, head of Securitized Products Research at MSCI. David, thank you so much for being here. I know you're very busy these days, not only with work, but with COVID relief efforts as well. Tell us a bit about that.

### David Zhang:

We have this organization called the ACUC, it's American Chinese United Care Alliance. So it's the Chinese Americans sort of within the New York City area bind together to support local hospitals and the local police, because they need the PPE, personal protective equipment. I'm actually the current President of the Chinese Finance Association in the US, and my organization is part of that Alliance. We actually raised over USD 4 million in last month, and actually delivered over millions of masks, surgical gowns, and other equipment to local hospitals and local police units.

### Adam Bass:

Such important work, thank you for that effort. When you're on the clock for MSCI though, instead of PPE, you're focused more on acronyms like MBS and ABS, as well as other securitized products. This is an often misunderstood, but quite significant part of the market.

### David Zhang:

Yeah, securitization is the biggest financial sector in the world after the US treasuries. And it's found in 50% of the US consumer spending and the business credit. For instance, MBS is an almost \$10 trillion sector, and one with the best credit, and the best liquidity, has huge volatility right after the crisis, actually five times higher than previous highs back in '08. This improved after Fed intervened. Fed bought a couple hundred billion in a couple of weeks.

**Adam Bass:**

Before the Fed intervened though, we saw some pretty significant reactions elsewhere in this market. What kind of reaction did we see in other credit sectors, commercial mortgage backed securities, for example?

**David Zhang:**

The other credit sectors, the worst, CMBS, and mortgage credit, and the COs, and followed by ABS. For example, for high yield wider than 500 bps. IG wider than 100 bps. CMBS will be wider than 500 bps, even AAA wider than 50 bps, that's a lot. Credit risk transfer deals initially wider than 1,300 bps. And for CMBS of course, the worst hit are hotels and the leisure sector, and the retails. Hotel loan delinquency increased from 1% to 14% in one month. Commercial real estate loans delinquency increased from 1% to 7% in a month. So this is a really hard hit from the crisis.

**Adam Bass:**

Not too surprising to hear that any security linked with travel or leisure has suffered, but as you mentioned, and as we've heard from other guests, such as Andy Sparks, the Fed has stepped into markets in a big way. And their aim, at least part of it, is to support living standards and small business in the US as well as the economy. Yes?

**David Zhang:**

Federal Reserve, they have experience from the last crisis. So the current program is much bigger. So in addition to QE, as your host of other programs to support the funding and the liquidity for many sectors, not only secondary market, but also primary market. And also we shouldn't forget that the lenders, whether they're the private industry. In late March, right after the California and in Washington state lockdown, the banks started to allow six to 12 months forbearance for a mortgage payment, and the credit card and other consumer lenders auto lending companies also started borrower assistant programs. And so for last crisis, we have done detailed research on the effects of these programs, and we feel these programs are very useful to lessen the economic impact.

**Adam Bass:**

What's the biggest difference you've seen with these efforts versus 2008?

**David Zhang:**

So for the previous crisis, or all those programs was tagged on halfway, or a few steps after the crisis is actually good at this time, we'll actually start this program right at the beginning of the crisis.

**Adam Bass:**

Any others?

**David Zhang:**

So this QE is a number four since 2008, and it's labeled as "unlimited." Previously Fed usually announces the total amount of portfolio buys. For examples, there was a USD 250 billion for treasury and USD 20 billion for mortgages. This time Fed is saying that we're going to spend as much as needed to support the economy, and support the financial market. The current QE actually expanded to corporate bonds, and they've announced to buy high yield ETF. So this is really unprecedented. Fed has been criticizing the excessive credit expansion, especially in high yield and bank loan, for the last three or four years, and for this whole turnaround now they're actually buying high yield, and the slow TALF to buy certain kinds of COs, this is a really shows that Fed is really expanding the toolbox to support the economy and the support the financial market.

**Adam Bass:**

Switching gears from past to future for a moment, while no one has a crystal ball, of course, what is your research found in terms of what the market is indicating?

**David Zhang:**

So for agency MBS, the big uncertainty is a prepayment behavior. On one hand, you have a social distancing which puts a barrier in selling your house, and refinance your mortgages, and there are a large amounts of people actually signed up for forbearance. On the other hand, last month, house price recording, and the prepayments piece look quite robust. So we are looking at this very closely.

For credit sector the spreads has more or less went back 50% to 70% to the pre-crisis levels, very significant recovery. Some of it's obviously coming from liquidity support, from Fed, and some coming from the expectations are to the worst crisis can be avoided. On the mortgage credit sector, the default and house price downturn will not be as severe as last time. We have actually very detailed analysis on this in our research. On the CO we think will be much worse than previous crisis. Bankruptcy reached a USD 1 trillion mark last year and the hires and the high yield sector. First time in the US history, and the CO, outstanding actually, tripled that in less than 10 years. So they all have expanded with much loose credit on the writing.

**Adam Bass:**

Back in 2008, senior CLOs or, "Collateralized Loan Obligations", did not default. Have you seen a difference this time around?

**David Zhang:**

What is unique about this time is that all of the sectors get hit all at once. You talk about energy sector, which actually was doing better last time. This time oil prices very low, oil sector, even hospital sector. This is a jointed default probability increased dramatically. So again, we have detailed research on this, published research. In consumer ABS sector, because of the deferred payment offered by the lenders, so data is still coming, so we're going to look at the data more carefully for the next few months.

**Adam Bass:**

A lot has been written about how the stock market has seemed disconnected from economic reality. For an institution that has historically run from uncertainty it hasn't seemed terribly bothered since the original draw down back in March.

**David Zhang:**

Even though the stock market is at a historical high, if you look at the treasury market, the 10 year treasury is at a 60 bps, so you'd be seeing about the treasury market at the 60 bps. Basically the investor in treasuries believe the rates will not go up for the next three to four years. So why is that? Because they probably think the economy will not improve or recover enough to warrant the Fed increased rates. So this a huge disconnect between the stock market and of the treasury market.

**Adam Bass:**

We started out talking about your work with ACUC, the American Chinese United Care Alliance. What does that work revealed to you? What will you take away when this is all behind us?

**David Zhang:**

This experience really shows to me we're all in this together to fight the pandemic, to revive the economy for everyone kind of living on this planet.

**Adam Bass:**

That's all for this week. Thanks to David and to all of you for joining us, and a special shout out to our colleague, Reg Lang, for his help putting this episode together. If you have a moment we hope you'll subscribe so you can stay up to date on our latest episodes and insights. If there's a topic you'd like explored or just want to let us know what you think, don't hesitate to leave us a comment. For more from MSCI check out our sister podcast ESG Now, follow us on the MSCI LinkedIn page, and don't forget to bookmark <http://www.msci.com/coronavirus> for all our crisis related content. Until next week. I'm your host, Adam Bass, and this is MSCI Perspectives. Stay safe, everyone.

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