Fixed Income **Strategy Insight**

November 8th, 2016

NATIXIS ASSET MANAGEMENT

Why invest in a European ABS Strategy?

Why invest in a European ABS Investment Grade strategy?

1. Why is an investment in European securitized debt relevant now ?

a. The European Central Banks' (ECB) ABS Purchase Program

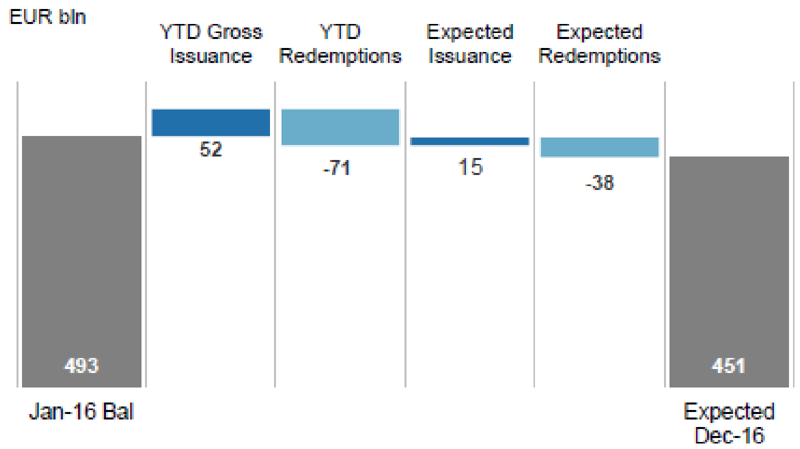
European policymakers have become increasingly clear about the need to revive the ABS market, given the vital role securitization plays in allowing banking groups to borrow against their loan books and transfer risk off their balance sheets. The European Central Bank has publicly called for an easing of the regulatory environment for ABS to improve both demand and supply and since late 2014 it has implemented an ABS purchase program (ABSPP) to buy ABS paper in both the primary and secondary markets. The purchases are intended to run until the end of March 2017 or longer until the moment the ECB sees a sustained adjustment in the path of inflation consistent with its inflation target.

From end of November 2014 to September 2016, the ECB bought around EUR 20 bn of Senior European ABS which represents a strong support for the asset class in terms of valuation.

b. Supportive technical factors

ABS redemptions have outpaced new issuance resulting in negative net issuance estimated at around EUR 40 bn for 2016. We expect the strong investor appetite to continue for the asset class. The ABS market is well diversified with market capitalization expected to reach around EUR 450 bn by the end of 2016, which would imply roughly a third of the investment grade market.

FIG. 1 **Net Negative Issuance**



Source: Morgan Stanley Research European ABS Strategy – September 14, 2016. Issuance and redemptions numbers are as of end of August 2016.
The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change without prior notice. There can be no assurance that developments will transpire as may be forecasted in this material.

c. A current attractive valuation

Although the ABS spreads have tightened, we consider senior ABS tranches' valuations still attractive, taking into account the high rating quality, the low volatility and the near-zero loss rate of the asset class (Please refer to next paragraph *"Historical Strong fundamentals and regulatory framework"*).

There is still a strong difference in terms of valuation between core and non-core ABS, with the latter offering a significant premium for the risk taken, as shown in charts below.

FIG. 2 **Core Senior European ABS Spreads**

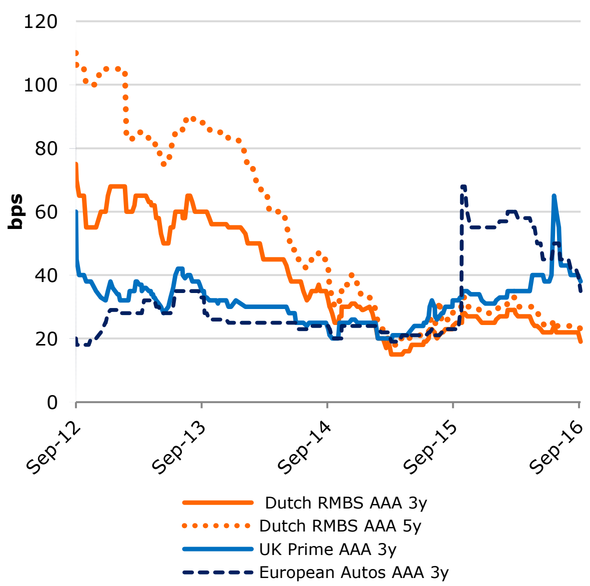
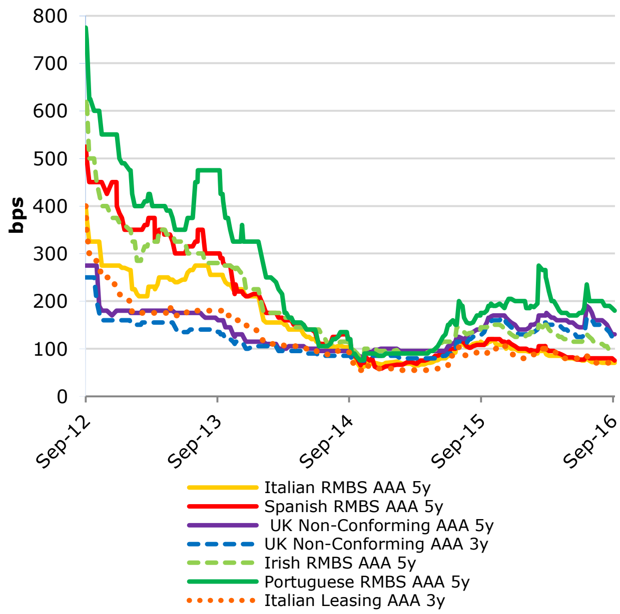


FIG. 3 **Non-Core Senior European ABS Spreads**



Source for both charts: Natixis Asset Management, Nomura. Period from 30.09.2012 to 09.09.2016. The figures given refer to previous years. Past performance is not a reliable indicator of future performance.

d. Historical strong fundamentals and regulatory framework

The European ABS asset class has demonstrated exceptional low losses throughout the financial crisis. According to Fitch, the cumulative European RMBS loss rate between 2000 and 2015 is very low at 0.2%. This compared to a US RMBS ABS cumulative loss rate of 7.9% for the same period, which is nearly 40 times higher! We definitely don't talk about the same risk and there is no reason to amalgamate the two markets between the two sides of the Atlantic!

However the contagion effect of the subprime crisis in 2007-2008 in the European ABS asset classes was huge in terms of valuation with a significant plunge of the ABS prices but with a low impact on default rates.

The ECB recognizes the importance of revitalizing the ABS market and alongside its own buying program, started in November 2014, has publicly called for an easing of the regulatory environment since April 2014. Consequently, we expect for 2017, the implementation of a new European ABS framework for Simple, Transparent and Standardized ABS ("STS ABS"[1]) which, we believe, should improve even more the demand and supply on this market. We also hope, in this new regulatory context, for a more favorable capital treatment under Basel III and Solvency II.

[1] For further details on ECB's Securitization initiative, please refer to http://ec.europa.eu/finance/securities/securitisation/index_en.htm#150930

2. Natixis AM's European ABS Investment Grade (ABS IG) strategy has stood the test of time

a. An experienced team with a strong risk management culture

The strategy is managed by a dedicated European ABS team since 2004. The investment managers bring a combination of investment and analytical skills, and have a long track record with more than 15 years on average, of combined financial-market experience.

The strategy is co-managed by **Sebastien André**, who has 12 years of investment experience and **Alexandre Boulinguez**, who has 8 years of investment experience under the supervision of **Emmanuel Schatz**, Head of Corporate Credit and ABS, with 27 years of investment experience.

The team's research effort is focused on ABS that fit with the risk profile of the strategy. They search for names that provide added value. They base their investment decisions on risk-return, liquidity, cash-flow profile considerations and so on.

Risk management is key to the investment process. For each ABS, a quantitative and qualitative analysis is done.

They believe that diversifying the risk (in terms of geography or type of asset) is vital to long-term success for the investment. Knowing what drives the performance of each asset that they invest in and seeking to ensure diversity at the fund level fits in with our approach to risk management.

b. Why we think the strategy is well positioned in the current market environment?

The profile of our European ABS IG strategy as of the end of September 2016:

- 60% ECB eligible ABS.
- 90% of senior ABS tranches with an average rating of AA. A diversification across geographical jurisdictions and sectors enable the investor to gain exposure to a pool of real economic assets and to mitigate the concentration risk.

FIG. 4 **Geographical breakdown of our European ABS IG strategy**

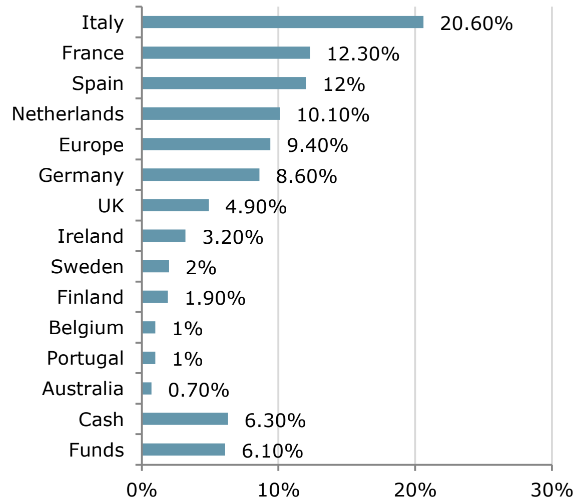
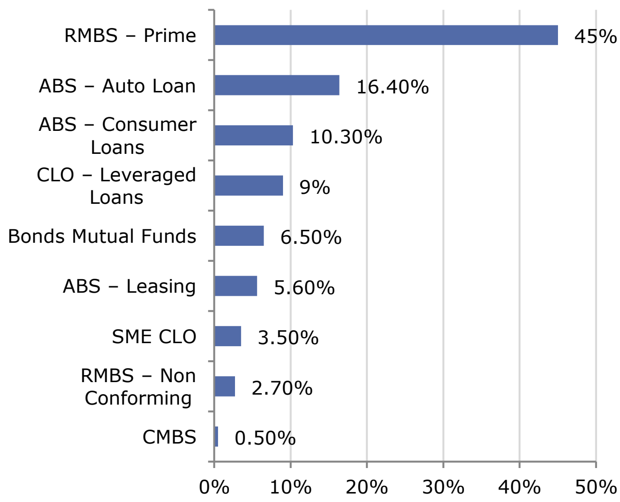


FIG. 5 **Sector breakdown of our European ABS IG strategy**



Source for both charts: Natixis Asset Management. Data as of 30.09.2016.

- A very low modified duration of 0.25 due to the floating rate nature of the asset class. It mitigates the interest rate risk, should rate increase,
- Given the high exposure to senior ABS tranches with an average AA rating, the strategy has shown a low volatility of 0.47% annualized[2] one year till October 31st, 2016.
- An attractive current yield at Euribor 3 months + 80bps[2] for a low current average life, below three years, making the strategy attractive in terms of risk return when compared corporate debt instruments with a similar rating.

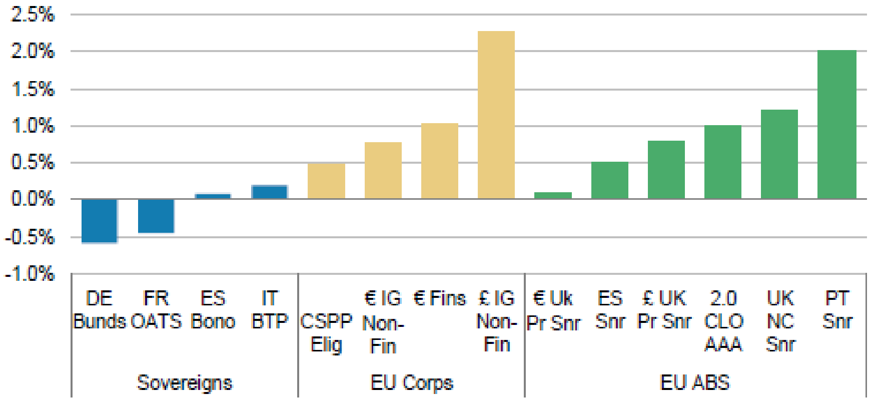
Today, we think the most compelling opportunities are most likely to be found in securities that do not form part of the ECB ABS Purchase Program like UK non-conforming RMBS, CMBS, CLO of leveraged loans, Peripheral RMBS.

Our experienced team's analysis aims to find those best opportunities in terms of risk-return.

3. Conclusion

The ECB's accommodative monetary policy has gradually pushed a growing universe of bonds near zero and even into negative-yield territory across Sovereign and corporate credit markets which has kept the relative value in European ABS attractive.

FIG. 6 **European Risk Assets: Yield Snapshot**



Source: Morgan Stanley Research European ABS Strategy – September 14, 2016.
The figures given refer to previous years. Past performance is not a reliable indicator of future performance.

The ECB has supported spread levels across most ABS sectors globally acting as the performance driver this year.

But even without the ECB, the appetite for the asset class is strong because of the prevailing good risk/return delivered. So, all other things being equal, we expect for next year that ABS valuations will be driven by the technicals of demand and supply which are in favor of a further tightening.

[2] Source: Natixis AM. Data as of 31.10.2016. The figures given refer to previous years. Past performance is not a reliable indicator of future performance.

Main Risks

The strategy invests primarily in Europeans fixed income securities. Fixed income investments are typically sensitive to changes in interest rates, and the fund could lose value when European interest rates rise. The strategy is subject to the following specific risks: capital loss, credit, liquidity risk, interest rate risk, counterparty risk and specific risks incurred by securitization assets. An investor's capital will be at risk; you may get back less than you invested.

The 2007 subprime crisis in the US and the Lehman Brothers bankruptcy in 2008 led to a major liquidity crisis in the ABS market and a steep fall in prices. This market crash and the highly-discounted valuation levels account for the positive returns in 2009 and 2010.

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