

**"This house believes the ABS market is showing signs of stress & overheating". Do you agree?**

Stratos Disagrees

So even though our company is a remarketing specialist and servicer with no ABS exposure, we have been keeping a close eye on the ABS market over the past few years, in part because many of the sellers of leased mid-life equipment have been so transfixed on the ABS market that they've sold a good chunk of equipment into this market. Obviously we're concerned about alignment of interests, structuring and the reliability of some of the underlying valuations – but we're here to discuss how solid this market is, so I'd like to just focus for a second on what a stressed or overheated market could look like: for me there would be 5 alarm bells: signs that trading volumes are slowing, new investors slowing investments and new issuers avoiding the market, pricing continues to fall with little or no regard for differential pricing across products, repeat issuers start to focus on alternative capital sources and finally product innovation and diversity slows...

I contend that not one of these five alarm bells have started to ring in our market and I'd like to get into a bit more detail on these five undeniable facts to prove that motion is just plain wrong

1) Trades continue to reach record levels – no let-up in sight

Total ABS issuance volume through Sept 2018 was over \$186b, up 11% yoy; Aircraft ABS Issuance volumes in 2017 reached record levels (\$6.2bn), and 2018 has seen 7 issuances (\$4bn) with a healthy pipeline that could easily match 2017. 2018 had nearly equaled 2016 levels by September already.

**If there was stress or overheating in this market, trades would have peaked already**

2) Continued introduction of new Investors and new Issuers, and ready acceptance of new Servicers

There has been a number of new debt buyers, especially asset managers who have preferred Bond over Loan formats. TBOLT 2018-A, which priced in July, had 41 unique investors, the highest number since the aircraft market re-opened in 2012. It included 5 investors new to Aircraft ABS. In the past 12 months there have also been many new Issuers, eg Zephyrus, Merx, Global Jet, Wings Capital & Worldstar;

**If there was stress or overheating in this market, new investors would not be appearing and new issuers would not be hitting the market**

3) No Evidence of Pricing Distress

Most aircraft deals continue to price at low yields – for aircraft at least, spread tightening has almost completely offset rises in interest rates generally; The modest increase in yields is much more a reflection of increased L-T benchmark rates than of any overheating of the ABS market. 5-yr swap rates have risen by c100bp since early 2017; A-tranche spreads have generally tightened by an equal amount and B-tranche spreads by even more. Nevertheless Investors continue to differentiate between good and not-so-good credits and asset classes. There has been no desperation, no rush to get unworthy deals done, as seen by the price differential in the recent Zephyrus transaction.

**If there was stress or overheating in this market, investors would be increasing pricing indiscriminately.**

4) Repeat issuers are still regularly accessing the market

Castlelake, Air Lease and Apollo have all come to market in 2018; they would not have done so in times of stress. Refinancings have also been in evidence as spreads have tightened. The current pipeline, as hinted by several of our Investment Bank colleagues, continues this trend.

**If there was stress or overheating in this market, repeat issuers would go elsewhere.**

5) Introduction of Broader asset classes and new product innovations

We're recently seen growing innovation in this sector such as tradeable E notes, single waterfall structures and broader asset classes: Proceeds from WESTF 2018-A issuance were used to buy 55 engines & only 1 airframe, other recent examples included Turboprops and Business Jets.

**If there was stress or overheating in this market, it would simply not be possible to introduce new product**