Weitz | INVESTMENT MANAGEMENT

ASSET MANAGER'S LENS

ABS in a Post-GFC World



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Asset-backed securities (ABS) are a vital yet often overlooked segment of the fixed income market. When thoughtfully selected, they can offer investors exposure to consumer and commercial credit risk, provide income diversification, and enhance portfolio resilience through a bottom-up investment lens. For fixed income investors seeking alternatives to Treasuries, agencies, and corporate bonds, we believe ABS merit consideration.

An asset-backed security is a debt instrument secured by a pool of contractual cash flows, typically comprised of loans, leases, or receivables. These securities fall under the broader category of structured credit or securitized products.

A BRIEF HISTORY

The modern non-mortgage ABS market emerged in the mid-1980s, initially built on auto loans and credit card receivables. Since then, it has evolved into a $1.6 trillion market*, encompassing a diverse array of underlying asset types.

The 2008 Global Financial Crisis (GFC) cast a long shadow over securitized products, particularly collateralized debt obligations (CDOs) tied to residential and commercial mortgages. These instruments were at the epicenter of the crisis, and their complexity led many investors to retreat from the entire structured credit space.

However, the years following the GFC saw the implementation of meaningful reforms, including stronger underwriting standards, better transparency, and more robust deal structures. These changes revitalized the ABS market, a resilience underscored by the sector's significantly lower default rate post crisis averaged across all ratings compared to overall traditional corporate credits.

DEFAULT RATE (%) HISTORY

	Corporate Bond		ABS	
Ratings	**Pre-GFC & GFC (1994-2009)**	**Post GFC (2010-2025)**	**Pre-GFC & GFC (1994-2009)**	**Post GFC (2010-2025)**
AAA	0.00	0.00	0.00	0.00
AA	0.03	0.00	0.02	0.00
A	0.10	0.00	0.21	0.01
BBB	0.25	0.03	0.34	0.04
BB	0.88	0.22	1.72	0.06
B	4.77	1.58	6.07	0.92
Average All Ratings	**4.51**	**3.24**	**0.40**	**0.23**

Average All Ratings comprises all ratings (including B- and below). ABS excludes CLOs.
Source: S&P Global Ratings default, Transitions, and Recovery: 2024 Annual Global Corporate Default and Ratings Transition Study.

THE MECHANICS OF SECURITIZATION

To understand the value of ABS, it's essential to start with the fundamental building block of any securitization: the structure.

CONTRACTS ARE THE CORE

Each ABS is built on an agreement between a borrower and a lender, where the borrower promises to make payments. These agreements might include an individual's auto loan, an airline's aircraft lease, or a franchisee's royalty obligation. The securitization process turns these contractual obligations into investment products.

Contrary to popular belief, the physical "hard" assets (cars, planes, equipment) are not the primary collateral. Instead, the contracts themselves—the rights to receive future cash flows—are the main asset. Physical assets serve only as secondary support in case of default.

THE ROLE OF SPVs

The structuring of an ABS begins with the creation of a **special-purpose vehicle (SPV)**. This legally distinct entity, also called "the issuer", purchases the underlying loan pool and issues debt, referred to as ABS, and equity to investors. The SPV insulates the assets from the financial health of the sponsor—typically a finance company.

ABS issuances are often structured with multiple **tranches**, or classes of securities, each offering different priorities in receiving cash flows. Senior tranches receive payments first and thus carry lower risk, while junior tranches offer higher returns with higher risk. A key post-GFC improvement is that sponsors often retain the equity or residual tranche, thereby aligning their interests with those of investors.

* The ABCs of Asset-Backed Securities – 2024. Guggenheim Investments, 2024.

THE SPECTRUM OF ABS COLLATERAL

Consumer ABS are secured by loans to individuals:

- Auto loans/leases
- Credit card receivables
- Student loans
- Personal loans (marketplace lending)
- Residential solar financing

Commercial ABS are secured by business obligations:

- Aircraft leases
- Equipment financing
- Data centers
- Shipping containers/railcars
- Whole business securitizations

ABS have become embedded in everyday economic activity, financing everything from vehicles and student loans to data centers and shipping containers. Broadly, ABS can be divided into consumer and commercial ABS.

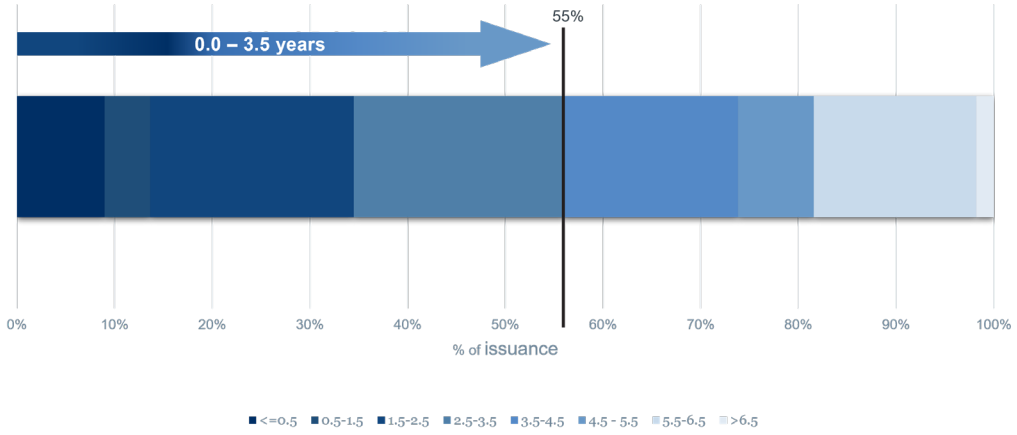
KEY FEATURES AND INVESTOR PROTECTIONS

ABS structures offer a combination of features designed to manage risk and enhance credit quality:

SHORT DURATION PROFILE

Approximately 73% of ABS have a weighted average life of less than 3.5 years, appealing to investors seeking lower interest rate sensitivity and faster return of principal.

Favorable ABS Average Life Profile



Source: Finsight, Morgan Stanley Research. Data represents ABS issuance from calendar year 2025. Average life is the weighted average length of time the principal is expected to be outstanding.

BANKRUPTCY REMOTENESS

The SPV structure is designed such that even if the sponsor goes bankrupt, the assets in the ABS remain insulated, safeguarding investor interests.

EXCESS SPREAD AND PERFORMANCE TRIGGERS

The loan pool typically generates a higher yield than what is promised to ABS holders. This "excess spread" normally flows to the equity tranche but can be used for transaction expenses or can be redirected to repay debt if performance deteriorates.

OVERCOLLATERALIZATION / LOAN-TO-VALUE (LTV) RATIOS

ABS structures usually involve issuing less debt than the value of the underlying assets—for example, issuing $90 of debt for $100 in auto loans—designed to be a protective cushion for investors.

DIVERSE PAYER BASE

ABS typically include payments from hundreds or thousands of borrowers or lessees. This diversification mitigates idiosyncratic risk and enhances credit stability.

TRANCHING AND AMORTIZATION

Tranches offer tailored risk/return profiles. Senior tranches carry higher ratings and typically shorter durations while subordinate tranches offer more yield with higher risk—enabling precision in portfolio construction.

ACTIVE MANAGEMENT AND SPONSOR ALIGNMENT

Sponsors frequently service the underlying assets and may actively redeploying capital in revolving ABS structures. Their ownership of equity tranches fosters alignment with debt investors.

TRANSPARENT REPORTING

A third-party trustee provides monthly reports on collateral composition, payment history, and performance metrics—offering transparency and aiding investor oversight.

THE CASE FOR ABS IN TODAY'S FIXED INCOME PLAYBOOK

Despite their historical stigma, modern ABS have matured into transparent, well-structured instruments with notable characteristics. For financial advisors and fixed income investors alike, understanding the mechanics, protections, and potential value of ABS is essential in today's complex market.

As investors look for diversification, income, and capital preservation, we believe ABS should be part of the conversation—not just an afterthought.

IMPORTANT DISCLOSURES

Holdings are subject to change and may not be representative of the Fund's current or future investments.

Consider these risks before investing: All investments involve risks, including possible loss of principal. Market risk includes political, regulatory, economic, social and health risks (including the risks presented by the spread of infectious diseases). Changing interest rates may have sudden and unpredictable effects in the markets and on the Fund's investments. The Fund may purchase lower-rated and unrated fixed-income securities, which involve an increased possibility that the issuers of these may not be able to make payments of interest and principal. See the Fund's prospectus for a further discussion of risks.

Investors should consider carefully the investment objectives, risks, and charges and expenses of the Funds before investing. This and other important information is contained in the prospectus and summary prospectus, which may be obtained at weitzinvestments.com.

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