

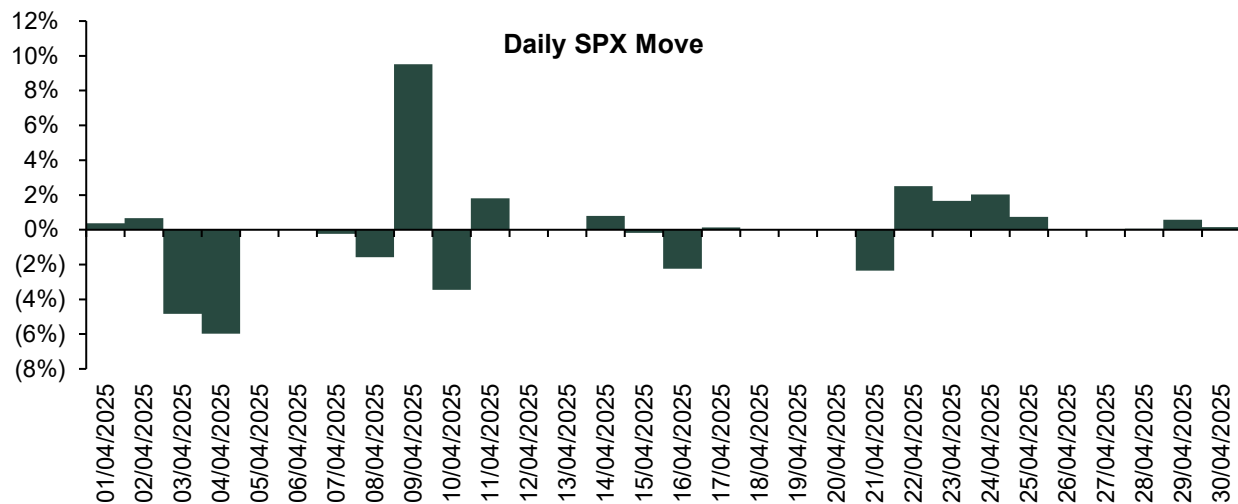
CCS – Q2 2025 Commentary

Macro & Sector Themes

The performance of risk assets through the second quarter or the first half of the year belies the extreme volatility long portfolios sustained, with the S&P 500 posting its fifth biggest two-day decline since WWII in the post-Liberation-Day selloff. Beyond the tariff volatility, geopolitical escalations and growing concerns around the fiscal position in the U.S. added to the tumultuous quarter. While the market ultimately rallied back sharply through the remainder of the quarter, prompting some to raise concerns around complacency, April served as a reminder of the benefits of effective market neutral strategies in an environment with a wider distribution of market outcomes.

Through all the turmoil, the U.S. economy, fueled by the majority of U.S. consumers, continued to show broad resilience, supporting aggregate collateral performance across our sectors. At the same time, dispersion within sectors – across cohorts of consumers, geographies in the housing market, and industries backing leveraged loans– has become more pronounced.

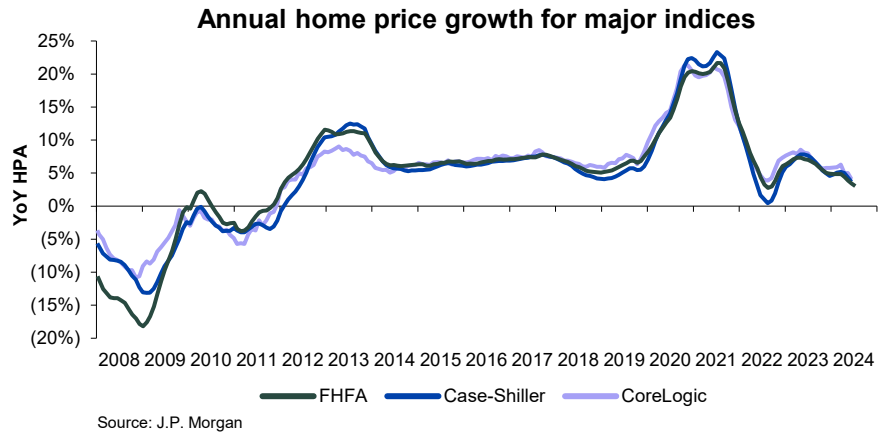
As we have discussed over recent quarters, the housing market has softened with the rate of home price growth declining. Active supply has steadily picked back up while persistently elevated mortgage rates have dampened demand, leading to a weakness in volume-sensitive metrics and a general slowing with days on market increasing through the spring buying season. The regional variation remains very significant, however. MSAs in the Northeast and Midwest that have historically seen lower base rates of growth continue to experience declining supply and price gains. On the other hand, MSAs in Florida, the West Coast, and Sun Belt states continue to experience supply increases, with price forecasts converging to single-digit declines in these areas. Mortgage credit performance has come into greater focus as a result. Loss severities on defaulted residential mortgage loans have been near-zero over recent years in large part due to underlying home price strength. Should home prices soften, even regionally, more homeowner credit problems will become investor loss problems.



Source: Bloomberg

Source: CCS Analysis

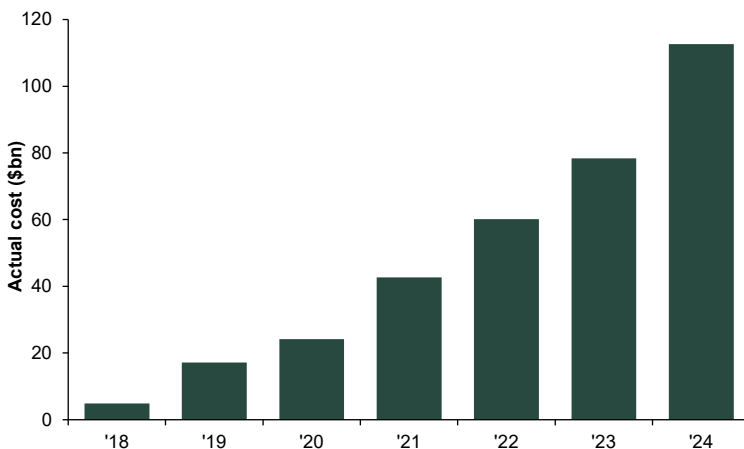
On that front, delinquencies and defaults have largely remained stable across most sectors. Pockets of weakness in non-QM and FHA, particularly in more recent vintages, can largely be explained by underwriting differences. This includes the most core drivers like FICO, loan-to-value, and debt-to-income, as well as expanded documentation types or product types in non-QM, arguably intended to lift origination volumes in a high-rate environment.



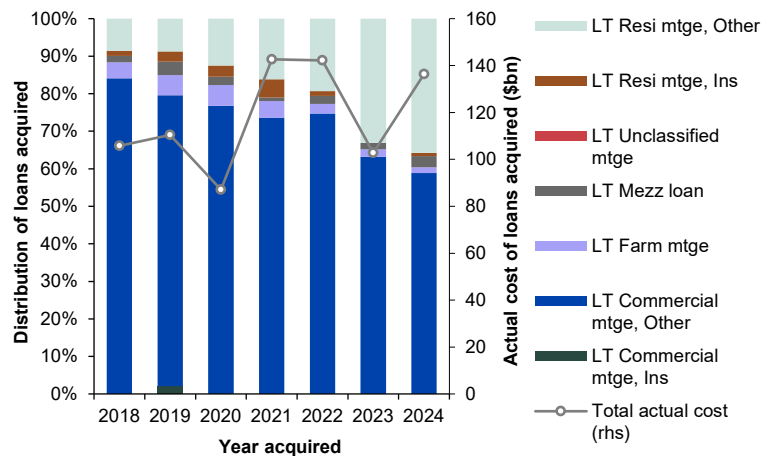
Underwriting standards have also explained performance in the unsecured consumer credit space. Consumer ABS delinquencies and defaults have largely stabilized or declined across the credit spectrum despite rising unemployment forecasts as tighter underwriting takes effect.¹ This improvement reflects “higher quality pools with lenders tightening up credit boxes after the weakness of the 2022/23 origination.” This stable performance is perhaps surprising given flashy headlines over recent months expressing concerns around consumer sentiment, negative tariff impacts, and student loan debt.

A combination of these headlines and market technicals have kept consumer spreads relatively wide compared to residential. Consumer assets are broadly in lower demand than residential credit assets from large institutional buyers like insurers. This largely reflects superior capital treatment for residential assets, and perhaps, to a lesser degree, the more favorable residential narrative over recent years particularly given weak consumer performance in the aftermath of aggressive underwriting in 2021. Insurers had historically preferred commercial mortgages, but secular office and retail headwinds made shifting towards residential mortgages attractive. This regulatory-capital-driven demand for residential assets has by and large kept mortgage credit spreads contained or even pressured them tighter despite a softening housing market.

Non-Agency RMBS Insurance Holdings



Insurance Loan Acquisitions



¹ J.P. Morgan 2025 Securitized Products Midyear Outlook



Despite the recent robust performance in unsecured consumer, dispersion within consumer cohorts was manifest in recent deterioration in private student loans and solar, driven both by weak underwriting and adverse policy. Private student loan delinquencies have been rising to varying degrees across shelves, and defaults and losses have risen close to a 10-year high.² With the recent fiscal bill, this market is poised to see significant growth in volume in the coming year. The solar ABS market has also come under pressure—beyond more aggressive underwriting, the U.S. clean energy industry has shown signs of buckling under multiple, overlapping challenges, including the bankruptcies of sponsors Sunnova and Mosaic.

On the corporate side, after plunging along with the broader market in early April, index loan prices rallied back to early 2025 levels by the end of June. Unsurprisingly, price declines for issuers with cross-border trade exposure were about double those for high-quality, tariff-remote issuers, reflecting dispersion across sectors. Though the index retraced, the percentage of loans trading above par remained around 50% below pre-tariff-volatility levels. Further recovery in this share of high dollar priced loans would spur repricings, likely leading to both faster de-leveraging for seasoned mezzanine bonds and spread compression that can adversely affect equity distributions. Stepping back, the leveraged credit universe is now experiencing a more balanced supply-demand equation after four consecutive years of heavy supply deficits. According to Morgan Stanley, the loan market has “showed its first meaningful expansion in three years. The market size reached a new high of \$1.5 trillion, after hovering around \$1.4 trillion since 2022, driven by the rise in new money creation and deceleration in the pace of bankruptcy filings.”

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² Deutsche Bank: Summer School: Private SLABS Review

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