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Rumbles in credit

A buyer's cold feet late last Friday caused Affirm Holdings, Inc., the buy-now, pay-later (BNPL) giant, to pull a $500 million debt securitization. In a bid for calm on Monday morning, management issued a press release to say that the company is dependent on no "single funding channel." Affirm's share price sank by 15% just the same (and despite fresh, upbeat earnings guidance).

We write not to pick on Affirm, whose share price, since our first bearish story in the issue dated Aug. 6, 2021, has plunged by 57.8% compared with a 3.1% decline in the S&P 500. We rather view our sparring partner as an exemplar of broader funding-market stresses. All is not well in credit.

To start with, there's a backup in structured securities issuance. To move triple-A-rated merchandise, managers of collateralized loan obligations are cutting prices, according to the March 11 edition of *Asset-Backed Alert*.

"To get investors to bite on a $1.1 billion private student-loan transaction, Sallie Mae Bank had to sweeten the pot even more," notes the *Alert*. "The $925 million triple-A-rated class of a deal it priced on March 9 . . . landed at 115 bp over swaps. A comparable slice from Sallie's last offering, which it priced on Nov. 2, went for 63 bp over swaps."

For another thing, Affirm is hardly alone in beating a retreat from an unreceptive market. In recent weeks, according to a March 11 Bloomberg dispatch, three commercial mortgage-backed securities deals have joined the queue of postponed financings, "including a $1.5 billion offering linked to Deutsche Bank's new headquarters in Columbus Circle in New York City."

It's a different story in corporate-bond land, relays Daniel Krieter, director of fixed-income strategy for BMO Capital Markets, in a March 14 client briefing, "with $127 bn in [high-grade bond] gross issuance in just the past two weeks after risk sentiment drove away many borrowers in the weeks prior. With $363 bn issued in the first 10 weeks of the year, 2022 supply stands as the second heaviest pace of issuance to start the year, only $18 bn or 4.8% below last year's pace."

Higher yields are the not-so-secret stimulant to the fast-paced deal flow, as credit spreads over Treasurys yawn wider. Thus, in the year to date, the premium of investment-grade yields to the government curve has risen by 54 basis points, to 1.51%, while the premium of speculative-grade corporates to the government benchmark has risen by 106 basis points, to 4.16%. Note, however, despite the cheapening, that high-grade bonds, at 3.64%, and junk bonds, at 6.23%, both yield less than the 7.9% rise in the February CPI.

Mr. Market might have forgiven Affirm's funding stumble if not for the simultaneous uptick in credit delinquencies, to 6.4% on Dec. 31, 2021 from 4% on June 30. Because defaulting borrowers typically take their time before skipping a payment, a fast-growing loan book masks the evidence of deteriorating credit quality, if such evidence is there to be unmasked. It's no good sign, then, that Affirm's mounting delinquencies pair with a 20.5% jump in loan receivables in the six months ended Dec. 31.

You can't blame the banking environment for those figures. According to the Federal Deposit Insurance Corp., charge-offs fell to 0.19% in the third quarter, lowest since that data series began in 1984. Last year, GDP expanded by a real 5.7%, another post-1984 record.

If a recession were in store, one would expect to see credit spreads widening, the yield curve flattening, the stock market breaking and the commodity bull market reversing. One would likewise expect weakness in the Atlanta Fed's GDPNow model (which, indeed, predicts first-quarter growth of just 0.5%) and, perhaps, evidence of falling real income (in February, the 5.1% year-over-year rise in hourly wages failed to keep pace with the CPI's 7.9% rise). So, yes, there are worrisome straws in the wind, but—take it from us—there usually are.

"[W]e choose the delinquency rates we want," Max Levchin, founder, CEO and chairman of Affirm, told CNBC viewers on Feb. 11. "We made a decision and told the market last quarter that we are going to loosen our approvals a little bit to encourage growth. We are still very much in control of those numbers."

"Investors may want to see Affirm take control of its own bottom line," colleague Evan Lorenz remarks. "In that Monday press release, management did boost its estimate of adjusted operating loss as a percentage of revenue for the March quarter to negative 15% from guidance of negative 19%–21% on Feb. 10. However, those adjusted figures do not include expenses for depreciation and amortization or for share-based compensation. The Street, for its part, sees red ink continuing through at least 2025."

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