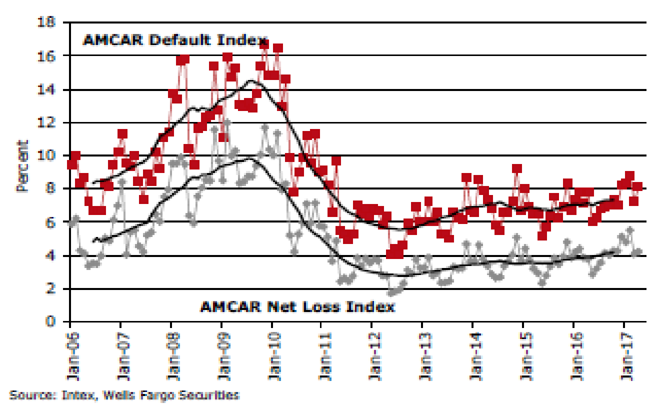
Emad A. Zikry, President and Chief Executive Officer

Automobile ABS, with a focus on Mercedes and BMW

While automobile loans have displayed some increasing defaults in recent months, the absolute level of defaults remains low, especially within Prime Auto ABS loans. There is an argument that the rise in defaults can be attributed to a normalization of credit conditions following extremely tight underwriting standards during a recessionary period. Chart 1 demonstrates the default profile within AMCAR, a subprime benchmark issuer. Defaults and losses have been increasing gradually since 2013 but, at 8% and 4% respectively, still remain well below recession levels.

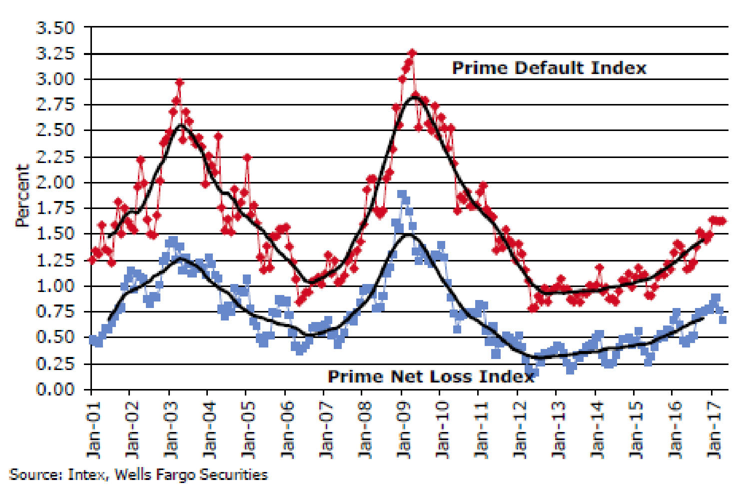
Chart 1

AMCAR Default and Net Loss Indexes



Similarly, Chart 2 shows an uptick in prime defaults and losses, but while the rate of increase may appear troubling, the absolute level of delinquencies, 1.5% and .75%, is still quite low, especially when considering how much credit support is built into ABS Auto loan deals.

Chart 2



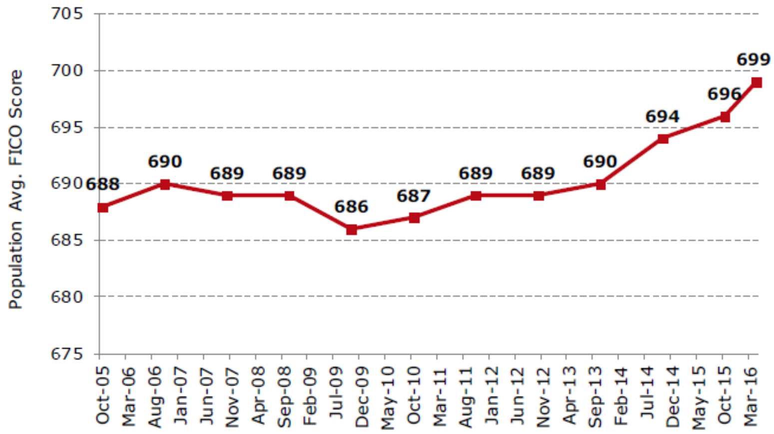
In addition to looking at the credit support of the ABS Auto sector as a whole, it's important to analyze individual deals that provide the best underlying borrower credit profiles and which should result in better monthly default performance. Let's take, for example, a deal issued by Mercedes and one by BMW to analyze.

Mercedes deal 2016-B was issued on 10/18/2016 with four AAA-rated tranches (A1, A2, A3, A4). The original credit support to each AAA rated tranche was 16.1%. This credit support is a function of the excess collateral supporting the deal. That is, the deal was originated with around 1.2 billion dollars, while the sum of the tranches only added to about 1 billion dollars, leaving 200 million dollars as overcollateralization in case of default. At present, tranche A1 has paid off at 100; tranche A2 is paying down and is scheduled to pay off on 2/2018; tranche A3 will pay down during the period 2/18 – 12/18; tranche A4 will pay down during the period 12/18 – 2/19. As these tranches pay down and the deal experiences few losses, the credit enhancement to the deal is gradually increasing and currently stands at 20.586%. The cumulative loss experienced by this deal in its 8 month life is a meager 0.07% or $892,000. In the pipeline for potential future defaults is another low 0.04% in 60+ day delinquencies. This deal has unusually high credit support versus default ratio. While this may appear as a boon to the investor, much of this performance could have been expected due to the credit characteristics of the deal's underlying borrowers. Specifically, the weighted average FICO score of the borrowers was 784, and the distribution of scores was skewed to higher scores, with only 12.6% of borrowers with scores between 650-699, a level that is on the low side, but still above Subprime.

BMW deal 2016-2 was issued on 10/4/2016, also with four AAA-rated tranches and 16.15% credit support in the form of excess collateral. This deal originated with 1.15 billion dollars in collateral supporting about 950 million dollars in tranches, and similarly leaving 200 million dollars as overcollateralization. At present, tranche A1 is paid off at 100; tranche A2 is paying down and is scheduled to pay off on 5/2018; tranche A3 will pay down during the period 5/18 – 2/19; tranche A4 will pay down during the period 2/19 – 4/19. Similar to the Mercedes deal, the credit enhancement is increasing in the BMW deal and currently stands at 21.245%. The cumulative loss to date is 0.01% or $153,000. The pipeline of potential defaults is about 0.08% in 60+ day delinquencies. This is clearly another deal with excessively high credit support to default ratio. The average FICO score for deal is a similarly impressive 778.

If we compare the defaults and losses of the Mercedes and BMW deals with those of the average in Chart 2, we can firmly conclude that these deals are outperforming their benchmark. Whereas the average prime defaults and losses are approximately 1.5% and 0.75% respectively, these statistics are drastically lower for the Mercedes and BMW deals. Our analysis would not be complete without taking a further step and looking at Chart 3 below, which depicts the average FICO scores of the U.S. consumer population. With U.S. consumers having a recent average FICO score of 699, it is fair to say that the borrowers whose loans comprise the Mercedes and BMW deals have significantly superior credit quality than the average consumer.

Chart 3



Source: Fair Isaac, Wells Fargo Securities

In conclusion, while automobile loans are showing some incremental increase in defaults, investors in AAA-rated tranches in general, and in Mercedes and BMW in particular, remain safely protected. In addition to these deals' inherent credit support cushion, their average securitized borrowers possess FICO scores that are well above the national average, deeming the AAA-rated securities from these deals a safe investment for those looking to pick up some yield over treasuries and agencies.

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Emad is the Managing Partner and Chief Executive Officer of Vanderbilt Avenue Asset Management LLC. Vanderbilt's client base includes Multi-national Corporations, Public Funds, Foundations/Endowments, and Taft Hartley accounts.

Previously, Emad was Chairman of Institutional Business at Pioneer Investments. Pioneer investments has more than $300 Billion in assets under management. The parent of Pioneer, UniCredit S.p.A., is the largest bank in Italy and the second largest bank in Europe. Pioneer had purchased Vanderbilt Capital Advisors, of which Emad was the founder and Chief Executive Officer.

Emad has had numerous articles published in professional and academic journals such as *The Journal of Forecasting*, *The American Economist* and *The Journal of Fixed Income*. He is a Board member of The National Investment Company. Emad was a member of the Board of Advisors of the Pacific Institute, The Advisory Committee of Fulcrum Global Partners, The Chief Executive Officers Club and formerly a board member of The Foreign Policy Association. He also served on the Board of Directors of the University of Albany Foundation, NextGen Healthcare Inc., The Park Avenue Bank, AA Bank and The New Providence Fund and Associates LP.

Emad is an FINRA Arbitrator. He is also a member of the National Association for Business Economists and The Economic Club of New York. Emad served as an adjunct professor at the University of Kansas and St. John's University.

Emad holds a Bachelor of Science from the University of Albany, and a M.A. and Ph.D. in Economics from the University of Kansas.