FINANCE

Investors Turn Wary on Consumer Debt

Demand softens for bonds backed by loans from riskier borrowers, along with shares of fintech consumer-lending companies.

By Matt Grossman and Matt Wirz

Investors are growing more skittish about bonds backed by consumer debt, worried that inflation and slowing growth will increase the number of low-income borrowers falling behind on car payments or credit-card Buyers of bonds backed by subprime car loans or credit cards are demanding the highest premiums over interest-rate benchmarks since mid-2020. Meanwhile, investors have punished shares of some financial-technology companies that helped fuel a recent surge in consumer borrowing, such as Affirm Holdings and Upstart Holdings.Clayton Triick, a portfolio manager at Atlanta-based Angel Oak Capital Advisors, said he is particularly wary of debt owed by people with low credit scores. Angel Oak has been “eating around the

credit scores. Angel Oak has been "eating around the edges" when purchasing so-called consumer asset-backed securities in 2022, he said, buying smaller amounts of new "When we're investing, we're investing less," Mr. Triick Wall Street's enthusiasm for consumers' debt has helped finance a surge in lending. About $900 billion of loans to individuals that were packaged into tradable bundles and sold to investors as bonds was outstanding last year, Moody's data show, supporting record borrowing for homes, cars and even electronics. Debt owed by households topped $15 trillion for the first time last year, according to the New York Federal Bond sales have become especially important for funding loans to lower- and middle-income consumers. New securitized car loans to subprime borrowers grew by 57% last year to $43.4 billion, according to Moody's. Bond issuance backed by the type of loans made by Affirm and Upstart almost doubled to about $18 billion in 2021, according to Consumer-debt bonds made up one of the best-performing corners of the debt markets during much of the pandemic. When Covid-19 struck in 2020, investors raced for the exits at first, fearing that lockdowns and business closures would lead to a surge in defaults. Instead, hefty government-assistance programs and forbearance from lenders kept even many of the most marginal borrowers on their This year, investors have sold bonds broadly, driving up yields, which rise when prices fall. But consumer-debt yields are rising even faster, a sign that traders believe the relative risk is increasing. Bonds backed by the most-traded category of subprime auto loans have recently yielded 1.45 percentage points more than standard benchmarks, according to data from JPMorgan Chase & Co., up from a 0.9-percentage-point premium, or spread, at the start of the year. Yields also have climbed for bonds backed by credit-card debt and other types of consumer debt.Rising costs in the bond market prompted at least one consumer lender to cancel a new financing in recent weeks: Affirm, which specializes in "buy-now-pay-later" loans for online purchases, pulled a $500 million bond backed by the loans in March after a large investor demanded a

higher interest rate on the deal, according to a hedge-fund manager.“We made the decision to hold off on issuing the refinancing transaction given the extreme pricing volatility due to heightened macro uncertainty,” a spokesman for Affirm said. The company has alternative funding options such as bank loans and loan-sale agreements, he Shares of Affirm and competitor Upstart have each lost about 75% since November when late payments started to rise, according to FactSet. Short interest as a percentage of shares outstanding has tripled for Upstart to about 15% and almost doubled for Affirm to 6%, according to data from S&P Capital IQ.A spokesman for Upstart declined to comment. Upstart Chief Financial Officer Sanjay Datta said on a call with analysts in February that the company isn't expecting meaningful problems from rising defaults.Persistent inflation and the end of pandemic-era federal aid are some of the reasons investors are bracing for more distress among household borrowers. In a sign of those challenges, some consumers have been cutting back on buying food staples and household Late payments for several types of securitized consumer debt are on the rise. In February, the share of subprime auto loans that were more than 60 days delinquent was 4.77%, up from 3.74% a year earlier and the highest level since April 2020. Delinquencies on credit-card payments also have ticked higher from lows reached last year, though at a more moderate Despite their growing caution, investors and analysts still see many reasons to be upbeat about consumers' financial health. Delinquency rates remain below historical norms. The unemployment rate, already near all-time lows, fell further in March to 3.6%, the Labor Department reported earlier this month. Plus, surging real-estate values over the past few years have boosted homeowners' finances.Still, investors are carefully monitoring how well subprime borrowers can keep up with payments this Adam Castle, a portfolio manager at Jersey City, N.J.-based Lord Abbett, said that the firm has been less active buying newly issued consumer-debt bonds this year as it keeps an eye on credit trends and waits for better pricing. In some

cases, spreads haven't risen enough yet to reflect higher levels of risk, he said, though much of the pain is already priced "It's incumbent upon an ABS investor to be vigilant about where underwriting standards go from here," Mr. Castle Write to Matt Grossman at matt.grossman@wsj.com and Matt Wirz at