Credit Watch

A Focus on the Consumer: Spending or Spent?

Global Head of Credit, Securitized Products and Public Finance Research

Stephen Dulake AC
(1-212) 834-9671
stephen.dulake@jpmorgan.com

US High Grade Strategy

Silvi Mantri
(1-212) 834-7239
silvi.mantri@jpmchase.com
J.P. Morgan Securities LLC

- **2H24 eyes on the consumer**. Our various strategy teams have recently rolled out their top-down, midyear outlooks. From a bottom-up perspective, we think the consumer will become an increasing focus as the second half of the year unfolds.
- **We use this edition of *Credit Watch* to offer a variety of perspectives on the consumer**: High end versus low end or whether the consumer is in fact "trifurcated"; paying for experiences versus seeking value; what's the message from the consumer-related securitization-related space; and trends in the US versus those in Europe.
- **Identifying relative value opportunities for a flying or fading consumer**. Our analysts highlight choices across the US Consumer, Retail REIT, European Retail, Gaming and Leisure, US-European Airlines and Transportation, Auto, Securitized Product, and Consumer Finance sectors.
- **A basket-based approach**. Our derivative strategists highlight a 25-name CDS basket that allows investors to track or potentially trade changes in US consumer momentum.
- **US Consumer is resilient but "trifurcated"**: The consumer market is "trifurcated" with low-income consumers better off, high-income consumers strong, and middle-market consumers feeling financial strain.
- **Retail and real estate dynamics**: Retail real estate leasing remains strong despite consumer financial pressures.
- **UK and European consumer recovery**: These consumers are showing signs of recovery as inflation subsides and real wages rise. UK retail sales and consumer confidence are improving, with disposable income increasing. However, food retailing remains stagnant, and discretionary spending on big-ticket items is cautious.
- **Preference to spend on experiences and travel**: Spending on leisure and entertainment remains robust. Cruise lines, gaming, and lodging businesses are performing well, although there are pockets of weakness among low-end consumers in regional casinos and theme parks. Airline spending remains strong with consumers traveling at rates above pre-pandemic levels.
- **Auto consumer stretched but not broken**: The automotive sector shows consumer resilience with strong demand for light vehicles despite higher rates and elevated transaction prices. Automotive financing portfolios remain healthy, though delinquencies are rising. Dealers are experiencing a slowdown in retail demand, particularly among sub-prime borrowers.
- **Consumer debt and credit trends**: Perhaps it should come as no surprise, but Mortgages are performing better than Consumer ABS. On the delinquency front, they're rising but there's a debate to be had as to whether what we're seeing represents *deterioration* or *normalization*.

See page 23 for analyst certification and important disclosures.

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Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

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Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

Consumer credit relative value opportunities

Table 1: Spending or spent

Sector	Type	Analyst	Ticker	Company	Coupon	Maturity	Description	Ratings	Pricing			Rationale
									Price	Yield	STW	
US Consumer	Spending	Casella	ABIBB	ABI InBev	4.70%	2036	Sr Notes	A3/A-	$97.0	5.00%	85bp	■ Global scale and diversification w/ upside in EM ■ Alcoholic bevs demand is relatively inelastic ■ Mgmt focused on delevering to ~2x (vs 3.4x today)
US Consumer	Spent	Casella	TGT	Target	4.40%	2033	Sr Notes	A2/A	$97.5	4.76%	50bp	■ No room for upside given tight levels ■ Discretionary categories under pressure ■ Consumers trading down to WMT for value
US REITs	Spending	Streeter	EPR	EPR Properties	3.60%	2031	Sr Notes	Baa3/BBB-	$83.8	6.40%	210bp	■ Experiential real estate focus; theater now <50% of rent and leases restructured ■ Low leverage supports low BBB ratings with upside back to mid BBB ■ Trades at BB yield/spread for IG risk
US REITs	Spent	Streeter	SPG	Simon Property Group	6.25%	2034	Sr Notes	A3/A-	$105.7	5.46%	118bp	■ Premier owner of shopping, dining, entertainment and mixed-use destinations (high ends malls and outlets) ■ Sector leading ~$1.8bn annual retained cash flow ■ Leading exposure to troubled mall-based retailers (several of which SPG and partners have rescued profitably)
Euro Retail	Spending	Keaney	MOBLUX	Mobilux	7.00%	2030	Sr Sec	B2/B+	$101.3	6.70%	374bp	■ Balance sheet strength trumps depressed category sales ■ Recent merger creates 2nd largest market player ■ Conservative financial policy
Euro Retail	Spent	Keaney	PICSUR	Picard	5.50%	2027	Sr Unsec	Caa1/CCC+	$98.3	6.20%	307bp	■ French Food retail market contracting ■ Intense price competition pressuring margins ■ Looks expensive vs px talk for Sr Sec issue (high 6%)
US Gaming	Spending	Pace	BYD	Boyd Gaming	4.75%	2031	Sr Notes	B1/BB	$90.3	6.51%	227bp	■ Akready concerns of a weakening low-end consumer ■ Best in class balance sheet (2.7x net levg) ■ Good relative value at 6.5% (wide to CZR/RRR)
US Gaming	Spent	Pace	PENN	Penn Entertainment	4.13%	2029	Sr Notes	B3/B-	$86.3	7.46%	320bp	■ No Vegas exposure and full OpCo (no real estate) ■ Brick and Mortar impotance given SB losses ■ Heightened levg given SB losses (~7x net, peaking 8-9x)
US Transport	Spending	Streeter	DAL	Delta Air Lines	7.38%	2026	Sr Notes	Baa3/BB+	$102.0	5.93%	116bp	■ The blue-chip US airline, focused on premium product, loyalty, international, lounges ■ S&P and Fitch should upgrade to low BBB within NTM, Moody's to Baa2 soon as well ■ Best value in the secured recourse debt (loyalty, routes/slot/gates, EETCs)
US Transport	Spent	Streeter	LUV	Southwest Airlines	5.13%	2027	Sr Notes	Baa1/BBB	$99.6	5.30%	78bp	■ Guided down this week on unit revenue; still negative net debt so rating stable ■ Activist Elliott attempting to force management turnover and product overhaul ■ Incumbent management admits product offering has not kept up with consumer preferences
Euro Transport	Spending	Ward	HTHROW	Heathrow			HoldCo Sec Notes	B1/-/BB+	$99.0	6.80%	291bp	■ Benefits from traffic volumes without exposure to air fares ■ Improved visibility on regulatory front ■ Value in subordinated HoldCo paper vs. comps
Euro Transport	Spent	Ward	LHAGR	Lufthansa		5yr	CDS	Baa3/BBB-/BBB-			134bp	■ Exposed to pricing softness ■ Ex-fuel unit cost pressures are also squeezing margins ■ Trades tight vs. higher-margin comps
US Autos (*) Security PIKs at 14% until Aug 15, 2025, and pays cash at 9% thereafter; YTW and STW per bbrg	Spending	Steiner	CVNA*	Carvana	14% PIK	2031	1st Lien	Ca / CCC+	$111.1	8.88%	462bp	■ A healthy consumer would help volumes, pricing, and financing ■ Attained profitability amid cost reductions, operating leverage ■ Focused on debt reduction w/open market buys funded w/eq ATM
US Autos	Spent	Piascik	NSANY	Nissan	7.05%	2028	Sr Notes	Baa3/BB+	$104.5	5.82%	154bp	■ Low margin profile versus BBB rated OEMs ■ Struggling to compete in China and in U.S. HEV market ■ Elevated downgrade risk in a weaker auto environment
Private Credit student Loan	Spending	Sze				3-year		AAA		5.55%	105bp	■ Spreads in this sector continue to lag plain vanilla ABS asset classes ■ High quality and prime consumer credit exposure ■ Limited supply driven by lower originations should provide technical support
Unsecured Consumer Marketplace Lending	Spent	Sze				3-year		BBB		6.95%	245bp	■ Elevated levels of idiosyncratic risks for a non-recession tested asset class ■ Greater volatility given the lingering macro rate/recession uncertainty ■ Early signs of performance stabilization for non-prime segments, recent delinquencies in prime trending higher
US Financials	Spending	Caprihan	ALLY	ALLY	4.70%	Perp	Pref	Ba1/BBB	$88.0	12.00%	450bp	■ Used car prices stabiizing ■ Pref should trade to call date rather than perp ■ Reserved for unemployment at 5%
US Financials	Spent	Caprihan	SYF	Synchrony	5.15%	2029	Sr Notes	Baa3/BBB-	$96.3	6.04%	160bp	■ Bonds have tightened as late fee rules been challenged ■ Pure play consumer unsecured exposure ■ Recent vintages have been performing well.

Source: J.P. Morgan.

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Stephen Dulake AC
(1-212) 834-9671
stephen.dulake@jpmorgan.com

Credit Derivative and Index Research

Saul Doctor
saul.doctor@jpmorgan.com
(44-20) 7134-1539

Pavan Talreja
pavan.talreja@jpmchase.com
(1-212) 834-2051

Tracking and trading the US consumer

For investors looking to gain exposure to the US consumer through credit markets, we propose a basket of liquid CDS names that are geared toward consumer spending. The basket comprises 25 current CDX.IG index names belonging to Autos, Home Builders, and Consumer Finance as well as cyclical segments of Retail and Consumer sectors (Table 2). The average daily volumes for the basket is $19.4mn/day/ name with an average spread of 66bp (~1.25x the CDX.IG index spread). Investors can trade the basket outright to take a view on the direction of credit spreads as well as the health of the US consumer or trade the basket versus the CDX.IG index to take a view on the relative health of the US consumer.

Table 2: Consumer exposure CDS basket

Issuer	Rating	Sector	Analyst	Analyst rating	CDS Liquidity ($mn/day)	5y CDS spread
Ally Financial Inc.	BBB-	Fin Cos	Kabir Caprihan	OW	20.3	138
American Express Co	A	Fin Cos	Kabir Caprihan	UW	16.8	32
AutoZone, Inc.	BBB	Retail	Carla Casella	OW	13.3	31
BorgWarner Inc.	BBB+	Automotive	Evan Piascik	UW	11.5	70
D.R. Horton, Inc.	BBB+	Home Builders	Arjun Chandar	UW	14.5	51
Darden Restaurants	BBB	Retail	-	-	11.9	49
Expedia Group, Inc.	BBB	Consumer	Christian Crosby	N	16.9	77
Ford Motor Company	BBB-	Automotive	Evan Piascik	OW	57.0	155
General Motors Co	BBB	Automotive	Evan Piascik	OW	42.7	113
Host Hotels & Resorts	BBB-	Consumer	-	-	13.5	87
Lennar Corporation	BBB	Home Builders	Arjun Chandar	UW	21.6	74
Lowe's Companies	BBB+	Retail	Carla Casella	N	26.9	37
M.D.C. Holdings, Inc.	BBB-	Home Builders	Arjun Chandar	N	28.1	45
Marriott International	BBB	Consumer	-	-	7.1	47
McDonald's Corporation	BBB+	Retail	Carla Casella	UW	14.8	28
Mondelez International	BBB	Consumer	Carla Casella	UW	8.5	38
Netflix, Inc.	BBB	Technology	Christian Crosby	N	8.7	39
Omnicom Group Inc.	BBB+	Media	Christian Crosby	UW	13.2	41
PulteGroup, Inc.	BBB	Home Builders	Arjun Chandar	UW	21.9	74
Southwest Airlines Co.	BBB+	Transport	Mark Streeter	N	15.3	96
Target Corporation	A	Retail	Carla Casella	UW	20.8	38
The Home Depot, Inc.	A	Retail	Carla Casella	UW	14.3	33
Toll Brothers, Inc.	BBB-	Home Builders	Arjun Chandar	N	21.6	87
Walmart Inc.	AA	Retail	Carla Casella	N	23.9	31
Whirlpool Corporation	BBB	Consumer	-	-	19.7	154
Basket avg	**BBB+**				**19.4**	**66**

Source: J.P. Morgan.

The basket typically exhibits a similar spread performance to the CDX.IG index though it tends to outperform/underperform based on shifts in consumer discretionary spending trends. As shown in Figure 2, the spread ratio of the basket relative to the CDX.IG index tends to decompress when Consumer Discretionary equity prices fall relative to an equally-weighted S&P 500 index and compress during periods of consumer strength. The current spread ratio of the basket relative to the CDX.IG index is at 1.25x, modestly below the long-term median of 1.32x. We would expect the spread ratio to continue to compress toward its pre-Covid lows of 1-1.05x if US consumer spending trends continue. On the flip side, the spread ratio for the basket vs CDX.IG index spreads increased to 1.75x during the summer of 2022 when markets were concerned regarding the health of the consumer against the backdrop a rising rates environment and crossed 2x during the peak of the Covid crisis.

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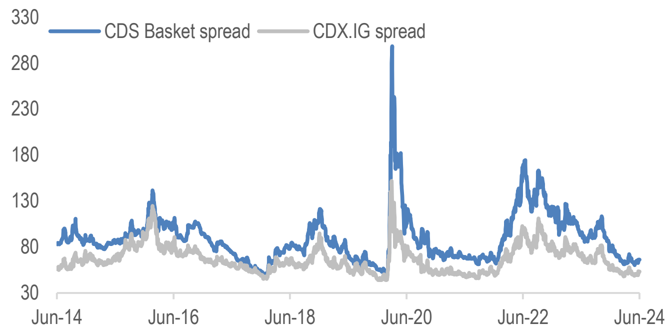
Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

Figure 1: CDS basket spread history



Source: J.P. Morgan.

Figure 2: The basket vs CDX.IG spread ratio tracks the equity market price action for Consumer Discretionary names

Source: J.P. Morgan.

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Stephen Dulake AC
(1-212) 834-9671
stephen.dulake@jpmorgan.com

US Credit Research

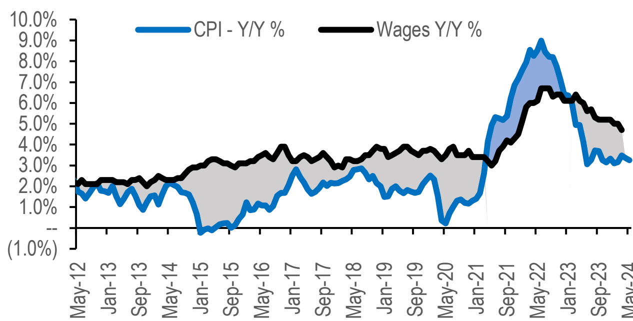
Carla Casella
carla.casella@jpmorgan.com
(1-212) 270-6798

Yaakov Musheyev
yaakov.a.musheyev@jpmorgan.com
(1-212) 834 5865

The US consumer is “trifurcated” and looking for value

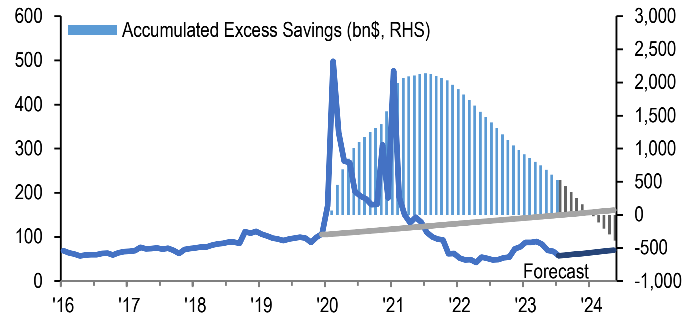
The US Consumer has held in better than expected as we work toward a level of “normalcy” post pandemic. We expect that headwinds from inflation, rates, and exhausted COVID surplus savings will temper spending in the back half of 2024 but not drive a full consumer retrenchment. We call the consumer “trifurcated” because the *low-income consumer is better off than pre-pandemic* with respect to jobs and wages. The *high-end consumer is strong and unwavering*, supported by wealth, real estate, and the markets, but the *middle-market consumer is feeling the strain* of inflation, student loan payments, rates, and healthcare and is making daily, weekly, or monthly choices on where to spend.

Figure 3: Wage growth > CPI inflation



Source: FRED, U.S. Census Bureau of Economics

Figure 4: Excess savings is exhausted as of mid-‘24



Source: J.P. Morgan Macro Equity Research

The consumer is seeking value. We are seeing the most weakness in discretionary spend. Chase card data shows the most dramatic slowing in Lodging, Airlines, Supermarkets, and Other Retail. Walmart, Costco, and Off-Price stores are gaining share as consumers trade down from traditional grocery into Walmart for better prices or Costco for value in buying bulk. Apparel and home shoppers are trading down from department stores into Walmart and off price. The middle-market consumer is making choices in monthly spend but still spending. For example, the family may choose to eat out at a casual dining option like Chili’s (3 for Me menu starting at $10.99) and “fund” that by eating out one fewer time that month, or forgoing another discretionary purchase. We’ve heard retailers from mass merchants to home centers to the dollar stores, department stores, and specialty *all* discuss consumer uncertainty and value-seeking behavior. They are spending more of their paychecks on non-discretionary categories, leaving less for discretionary. They are trading down to private brands, putting off home projects, and shopping sale events. **We believe this could have a modest impact on 2Q24 margins as retailers increase promotions to drive consumers through the doors**.

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Stephen Dulake AC
(1-212) 834-9671
stephen.dulake@jpmorgan.com

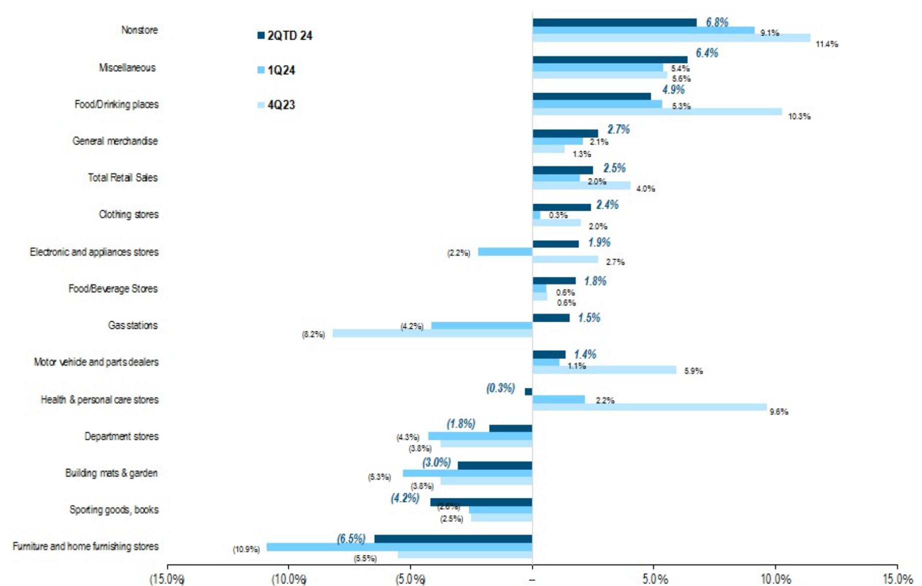
Figure 5: Chase Card data shows spending slowing, with discretionary spend in decline

	YOY											
	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24
	7/23	8/23	9/23	10/23	11/23	12/23	1/24	2/24	3/24	4/24	5/24	6/24
Discretionary	5.6%	3.5%	2.3%	2.1%	3.5%	2.8%	0.1%	1.0%	2.4%	1.0%	0.5%	-1.1%
Nondiscretionary	1.1%	3.5%	4.2%	2.7%	2.7%	3.4%	2.9%	2.3%	3.5%	1.7%	1.9%	1.5%
Other Retail	3.2%	1.0%	0.2%	-0.2%	3.5%	0.2%	-1.3%	-0.2%	2.2%	-0.9%	-0.1%	-2.3%
Wholesale Clubs & Discount Stores	5.2%	4.3%	2.8%	3.7%	5.0%	3.7%	5.7%	2.0%	3.7%	1.3%	2.1%	4.7%
Supermarkets	3.7%	2.8%	2.4%	2.0%	2.1%	2.5%	4.0%	2.8%	4.2%	-0.1%	0.7%	-2.6%
Airlines	5.2%	4.8%	-0.5%	-6.5%	-2.1%	0.8%	5.1%	-0.6%	-1.7%	-3.1%	-3.7%	-2.8%
Lodging	-0.6%	-3.9%	-5.3%	-1.6%	-2.8%	-4.7%	-5.6%	-4.8%	-3.3%	-3.0%	-1.7%	-4.7%
T&E	7.2%	4.0%	2.3%	2.0%	1.5%	4.1%	-0.9%	0.0%	0.9%	0.4%	0.5%	-1.0%
Restaurants	6.6%	3.5%	2.2%	3.0%	2.8%	5.6%	-2.4%	0.1%	1.4%	1.9%	1.8%	-0.1%

Source: J.P. Morgan Chase
Note: See here for Chase Card data disclaimers and methodology.

We are keeping a keen focus on jobs and wages, which are the biggest underlying consumer drivers. A softer consumer that is looking for value and making choices with their monthly paycheck can still prove a healthy backdrop (maybe not robust, but healthy) for retailers that manage the balance sheet well. We would be cautious on big-ticket discretionary or home-related spending until we see a better rate backdrop or job growth. It may be late 2025 before we see these COVID beneficiaries rebound, keeping us cautious discretionary home players like Target (TGT) and Newell (NWL). **We are most comfortable holding defensive categories like alcoholic beverages, which are relatively inelastic (I guess we drink in good times and in bad) like ABI InBev (ABIBB) or Constellation Brands (STZ), food/bev like JBS and Pilgrim's Pride (PPC), or any undervalued Consumer/Retail credits with a solid balance sheet**.

Figure 6: Retail sales are slowing, but still growing overall; big ticket discretionary declining



Source: U.S. Census Bureau of Economics

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Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

US Credit Research

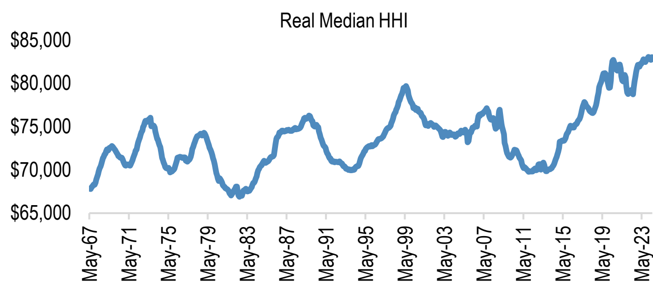
Mark Streeter, CFA
mark.streeter@jpmorgan.com
(1-212) 834-5086

Tyler Schachner
tyler.schachner@jpmchase.com
(1-212) 834-2238

Experiential spending driving retail real estate growth

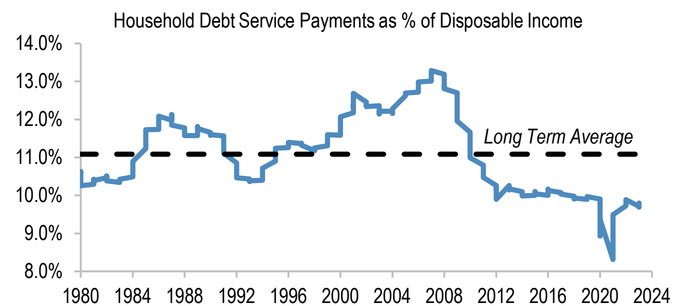
Retail real estate leasing remains strong despite more stretched consumer, experiential spending garners more share of the wallet: Consumers are earning more than ever (Figure 7) and debt payments are not yet impeding consumers' ability to spend (Figure 8). Spending on food services, drinking places, and the general category of "experiences" is outpacing the growth of the traditional "bricks and mortar" channel (Figure 9). But it is fascinating to note the growth of brick and mortar real estate in terms of omnichannel real estate share (Figure 10). The percentage of sales involving a physical store has increased substantially over the last decade. Many retail REITs under our coverage are the resulting beneficiaries of these trends, specifically those with centers focused around services and necessities, as well as a select subset of higher end malls and outlets. Given the muted retail supply pipeline and lower vacancies, tenants are now more willing to rent less favorable configurations at higher prices. Benefitting from the current strength of the leasing pipeline, landlords are now leveraging this dynamic to push for higher rent bumps in new leases and are looking past any near-term volatility to address openings for 2025 and beyond.

Figure 7: Consumers are earning more than ever



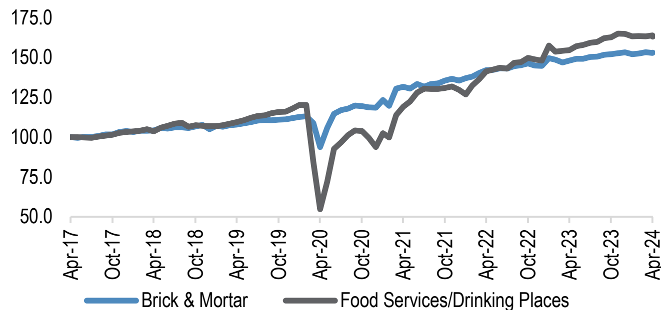
Source: – U.S. Bureau of Economic Analysis (BEA), JPMAM as of 3/31/2024

Figure 8: Household debt burden



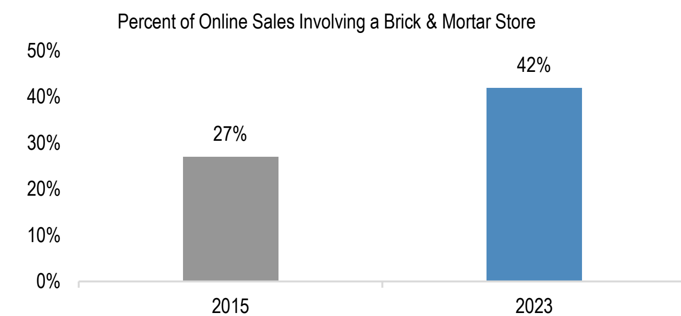
Source: St. Louis Fed, Board of the Federal Reserve System, JPMAM as of 12/31/23

Figure 9: Consumers are favoring experiential spending



Source: Census Bureau, JPMAM as of 5/31/24

Figure 10: Growing brick & mortar online share



Source: GlobalData, JPMAM as of 12/31/23

European Credit - Consumer & Retail

Neill Keaney
neill.keaney@jpmorgan.com
(44 20) 7134-2002

The European consumer

The UK and Continental European consumer are both showing signs of life as inflation subsides and real wages rise. However, as we go on to explain, we do not necessarily expect this to be a boon for all issuers under coverage.

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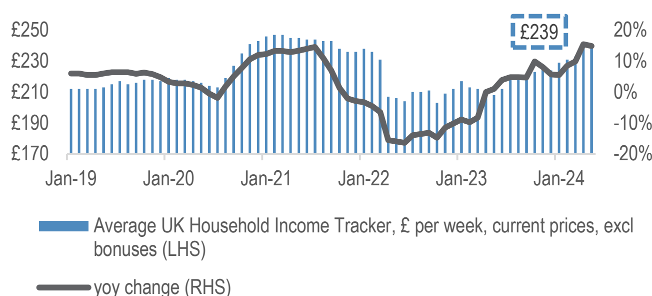
Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

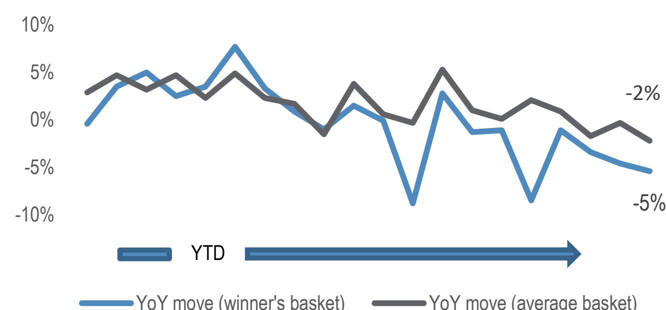
UK retail sales (by volume, ex automotive fuel, SA) inflected positive in May, delivering a strong beat of consensus estimates and compared to three consecutive months of annualised declines since February. Consumer confidence too has risen steadily from the lows, hitting its highest level in June since November '21. Perhaps the strongest indicator comes in the form of the Asda Income Tracker, which presents compelling evidence of real wage growth: average disposal income for UK households rose by 15% yoy in May to hit a 32-month high. Whilst gains were not equal, they were broad based with even the lowest quintile of households seeing a 13% rise whilst the top 40% of UK households saw their disposable income exceed their pre-cost-of-living-crisis peak.

Figure 11: UK Household weekly disposable income



Source: CEBR Asda Income Tracker

Figure 12: UK Grocery Retail: 2024 Basket price move (yoy)



Source: Grocer 33

However, when it comes to categories which display little in the way of demand elasticity, most notably food retailing, the renewed purchasing power of the consumer is having little in the way of positive impact. In fact, as rapidly decelerating inflation is met with little in the way of a consequent customer volume response, price investment and promotional activity on the part of players to defend and take market share is compounding the problem and threatening incumbents' top lines. Data from Kantar shows market-level growth fell to just 2.3% (total value sales) in the four weeks to 9 June, with Kantar's own measure of inflation sitting at just 2.1%. Several market players slipped into negative growth territory led by Asda which posted a 5.4% yoy decline. As we have discussed previously, those retailers with higher market shares, greater scale across formats and stronger balance sheets display more pricing power and greater wherewithal for investment in their respective customer value proposition. Consequently, we have seen Tesco and Sainsbury's, the UK's two largest operators, grow their combined market share by almost a full percentage point – principally at the expense of Asda, Morrison's and, for the first time, discounter Aldi. Whilst it may be too early to tell, this trend may also represent a level of "up-trading" toward branded and premium private label product after two years of down-trading and private label gains. Further, we think wage inflation (which has tracked the increase in the UK's minimum wage rate at almost 10%) presents a significant headwind to margins, personnel costs being the single biggest opex line for most retailers and averaging at c.12% of top line across the UK grocery retail space.

Similar dynamics are driving the behaviour of the continental European consumer. French grocery retail, for example, remains stagnant, at best, with the latest Kantar print indicative of a shrinking market (-1%). With inflation having disappeared almost completely, this points to no pickup in volumes, in turn, driving self-help from the likes of Carrefour and Auchan in the form of price investment to help arrest recent share

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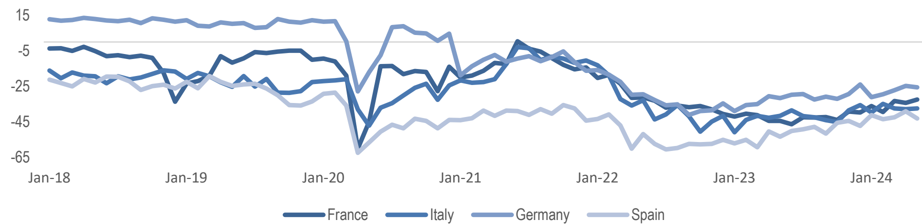
Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

donation to market leader, and most keenly priced, LeClerc. Absent a pickup in volumes however, margins are likely to become pressured and profitability challenged.

Figure 13: Europe Consumer Confidence: The climate for major purchases remains subdued



Source: European Commission

When it comes to discretionary retail, the European consumer appears reticent to make big ticket purchases. As shown below, the climate for major purchases has barely improved. This is correlated with weakness in housing starts and recent commentary from those retailers linked to residential construction and home improvement indicates no inflection point in big ticket demand. Within this sub-sector **we express our preference for larger, better capitalised issuers capable of investing in price and capable of withstanding WC swings. Here we note French furniture retailer Mobilux and pan-European DIY retailer Hornbach**, both of which have been growing market share despite cautious consumer sentiment and consequently challenging market backdrop.

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Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

US Credit Research

Michael Pace
michael.pace@jpmorgan.com
(1-212) 270-6530

Mark Streeter, CFA
mark.streeter@jpmorgan.com
(1-212) 834-5086

Stanislav R Van Genderen
stanislav.vangenderen@jpmchase.com
(1-212) 834-5481

Tyler Schachner
tyler.schachner@jpmchase.com
(1-212) 834-2238

Travel and Leisure

The resurgence of leisure and entertainment spending post-pandemic

Spending on Leisure and Entertainment has remained strong following the closure and reopening of these businesses due to the Covid pandemic. In fact, most Leisure segments are performing better now than pre-pandemic, which we attribute to both the continued (and somewhat surprising) strength of the consumer *and* their desire to prioritize spending on "experiences" vs physical goods. Undoubtedly, initial strength post-pandemic was pent-up demand, but continued strength is likely a fundamental change in consumer behavior. Cruise line demand remains the strongest (debatable vs concerts), as can be seen from Carnival's recent fiscal 2Q24 results, increased full-year 2024 guidance, and strong forward booking commentary (see note <here>). Gaming/Lodging businesses also remain good overall as can be seen from record (or near-record) results recently, driven largely from strength in Vegas for casinos (particularly adjusting for weather) and pricing power at hotels.

However, not all Leisure segments or consumers are created equal. We have seen some pockets of weakness, particularly at the low-end consumer for regional casino properties. Although these hints of potential weakness have yet to materialize into a real/sustained shift, certain markets have been impacted. During its 2Q23 earnings call, Boyd Gaming first highlighted some pullback in visits, particularly softness in unrated players and the low end of its database. Other operators noted similar observations since then, including recently regrading 1Q24 when MGM noted "some signs of fatigue at the lower-end of the market" in Las Vegas. We suspect part of this low-end pressure at both regional and strip properties is due to difficult comparables, particularly when stimulus checks were being spent. We also believe high-end customer strength (higher spending per visit) has masked some of the low-end weakness. Regional theme parks (typically not high end) have also been somewhat mixed as attendance levels at some operators are still below pre-pandemic levels, although we attribute much of this to the conscious decision to focus on pricing over volume; ticket prices and in-park spending (F&B) are both at record levels.

Net/net, we believe the overall consumer is fine, particularly in the Leisure and Entertainment segments. Again, we believe there has likely been a fundamental shift toward experiential spending and away from material items. However, our base-case modeling for most Leisure sectors includes some increasing consumer headwinds. **Our top pick in an improving consumer backdrop is BYD 4.75s '31** given historical consumer concerns, the strength of the balance sheet (2.7x net levg), and trading levels (~90/6.5%/+227bp). We do note some recent M&A risk/noise in the latter. **Our top pan in a weakening consumer environment is PENN 4.125s '29** due to the importance of its brick and mortar casino business given late-to-market and cash deficits at its ESPN partnership, heightened leverage due to the latter (7x net lease adj now, peaking 8-9x), offset in part by above-average yields/spreads.

Airline spending soaring high with a shift toward premium travel experiences

Airline spending remains strong with consumers traveling at rates above pre-pandemic levels, increasing preferences for full-service experience: Demand for air

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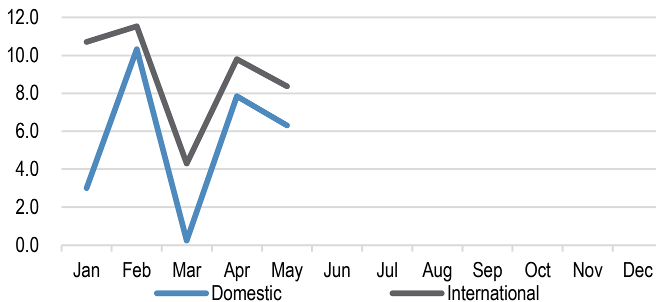
Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

travel continues to be robust, at least for airlines that lean into the products consumers increasingly look for: international destinations, premium experiences, and benefits tied to their loyalty ecosystems. Largely for these reasons, airlines like Delta and United have now claimed the margin high ground once controlled by low-frill, egalitarian airlines such as Spirit. Recent data from Airlines for America (A4A) suggests that 78% are expecting to use a premier airline brand with more meaningful loyalty programs (ALK, AAL, DAL, HA, JBLU, LUV, UAL) while only 9% of customers are expecting to fly ULCCs for most of their domestic travel during 2024. Admittedly, the low-end consumer is showing signs of economic strain, though this only manifests toward down-market airlines. Just as some consumers are cutting back at McDonald's, the aforementioned egalitarian airlines are suffering from weak demand and low fares, of the type captured by CPI. To wit, CPI is a sample of an established subset of markets, where only the lowest offered fare is tracked, without regard to the number of seats sold. As such, **there's no meaningful correlation between CPI and what airlines ultimately capture from consumers**.

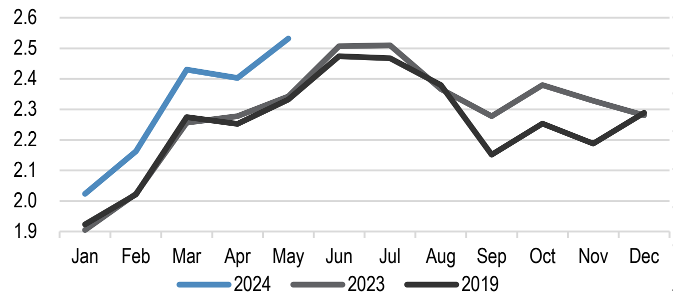
While ticket price/value remains the number one consideration for consumers when choosing from multiple airlines, the Chase card data (Figure 16) and the A4A Change in US Personal Consumption Expenditures (Figure 17) both further demonstrate that spending on air travel remains well above the 2019 comparable level. And there does not seem to be an immediate slowdown anytime soon with daily TSA volume up 5.8% y/y through the first five months of 2024 – a record start that remains above pre-pandemic levels (TSA is setting almost daily records for travels these days). Studies done by McKinsey (Consumer Trends and Loyalty Programs) affirm our thesis on the industry: **premium products not only improve brand loyalty, but customers are increasingly willing to participate in the programs and trade up into premium selections**.

Figure 14: Change (%) in US ticket sales - '24 vs. '23



Source: A4A analysis of data from Airlines Reporting Corporation (ARC)

Figure 15: Daily average TSA throughput (millions)



Source: A4A analysis of data from the Transportation Security Administration

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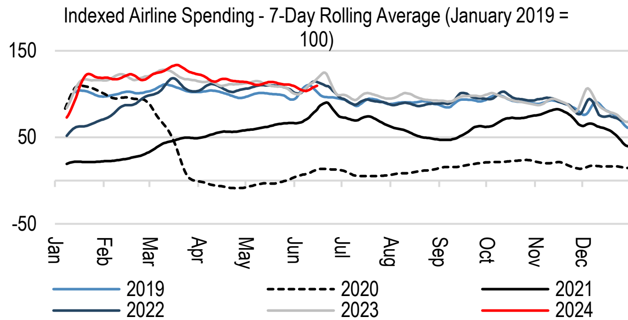
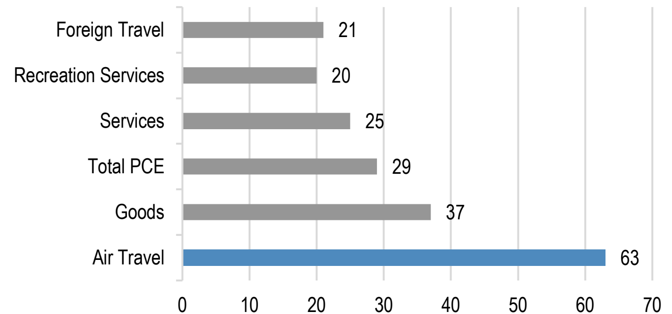
Figure 16: Chase card spending data



Source: J.P. Morgan, DataQuery. Click here for disclaimers and methodology for Chase Card Tracker Data

Figure 17: Change (%) in personal consumption '19 - '23



Source: Bureau of Economic Analysis

European Credit - Transportation and Healthcare

Danielle Ward, CFA
danielle.x.ward@jpmorgan.com
(44-20) 7742-7344

European travellers are increasingly seeking "value for money"

Sector data points show appetite for travel remains intact, with **record traffic prints in May at several UK airports** (including Heathrow, Stansted, Manchester) and European airport passenger traffic continuing to close the gap with pre-pandemic activity levels. **Concerns have begun to emerge about the outlook for peak summer air fares**, however, with low cost carrier Ryanair trimming its pricing growth expectation to 0-5% from its prior +5-10% assumption, and other UK travel operators observing that the pricing environment has become more competitive. Lufthansa similarly pared back its yield expectations for FY24 (now expecting passenger unit revenues to decline low single digits, in part due to impacts from strike activity earlier in the year) while other network carriers have provided limited guidance commentary.

Numerous sources suggest **consumers are increasingly seeking value**, whether at the premium end (TUI Cruises cited the "significant value for money" offered by cruises as a factor behind the "exceptionally strong" demand it has witnessed) or at the budget end (Ryanair has seen strong volume performance on the back of price stimulation), while **UK holiday makers are increasingly opting for all-inclusive options** (c. 46% of summer holiday bookings this year, increasing from 42% in 2023, according to the UK's Advantage Travel Partnership). There is some evidence that **consumers with lower purchasing power are pulling back more so than those purchasing higher-end products**, with UK tour operator On The Beach seeing a clear disparity between growth patterns in Premium vs. Value transactions. In contrast to the US landscape, **Europe is not seeing such a divide between its budget airlines and network carriers, however**: even in a slightly more muted pricing environment, European low-cost carriers such as Ryanair and easyJet remain relatively well positioned from a demand and unit cost perspective, cushioned too by strong balance sheets (solid IG ratings, unencumbered fleet value).

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Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

US Credit Research

Avi Steiner, CFA
avi.a.steiner@jpmorgan.com
(1-212) 270-5512

Evan Piascik
evan.piascik@jpmchase.com
(1-212) 834-4432

William O'Gorman
william.ogorman@jpmchase.com
(1-212) 622-8859

Automotive

We have long viewed the broader Automotive sector, and the Manufacturer and Dealer segments specifically, as key barometers of consumer health, given they are largely reliant on a retail customer base for revenue, which in turn is driven by the level of employment, financing costs and availability, and the microeconomic backdrop. Overall, **our view from the Automotive lens is that consumer health is increasingly strained, but nevertheless has proven resilient, though we expect still elevated transaction prices and interest rates to continue to weigh and test this resiliency**.

Below we discuss the state of the consumer from the perspective of the Automotive Manufacturers, and specifically their captive finance subsidiaries, and the Automotive Dealer groups.

Automotive manufacturers and captives

The auto consumer, in our view, is stretched but not broken. Consumer demand for light vehicles has been resilient despite the impact of higher rates on monthly car payments. YTD light vehicle sales SAAR was 15.5 million, in line with a solid 2023 (15.5 million) with expectations for full-year light vehicle sales to total ~16.0 million, or up ~3% y/y (per S&P Global Mobility). Meanwhile, average transaction prices have moderated downward (~2% y/y) over the past several months, net of incentives from OEMs to dealers, which continue to climb back toward pre-pandemic levels (but remain well below the 2019 average).

We believe the modest y/y declines in pricing could support light vehicle consumer demand and are absorbable by the OEMs, in our view, given the supportive auto industry outlook. That said, ATPs remain elevated on an absolute basis (~$45k in May v. ~$35k average in 2019), which have contributed to a ~$160 increase in average monthly loan payments compared to 2021 (to $735/month v. $688/month in 1Q21) when combined with higher auto loan rates that largely reflect the Fed's interest rate hikes. That said, the impact to auto consumer demand is muted so far, and average monthly payments have started to stabilize recently, albeit at elevated levels (see Figure 19). Overall, we maintain a level of caution as risks to the auto consumer outlook are prevalent, particularly if auto loan rates remain elevated in a "higher-for-longer" interest rate environment leading to a deterioration in the automotive consumer health with already-elevated average monthly payments.

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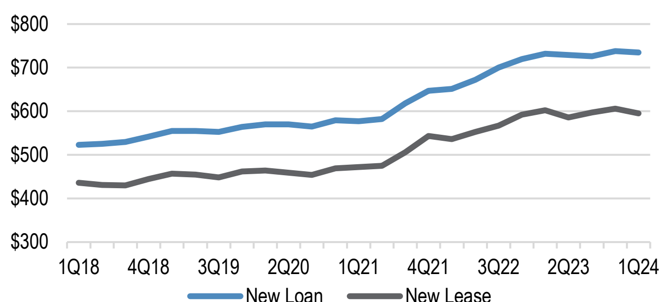
Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

Figure 18: Average Auto Monthly Payments



Source: Experian.

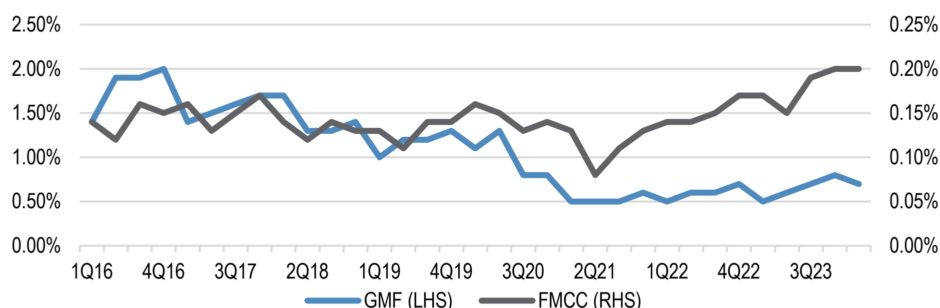
Figure 19: Effect of Higher Interest Rates on Monthly Payments

	May-23	Jan-24	May-24
Average New Vehicle Loan [1]	$45,838	$45,106	$45,033
Average Interest Rate [2]	7.00%	7.10%	7.10%
Term (Months)[3]	68	68	68
JDP Avg. Monthly Payment (Reported)	$736	$721	$727
Increase in monthly payment in $s YTD			***$6***
Increase in monthly payment in % YTD			***0.8%***
Increase in monthly payment in $s Y/Y			***($9)***
Increase in monthly payment in % Y/Y			***-1.2%***

Source: J.D. Power, Experian, J.P. Morgan. Note: 1) JDP estimated average transaction price. 2) average interest rate for loans per JDP. 3) Average new vehicle loan term per Experian.

Automotive captive financing portfolios tell a similar story, and portfolio quality is largely healthy in our view. 30+ and 60+ delinquencies have risen from post-pandemic lows (including at Ford and GM) but are only modestly above 2019 levels (2.72% 30-day delinquencies in 1Q24 v. 2.66% in 1Q19). Meanwhile, captive portfolio quality has improved meaningfully in the same period. The share of overall Prime and above risk grew to ~69% in 1Q24 compared to 60% in 1Q19, while Subprime and below has declined to ~16% versus 23% in 1Q19. Note these metrics include all financing sources for autos, which includes banks (~27.5% share in 1Q24), captives (~23.7% share), credit unions (22.9% share) among other lending entities. To gauge captive-specific portfolio quality, GM's prime loan originations were 82% of total loan originations in 2023 (and over 75% of the retail portfolio at March 31), and Ford Motor Credit's "higher risk" portfolio mix was only 4% of the retail and lease portfolio at March 31.

Figure 20: General Motors Financial and Ford Motor Credit 60+ Day Delinquencies



Source: Company reports.

Automotive dealers

Within the Automotive sector, the health of the consumer is most acutely felt within the Dealer segment, where the vast majority of revenue (excluding fleet) is retail based, including new vehicle sales, used vehicle sales, finance and insurance, and parts and service. Though the pandemic and resulting supply chain shortages have boosted dealer-level earnings through the start of 2023, profitability since that time has begun to normalize, in part driven by slowing retail demand, amid an increasingly uneven economic backdrop, higher rates, and signs of growing consumer strain.

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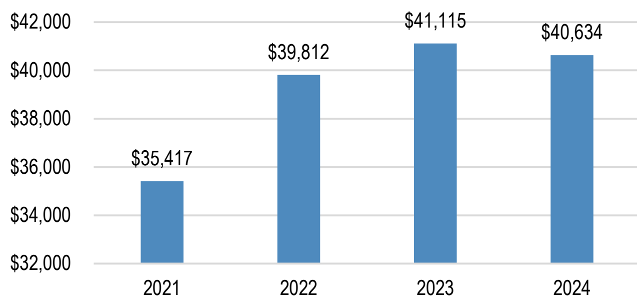
Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

To level set, retail (ex fleet) sales of new light vehicles have increased just 1% year to date through the month of May, a notable decline from the 8% growth seen in 2023. We believe the meaningful slowdown in growth largely reflects the impact of higher interest rates as the vast majority of new car purchases are acquired with some form of financing (~80% per Experian). Moreover, while average new car transaction prices have begun to decline, they remain well above pre-pandemic levels, which in combination with higher rates have led to elevated loan balances and higher monthly payments.

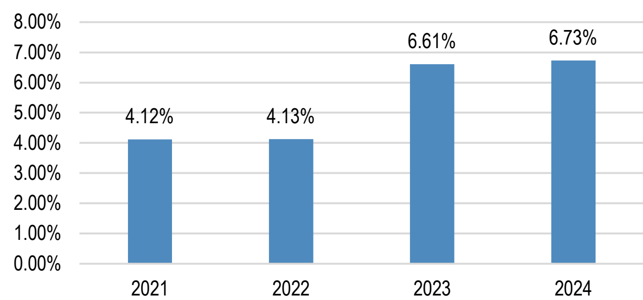
As can be seen in the accompanying charts below (and Figure 11 above), based on first quarter Experian data, the average amount financed for a new car remains near the highs, while the average new loan rate and average monthly payment are at the highs.

Figure 21: Average New Amount Financed



Source: Experian.

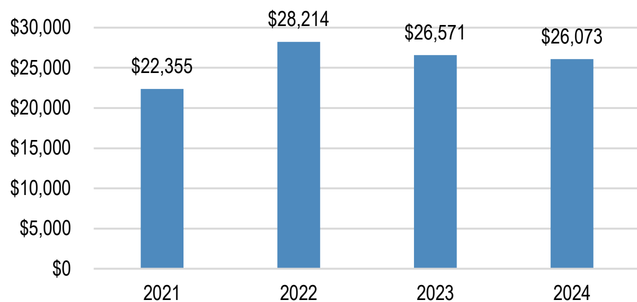
Figure 22: Average New Auto Loan Rate



Source: Experian.

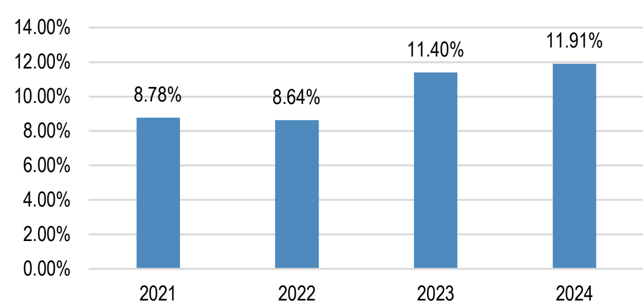
Used vehicle data show similar trends, with the average used loan amount only modestly lower YoY, offset by higher rates, which drives the average used monthly payment higher.

Figure 23: Average Used Amount Financed



Source: Experian.

Figure 24: Average Used Loan Rate



Source: Experian.

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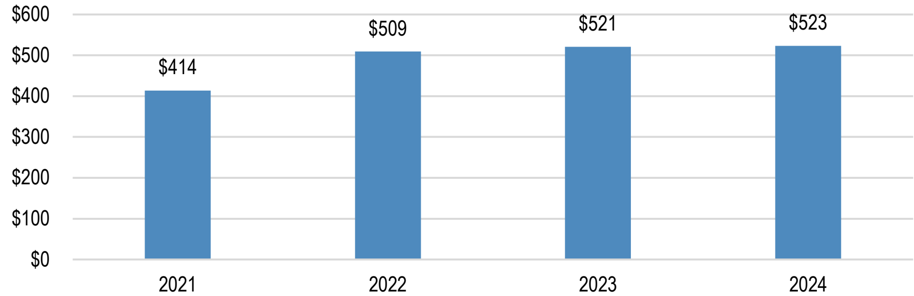
Stephen Dulake AC
(1-212) 834-9671
stephen.dulake@jpmorgan.com

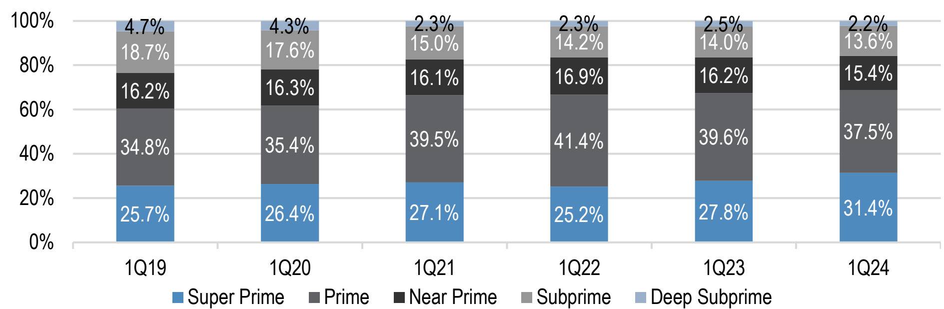
Figure 25: Average Used Monthly Payment



Source: Experian.

The impact of higher interest rates can also been seen through the lens of borrower type as higher rates typically impact the lower credit score sub-prime borrower most acutely. To this end, we note that through the first quarter of 2024, both new and used vehicle sub-prime loans accounted for just ~17.5% of total Automotive loans (per Experian), which compares to ~25% immediately prior to the pandemic and ~18% in 2023. The impact of higher rates can more easily be seen when looking at used loans in isolation, where subprime borrowers accounted for ~22.5% of total loan risk distribution in the first quarter of 2024 compared to ~33% in 2019 and ~24% in 2023. The skew toward higher quality borrowers is even more stark when looking at new loan originations, with loans to prime and super prime borrowers now accounting for nearly 84% of all originations compared to ~76% in the year immediately preceding the pandemic.

Figure 26: Total Automotive Risk Distribution



Source: Experian. Note: includes both loans and leases for new and used vehicles.

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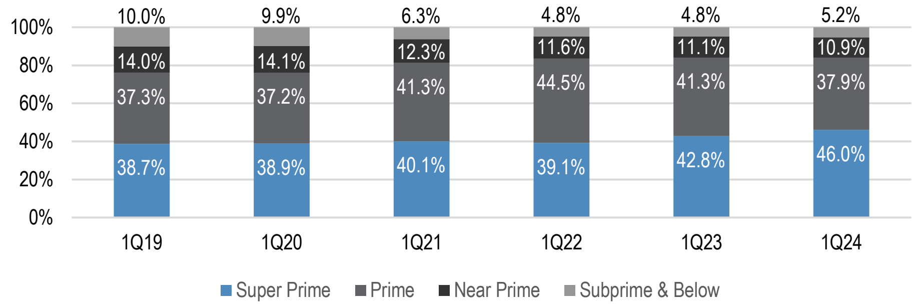
Stephen Dulake AC
(1-212) 834-9671
stephen.dulake@jpmorgan.com

Figure 27: New Loan Risk Distribution

Note: Deep subprime <1%.



Source: Experian

This document is being provided for the exclusive use of blake@sandboxfp.com.

Securitized Products Research
Amy Sze
amy.sze@jpmorgan.com
(1-212) 270-0030

Akshit R Jaisinghani, CFA, FRM
akshit.r.jaisinghani@jpmorgan.com
(1-212) 834-7041

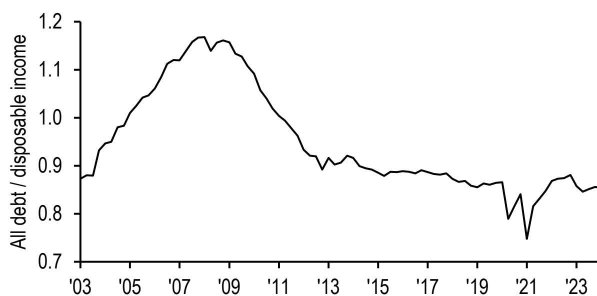
Chong Sin
chong.c.sin@jpmorgan.com
(1-212) 834-2611

Eyeing the consumer through a securitized lens...

U.S. consumer debt relative to income hit a low, post-COVID, as legislative fiscal stimulus of roughly $6 trillion was distributed to consumers either directly or indirectly. Now, we see normalization with the ratio of debt to disposable income at 85%, in line with post-GFC levels. More importantly, however, is not how much debt consumers have but if they are making payments on it (Figure 28).

Figure 28: Post-COVID debt to income has normalized

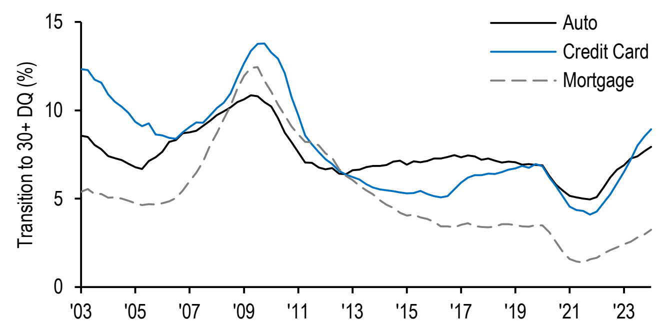
All consumer debt / disposable income in the U.S.



Source: J.P. Morgan, New York FED, BEA

Figure 29: Auto and credit card delinquencies are rising above pre-COVID levels, while mortgage delinquencies increase at a slower pace

% of 30+ delinquencies by consumer debt category



Source: J.P. Morgan, New York FED, Consumer Credit Panel/Equifax

Certainly, delinquencies are on the rise. As we can see, both auto and credit card delinquencies have been quickly rising post fiscal stimulus (Figure 29). Current levels are higher than pre-COVID but still not quite GFC levels. Mortgages are performing the best, where delinquencies have barely returned to pre-COVID norms. This suggests that, perhaps, there is more stress for lower end consumers. A high share of low-end consumers do not have a mortgage. Their debt is more often in the form of auto and credit cards. Moreover, within the auto segment, we find that subprime auto delinquencies have risen to higher levels than observed during the GFC, while prime has remained low. **Clearly there is some pain for the low-end consumer** (Figure 30).

Taking this one step further and looking at the subprime auto sector by FICO, we see lower FICO borrowers are deteriorating at a faster pace than higher FICO borrowers (Figure 31). Additionally, while not shown, we have observed more recent vintages ('22/'23) performing worse than older vintages when normalizing for loan age. In other words, all else equal, recent vintages are becoming delinquent sooner. Initially, this trend started appearing in lower FICO segments, but recently the trend has also shown up in higher FICO bands.

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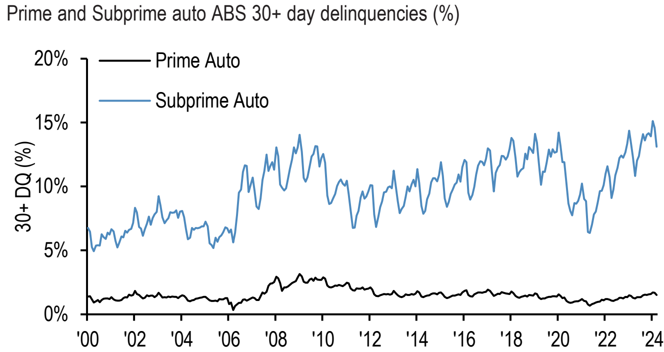
Stephen Dulake AC
(1-212) 834-9671
stephen.dulake@jpmorgan.com

Figure 30: Subprime auto delinquencies are worse than during the GFC. Prime is starting to rise, but slowly

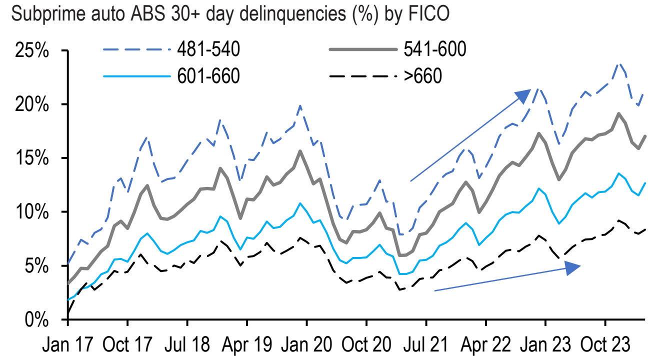
Prime and Subprime auto ABS 30+ day delinquencies (%)



Source: J.P. Morgan, Intex

Figure 31: Lower FICO subprime auto has been deteriorating more quickly than higher FICO

Subprime auto ABS 30+ day delinquencies (%) by FICO

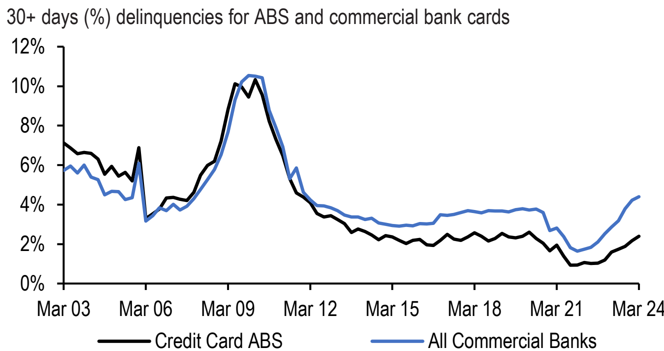


Source: J.P. Morgan, ABS-EE via 1010data

Moreover, aggregate performance in ABS is often much better than what sits on bank balance sheets (Figure 32). Securitized pools represent only a small slice (approximately 10% across autos, credit cards, and student loans) of aggregate consumers and are heavily concentrated in prime accounts. For example, credit card ABS outstanding is approximately $80bn versus household credit card debt at $1.11 trillion. Furthermore, the bulk of credit card ABS trust receivables are concentrated with prime borrowers in very seasoned accounts. Credit quality and underwriting standards are the main drivers of divergence in performance between the aggregate and ABS data. ABS delinquencies and charge-offs have consistently tracked inside of aggregate (all commercial banks) since the GFC. The main takeaway here is that the consumer is doing a little worse than what is implied by ABS data.

Figure 32: Credit Card ABS delinquencies are better than the rest of the market, notably commercial bank card portfolios

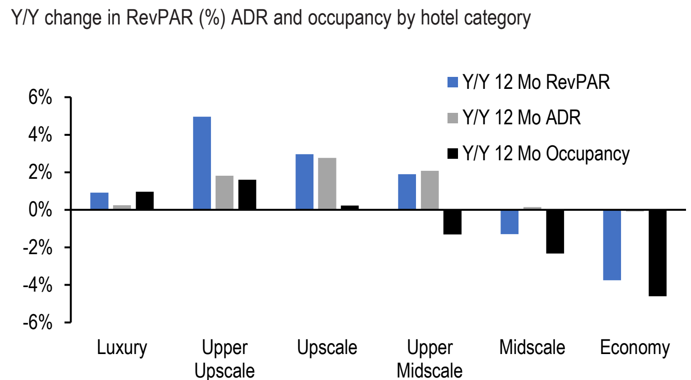
30+ days (%) delinquencies for ABS and commercial bank cards



Source: J.P. Morgan, ABS deal documents, FFIEC

Figure 33: Revenues for economy hotels are declining the most

Y/Y change in RevPAR (%) ADR and occupancy by hotel category



Source: J.P. Morgan, CoStar

Turning to commercial real estate, data shows that revenues for economy hotels has been declining more than other segments. This implies that low-end consumers are not traveling as much (Figure 33). So it's pretty clear that the low-end consumer segment is both deteriorating more quickly, with respect to making debt payments on time, than the higher-end and pulling back on their spending.

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Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

Securitized Products Research

John Sim
john.sim@jpmorgan.com
(1-212) 834-3124

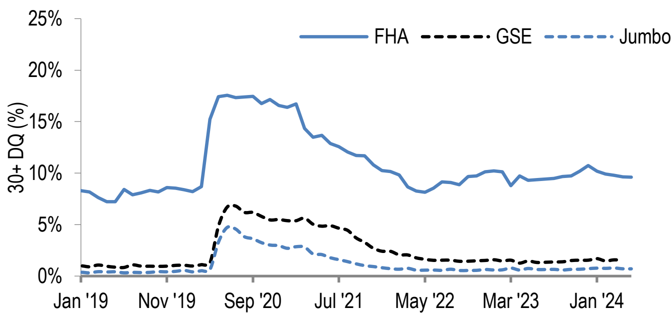
Nick Maciunas
nicholas.m.maciunas@jpmorgan.com
(1-212) 834-5671

Mortgage stability versus rental strain

One consumer segment, as pointed out earlier, that is holding up better is mortgages. We look at how delinquencies stack up for mortgage holders by tier. Federal Housing Administration (FHA) and Veteran (VA) borrowers are traditional low FICO, high LTV, and high DTI. These are government-run affordable lending platforms, with roughly 20% of all mortgage falling into this segment. Generally, we see FHA, GSE, and jumbo loans all pretty stable (Figure 34). Low mortgage rates continue to support borrowers who likely find it more expensive to move than to stay in place. More than 70% of all mortgage holders have a rate below 4%. Existing mortgage holder payments represent just over 20% of their monthly income. Consumers with a mortgage are likely to prioritize mortgage payments over all else to preserve their low rate. Alternatively, renters are in a much more challenging situation; at current mortgage rates, it would cost more than 50% of their income to make monthly payments, whereas renting is around 40% (Figure 35). This segment has less disposable income after paying rent, relative to homeowners. Here is where stress is likely to emerge in a weaker labor market.

Figure 34: Stable delinquencies for mortgages

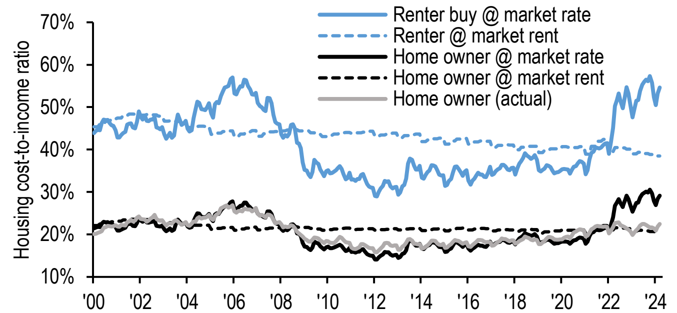
30+ day (%) delinquencies for various mortgage segments



Source: J.P. Morgan, CoreLogic, Fannie Mae, Freddie Mac, Ginnie Mae

Figure 35: Mortgage holders have a housing cost to income of just over 20%, while renters have a cost of nearly 40% of income

Renter/ homeowner cost-to-income vs cost-to-rent



Source: J.P. Morgan, Case-Shiller, CoStar, Optimal Blue, Bloomberg Finance L.P.

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Stephen Dulake [AC]
(1-212) 834-9671
stephen.dulake@jpmorgan.com

US Credit Research

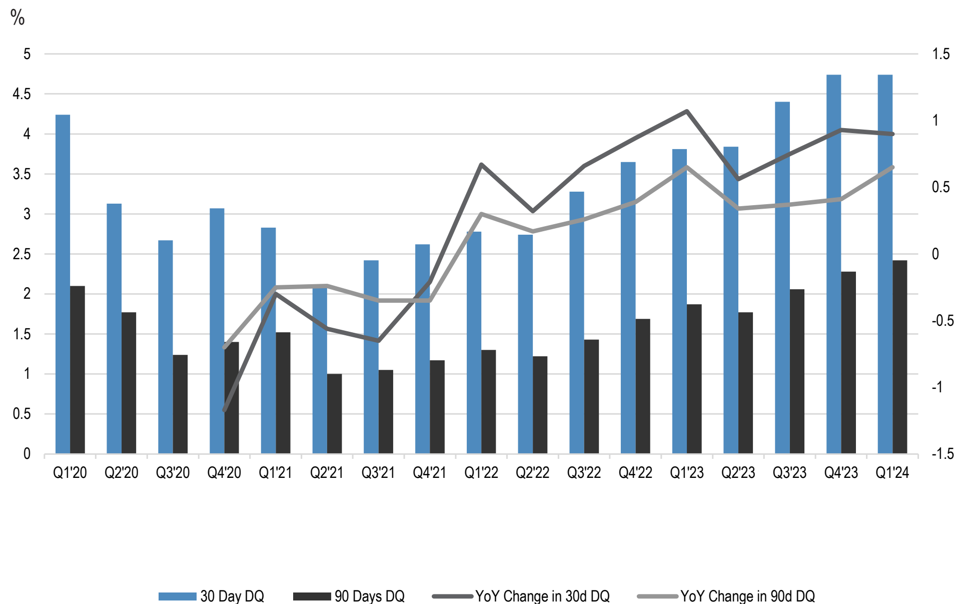
Kabir Caprihan, CFA
kabir.x.caprihan@jpmorgan.com
(1-212) 834-5613

...and then from an unsecured Consumer Finance perspective

Commentary from credit card issuers like Capital One Financial and Synchrony Financial remain sanguine. While delinquencies and net charge-offs are trending higher on the credit card portfolio, the companies see it more as "normalization" rather than deterioration. In short, credit outperformed during COVID, and we are now getting back to what should be normal levels of delinquency and charge-offs. Capital One expects that charge-offs are settling in 15% higher than 2019 levels. **What gives the management teams comfort despite delinquencies rising 82bp in Q1'24 from a year ago and net charge-offs rising 59bp? Answer: the roll rate!**

Issuers are seeing a steady deceleration in credit trends as the sequential pace of delinquencies and net-charge offs continues to improve. In term of spending patterns, Synchrony mentioned that they have seen the consumer focus more on non-discretionary items in the quarter and shifted out of certain discretionary items like home furnishings, travel, and entertainment. Spend from non-prime consumer has slowed, and the purchase volume is being driven by higher credit grade consumers. Payment rates also continue to moderate and were about 15.8% for the company, which is about 90bp lower than a year ago but still 60bp higher than rates observed in 2015-2019. Trends in payment rates as well as asset quality trends suggest that the portfolio is reverting to metrics that are more consistent with pre-pandemic norms.

Figure 36: 30- and 90-Delinquency Trends for Synchrony Financial



Source: Company reports and J.P. Morgan estimates.

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stephen.dulake@jpmorgan.com

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