

THE CASE FOR PRIVATE LENDING

OVERVIEW

The yields available today from traditional fixed income investments are at all-time lows. One area where there are still opportunities for significant yield generation with security is Private Lending. A drawback with Private Lending investing is its illiquid nature. While we do understand that many investors have a preference for liquidity, the extra yield premium that can be attained by investing in this area should help to compensate for this lower level of liquidity. Given the vast majority of high net worth investors have liquid portfolios, we see a significant opportunity for investment in to this asset class.

WHAT IS PRIVATE LENDING?

Private Lending can be broadly defined as privately negotiated loans to companies or individuals that takes place outside the traditional banking and government systems. These loans tend to have an illiquid profile as they do not trade. Private Lending is often used by small and mid sized companies who, because of their size, have limited access to liquid capital markets.

BENEFITS OF PRIVATE LENDING

Private Lending is a term which encompasses a wide and diverse number of debt investments. Many of these can provide a variety of benefits to investors. Some of these benefits include:

Strong return and high cash flow characteristics relative to other fixed income investments created by:

Illiquidity Premium

A higher yield can be achieved without taking on more risk for those willing to forego the need for immediate liquidity

Barriers to Entry

Privately negotiated transactions create market inefficiencies which can translate into higher yields

Banks Scaling Back from Lending Activity

Regulatory changes have forced banks to scale back their lending activities creating a large unfilled void and an opportunity for other lenders to attain premium pricing, yields

Low Historical Correlation to other Asset Classes

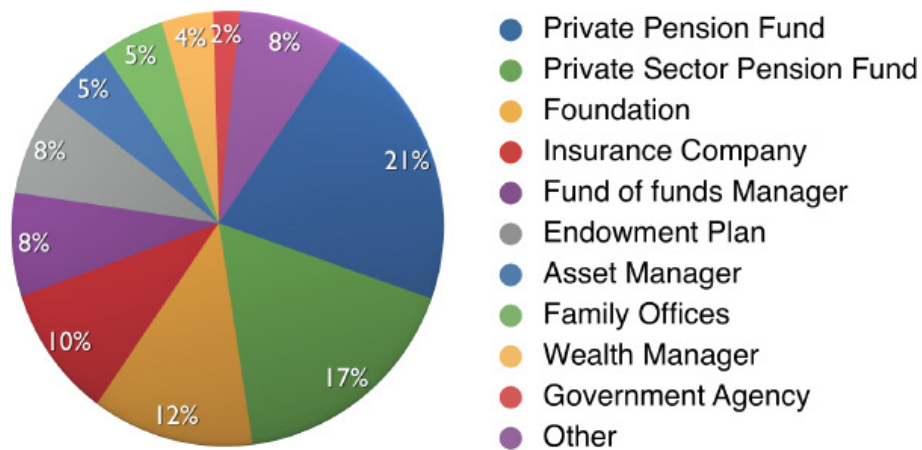
Private loans are not market priced and therefore have minimal market volatility compared to equities and bonds

Focus on Preservation of Capital

Lenders tend to have stronger credit risk controls than traditional lenders in liquid loan markets through stronger covenants, collateral securities and a direct relationship with the borrower.

WHO INVESTS IN PRIVATE LENDING?

Although the list below highlights a mostly institutional investor base, new structures can make this asset class more accessible to retail investors as well.



Source: Preqin Private Debt Online 2015

WHERE DOES PRIVATE LENDING FIT WITHIN A PORTFOLIO?

Depending on the liquidity constraints placed within the fixed income component of a portfolio, a case could be made for inclusion within it. Notwithstanding, due to the less liquid and low correlation nature of the strategy, it is often found as a component within alternatives.



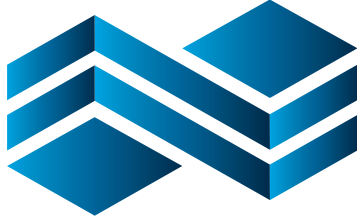
Alternative Credit should play a pivotal role in client portfolios, but instead tends to be under exploited, both in terms of asset allocation and the implementation of options created. Notably, alternative credit can play a role in helping to reduce the reliance on the equity premium to drive investment returns and as such help to improve investment efficiency and portfolio robustness.

- Towers Watson Alternative Credit Report, September 2015

TYPES OF PRIVATE LENDING

Asset Backed Lending	Privately negotiated loans to companies, special purpose vehicles or individuals secured by collateral (assets). The loan, or line of credit, is secured by inventory, accounts receivable and/or other balance-sheet assets.
Direct Lending	Includes loans to private companies, privately placed debt of public companies, or loans backed by real assets (real estate, infrastructure and so on).
Distressed Debt	Debt of companies or government entities that are experiencing financial or operational distress, default, or are under bankruptcy.
Mezzanine Debt	A hybrid of debt and equity financing that is typically used to finance the expansion of existing companies. Mezzanine financing is basically debt capital that gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full.
Private Mortgage Lending	A private mortgage is one that is offered by an individual or a company who is not a mainstream or alternative institutional lender.
Senior Secured Loans	Senior loans are usually secured via a lien against the assets of the borrower. At the originated and time the loan is made, there typically tend to be no other existing liens on the borrower's assets, or at least not on any of the assets being secured by the senior loan.
Specialty Finance	Consumer or small business enterprise ("SME") loans which are originated by non-bank lenders.
Supply Chain Financing	Supply chain finance allows a supplier to sell its invoices to a lender at a discount as soon as they are approved by the buyer. That allows the buyer to pay later and the supplier to secure its money earlier. Instead of relying on the creditworthiness of the supplier, the lender deals with the buyer – usually a less risky prospect.

Investing in Private Lending provides strong returns, high yields relative to other fixed income options, low correlation and a capital preservation focus that makes for an attractive investment opportunity. The less liquid nature of the investment is a barrier to entry; but the yield premium available should help alleviate this drawback for an investor. Although we believe the addition of Private Lending to a diversified portfolio to be prudent, we encourage an allocation to the asset class via an experienced team that specializes in the sector.



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