Blain's Alternative Asset Outlook

March 2019

DESPITE UNCERTAINTY, MARKETS TAKE 2019 IN THEIR STRIDE...BUT FOR HOW MUCH LONGER?


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The first quarter of 2019 opened better than we might have expected after the December mini-crash. The US Federal Reserve has pulled back from hiking US interest-rates boosting both bonds and stocks. Fears of global trade wars have ebbed and flowed, but the emerging consensus (or is it complacency) is that a global trade Armageddon looks less likely.

On the other hand, the global economy does appear to be taking its foot off the pedal and slowing. Large parts of Europe have slid into recession. The jobs boom driving the US has apparently stalled. China GDP growth is lagging expectations.

Can global stocks sustain their current levels – which we all suspect are still distorted by QE - through a global slowdown? Do Trump and populist politics (including Brexit) retain the capacity to shock financial asset markets? How real are fears of a China-US faceoff? With US congressmen and presidential hopefuls openly claiming to be socialists, what about the dangers of social revolution and income inequality? How scared should we be of the evolution of Surveillance Capitalism? Or should we just "calm down dear?"

There are still lots of investors wondering just how secure and safe global asset markets are. How do fund managers ensure the out-performance of pension funds in periods of near zero rates? How to prepare for a rise/normalisation in interest rates precipitating a wave of corporate defaults and equity down-valuations? Is the much feared global reset button on financial assets about to be pushed?

Here at Shard Capital, we like to clearly differentiate between financial assets – listed bonds and equity versus real assets: physical things like ships, planes, trains, infrastructure, real estate and property. In periods of sustained instability, how much more attractive are off-market real investments offering real returns for taking real risk?

Alternatives that delink from financial market instability and uncertainty have the potential to offer broader, more effective, better aligned risk, diversified and uncorrelated investment returns!

This monthly Alternatives Outlook hints at some of the deals we're working on, and the areas we think investors should be thinking about.

Welcome to the **March 2019 Alternative Asset Outlook** from **Shard Capital**.

Bill Blain, Strategist

London, March 2019

> ***"There are still lots of investors wondering just how secure and safe global asset markets are"***

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ALTERNATIVES – THEMES FOR MARCH

UK Property

From Shard Towers I can see the whole of London from Essex in the East right down to Battersea in the West. Despite the slowdown in London property prices, I'm still looking at literally hundreds of cranes building office and residential towers.

For all the talk of Brexit ending the attractions of London to the internationally wealthy – we think it's a nonsense. London will remain the most cosmopolitan city on the planet – an attractive place for the bolt-hole home and educating the kids in English at a prestige university. The crisis caused by Brexit is one of political uncertainty. It's got little to do with the real world.

But you do have to wonder who else among the Great British Working Public can afford anything in London? It does feel that "normal" homes are now out of reach of most workers – does this mean a correction or a period of catch up. Everyone talks about affordable homes, but my kids have never seen one. The government's much hyped "Help to Buy Scheme" has made property company owners into billionaires, but there are never enough homes.

Photo credit: Depositphotos.com

We are seeing a significant change in UK property investment – away from London towards the more affordable regional cities and toward new ownership and living spaces: Co-Ownership and Co-Living. We've interesting investment opportunities in both these areas.

Aviation

The market for senior debt and equity secured on aviation assets continues to develop, but a number of recent events have given investors cause for concern.

The cancellation of the Airbus A-380 programme leaves an uncertain future for many investors who financed the early aircraft. They expected the leases would be renewed, or the aircraft acquired by the operators, thus paying back their investments. Instead, the early aircraft have failed to find buyers and have been scrapped – even though they are only 10-12 years old!

Photo credit: Depositphotos.com

We've heard some very optimistic valuations placed on these scrapped aircraft, based on the value of the useable second hand parts – but they will take years to sell, and will fall quickly in value as other scrappages are added to the list.

What went wrong with the A-380? Long story, but it essentially boils down to pride and hubris – Airbus wanted to prove they could build a better Jumbo jet. And they did – it's a great plane. It's just it arrived just as everyone else wanted smaller more versatile planes.

Meanwhile, the crash of a second B-737 MAX only 5 months after the first, has spooked the market. Boeing stock took a pounding and as aviation regulators from the UK to Australia grounded the type, investors in deals with B-737 MAX collateral have been fretting about aircraft sitting on airport aprons not earning any money.

Threats of further low-cost airline defaults and fears of their aircraft hitting the markets have also caused concerns. The threat of higher fuel prices, caused by marine fuel regulations, also threatens the sector. And there is also the rising wage bill for pilots who find themselves in short-supply.

It's not a pretty picture, but we reckon the market will quickly balance. Aviation yields remain attractive, but it's picking the right leasing company to manage the deal with the right list of aircraft and operators!

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Fin-Tech vs Peer-to-Peer and Crowd Funding

In recent weeks we've seen the UK peer-to-peer lender, Lendy, put under special supervision by the UK regulator the FCA. Apparently, its lending standards have been lax leading to hefty losses – the FCS has doubts about its business model, leadership and survivability.

We've long expected a crisis in P2P and crowd-funding driven lending. Some models work – like Amigo (although we fail to understand why the guarantors of Amigo loans don't just borrow the money much more cheaply themselves!). Most P2P lenders are struggling as loan losses mount. These lenders emerged when bank lending collapsed in the wake of the 2008 crisis. They are a flawed solution.

Instead, we're looking at financing new lenders that are lending smarter better. We're out with one deal that will finance UK property development – the lender has a substantial track record with over 160 successful deals behind it. (It took over the one project that had defaulted and completed it for a considerable profit.)

We're also looking at a number of new financial lending deals in the SME sector, mortgage lending and loans. These are typically smart new lenders employing a mix of Fin-Tech to "scrape" financial and personal information on borrowers, alongside live credit analysis done by real-live credit analysts. Many of these firms have now proved their models work, but need access to quantum cash long term warehouse-type funding to turn them profitable.

Shard Capital in the Alternatives Sector

We've got some big ideas to address in the Alternatives sector:

- How can we make the alternative sector more open, transparent and investible?
- What kind of alternative assets are we working on?
- What service can we offer clients?

As yet, there is no standardised definition of an "Alternative Asset".

I'd include anything that's non-standard, including private equity, venture capital and debt, infrastructure and transport financing, direct lending and private placements of debt, quasi-equity and equity. If it's not conventionally listed – it counts. I don't care if its rated or not, but ratings are just expensive opinions provided by analysts with no real financial stake in the deal.

DEALS WE'RE WORKING ON

Typically, we like deals that are structured on the back of predictable cash flows from leases or contracts. Deals don't come to market until they've been tested and back-tested – and can be justified in terms of contracts, supply and demand, IP and the many other factors required.

At the moment we're looking at potential deals in Shipping, Aviation, Property Development, Affordable Property initiatives, plus we're always marketing our own funds; Shard Credit Partners (which provides alternative finance to SMEs) and Suir Valley Ventures (which invests in early stage tech companies).

We are looking for funders to back SME lending, Co-Ownership Housing, Co-Living Projects, Property Development Lending. These deals can all be structured on the back of secured lending to the lender's specification.

For anyone looking for something utterly off the wall – how about something FINTECH – BLOCKCHAIN related – A new Gold Linked Currency! While Crypto currencies were backed by nothing except the naivety of the buyers, this one is tied to physical gold held in depositories. It will act, smell, feel and price exactly like gold, and if you fear the Global Reset… might be worth getting involved!

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MARCH FOCUS

Co-Living Developments - £75mm Double Digit Returns 6-years

Modern Co-Living is nothing like many of us suspect it might be – remembering the horror of Student Days spent in miserable Halls of Residence or scruffy flats. In recent years a number of new initiatives have successfully - and profitably – been launched. New Co-Living projects offer residents their own studio living space and shared communal facilities with others. It's a concept that's proved successful, fashionable, and is now spreading from London across Europe. We're looking at projects around the major cities in the UK, and on the continent.


Photo credit: Depositphotos.com

The Co-Living concept is targeted at the rising number of one-person households. The market is growing – and it's not just young professionals entering the workforce living away from the parental home. We are also seeing a base of older residents looking for accommodation from long-term work contracts, and an increasing number of singletons due to rising age of marriages, divorce and longevity. Many of the stronger co-living projects put sociability at the centre of their design.

> ***"Don't underestimate the importance and weight people put on making friends"***

Affordability of homes is worsening due to rising home prices, and Co-Living offers an alternative at a time when sharing has become socially acceptable – witness work spaces like We-Work and Car-Sharing. Typical Co-Living projects include shared amenities such as co-working spaces, gyms, spas, kitchens, entertainment spaces and bars. Don't underestimate the importance and weight people put on making friends.

The residents of Co-Living projects tend to be transient – with young professional and skilled workers looking to move into cities, save for their own homes and move on. Leading professional firms, including banks and accountants are offering graduate recruits places for their first years in Co-Living projects as part of their package.

We are looking at a number of Co-Living Projects, working with an established property developer to finance a pipeline of projects in the UK and in Germany. The initial projects are vacant city centre locations allowing "millennial" residents to be close to work and social life. The projects are scalable in the next few years up to £1 bln! And will offer substantial returns. Backing up the project is a major European property development company.

The MicroBond Fallacy

In recent months I've met a number of projects and firms seeking finance who have been advised by financial brokerages to use "micro-bonds" to finance their expansion plans from launch to SME status. They've been advised such micro-bonds are the best way to secure investments from Ultra and High Net Worth Individuals into new projects. These borrowers have also been told family offices and local authorities are big investors in such private deals that are settled across global stock exchanges.

There are "micro-bonds" listed across Europe – on reputable exchanges from Scandinavia to Germany and even in Ireland. But we aren't necessarily in favour of them. There is a whiff of disreputability and scandal attached to many of them. Too many Microbonds have defaulted or failed to otherwise deliver. Sure, some are perfectly perfect, but as an asset class they don't appeal to the institutional investment markets.

The collapse of London Capital & Finance, which raised over £230mm from retail investors through minibonds is likely to result in deeper scrutiny – apparently, they were sold as ISA eligible when they were not. Bond holders will be lucky to get 20% recoveries.

Our primary investment clients at Shard for Alternative investments are institutional – the pension funds, credit funds and insurance companies managing "real money" funds, hedge funds and focus funds, sovereign wealth funds and even a small number of genuine family offices. (Most family offices I've met over my nearly 35 years in the City have proved to be brokers – although some are genuine investors.)

Most institutional investors we talk to won't touch borrowers from the Microbond market – they would much prefer to deal directly with them through private placements or direct lending. We'd advise any borrower looking for capital to raise a functional business to look at engaging direct with institutional money. Long term sponsorship, mentoring and access to sticky institutional capital may require some form of equity kicker, but it's preferable to sub-optimal scrabbling for non-bank finance. Institutional engagement is far more likely to give sustainable and diversified funding rather than hoping to tap up the next wealthy pensioner driving an Aston into the Gold Club!

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