Credit Unit Class
TAMIM Fund

At October 2018

CURRENT FORWARD YIELD: 8.47% p.a.

Firstly, we welcome you as an investor in the Credit unit class of the TAMIM Fund and also to the inaugural monthly update. Over the coming months we will share with you our views and the emerging themes in the private debt credit markets along with other relevant topics in the ever-evolving world of fixed income. In addition to this, we will also provide a discussion of a credit manager or loan platform that we are either invested in or in discussions with as a potential investment target. Given that this is our first edition, we would like to give you some background on the development of this asset class over the past few years and draw your attention to some of the themes currently impacting the Australian private debt market.

One of the few positive aspects arising out of the financial crisis was the rise of private credit as an asset class and it is now widely invested in by institutional investors around the world. Pre-crisis, most institutional investors did not focus as much on these assets and only a few had explicit asset allocations. Insurance companies have been lending money to middle market companies for many years and they and the banks had participated widely in real estate debt. It took a major financial and economic crisis for these investments to become mainstream in the institutional investment world.

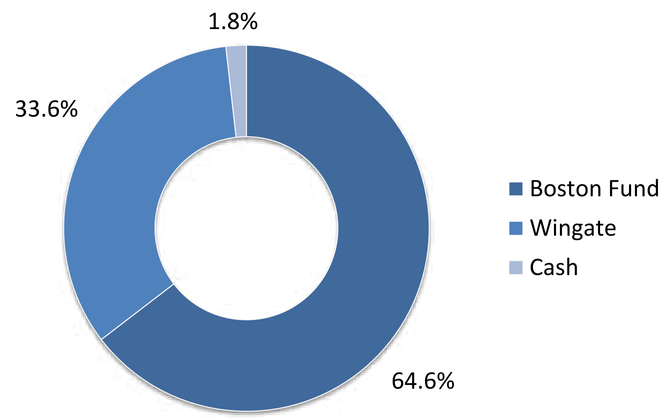
Regulators around the world have and continue to focus on the banking system, putting in place incentives that moved the risk out of the banking system. As new bank regulations were put in place globally and economies gradually recovered the demand for credit exceeded the ability of banks to lend to companies, particularly those with higher leverage and, in the Australian SME market, those companies not able to offer property collateral and/or personal guarantees. At the same time, central banks around the world have injected previously unforeseen levels of liquidity into the financial system mainly through record low interest rates. This has created significant demand for higher yielding fixed income instruments among investors.

Volume has grown enormously—total private credit outstanding globally hit over $410 billion in 2017, up from only $75 billion in 2006 according to Preqin. The credit spectrum has also moved well beyond investment grade debt. The traditional private placement market remains 80% investment grade but funds target sub-investment grade and mezzanine credit as well. Recently, the biggest growth has been in direct lending, which

Key Facts

Investment Structure:	Unlisted unit trust
Minimum investment:	A$100,000
Applications:	Processed monthly
Redemptions:	Quarterly, with 30 days notice
Unit pricing frequency:	Monthly
Distribution frequency:	Quarterly
Management fee:	1.25% p.a.
Performance fee:	Nil
Lock up period:	18 months
Buy/Sell Spread:	+0.20%/-0.20%
Exit fee:	Nil
Administration & expense recovery fee:	Up to 0.35%
Unsecured debt limit:	5% of Fund assets

Portfolio Allocation



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Monthly Return Stream

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	YTD
2018	-	-	-	-	-	-	-	-	-	0.57%			0.57%
2019													

Note: Returns are quoted net of fees. Past performance is no guarantee of future performance.

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targets below investment grade credit and raised over $50 billion in 2017.

This asset class is not without risk, particularly given increasing levels of competition for assets. This lifecycle of a new asset class will usually follow a somewhat familiar pattern. There is usually rapid growth and high returns in the early years, which leads to unrealistic expectations and too much demand. Risk then rises, and capital is lost when the credit cycle turns. The evolution of “junk bonds” into a fully formed asset class called “high yield” is an example of this. There will likely be a shake-out in private credit in the next downturn, but investors who understand the risks and choose quality managers with unique deal flow and strong underwriting will fare well. From an Australian market perspective, household and business lending has historically been and is still dominated by the ‘Big Four’ banks and therefore the shift to this asset class for institutional and sophisticated investors such as family offices, high net worths etc. is probably a few years behind the US and European markets and thus represents an enticing investment opportunity.

Private debt has been a good place to invest for institutional investors in Australia as a shallower pool of buyers and illiquidity premiums have helped to drive higher risk-adjusted returns. With stringent bank capital adequacy regimes in place and more regulation likely to emerge out of the Banking Royal Commission, the opportunity for institutional investors to access enhanced returns is likely to exist for some time. For non-institutional investors, such as family offices, HNW individuals and self-managed super funds, exposure to this asset class has until now been difficult to obtain with options outside of the equity markets typically being restricted to debt issued in the public markets and bank deposits. This is obviously not ideal given record low interest rates which remain today.

Post-GFC and in the lead up to the adoption of tighter capital adequacy standards in 2012, Australia’s major banks significantly increased their residential mortgage books (from ~57% of lending in 2008 to ~66% today). Over the same period corporate lending declined from 28% to 25% today meaning the private debt lending books of the major banks have proportionally fallen over the past 10 years by at least $60 billion.

APRA requires banks to set aside capital based on prescribed risk weightings, with investment grade (IG) and sub-investment grade (HY) debt requiring an additional 100% and 150% in capital compared to just 35% for residential mortgages. It goes without saying that this is the main factor explaining why small and medium sized businesses struggle to obtain credit facilities from Australia’s major banks and why the banks’ preference is to lend against real property collateral. Other regulatory changes, such as limits on investor and interest only loans, are also providing opportunities for non-bank financial institutions to grow their market share. This has seen the emergence of funds/loan platforms that fund property investment and development, asset finance, business (enterprise value) lending and consumer credit. As outlined in our Information Memorandum, we aim to invest across these credit classes in order to diversify the portfolio, provide a blend of differing return streams and types of security.

In conclusion, with the banks’ appetite for private debt constrained, opportunities for investors to boost risk-adjusted returns and add a layer of sustainable, defensive income with capital protection are on the rise. Regulatory constraints are likely to maintain a steady pipeline of deals offering attractive return profiles and investor-friendly covenant protection.