RMWC

November 2016

RMWC Direct Lending Perspectives

Election Surprise…Now What?

These Perspectives are offered from time to time in answer to the questions that we are most frequently hearing from institutional and high net worth investors.

Q. How do the results of the Presidential election, combined with uncertainties about Fed policy direction, affect direct lending strategies?

A. We believe the stage is set for a relatively dramatic shift in favor of growth-oriented tax, spending, and regulatory policies. Suddenly, years of reliance on monetary policy stimulus are set to be replaced by a potentially potent mix of tax reduction and simplification, fiscal spending increases, and a rollback of regulation that has stymied growth in several sectors. This positive mix could well be boosted by a heightening of "animal spirits," the intangible that seems so crucial to sustained entrepreneurial endeavor. We expect to see sustained demand for the short-term, heavily collateralized, senior secured bridge loans that normally fuel a growth-oriented economy.

Q. But won't a rollback of regulation unleash more aggressive lending by commercial banks in your favored sector?

A. Regulatory rollback will likely be focused largely on sectors sensitive to energy, environmental, and labor regulations, not on banking. There is no indication that the Fed, the Office of the Comptroller of the Currency, and State Banking Regulators will soon reverse the powerful ongoing trend in favor of greater regulatory oversight of banks. This trend will likely continue to limit the availability of credit to smaller borrowers, who are increasingly turning to private lenders to fill the gap.

Q. Do rising rates pose a special challenge?

A. Rising rates pose a challenge for investors who have sought to replace lost yield by moving well out the risk spectrum, which the Fed has encouraged with Zero Interest Rate Policy. Investors who moved to longer duration portfolios of traditional fixed income are now stuck with *both* low coupons and reduced principal value. Similarly, investors who shifted to high-yield debt or to the crowded middle market lending sector may face a less attractive risk/return proposition. Fortunately, there are other choices available in private lending which involve more conservative risk/return metrics while compensating well for illiquidity.

Q. Isn't it late in the credit cycle? Shouldn't all credit be avoided?

A. Certain sectors need to be avoided; others remain attractive for disciplined lenders. Generally, larger sectors have seen substantial inflows of capital and significant appreciation in the prices of underlying assets. One example: large, trophy commercial buildings in Manhattan. Another example: leveraged loans to large operating companies in the United States. But, smaller, localized, fragmented segments offer performing credits at rational prices.

Bain Capital Co-Founder Coleman Andrews now leads RMWC, a Palo Alto-based alternative investment manager specializing in private credit.

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