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CORPORATE EXCELLENCE INSIGHTS

We are a specialized provider of systematic Quality Investment Solutions and one of the few providers of Quality equity investment strategies worldwide. Corporate Excellence Insight is our monthly publication that includes a brief update on markets and our thoughts about major trends that are impacting the investment management industry.

MARKET UPDATE: STRONG CORPORATE GROWTH

Strong global economic and corporate profit growth outweighed the escalating trade tensions in July. Economic data surprised on the upside in the US, picked up in Japan while stabilized in Europe. Strong Q2 corporate results reaffirmed the estimates for double digit profit growth in 2018.

$3.5bn

WORLD'S FIRST BIG 5G DEAL

T-Mobile US named Nokia to supply it with next-generation 5G network gear, marking the world's largest 5G deal so far and concrete evidence of a new wireless upgrade cycle taking root.

48.5

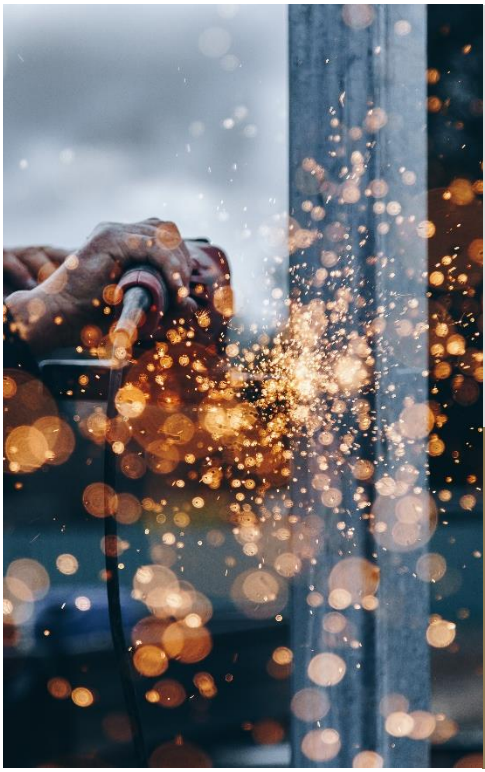
U.S. WEEKLY JOBLESS CLAIMS HIT MORE THAN 48-AND-A-HALF-YEAR LOW

The number of Americans filing for unemployment benefits dropped to a more than 48-1/2-year low in July as the labor market strengthens further, however trade tensions are casting a shadow over the economy's outlook.

x11

FIAT'S VALUE WAS MULTIPLIED 11 TIMES THROUGH 14 YEARS

Sergio Marchionne, the executive who rescued Fiat and Chrysler from bankruptcy after taking the wheel of the Italian carmaker in 2004 and multiplied Fiat's value 11 times through 14 years, has died aged 66.



MONTHLY TOPIC PEER-TO-PEER LENDING

Central banks in Europe and the United States got into the rate increasing stance, but the levels are still low and the pace of rate increase is very moderate. In this environment, peer-to-peer lending as an asset class might become an alternative to low-yielding bonds. Naturally, yield is not coming without risk, but let's have a look where the risks are and how to deal with it.

The return of P2P Investments clearly come as very attractive, especially if compared to the 10-year government bonds in Switzerland or Germany which yield now -0.11% and 0.31%, respectively. Even by taking the global investment grade debt, including treasury, government related, corporate and securitized fixed-rate bonds, P2P returns look very appealing.

An additional concern for the P2P investor is the default rate, which might be higher than for traditional debt instruments. Over the last ten years, the default rates for investment grade loans issued through P2P platforms are below 4% both in US and in Europe.

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INVESTMENTS IN P2P LENDING AS RISK-DIVERSIFYING AND RETURN-BOOSTING ADDITIONS TO THE PORTFOLIO

Peer-to-peer lending is the fastest-growing form of private debt, which also includes Distressed Debt, Venture Debt, Mezzanine Financing and Direct Lending. Over the last twelve years, peer-to-peer lending has created more than $120bn of credit globally without showing any signs of a slowdown in growth. The future looks bright as well, as, according to PwC[1], the volume of peer-to-peer lending is projected to reach $150 billion by 2025, even if the double-digit growth rate slows significantly compared to recent years. The more optimistic projection is set as high as $1 trillion by the end of 2025, which, in comparison to the entire global debt market is just 1% and 1.3% if compared to the global equity market[2].

P2P debt – low correlation to other asset classes

In essence, P2P platforms try to close the gap created by banks in funding small and mid-sized businesses and households. One of the beauties of Direct Lending is that it offers a form of investment that is never standardized, so the design could be customized to meet specific risk and return objectives. Combined with the rather small amounts per credit it usually results in a broad diversified portfolio and a very low correlation with stocks, and, more importantly, a negative correlation with global bonds (see middle market loans, Fig.1).

Fig 1. Correlations of private debt and public assets: 1998 - 2017

	Middle market loans	Broadly syndicated loans	High-yield bonds	Global bonds	U.S. stocks
Broadly syndicated loans	0.91				
High-yield bonds	0.75	0.85			
Global bonds	(-0.11)	(-0.05)	0.06		
U.S. stocks	0.52	0.55	0.68	(-0.12)	
Non-U.S. stocks	0.54	0.59	0.71	0.11	0.88

Source: S&P Capital IQ LCD, Morningstar, Nuveen, LCC. . (Global Bonds – Barclays Global Aggregate Bond Index, High Yield – Merill Lynch US High Yield)

Fig 2. Return dispersion within debt space: 1998 - 2017

	Return	Standard Deviation	Sharpe Ratio
Middle market loans	**6.24%**	6.98%	0.61%
Broadly syndicated loans	**4.90%**	8.50%	0.35%
High-yield bonds	**6.74%**	10.12%	0.47%
Global bonds	**4.55%**	6.20%	0.42%
U.S. stocks	**7.01%**	17.24%	0.29%
Non-U.S. stocks	**5.57%**	20.00%	0.18%
Ger 10y Bonds	**3.00%**	1.65%	-
Swiss 10y Bonds	**1.85%**	1.26%	-

Source: S&P Capital IQ LCD, Morningstar, Nuveen, LCC. (Global Bonds – Barclays Global Aggregate Bond Index, High Yield – Merill Lynch US High Yield)

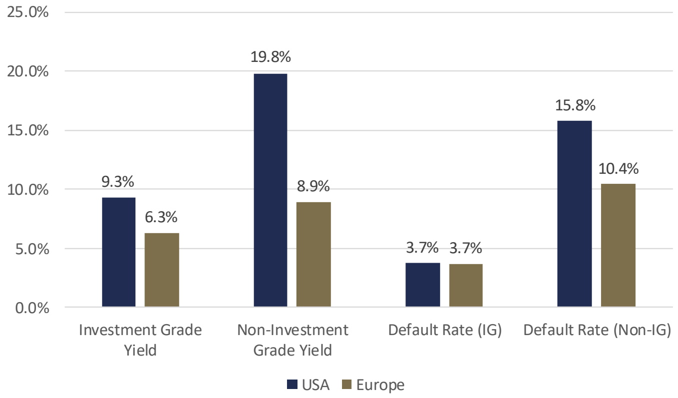
The return of P2P investments is clearly something you cannot ignore, especially if you compare it to the 10-year government bonds in Switzerland or Germany which yield now -0.11% and 0.31%, respectively. Even by taking the global investment grade debt, including treasury, government related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers, P2P investments' return looks more appealing.

Additionally, the option to customize your designated Risk-Return Profile with P2P Investments can help to lower the overall risk without sacrificing higher return potential. By increasing exposure to small and middle-market loans we get higher risk-adjusted returns that are competitive enough in the global scheme of asset classes (Fig. 2.). Some platforms also provide a comparison of their risk-adjusted returns with stock and bond returns. The Finnish P2P platform Fellow Finance, for instance, indicates that its Sharpe ratio is 11.3 as contrasted with the 0.13 for EuroStoxx 50 and -0.15 for corporate bonds.

Tamed default rates

An additional concern for the P2P investor is the default rate, which might be higher than for traditional debt instruments. Historically, if we take the US and the European region, the default rates were essentially not that high for debt processed by the largest P2P platforms, especially when considering higher quality borrowers (Fig 3.).

Fig 3. Average Yields and Default Rates for Investment and Non-investment grade P2P lending since 2007.



Source: US - Lending Club, Funding Circle, Prosper Marketplace; Europe - Zopa, Ratesetter, Auxmoney, CreditGate24, Lendix, Bondora, Lendico, Fellowfinance.

Interestingly enough, the average default rate over the last ten years for investment grade (IG) debt is almost identical in both regions, standing at 3.7%, however for non-investment grade (Non-IG) debt the difference is more pronounced, constituting 5.3%. From the yield perspective, in the US investors are also better compensated for holding both IG and Non-IG debt, with a delta of 3% and 11%, respectively. In Europe, the focus on strong loan books is much more important than in the U.S., thus yields are prone to be lower. The liquidity of P2P investments is generally below what we can observe in Corporate or Government bond markets, although the availability of secondary markets makes P2P investments more liquid. Putting P2P in context with other asset classes, a well-diversified P2P portfolio obviously would be less liquid than the corporate bonds and equities, but more liquid if compared to private equity, other types of direct lending and direct property.

Whether or not private debt will be able to sustain considerably greater alpha during the next recession is a big unknown. For now, it has managed to establish itself as a credible alternative source of income globally, offering much-needed diversification capabilities and shielding investors from unprecedented low-interest rates. We believe that by being intensely selective in the capital structure of private debt, having the necessary safeguard mechanisms, and having clear risk/reward objectives, could noticeably improve the total alpha of any portfolio.

1 PWC, How peer-to-peer lending are transforming consumer lending industry? https://www.pwc.com/us/en/consumer-finance/publications/assets/peer-to-peer-lending.pdf

2 World bank, https://data.worldbank.org/

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