Sep '20- Speculative Markets, Deteriorating Backdrop, Where to Hide?

15 September 2020 | Tony Bremness, Laureola Advisors

Many investors have turned to real estate or real estate debt for fixed income alternatives but there are danger signs here too. Many larger players (Brookfield, Starwood, Blackstone) are skipping payments on MBS backed by commercial real estate.

THE INVESTMENT ENVIRONMENT - Speculative Markets, Deteriorating Backdrop, Where to Hide?

The S&P 500 is now up 8.4% ytd, the Nasdaq +37% and the HUI Gold index +44%. But the end result is that equities are more expensive than ever: the P/E of the median stock is at the 100th percentile of historical levels, despite dividends being cut between 17% and 23% this year.

Fixed income offers fundamental investors no respite. Government bonds yield near zero, despite the Fed abandoning its inflation targets in favour of job growth. Speculative bonds offer 5.6%, but with rapidly deteriorating credit risk. The worst news for bond investors may come from Credit Suisse, whose analysis confirms that, in today's markets, bonds no longer offer diversification from equity risk.

Many investors have turned to real estate or real estate debt for fixed income alternatives but there are danger signs here too. Many larger players (Brookfield, Starwood, Blackstone) are skipping payments on MBS backed by commercial real estate. US Banks are increasingly concerned: the level of real estate criticized (high risk) loans increased 144% in Q2 and represent 25% of tier 1 capital at Wells Fargo.

Investors are not being paid for the risk they are taking in the traditional markets. One asset class still providing an attractive risk/return profile is Life Settlements, which continues to offer strong fundamentals, an above average yield, low credit risk, and genuine diversification.

LAST MONTH IN THE LIFE SETTLEMENT MARKETS - Markets Robust; How Life Settlements Can Still Provide a Fixed Income Alternative

The Life Settlements markets continue to trade with average gross projected IRRs in low to mid-teens. Capital flows are fluid: some Funds are failing to meet redemptions and need to sell, while others are raising capital to invest. Supply is growing at a double-digit pace with the consequences of Covid expected to increase the supply in the secondary market.

FUNDMONITORS.COM Insights

LAUREOLA ADVISORS
INTEGRITY | DILIGENCE | SUCCESS

Today's fixed income investors face a real dilemma. Traditionally, bonds could be relied upon to provide: 1) capital protection/low credit risk, 2) a regular cash income, 3) returns greater than inflation, 4) non-correlation with equity markets and the economy, and 5) the ability to sleep at night.

Bonds and most fixed income alternatives currently provide two of these benefits or less, but a well-managed portfolio of Life Settlements will provide most of them. Most Life Settlements are backed by insurance companies rated A or better, and a portfolio will provide regular cash flow and returns well in excess of current inflation. Perhaps the most desired feature in today's environment is the non-correlation with traditional markets and economic conditions; a Life Settlement portfolio generating most of its returns from maturities will tick this important box. And all these features combined will allow investors to sleep at night.