Private Debt Investor

8 January 2021 • privatedebtinvestor.com

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This time it really was different

Timeframes for taking advantage of dislocation opportunities following crises have compressed, according to David Allen of AlbaCore Capital Group. Those who reacted fastest after the initial wave of the pandemic were rewarded most.

I have been analysing, studying and investing in markets for more than three decades now. Over that time I have experienced several market crises at first hand. I was an active equity investor before, during and after Black Monday in 1987, when the Dow Jones dropped 22.6 percent in one day. I began my first day at Morgan Stanley a few months after the 1990-91 recession ended. The late 1990s brought the Thai baht and Russia crises back to back in 1997 and 1998.

The attacks of 11 September 2001 and the dot-com bust occurred during my years as an Institutional Investor 'All-Star' analyst while at Morgan Stanley in New York. The global financial crisis happened while I was a partner and head of Europe for a global credit manager. The European sovereign crisis struck while I was running the European credit portfolio at CPPIB, working alongside Bill Ammons, who joined me in founding AlbaCore a few years later.

All of those experiences, but particularly the 2008 and 2012 trials, were instrumental in fine-tuning AlbaCore's investment philosophy. Simple concepts such as limiting leverage, never being a forced seller, being selective with credits at all times, and not forgetting to sell.

We ask our investment team to follow

David Allen

many high-quality companies that may be trading at the wrong price. That means keeping models up-to-date, visiting companies, staying in touch with management teams, and following industries intensely. Patience has a way of making everything very cheap, or expensive, at some point. Given our large coverage universe and fund liquidity, we were able to be one of the first firms in Europe to buy credit last March as the world experienced a dramatic 'margin call' with sellers outnumbering buyers in droves. We like buying at those times.

A consistent theme we have heard in conversations with investors since founding the firm four and a half years ago has been an acknowledgment that the credit cycle would turn. When it did, investors would be ready, and their allocation focus would shift to distressed and special situations credit opportunities. Markets inevitably crash but, post-GFC, everyone seemed to believe that distressed credit would be an 'easy' place to invest capital during and after a dislocation. Even more traditionally equity-focused investors seem to like distressed credit once a decade.

One interesting trend we have noticed in the past 10 years, though, is that the length and severity of credit market dislocations continue to compress. During the GFC, investors had more than a year in which spreads exceeded 800 to 1,000bps. There was time to recover from the shock, calibrate the damage, adjust and re-allocate. These allocations typically took the form of multi-year credit funds focused on stressed and distressed opportunities across the credit spectrum.

Investors who took the plunge into credit, post-GFC, generally got it right, and generated equity-like returns with credit-like risk in the ensuing years. Many of those funds were also able to take advantage of the European sovereign crisis a couple of

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years later. Significant market dislocations have been lacking in recent years – though, interestingly, a surprising number of those post-GFC distressed funds are still around almost a decade later, after a full market recovery; many are still waiting to realise positions.

The difference is time

Unlike recent crises since 2000, the covid-related dislocation was over almost before it began. Investors barely had two weeks to mobilise at distressed-level (1,000+) spreads. If you were able to deploy capital in March and early April of last year, you were richly rewarded (50 percent-plus IRRs). Investors able to mobilise in May, June and July were able to generate attractive 30 percent-plus IRRs. Even through the late summer and autumn we were able to identify attractive opportunities that have performed well in the past several months, and we believe there are positions that still offer the potential for 10-15 percent returns in a market yielding below 4 percent.

As the liquid markets have tightened, we have been seeing better opportunities in some private capital opportunities. These private deals provide capital for companies in transition, including opportunistic M&A, pre-IPO financings and strategic refinancings to extend maturities or right-size balance sheets. Often, they pay material premiums to the listed market and, when we underwrite those deals, many have fees ranging from 2-3 percentage points.

Don't forget to sell

We have been active sellers of risk over the last few weeks. At current levels, many risk assets look expensive. Although it's not clear whether this is a bubble, there are many credit and equity investments that look asymmetrically risky, just as most assets looked asymmetrically cheap last March. There will be losers in the post-covid world. Just because a company has raised capital and has a runway to trade into 2021 doesn't mean that its business will return to 'normal' – because there is no 'normal' anymore. So much has changed, and those impacts are only beginning to reveal themselves.

Consider airlines, restaurants and traditional retailers. Business travel has always been an expensive, time-consuming and carbon-negative proposition. It is hard to imagine ever returning to 2019 levels of business travel. Some retailers and restaurants will fail as consumers become accustomed to ordering online rather than in-person. We have seen this trend creep into bigger-ticket items such as used cars: in the UK, consumer activity for used cars has spiked, and nearly 100 percent of it is taking place virtually (compared with 50 percent pre-covid), and at higher volumes than before the crisis.

Current investing climate and 2021 outlook

The past year has marked a new kind of market environment in which the ability to preserve capital, while being quickly opportunistic, has proven invaluable. Although the market has recovered, underlying economic fundamentals are still weak, and the effects of this are only starting to percolate around the world.

Pockets of volatility lie ahead with Brexit, a new US administration and underlying sickness in the global economy, notwithstanding the market recovery. We remain steadfastly committed to our credit underwriting process, and are incorporating lessons from the past year to further sharpen our approach across markets and to seek out opportunities in the years to come. ■

David Allen is founder and chief investment officer at AlbaCore Capital Group, the London-based fund manager

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