

CONVERSATION

WITH STEVEN FLEMING

Partner

Gryphon Capital Investments

Managing Partner Sean McMahon chats with Steven Fleming from Gryphon Capital Investments, about their new listed investment trust and whether Australian investors are ready for income investments.



SM *Gryphon Capital Investments is currently raising up to \$350 million for the new listed investment trust, Gryphon Capital Income Trust, which began trading on the ASX on 25 May 2018. What is the strategy behind this fixed income focused product?*

SF Investment objectives are met by allocating capital effectively to meet that goal. This generally involves creating a balanced and diversified investment portfolio that satisfies an investor's tolerance for risk and return expectations. Relatively secure income investments often make up an important part of most investors' portfolios, particularly for those in retirement phase.

When we think of income investors we are generally looking for:

- regular and stable income
- stable capital.

Although the majority of investors would benefit from a portion of their portfolio in defensive assets, such as fixed income, it becomes increasingly important for investors at or nearing retirement. They should have an increased exposure to fixed income to insulate their portfolio from sharp falls in asset values.

Sadly, fixed income is not an asset class that is particularly well understood in Australia. Fixed income, by its design, is a promise on the return of capital, whereas equity is a perpetual instrument. Fixed income is a commitment by a borrower to pay an agreed rate of interest on the amount borrowed over a set period of time, and when that period ends the money is repaid in full. So, if the objective is the return of capital it is very important to ascertain the quality of the underlying collateral backing the asset as well as where it sits in the capital structure of the borrower.

A subset of Australian fixed income is Residential Mortgage Backed Securities (RMBS) and Asset Backed Securities (ABS), which are secured bonds. It is a huge institutional market double the size of the corporate debt market and approximately three times the size of the hybrid market. RMBS and ABS are assets secured directly against assets such as residential mortgages, credit card receivables and car loans.

The Gryphon Capital Income Trust (Trust) will offer exposure to a portfolio of RMBS and ABS, with the purpose of providing consistent monthly distributions, diversification and capital preservation. The

Trust therefore provides asset class diversification and is complementary to other fixed income securities.

In addition to the attractive target returns of RBA + 3.5 percent (5 percent based on the current RBA cash rate of 1.5 percent), investors can look to the multiple layers of protection afforded to them by investing in a diversified portfolio of secured bonds.

SM *Why did you opt for a trust structure?*

SF There are a number of compelling reasons for Gryphon Capital pursuing a listed income trust (LIT).

Australian retail and SMSF investors' portfolios are overweight with cash and, with a record low RBA cash rate, there is clearly a need in the market for a product offering strong returns but also certainty of capital protection.

Until now, our strategies were only available to institutional investors. The LIT will be the only avenue for retail and SMSF investors to gain access to a capital secure income alternative.

Finally, the ASX listing allows us to invest and construct the portfolio in a manner consistent with our institutional mandates without the need to source

liquidity for potential investor redemptions. The investors source liquidity through the ASX listing.

We feel strongly that the trust structure is the most appropriate legal form of investment; balancing the investor's desire for return and liquidity, and also not relying on imputation credits for returns.

SM *Compared with overseas markets, Australian investors have not had a lot of exposure to income investments. Are Australian investors ready for income investments?*

SF If the investment objective when investing for income is attractive total returns primarily from providing income whilst preserving capital, then the average Australian retail investor is often using the wrong asset classes for their income investments.

Compared to other developed markets, Australian retail investors have a higher allocation to cash and term deposits and are using these investment alternatives for income rather than liquidity purposes. Traditionally, the Australian retail investor also has a high reliance on growth assets, including equities and hybrids for their income needs. The issue with being overly reliant

on growth assets, including equities, for income is the risk of capital loss. This is a major concern if you are in the pension or income phase. The circa 25 percent fall in the Telstra share price over the last 12 months emphasises this risk.

So, while retail and SMSF investors may have an appropriate allocation to the asset classes they are using for "income", these asset classes are actually not delivering the desired investment outcomes of attractive income returns and capital preservation.

The key for a retail and SMSF is portfolio diversification.

An investment in the Trust offers attractive cash income paid monthly with a key objective of capital preservation. With the Trust's investments being a diversified portfolio of secured debt with multiple investor protections, an investment in the Trust carries slightly more risk than a term deposit for significantly more return and materially less risk than subordinated, unsecured income alternatives (ie hybrids), but with comparable returns.

Unlike many subordinated, unsecured income alternatives an investment in the Trust will not typically be correlated to the equity markets.

SM *What is different about Gryphon's investment approach compared with its peers?*

SF We are a specialist fixed income manager with significant experience in the Australian and international RMBS and ABS markets. We manage segregated accounts on behalf of institutional investors seeking opportunities in fixed income credit markets and have exceptional historical investment performance in comparable investment strategies.

Our experience and proprietary database allows us to assess risk to create a portfolio of the best relative-value securities available within the investment mandate. We operate an active program with ongoing monitoring of relative value and risk allowing us to switch investment where greater relative value exists for underlying investors.

For further details about the top reasons to invest in RMBS and ABS please **click here**.

SHORTEN PREFERRED



SEAN MCMAHON

Managing Partner
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The Royal Commission into the Banking Industry began with Bill Shorten attempting to score some political points by putting the government into a position where they were required to come out in support of the banks. Fast forward six months and even Mr Shorten would agree that not even he expected the Commission to uncover the extent of the nefarious behaviour which was brought to light in only 19 actual sitting days. Remember, the Commission was scheduled to have only 29 sitting days in total. It is hard to see how the government doesn't extend this. To end it early would be like walking out of a movie at intermission. But, then again, by now most viewers can see how this one ends.

The most important part of the Commission will be the recommendations and the implementation of them by government. What will be important to remember is that the regulations are already in place, they just haven't been respected by some participants. It will be a shame if regulators impose their will on the way businesses are structured as opposed to how they are required to conduct themselves. For example, I don't believe we need to legislate what lines of business a company can or can't pursue. Or to put it another way, a 'break-up' of banks is not the answer. What we need is businesses in the financial services sector with a compliance culture permeating the organisation and guiding decision making from top to bottom, and harsher penalties for those that ignore the rules.