



October 30, 2018

Bang, Oops, Another Down

By Alan Snyder

Should all of us join the precariat investment class, given current events? We fear for our portfolio's existence and security – valuations volatile, yield curves flattening, the Federal Reserve active, Minsky moments nearby, government turmoil, etc. All fears are in place, notwithstanding a currently strong economy. Some may be millenarians believing the end is near with the coming transformation of society after which all things will be changed for the better. We are not such viewpoint subscribers.

Richard Holbrooke, one of America's storied diplomats, captured our sentiments when he said: "You have to test your hypothesis against other theories. Certainty, in the face of complex situations is very dangerous." Our hypothesis is that a bird in hand is worth two in the bush. A currently paid high yield with consistency and security not only preserves capital but provides growth. The enemy is duration.

The King James Bible, Mathew 16:3, advises: "And in the morning, It will be foul weather today: for the sky is red and lowring. O ye hypocrites, ye can discern the face of the sky; but can ye not discern the signs of the times?" The attachment to this note provides the facts of duration risk and underwhelming return expectations for most traditional asset classes. President John F. Kennedy put the pickle on the fork for any yield investors: "We must use time as a tool and not as a crutch." Investing for yield with "longish" duration can be a portfolio return killer.

Ostrich-like, we can assert that we are long-term holders and needn't worry about intermediate declines when in pursuit of marginally higher yields, lulled to sleep by most private credit funds not marking positions to market or concerned about spread duration. (Maybe the enormous capital inflows to such investments have warmed the cockles of these executioners' hearts despite this and the covenant-light structures?) We wonder if the belief has become almost autarkic, economic independence with little need for any external assistance.

It is true, as Don Meredith, the first Dallas Cowboys quarterback, often noted: the opera "ain't over until the fat lady sings." Of course, his political incorrectness could never be repeated today. For us, we revert to not taking the risk of duration and instead grinding out a steady return. Easy to write, but what is the prescription?

Niche investing versus crowded trades floats our boat. We assert that most investors should deploy at least some of this in their portfolios. We continue to believe in alternative lending, which:

1. Remains capital shy
2. Requires borrowers to pay up and provide collateral
3. Has generally little correlation to equities and general interest rates
4. Offers sound diversification from the many flavors

We invest our own money in two portfolios - one is widely diversified and the other, in formation, is in hard asset lending secured by fine art.

Please take a squint at the attachment for more. All input from our readers is most welcome including dissent.

Happy Halloween, too!

Upcoming Events

See attached schedule of industry related events at which Shinnecock will be sharing more in-depth information and let us know if you'll be attending so we can look for you!



If there's somethin' strange
In your neighborhood
Who ya gonna call
GHOSTBUSTERS!

If there's somethin' weird
And it don't look good
Who ya gonna call
GHOSTBUSTERS!

“Who Ya Gonna Call”

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Blackrock's Investment Outlook

Asset		Five-Year Expected Return	Long-Term Expected Return	Long-Term Expected Volatility
Fixed Income	US cash	2.5%	2.0%	0.0%
	US Treasuries (all maturities)	2.4%	2.6%	4.9%
	US Treasuries (10+ years)	0.8%	3.4%	14.1%
	US inflation-linked Treasuries	2.5%	2.7%	5.9%
	US credit (all maturities)	2.8%	3.7%	5.9%
	US credit (long bonds)	2.1%	5.2%	12.0%
	US high yield	3.4%	4.8%	8.7%
	US aggregate bond index	2.7%	3.1%	4.6%
	Global ex-US Treasuries	2.4%	2.3%	3.3%
	USD EM debt	3.8%	4.9%	9.5%
	Local-currency EM debt (unhedged)	5.0%	4.1%	12.5%
	US bank loans	3.9%	3.5%	8.4%
Equities	US large cap	5.1%	6.0%	16.1%
	Global ex-US large cap	7.4%	6.4%	17.3%
	US small cap	4.9%	6.0%	18.3%
	EM equity	9.0%	5.9%	24.1%
Alternatives	US core real estate	5.1%	4.0%	14.8%
	Global private equity	7.0%	6.8%	23.9%
	Global infrastructure equity	6.0%	6.7%	17.9%
	Hedge funds (global)	4.0%	3.6%	7.6%
	Commodities	4.1%	3.2%	15.1%
	Global infrastructure debt IG	2.5%	4.1%	8.6%

BlackRock Investment Institute, August 2018. Data as of 30 June 2018

Ugly Results: Fixed Income in 2018

Asset	ETF	YTD (9/30/2018)	Duration (years)	Benchmark Index	YTD (9/30/2018)
US Investment-Grade Bonds	iShares Core US Aggregate Bond ETF (AGG)	(1.6%)	5.9	Bloomberg Barclays US Aggregate Bond Index	(1.6%)
	Vanguard Total Bond Market ETF (BND)	(1.7%)	6.2	Bloomberg Barclays US Aggregate Bond Index	(1.6%)
US Investment-Grade MBS	iShares MBS ETF (MBB)	(1.2%)	5.0	Bloomberg Barclays US MBS	(1.1%)
	SPDR Bloomberg Barclays Mortgage Backed Bond ETF (MBG)	(1.2%)	5.4	Bloomberg Barclays US MBS	(1.1%)
US Investment-Grade Municipal Bonds	iShares National Muni Bond ETF (MUB)	(0.7%)	6.1	S&P National AMT-Free Municipal Bond Index	(0.6%)
	Vanguard Tax-Exempt Bond ETF (VTEB)	(0.8%)	5.8	S&P National AMT-Free Municipal Bond Index	(0.6%)
US Treasury - 10 or more years to maturity	Vanguard Long Term Treasury ETF (VGLT)	(5.8%)	16.9	Bloomberg Barclays US Long Treasury Index	(5.8%)
	SPDR Portfolio Long Term Treasury ETF (SPTL)	(5.8%)	17.0	Bloomberg Barclays US Long Treasury Index	(5.8%)
US Investment-Grade, Fixed Rate, Taxable Bonds	Vanguard Total Corporate Bond ETF (VTC)	(2.4%)	7.0	Bloomberg Barclays US Corporate Bond Index	(2.3%)
Short-Term High-Yield Corporate Bonds	PIMCO 0-5 Year High Yield Corporate Bond Index	3.4%	2.1	BofA Merrill Lynch 0-5 Year US High Yield Constrained Index	4.2%

Is the Search for Yield an Impossible Quest?



- **Investors demand:**
 - Consistent yield now
 - Principal protection from the unexpected, whether rising interest rates or recession
 - Liquidity
 - Low correlation between investments (portfolio complement)
 - Cash income
 - Quality controls
 - Experienced and engaged manager
 - Simple
 - Cost efficient
- **Are we Don Quixote in a Zero Interest Rate Environment?**

Alternative Lending – What, Why and How



- **\$51 trillion rapidly growing global market serviced by “non-bank” financial institutions – Goldman estimate**
- **Traditional lenders hamstrung by bloated bureaucracies, dated technology, restrictive regulation and need to repair balance sheets**
- **Alternative lenders as distinguished from traditional banks:**
 - Do not accept deposits
 - Act as intermediaries, pooling loans
 - Provide a conduit between investors and borrowers
 - Enjoy a substantial cost advantage
 - Usually specialize in a particular niche

Enormous and High-Growth Market

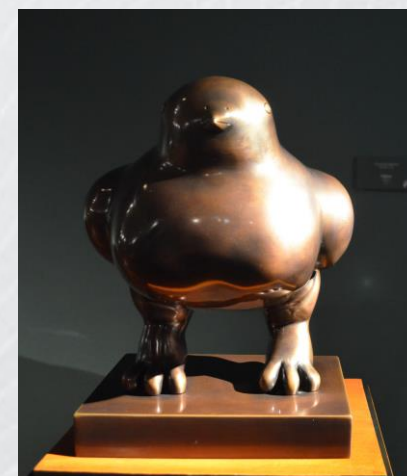


- **\$12 trillion in outstanding U.S. loans, including:**
 - \$843 billion in consumer loans
 - \$186 billion in small and medium business loans
 - \$832 billion in leveraged business lending
 - \$2.35 trillion in commercial real estate debt
 - \$1.17 trillion in mortgage originations
 - Over \$6.50 trillion in other loans (e.g. securitizations)
- **From these segments, approximately \$1.6 trillion is forecasted to move quickly to alternative lenders with annual net profits of \$11 billion for investors**
- **Global market in trade finance of \$18 billion**
- **Conning estimates a \$180 billion life settlement market... “a growing unmet need” and an “increasing opportunity”**

Alternative Lending Possibilities

- CLO Warehouse Lines
- Trade Finance
- Bridge Real Estate
- Life Settlements
- Specialty Finance – Lending to Loan Originators
 - Payday Lending
 - Merchant Cash Advance*
 - Point of Sale Finance*
 - Impact Lending in LDC's
- Film and other Royalty Streams*
- Corporate Debt
- Government Receivables
- Student Debt
- Cryptocurrency Margin*
- Fine Art-Secured Lending*

*See www.shinnecock.com for our research papers on these subjects



Fernando Botero
Pájaro



Niche Opportunity: Fine Art-Secured Lending

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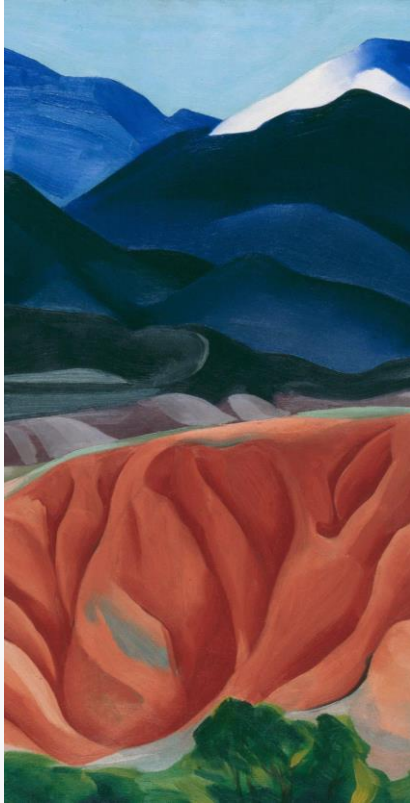
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What is Art-Secured Lending?



Art-secured lending is hard asset lending. Individual or multiple works of fine art are used as collateral to secure each loan.

Art dealers and collectors borrow against their art to:

- Fund art acquisitions/finance dealer inventory
- Pursue other opportunities

Taking out a loan instead of selling individual artworks allows borrowers to:

- Avoid taxes and transaction fees associated with sales
- Retain ownership and any appreciation in value

Georgia O'Keeffe

Black Mesa Landscape, New Mexico / Out Back of Marie's II, 1930

Investor Benefits

Attractive & Consistent Yield	<ul style="list-style-type: none">➤ 9% net return target
Short Duration	<ul style="list-style-type: none">➤ 6 - 9 months
Principal Protection	<ul style="list-style-type: none">➤ Loan-to-value target: 50%➤ Borrower financial guarantee
Uniquely Appealing Collateral	<ul style="list-style-type: none">➤ Generally appreciating asset➤ International market➤ Low correlation

Investor Benefits

Strong Collateral Protection	<ul style="list-style-type: none">➤ Senior loan➤ Lender possesses collateral
Immediate Diversification	<ul style="list-style-type: none">➤ Multiple positions across artists, genres, media, and borrowers
Liquidity	<ul style="list-style-type: none">➤ Quarterly after first year
Institutional-Grade Service Providers	<ul style="list-style-type: none">➤ Deloitte, auditor➤ SS&C, administrator➤ Cash custodian

Conclusion

We believe alternative lending is the best available yield investment on a risk-adjusted basis today. It offers an uncorrelated complement to a diversified investment portfolio.

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Upcoming Events

Shinnecock will be in attendance and/or speaking at the following events. We'd be happy to have you join us!

November 5-6 – New York

Agecroft Partners LLC – Gaining the Edge: Hedge Fund Investor Leadership Conference

The Roosevelt Hotel

45 East 45th St., New York, NY 10017

For information and registration: <https://www.apgainingtheedge.com/2018-hedge-fund-conference>

November 5-6 – New York

2018 Beryl Elites Alternative Investment Conference – Emerging Technology and Alternative Data

The Cutting Room

44 East 32nd St., New York, NY 10016

For information and registration: <https://berylelites.com/artificial-intelligence>

November 13 – Santa Monica

Family Office Connect West 2018

Shutters on the Beach

1 Pico Blvd., Santa Monica, CA 90405

For information and registration: <https://partnerconnectevents.com/focw2018/>

November 28-30 – Dana Point

Opal Group Marketplace Lending & Alternative Financing Summit 2018

Monarch Beach Resort

1 Monarch Beach Resort, Dana Point, CA 92629

For information and registration: <http://opalgrou.net/conferences/#finance-group>

***Friends of Shinnecock enjoy a 20% discount on registration using code: 20SHINEMPL2018**