High Yield Credit and Infrastructure: Quasi equity-like Returns with Fixed Income-type Risk

By Conway Williams Prescient Portfolio Manager, *Michelle Green Prescient Credit Analyst

August 2024

Traditional investment strategies face mounting macroeconomic and geopolitical challenges in today's investment landscape. With this in mind, we at Prescient Investment Management have had to, and continue to, leverage innovative approaches to achieve robust returns. An example is our particular areas of interest, high-yield credit and infrastructure investment, where we have focussed considerable energy on identifying the opportunities available to investors.

These two asset classes stand out from conventional investment options, offering quasi equity-like returns but with fixed income-type risk. This strategy is particularly compelling in the current environment of elevated interest rates, which has proven a boon for investors across these strategies.

While high interest rates can suppress equity performance for many reasons, they present a unique opportunity for high-yield or private debt investments. We have seen that in such environments, equities tend to underperform due to higher borrowing costs and reduced corporate profits. However, high-yield and private debt tend to deliver better value as investors are compensated with attractive yields on the capital they invest. Simply put, elevated rates mean that borrowers are required to pay a premium to access funds, translating into enhanced returns for our investors.

At Prescient Investment Management, we employ a considered approach to asset selection, ensuring that every investment aligns with our standards. Our team carefully evaluates credit assets, considering the full risk spectrum across the capital stack. This comprehensive analysis allows us to structure investments, optimising returns while managing risk effectively. Moreover, we include investor protections that are not always available in the listed market. These protections encompass reporting obligations, financial and non-financial covenants, and where applicable, observer status at the board level. This proactive engagement allows us to be at the coalface, staying up to date with developments at the borrower level, and monitor our investments appropriately, while ensuring that we earn robust returns for our investors.

Our position is further strengthened by our dedicated and experienced origination team. Unlike many traditional funders who rely solely on desktop analysis, our team is actively on the ground, identifying and assessing potential opportunities firsthand. This proactive stance allows us to uncover high-quality assets that conventional financiers may overlook.

Further, a key differentiator in our strategy is how we structure our deals. While we earn steady coupons, we also structure our investments to include kickers, namely additional returns that come into play as the businesses we fund grow and succeed. This alignment of interests ensures that as our portfolio companies thrive, so do our investors.

Our approach is tailored to look beyond the conventional, seeking out opportunities that traditional funders might dismiss. We focus on smaller ticket sizes and move swiftly, targeting high-quality borrowers who may not attract attention from larger banks or traditional financiers. Employing a partnership approach and our agility allows us to seize opportunities promptly and negotiate attractive rates that benefit our investors.

In this vein, one of our core advantages is our willingness to take the "first risk." By considering and then investing in profitable businesses with adequate track records but with fewer funding options, we position ourselves to earn higher returns compared to investing in more mature companies with abundant access to financing sources. This first-risk approach means we are often the initial or primary funder, capturing the significant upside potential that comes with early involvement. This strategy not only yields superior returns but also allows us to build strong relationships with promising companies from the ground up.

It goes without saying that the current market conditions have created a significant funding gap, particularly in the lower and middle-market segments of the South African economy. These companies, often underserved by traditional financial institutions, present a robust pipeline of opportunities across our investment strategies. By providing loans to these businesses, we tap into an asymmetric risk/return profile—where the potential upside far outweighs the downside risk.

Our investments are not only financially rewarding but also strategically advantageous. By funding these companies, we support economic growth and development in segments that are crucial for the broader economy yet often neglected by mainstream financiers. This approach has resulted in consistent outperformance of our Prescient Infrastructure Debt Strategy and our Prescient Clean Energy and Infrastructure Debt Strategy.

Prescient Investment Management's approach to this alternative debt segment is unique. It offers a compelling proposition for investors seeking robust or quasi-equity-like returns but with the characteristics of fixed income-type risk. In an environment of elevated interest rates, we believe that our strategies are compelling, as they can capitalise on the unique opportunities a particular market segment presents. Through careful asset selection, proactive origination, and innovative deal structuring, we consistently deliver superior returns while managing risk effectively. Our commitment to exploring opportunities beyond the traditional funding avenues ensures that we remain at the forefront of investment innovation, driving growth and returns for our investors.

Ends

Disclaimer:

- Prescient Investment Management (Pty) Ltd is an authorised Financial Services Provider (FSP 612).
- Please note that there are risks involved in buying or selling a financial product, and past performance of a financial product is not necessarily a guide to future performance. The value of financial products can increase as well as decrease over time, depending on the value of the underlying securities and market conditions. There is no guarantee in respect of capital or returns in a portfolio. No action should be taken on the basis of this information without first seeking independent professional advice. *Representative acting under supervision.
- This document is for information purposes only and does not constitute or form part of any offer to issue or sell or any solicitation of any offer to subscribe for or purchase any particular investment. Opinions expressed in this document may be changed without notice at any time after publication. We therefore disclaim any liability for any loss, liability, damage (whether direct or consequential) or expense of any nature whatsoever that may be suffered as a result of or which may be attributable directly or indirectly to the use of or reliance upon the information. For more information, visit www.prescient.co.za