Lead Left Interview – Tod Trabocco

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This week we chat with Tod Trabocco, Managing Director at Cambridge Associates LLC. Cambridge is a leading investment advisor to foundations, endowments, private wealth, and corporations worldwide.
The Lead Left: For Lead Left readers who may not know Cambridge Associates, could you give a brief introduction of the firm and your role in it?
Tod Trabocco: Cambridge Associates is a leading global investment firm. We work with 1,100 institutional investors and private clients around the globe to help build portfolios that maximize returns based on each client's unique risk expectations. We offer a spectrum of services to help clients meet their investment objectives, from acting as a fully outsourced investment office to providing stand-alone access to our world-class manager research platform.

I am a leader in the Credit Investment Group, which focuses on our credit manager coverage and provides specialized credit services to our clients. I specialize in private credit managers.

TLL: We know Cambridge is popular with a lot of our subscribers – direct lenders, mezz funds and CLOs, and other institutional investors.
TT: Those types of investors are at the core of our private credit research. We also research structured equity funds, distressed managers and specialty lenders, like those in the royalties or life settlement spaces, for example. But direct lenders of all stripes have really risen in prominence in the alternate investment universe. Private credit is emerging as its own asset class, with several distinct sub-strategies relevant to The Lead Left readers, including direct lending and mezzanine.
TLL: Direct lending has really taken off. How many managers have you seen since you joined?
TT: Since last November, I've personally met with or know of 31 managers raising a combined $22.4 billion. With one-to-one leverage, that's almost $50 billion. But that amount excludes all the SMAs, private BDCs and insurance affiliates who tend not to raise capital through CA.

TLL: And is investor demand keeping up with the supply of new managers?
TT: Many of those managers have just started fund raising, but as far as we can see they are not having problems raising money. Investors have been stung by hedge funds lately and are coming to grips with the new "lower for longer" paradigm. I don't need to tell you or your readers that private debt – such as direct lending funds – offer very attractive, low volatility yields that are inflation protected.

TLL: What are you advising your clients about direct lending?
TT: Direct lenders appear very similar on the surface, so we help our clients get past the similarities and dig down into what differentiates managers. Broadly speaking we look to leverage, platform, focus, risk and DNA. Let's quickly tick through these.

- Leverage: Some managers use more than others and some not at all. Certain investors are sensitive to the use of leverage.
- Platform: We see managers who are part of a larger platform, which can have its benefits with respect to underwriting, diligence, portfolio management and general oversight. Some investors may like that a

direct lending portfolio has to pass through an additional layer of review beyond the principals making the loans. Others are less sensitive.

- Focus: Some lenders have a target niche like healthcare, software, or unsponsored borrowers. The vast majority are generalists pursing a sponsor coverage model.
- Risk: We like to help our borrowers understand the true risk being assumed. A senior secured loan can have a 4% coupon or a 12% coupon. I submit that these can both be senior to other indebtedness and secured by a first claim priority pledge on collateral. I also submit that they likely carry different risks. The borrowers can vary dramatically by size and cash flow profile, so we like to segment lenders by borrower profile. Moreover, senior documentation and security can also vary widely. For example, a senior document can have no covenants. Collateral pools can be shared, with one lender taking intellectual property and leaving hard assets to another lender.

Finally, we try to drill down into the DNA of the individuals. We see teams that came from GE, Heller, and similar types of institutions as well as teams that come from leveraged finance desks at investment banks. Some of these teams have been through a cycle or two. Others have not.

There are other considerations, too, such as the level of participations and syndication, team size, infrastructure, etcetera. The important thing to take away is all of these styles can have a place in a portfolio and no singular niche, risk profile or organization is necessarily good or bad. We just want to make sure that our clients understand their GPs as best as possible.

TLL: What's been your firm's experience in terms of hurdles to fundraising?
TT: There are three obstacles that I can see. First, investors are still looking for a home for private credit and direct lenders in particular. Some institutions are carving out private credit buckets, but many are not. Do they belong in fixed income? Well, most lock-up structures are too illiquid to qualify. Should they be in alternatives since they're illiquid? Of course! But then where do you put them? Private equity? Special situations? These are the types of questions we are helping investors resolve. Recently foundations and endowments have been showing interest in the asset class. We have also helped some clients re-allocate from fixed income and hedge funds to direct lending. So things are changing.

Second is benchmarking. In the past, it was enough for direct lenders to benchmark against the LSTA (Loan Syndications & Trading Association) flow names or a high yield bond index. Now, with all the new funds out there, investors are asking for a specific manager benchmark. By the way, this helps with the first problem and shows the asset class is maturing.

Finally, as you know, credit is a much more complex marketspace than fixed income, yet many investors assume it is straightforward. This is something we aim to educate our clients on, through our Credit Investment Group's dedicated research team and analysis, and insights from portfolio managers who work with meaningful or dedicated credit allocations.

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