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INVESTMENT MANAGEMENT

In the Search for Yield with Low Duration, Alternative Lending Delivers

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2020 provided a stark stress test for alternative lending—and the nascent asset class delivered, generating strong performance and strengthening our conviction in its resilience. In response to COVID-induced economic shutdowns, alternative lending platforms tightened credit standards, decreasing underwriting volumes and increasing borrower selectivity, while also increasing borrower interest rates.

Entering 2021, the economic and health impacts of the COVID-19 pandemic remain acute. While we are tracking progression of the mutating virus closely, we are excited by the forward-looking opportunity set within alternative lending. Fiscal transfers and a dearth of opportunities to spend have left consumer balance sheets very well-positioned in aggregate. Per Morgan Stanley Research, pandemic-induced unemployment has cost U.S. households $400 billion in lost wage income, but that has been more than offset by over $1 trillion in transfers[1]—even before deployment of the additional stimulus rounds approved in December 2020 and March 2021. The U.S. personal saving rate spiked to record-high levels early in the COVID pandemic and remains very elevated.[2] Households have accumulated $1.5 trillion in excess

[1] Source: Morgan Stanley Research "Sunday Start | What's Next in Global Macro: The Coming High Pressure Economy," Chetan Ahya

[2] https://fred.stlouisfed.org/series/PSAVERT

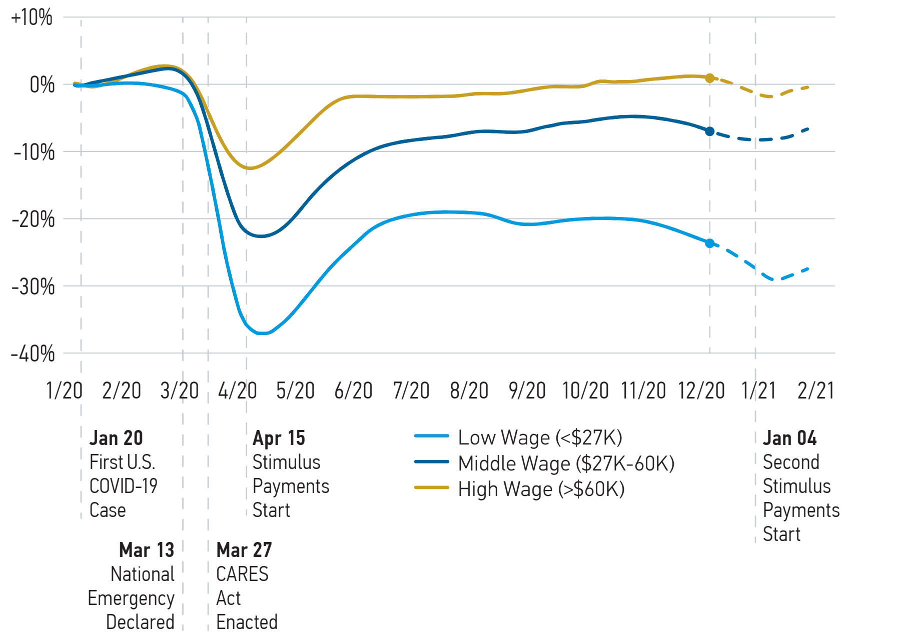
savings, which Morgan Stanley research expects will rise to $2 trillion (9.5% of GDP) in March.[3] Furthermore, U.S. household debt declined significantly relative to GDP between the start of the 2008 financial crisis and the start of the COVID crisis, which contrasts with aggressive re-leveraging undertaken by corporations following that crisis.

While consumer balance sheets are well-positioned in aggregate, the economic impacts of COVID-19 are far from evenly distributed. Low wage workers *(Display 1)* and workers in specific industries *(Display 2)* have borne the brunt of job losses. Returning to full employment will take time, but accelerating vaccinations portend rapid rebounds in COVID-sensitive industries. When combined with coordinated fiscal and monetary policy, we see ample scope for continued labor market tightening.

Even absent further tightening, we believe that the types of U.S. consumers taking alternative loans represent compelling credit risk. As mentioned previously, alternative lenders generally increased borrower selectivity last year to account for the unique risks posed by COVID economic shutdowns. Additionally, the employment rate for U.S. workers in the top wage quartile—above $60,000 in annual income—was actually higher in late 2020 than it was at the beginning of 2020.[4] Broadly speaking, higher wage workers managing some level of debt represent target borrowers for many consumer-focused alternative lending platforms. *(Display 1)*

DISPLAY 1

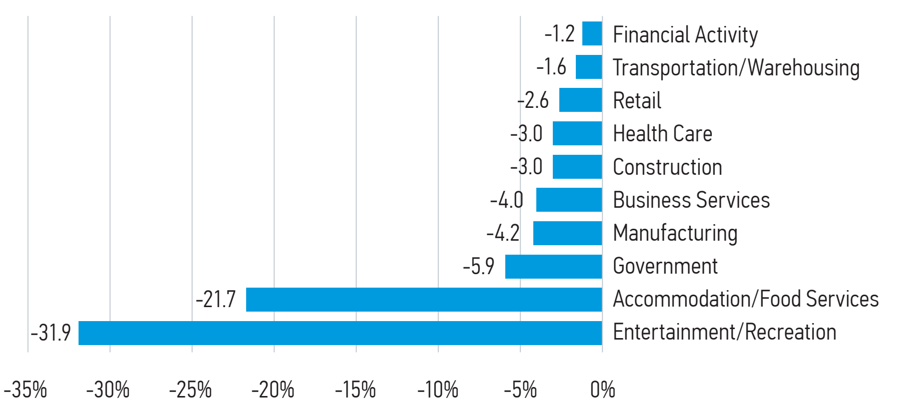
Cumulative Change in U.S. Employment (January 15, 2020 – January 31, 2021)



Source: tracktherecovery.org. Based on payroll data from Paychex and Intuit, worker-level data on employment and earnings from Earnin, and timesheet data from Kronos. The dotted lines are a prediction of employment rates based on Kronos data. Last updated March 1, 2021. Accessed March 10, 2021.

DISPLAY 2

Change in U.S. Payrolls (March 1, 2020 – December 31, 2020)



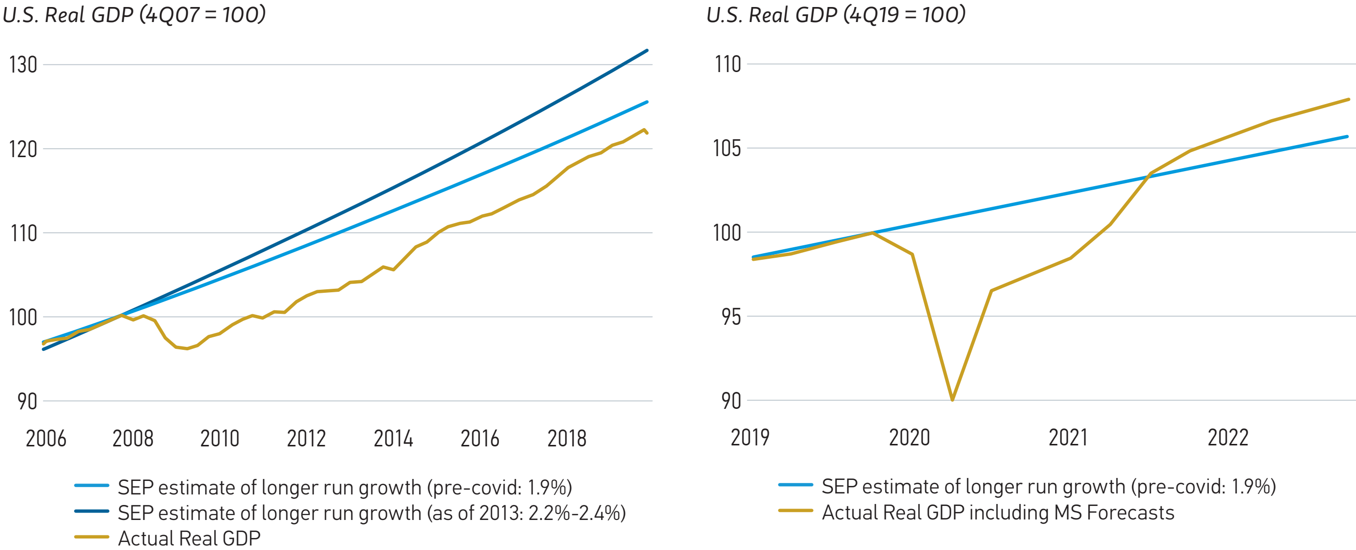
Source: Bureau of Labor Statistics, via https://www.bloomberg.com/news/articles/2021-01-22/biden-seeks-immediate-help-for-millions-as-big-stimulus-at-risk

[3] Source: Morgan Stanley Research "Sunday Start | What's Next in Global Macro: The Coming High Pressure Economy," Chetan Ahya

[4] Source: tracktherecovery.org. Based on payroll data from Paychex and Intuit, worker-level data on employment and earnings from Earnin, and timesheet data from Kronos. The dotted lines from November 15, 2020 to December 20, 2020 are a prediction of employment rates based on Kronos data.

DISPLAY 3

Comparison of GDP Recovery post-GFC to post-COVID



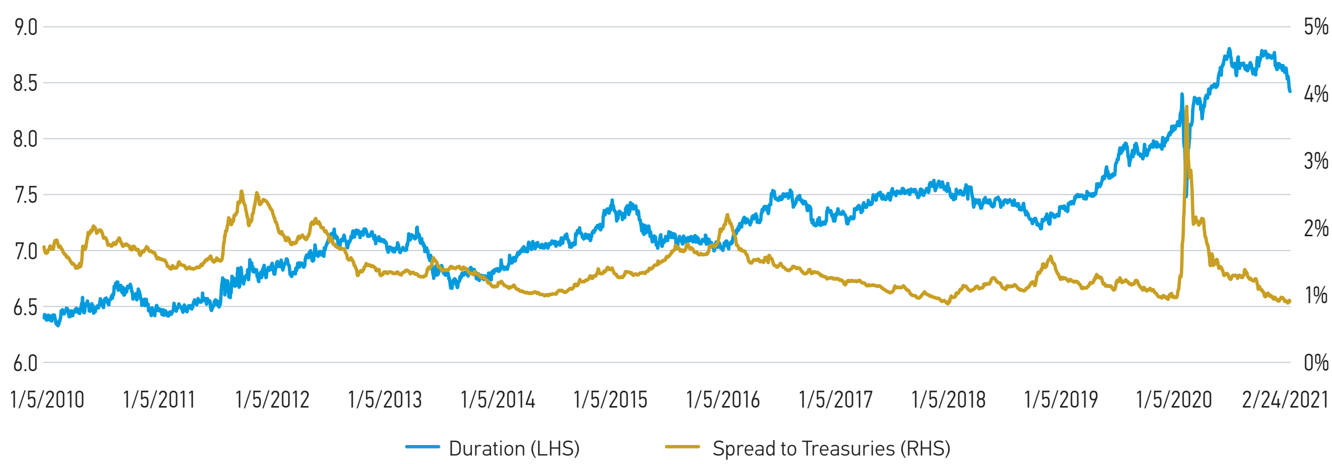
Source: Morgan Stanley Research "Sunday Start | What's Next in Global Macro: The Coming High Pressure Economy," Chetan Ahya

Looking ahead, we believe U.S. consumers stand to benefit considerably from rebounding U.S. growth. Morgan Stanley Research forecasts tremendously high GDP growth of 6.5% this year (7.6% 4Q/4Q) and 5% in 2022 (2.9% 4Q/4Q).[5] To put this into historical context, annual GDP growth last exceeded 5% in 1978.[6] High expected GDP growth suggests potential for a rapid rebound in GDP to *above* pre-COVID trend, which was never achieved following the 2008 Global Financial Crisis. *(Display 3)*

We believe these fundamentals bode well for alternative lending and make it a compelling investment option, particularly when compared to other types of fixed income. Alternative lending's yield and duration characteristics stand in stark contrast to

DISPLAY 4

Duration and Spread of Bloomberg Barclays U.S. Corporate Index



Source: Bloomberg, accessed February 25, 2021

[5] Source: Morgan Stanley Research "Sunday Start | What's Next in Global Macro: The Coming High Pressure Economy," Chetan Ahya

[6] Source: https://www.macrotrends.net/countries/USA/united-states/gdp-growth-rate

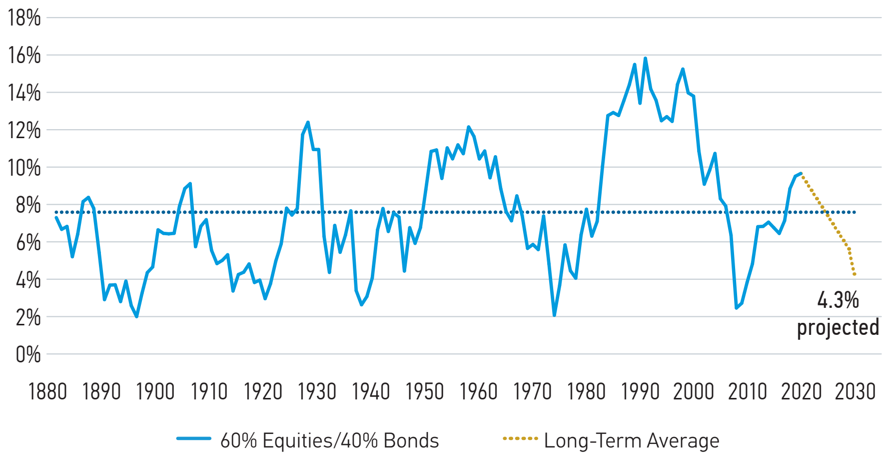
corporate debt. With investment grade duration extending to nearly nine years, meager corporate credit spreads over U.S. Treasuries provide limited compensation for the duration risk. *(Display 4)*

While we view alternative lending as a through-the-cycle allocation in well-diversified portfolios, we also believe that its attractive and rare combination of elevated yield, short duration and amortizing loan structures make it particularly attractive today, when forward return expectations for traditional assets are muted. *(Display 5)* Furthermore, with limited correlation to traditional asset classes, alternative lending represents a differentiated private credit strategy that can diversify both traditional fixed income and corporate private credit allocations.

2020 demonstrated fundamental resilience on the part of consumer borrowers. We believe it validated alternative lending's long-term value proposition.

DISPLAY 5

Expected Returns for Traditional 60/40 Portfolio Below Historical Average



* 60/40 portfolio is comprised of 60% U.S. equities (S&P 500) and 40% 10-year U.S. Treasury bonds.
Source: NBER, Jordà-Schularick-Taylor Macrohistory Database, Bloomberg, Morgan Stanley Research.
Note: Dotted line based on long-term expected return estimates.

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