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# Specialty finance: The next frontier of credit investing

**Resurgent inflation, looming interest rate hikes and stretched equity markets have left investors searching for new ways of achieving attractive portfolio yield and return.**

Specialty finance, a growing and innovative branch of private credit investing, may fit that bill for many portfolios. It has historically provided investors with exposure to strong risk-adjusted returns, high cash yields and less correlation to mainstream equity and credit markets.

Mackenzie Investments has partnered with Northleaf Capital Partners to bring accredited investors the Mackenzie Northleaf Private Credit Fund which incorporates specialty finance lending opportunities into its private credit portfolio.

## What is specialty finance?

Similar to leveraged lending to corporates, specialty finance is an essential form of financing to millions of businesses and consumers around the world. Specialty finance typically involves financing or investing in some form of privately held financial asset, usually one that generates a stream of income (such as royalties or other payments). Specialty finance can be broken down into three buckets:

### Consumer lending

**Examples:**

- Auto loans
- Student loans

### Commercial lending

- Small business loans
- Factoring arrangements
- Equipment financing

### Esoteric or niche lending

- Contractual income
- Royalty streams coming from underlying assets



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Esoteric or niche lending is one of Northleaf Private Credit's area of expertise. Northleaf focuses on originating and capturing income streams from assets and activities that most casual observers would not realize could be turned into an income opportunity.

Below we provide three examples of esoteric credit investing that Northleaf is actively exploring for client portfolios. Each one brings exciting opportunities amid what is expected to be a difficult environment for traditional fixed income investing.

### **Music royalties**

Many people are familiar with recording artists selling their back catalogues of music for large amounts of money. In 1997, David Bowie was one of the first artists to sell his old songs to outside investors. That transaction took the form of "Bowie Bonds," which offered a guaranteed return of 7.9% for 10 years, in exchange for an up-front cash payment to Bowie of US\$55 million. Since then, the practice of selling back catalogues of music has grown widely in popularity among many famous musicians and bands.

It's clear what's in it for the artist — a hefty up-front payment that can replace the grind of recording and touring — but what's in it for the buyers? In a word: royalties. Investors are attracted to owning the rights to music "in perpetuity" because those rights can generate a steady cash flow for as long as that music is played, anywhere. Radio stations, streaming services, movies and tv shows must pay a fee to artists every time one of their songs is played. Even if each play generates only a fraction of a cent, owning a large catalogue of popular music can generate a meaningful income stream.

In recent years, investor-led catalogue transactions have surged in popularity. One of the most prolific buyers of music rights is the Hipgnosis Songs Fund, a portfolio of over 60,000 songs that trades on the London FTSE under the symbol SONG. The Round Hill Music Royalty Fund has an even larger portfolio of 120,000 songs and also trades on the FTSE, under the symbol RHM.

Investing in music royalties is appealing because it can generate an income stream that is independent of typical stock and bond market dynamics. It can also be fun: who wouldn't enjoy hearing a song being played and being able to say: "Hey, I just made a bit of money from that"?

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### **Litigation finance**

Litigation finance involves funding a court case and then sharing in any monetary settlement that results from it. It focuses on both consumer and commercial legal disputes, where typically a smaller company or individual with limited resources has been forced to sue a larger company.

Litigation can be prohibitively expensive for individuals and small firms, which tilts the balance of power toward larger defendants. Litigation finance helps restore the balance by lending money to the plaintiff to initiate the court case (similar to a private credit relationship) or providing funding in exchange for a share of the settlement (similar to a private equity relationship).

Either way, the litigation finance provider will engage in advanced analytics and specialized diligence to increase their odds of funding winning cases. A portfolio of dozens or hundreds of court cases that vary by industry and geography can be a highly diversifying income stream for investors. It's also generally independent of the short-term direction of the stock market and actually counter-cyclical over longer time periods, as litigation tends to increase in times of economic weakness.

While the popular saying goes, "the only ones that win are the lawyers", litigation finance provides credit investors with a way to participate in a small piece of the action.



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## Health care receivables

Health care receivables refers to the sale, rental or lease of durable health care goods (including medical equipment) or the provision of medical services.

There can often be a delay between the delivery of those services (in a hospital, for example) and reimbursement for them. This is particularly the case in countries where health care services are delivered mainly by the private sector, and where funding for most of those services comes either from private insurance policies or government programs.

**Interest income from health care financing is almost completely independent of market factors, making this type of specialty finance another excellent portfolio diversifier.**

Specialized investors can provide financing to health care providers or consumers, thereby allowing equipment to be purchased and medical services to be delivered when needed, independent of the timing of reimbursement. Interest income from health care financing is almost completely independent of market factors, making this type of specialty finance another excellent portfolio diversifier.

## Specialty finance requires specialized skills

The most attractive features of esoteric financial assets include:



**Low correlation to economic cycles**



**Strong yields**



**Broad diversification of risk**

However, traditional banks are reluctant to lend to these niche segments of specialty finance, so this opens the door for skilled private lenders like Northleaf.

These structures are complex, however, and opportunities are difficult to access. That's where Mackenzie comes in, by partnering with Northleaf's experienced and dedicated team that has the expertise to originate and structure these complicated deals and integrate them into their private credit portfolios. Together, Mackenzie and Northleaf are making the benefits of specialty finance accessible to a much broader group of investors.



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**Contact your Mackenzie sales representative to find out more about the attractive yield and increased diversification potential of the Mackenzie Northleaf Private Credit Fund.**

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