

# Portfolio Update

## Kingsbridge's Portfolio of Home Equity Contracts – 1 Year Later

Innovative Strategy | Recession Mitigation | Low Correlation | Inflation Hedge

### The following article provides an annual update for year-end 2020 and an overview of the Kingsbridge Alternative Strategies Fund (KASF), which invests exclusively in Home Equity Contracts (HECs)

We begin by providing the latest update on the Fund's performance as of December 31st, 2020, including the net returns generated, as well as the growth of the Fund's portfolio in terms of both the number of active HECs and the Fund's assets under management (AUM). We explain why HECs have continued to perform well for investors in 2020 despite the coronavirus pandemic, and highlight the following investment attributes:

- Rising home prices throughout the year
- The stable nature of the owner-occupied US residential real estate market
- The built-in downside dampening built into every contract through a "risk adjustment"
- The low correlation HECs have with traditional asset classes, such as equity and debt
- High geographical diversification of homes included in the Kingsbridge Portfolio

We then look forward to 2021, a year in which securitization of HECs may be on the horizon, and the likely growth in the HEC market during the coming year due to the increase in home equity, the additional originators entering the space, and a bullish outlook for home prices.

## Portfolio Update

With interest rates at historic lows, the low yield environment of 2020 meant that it became a priority for investors to seek alternative sources of yield without having to invest in high-risk assets. With HECs, investors were able to gain exposure to a remarkably stable but previously inaccessible asset class: Owner-Occupied US Residential Real Estate.

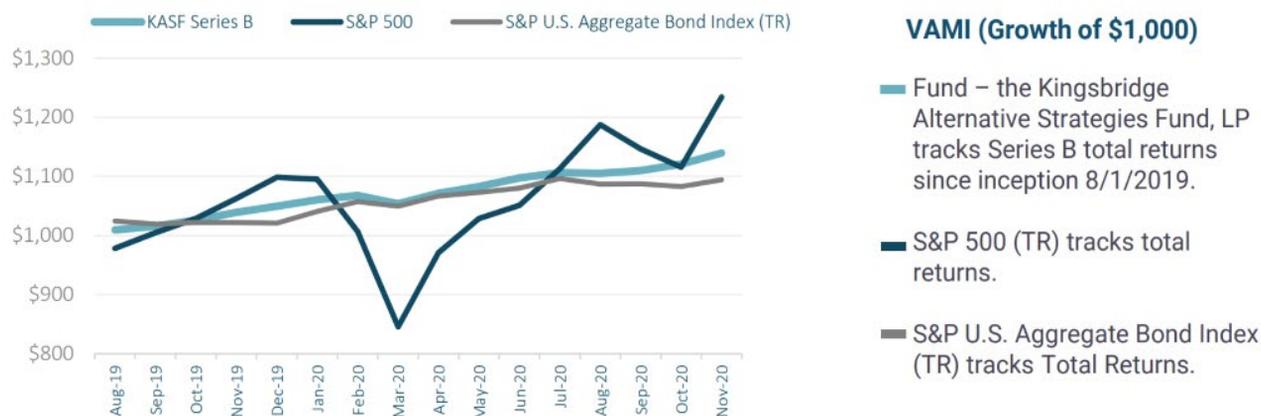
The HEC itself is a structured option purchase contract on residential real estate, with dampened downside participation and accelerated upside participation, secured by a performance deed of trust on an owner-occupied residential home in the United States.

Although financial markets as a whole were impacted during 2020, HECs represented one of the very few asset classes to generate stable, largely positive returns with muted volatility. The Kingsbridge Alternative Strategies Fund (KASF), which invests in HECs to maximize risk-adjusted returns with low downside risk, generated a positive, **unlevered net return of 9.59%\*** for 2020. The Fund's compound **annualized return of 10.38%** (since Series B inception 8/1/2019) fell firmly in line with our targeted returns for the year.

*\*Series B, unaudited returns for 2020*

## Portfolio Update (continued)

Since Series B inception on 1st August 2019, the Kingsbridge Alternative Strategies Fund returns have landed between the S&P US Aggregate Bond Index and the S&P 500 Total Return, all the while exhibiting an **annualized standard deviation of 2.44%**. Although the S&P has ended up generating higher returns over the last decade, it has come at the cost of substantially more volatility, not least in March 2020 when stock markets dropped all around the world.



**Value added monthly index (VAMI) since KASF inception in August 2019**  
(As of 12/31/2020 for Series B)

The Kingsbridge Alternative Strategies Fund's portfolio of Home Equity Contracts exhibits a Sharpe Ratio of 4.27, representing the attractive risk/reward tradeoff that investors in the Fund have received since inception.

	Annualized Total Return	Standard Deviation	Sharpe Ratio **
*S&P 500 TR (10 year)	11.19%	13.55%	0.81
*AGG (10 year)	3.67%	2.97%	1.03
*KASF (08/01/2019)	10.38%	2.44%	4.27

When compared with the S&P 500 TR and an index of U.S. Aggregate Bonds (NYSE: AGG), it becomes apparent that Home Equity Contracts are an attractive risk/reward tradeoff:

The Kingsbridge Alternative Strategies Fund (as of 12/31/2020) also continues to exhibit a low correlation to public equity and debt markets, with **weak R-Squared values of 0.43 and 0.25** recorded in December for the portfolio's performance against the **S&P 500 TR and the S&P US Aggregate Bond Index respectively**. Not only does this further underline the excellent source of alternative yield offered by HECs, but also their appeal to investors seeking investments to diversify their portfolios.

Over the course of the year, there were two portfolio markdowns, in March and August, of -1.33% and -0.13% respectively. These can be attributed to changes in the inputs of the probability-weighted option-pricing model used to value the portfolio. As is best practice, the portfolio is valued on a monthly basis by an established third-party valuation firm, which utilizes multiple option pricing models and inputs to value the HECs. These factors may vary depending on economic indicators even though the underlying value and structure of the HEC remain unchanged.

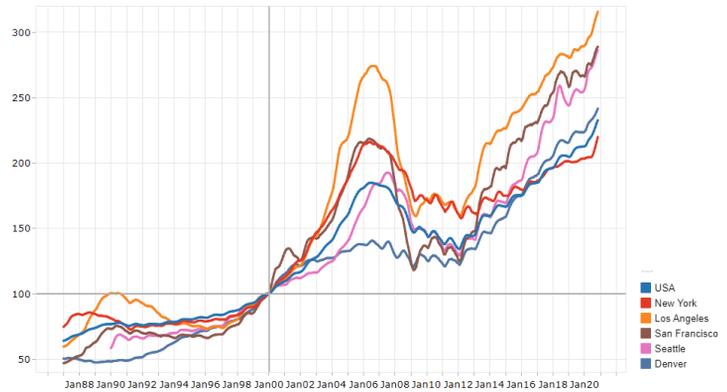
*\*Past performance is not indicative of future results. A 10-year period of volatility for the indexes is used in this example to account for the long-term volatility of the public markets. The statistics of the Fund include data between 8/1/2019 – 12/31/2020. This period of time has been disproportionately volatile compared to the long-term track record of public markets and may not adequately represent long-term volatility. An investment in the Fund, like all investments, contains risk including the risk of total loss, and may not be appropriate for all investors. S&P 500 TR & AGG data gathered from Morningstar through time period 1/31/2011 – 1/31/2021.*

*\*\*Sharpe Ratio assumes  $r_f = 0\%$*

## Portfolio Update (continued)

The Kingsbridge Alternative Strategy Fund's performance is especially formidable given the pronounced economic shock experienced in the US last year. These strong results can mainly be attributed to the many appealing features HECs offer to investors. For the investor who receives an equity-like participation in the home, positive returns are generated as the value of the home rises. With home prices consistently rising during 2020, investors were well compensated for their risked capital. Indeed, the performance of the broader residential real estate market during the pandemic has yielded strong positive returns. Home prices rose by 6.7% between January and September, with the price appreciation only gathering more pace in the latter months.

*Case-Shiller Home Price Index,  
January 2000 Home Prices = 100*



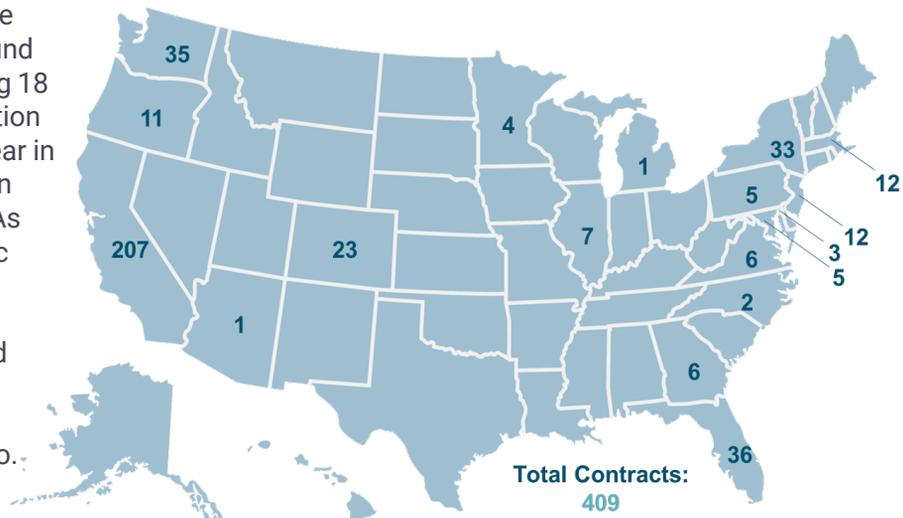
The Contracts in the Kingsbridge Portfolio have a built-in structural downside "dampening" which, as of December 31st, 2020, provided an 18.86% discount to the fair value of the home, on average. This helps to significantly mitigate any severe adverse home price movements stemming from such scenarios as a deep recession, although this did not transpire in 2020.

*Source: S&P CoreLogic Case-Shiller Home Price Index*

Nonetheless, this discount was changed by some HEC originators during the year, particularly in April (not long after the pandemic reached the US) and there was considerable uncertainty surrounding the outlook for the housing market. With the origination process slowing and being transformed to a highly digitized process, certain contract buyers insisted that the discount risk adjustment be changed to reflect this uncertainty. Ultimately, this risk did not materialize in 2020.

Another attractive feature of the HECs held within the Kingsbridge Alternative Strategies Fund is their broad geographical diversity, covering many of the top biggest metropolitan statistical areas (MSAs) in the country.

As of December 2020, the homes underpinning the HECs held within the Kingsbridge Alternative Strategies Fund are located across 70 MSAs, covering 18 states in total. This broad diversification has been important during 2020, a year in which COVID-19 has impacted certain MSAs and states more than others. As such, it means that had the pandemic created pronounced bearish housing market sentiment in one particular MSA/state, it would not have inflicted significant damage on the overall performance of the Kingsbridge Alternative Strategies Fund's portfolio.



## Portfolio Update (continued)

As for the homeowner, the lack of a monthly payment requirement (which is required with debt financing solutions), coupled with control over when to exit the contract – typically either 10 years or 30 years – provides much needed flexibility to endure challenging times.

With HECs offering broad appeal to both homeowners and investors, it is no surprise that the Kingsbridge Alternative Strategies Fund experienced growth during 2020. The number of active HECs within the Fund increased from 343 to 409 over the course of the year, while the total value of all contracts grew from \$32.3 million to \$45.6 million over the same period. Total assets under management (AUM), meanwhile, grew from \$41 million to \$51.7 million during this time.

## Investment Instrument Update

In a bid to appeal to a broader cross section of investors with varying risk and return profiles, we expect to securitize a portion of our portfolio of HECs during the first half of 2021. We believe this milestone will bring awareness and recognition of this new asset class, while also addressing the concern of illiquidity and duration risk for the Kingsbridge Alternative Strategies Fund portfolio.

## Additional Originators

New Home Equity Contract originators are stepping up to meet the increasing demand for Home Equity Contracts. In addition to the Kingsbridge Alternative Strategies Fund's primary originator, Point Digital Finance, several other originators are entering the space. Several originators have sprung up across the country, with more expected to follow:



## Conclusion

We anticipate that the demand for HECs will continue to be strong throughout the year. As the pandemic continues to sow uncertainty across most financial markets, HECs remain set to offer an attractive risk/return profile for investors in 2021. For those investors who have been waiting on the sidelines to assess the real-world merits of HECs, the Kingsbridge Alternative Strategies Fund's strong performance in 2020 represents a compelling illustration of the strategy's potential.

With interest rates likely to remain at historic lows throughout 2021 and beyond, the demand for homes appears to remain buoyant for the coming year. With housing supply still constrained, home prices are forecasted to continue rising for the next year. "In 2021, I think demand, work-from-home demand for larger-sized homes, will continue," according to in the words of Lawrence Yun, chief economist for the National Association of Realtors, who predicts US home prices will rise by 3% in 2021.

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