



## Making a list

### Opportunities abound as listed credit hedge funds start to reappear

Credit hedge funds have a plethora of opportunities open to them if they are savvy enough to exploit them. Europe's largest hedge fund manager, Brevan Howard, is widely understood to be planning to list a fund in December and there are already signs that others are following suit.

George Tintor, md at Schwartzkopff Partners, notes that Brevan Howard's move could constitute a changing tide. He says: "I am not aware of anyone since 2007 who has listed a vehicle which is investing in credit or structured credit. There were relatively few closed-end funds prior to 2007 and of those a number did list. [Now] Brevan Howard announced last week that they will list a vehicle."

Another of the UK's largest hedge funds, CQS, is also understood to be readying a new fund for a public offering. Meanwhile, New York-based Avenue Capital Group has filed a prospectus with the US SEC as it plans to raise and list a fund of its own. Whereas Brevan Howard is looking to list its existing Credit Catalyst fund, the CQS and Avenue listings would be brand new funds.

The timing may be hard to beat. Tintor says: "Now is absolutely a good environment to launch a new hedge fund in because the market is large, illiquid and inefficient. However, whether a new manager can pull it off is another matter."

He continues: "With credit and structured credit having such negative connotations right now, it would be difficult – but that just makes the opportunities all the more attractive for existing managers, because there is less competition among hedge funds."

Despite the difficulties, Loic Fery, managing partner at Chenavari, agrees that the current market presents good opportunities for credit hedge funds. He says: "There are a lot of opportunities in synthetic credits – either straight or for portfolios – and through that there is a lot of secondary offering at the moment. There is a lot of demand for picking up complex assets, or good assets packaged in a complex way. Often at the moment prices do not reflect the quality of the underlying."

He adds: "In structured credit we have a fund called Toro Capital I, which has returned 3x investment in less than 18 months. That is still running and we currently have US\$260m of assets. There are still opportunities, but you need to be extremely cautious."

What those opportunities are now has shifted. Tintor explains: "The opportunities in early 2009 were a no-brainer. For example, you could pick up single-A CLOs in January that could have

100% defaults and 30% loss severity and still get your money back. That's how ridiculously cheap they were. You could just buy indiscriminately."

He continues: "Today, the indiscriminate 'beta' trade is over, but there is still such a broad dispersion of prices that one can still find specific securities with outstanding return-risk characteristics."

Tintor believes the US and European RMBS and CMBS markets still provide the main prospects for credit hedge funds. Although CMBS requires additional fundamental credit analysis, he says that relatively small, unique CMBS makes for particularly attractive possibilities.

Aside from the MBS markets, Tintor suggests that corporate synthetic tranching credit instruments are also attractive. He notes: "The best opportunities clearly are still relative value. Our advice now is to go with relative value managers, because relative value opportunities are more abundant than long-only in this environment."

It is understood that Brevan Howard's listed fund will trade across corporate and asset-backed credit markets. The Avenue fund will invest at least 80% in leveraged unsecured high yield debt and structured products, including CDOs.

How well the listed funds will perform remains to be seen, but Tintor stresses it is vital that any credit hedge fund looking to operate learns the lessons of the last few years, especially after the hubris of 2006 saw many quickly fall by the wayside. He says: "Back then everybody knew subprime was going to blow up, so we were asking managers what they would do when liquidity dried up and prices dropped. We asked if they were putting on short positions – either portfolio shorts or security-specific shorts."

He adds: "Some managers were, but others felt confident that their portfolios were strong enough to withstand a market shock. 'Short duration', 'high credit enhancement' and 'favourable structural features' were some of things we heard, and a lot of people underestimated how far the market would drop. Sure enough, all of these people got wiped out because the drop was more extreme than people expected."

Fery agrees that it is a mistake to go long-only. He says: "What is attractive at the moment is being a long-short credit fund. Most people think the good opportunities are on the long side. We are credit-spread neutral, so our job is to beat both the long opportunities and the short opportunities. It is true there are very attractive longs, but there are also attractive shorts."

Tintor concludes: "The funny thing is listening to a few long-only folks today and hearing exactly what we heard back in 2006 about how their securities are well credit enhanced and are short-duration. When I talk to them, I say to myself, 'I have seen this movie before.' Will the market drop 50 points like it did back then? I do not know, but these are uncertain times and anything can happen."

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