> Byron Capital Partners:

Providing Liquid and Regulated Absolute Return Investments

BYRON CAPITAL PARTNERS

Byron Capital Partners, a London-based boutique alternative asset manager, has adapted to the post-financial crisis environment by answering investor demand for regulated, onshore absolute return solutions. With their liquid alternatives focus being on absolute return fixed income and relative value credit, Byron Capital Partners aims to provide investors with strong risk-adjusted returns in a low yield environment. Nearly four years on from launching the first UCITS Fund (Undertakings for Collective Investment in Transferable Securities), the company remains optimistic on the outlook for both the investment strategy and sector.

The financial crisis of 2008 marked an inflection point for the hedge fund industry. Faced with significant losses of principal, restricted access to capital through gates and side pockets and even exposure to fraud in some cases, investors have become significantly more risk averse. As a result there was a flight to size in the alternative investments industry with post-crisis investors allocating capital to large multi-strategy hedge funds with substantial amounts of assets under management and significant operational reach with institutional infrastructure. Boutique names in the alternative investments industry have been forced to revisit business models in order to remain competitive against a backdrop of increased regulatory pressures, zero interest rate policy across most of the developed world and a demand from investors for funds to be more investor friendly, specifically providing enhanced transparency, stronger risk management, better liquidity and more favourable or flexible terms. It is against this backdrop that Byron Capital Partners has refocused to excel in the niche of UCITS absolute return fixed income and relative value credit.

NEGATIVE YIELDS

Alternative investments are increasingly on the radar of both institutional and retail investors as traditional classes – such as equities and bonds – are generally regarded as expensive, certainly from a cyclical perspective and even from a historical view. Yields on 10-year German bonds dipped below 1% in August 2014. This barely results in a positive real return even with an investment maturity of 10 years. That same month, the yield on the German 2-year actually went negative (having first turned negative in 2012).

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Negative yields on short term sovereign debt is not solely a German-phenomenon. In early September 2014, French 2-year government bond yields turned negative, as they have already done in Germany, The Netherlands, Austria, Finland and Belgium. Even more remarkably, in early September 2014, the yield on 2-year Irish sovereign debt turned negative for the first time, not even four years on from receiving a EUR67.5 billion bailout from the EU and IMF.

With short term rates negative, investors are being forced to take additional duration and credit risks to pick up yield. When Ireland issued EUR5bn of 10-year debt in 2013, it attracted in excess of EUR12bn in orders. Greece, after announcing the world's largest sovereign debt restructuring in history in 2012, returned to the markets in April 2014 issuing EUR3bn of a euro-denominated five-year bond. An order book of EUR20bn drove yields down to a remarkable 4.95%, despite Greece's poor credit rating (Caa1 from Moody's and B-/B from S&P) and a debt-to-GDP ratio of 175%. Even emerging markets are benefiting from record low bond yields in the developed world: Ecuador, which defaulted as recently as 2008 and 2009, sold $2bn of 10-year US Dollar-denominated bonds at 7.95%.

ABSOLUTE RETURN STRATEGIES

This dearth of yield is forcing traditionally conservative investors to look at absolute return strategies and diversification for their long-only allocations in an overall portfolio context. However, given the well-documented problems experienced by hedge fund investors in 2008, in the post-crisis, more regulated environment of today, many investors are looking at solutions that provide enhanced investor protection.

UCITS-compliant vehicles address some of the more prominent concerns of investors that have arisen since the financial crisis including, amongst others, liquidity, custody of assets, regulation, transparency and risk management. Liquidity is particularly valued by investors following the financial crisis. Most offshore hedge funds offer monthly or quarterly redemption frequencies but under UCITS legislation, funds are compelled to offer redemptions at least with a bi-monthly frequency with most offering daily or weekly liquidity. Both in and outside of Europe, the UCITS directive has evolved into one of the most widely recognised regulatory frameworks of

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investment funds, allowing investors to access absolute return strategies through UCITS-compliant onshore structures while obtaining increased transparency and liquidity.

Portfolio concentration limits that form part of UCITS restrict the ability of the investment manager to take large idiosyncratic exposures and reflect one of the principle concepts of UCITS, namely diversification. Adherence to these portfolio concentration limits, such as the well known 5/10/40 rule are monitored by the trustee and have to be respected by the investment manager. Exposure limitations are also in place: For example, no more than 20% of net assets can be invested in cash deposits with any one credit institution and the maximum exposure to a single OTC derivative counterparty is 5% (increasing to 10% for certain credit institutions). Leverage is also limited to 10% of net assets and can only be used for short-term liquidity purposes.

BYRON FIXED INCOME ALPHA FUND (BFIAF)

Byron Capital Partners launched the UCITS-compliant Byron Fixed Income Alpha Fund in November 2010 to respond to traditional fixed income investors' requirements to look for uncorrelated sources of return to global bond indices. Faced with an ultra low yield environment, some asset allocators favour a move into equities. However, equities as an asset class are not cheap and are more volatile than fixed income. For example the S&P 500 since 1972 has fallen on 27 occasions by at least 7%. For some investor groups such as private individuals – still affected mentally by losses incurred since the financial crisis – the risks posed by equities (in spite of recent very low levels of volatility) are too high. Demographics

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in the western world also favour fixed income as an asset class.

This year the Byron Fixed Income Alpha Fund is up approx. +4.07% for the year through September 4, 2014. Despite negative predictions at the start of the year for fixed income, 2014 at the time of writing has been a good year for fixed income with the Barclays Global Aggregate Bond Index up +3.46% for the year to date through September 4, 2014. 2013 on the other hand was a poor year for fixed income with the same index registering a decline of 2.6% and investment grade bonds suffering their worst year since 1994, registering their first annual loss since 1999 (only the third time in 34 years the asset class finished the year in the red). Long duration bonds suffered even heavier losses in 2013, with the Barclays US Treasury Index 20+ Years maturities returning -13.88%. In contrast the Byron Fixed Income Alpha Fund returned +3.47% in 2013. The ability to achieve alpha on the short side particularly manifested itself last year with gains being made in short US Treasuries that sold off as of May 2013 following Bernanke's taper talk: From May 2 to June 25, 2013, the yield on 10-year US Treasuries went from 1.63% to 2.59%, causing sharp losses in fixed income portfolios, as investors priced in stronger US economic growth and the withdrawal of Fed stimulus.

STRONG PERFORMANCE

Since the inception of the Byron Fixed Income Alpha Fund, credit risk has been tightly managed with the fund running an average credit rating of BBB. Duration has averaged approximately 2 and is currently standing at 1.8. Emerging market exposure is limited to 20% and while the fund has the ability to take sub-investment grade exposure, as per the prospectus, exposure is limited to 40%. These limitations serve the fund well as reflected by the recent sell off in high yield bonds with the Lipper High Yield Bond Index declining 1.29% over the month of July 2014.

In contrast, the Byron Fixed Income Alpha Fund returned +0.22% over the same month. Volatility of the fund since inception has remained low at approximately 2.2% resulting in a Sharpe ratio of 1.3. Importantly, the Fund produced a positive return in 2013, while many of its peers stumbled as of May 2013 following the taper talk outlined above. This followed on from a very strong performance in 2012 with a return of 7.43% with a volatility of 1.8%.

With short-term interest rates in the developed world likely to remain low for the foreseeable future, a premium will be put on the ability to generate positive real returns without exposing investors to excessive duration and credit risk, as well as illiquidity. Furthermore, with the demand for regulated liquid alternative investments increasing, particularly in Europe, Byron Capital Partners is set to profit from these developments. ❇

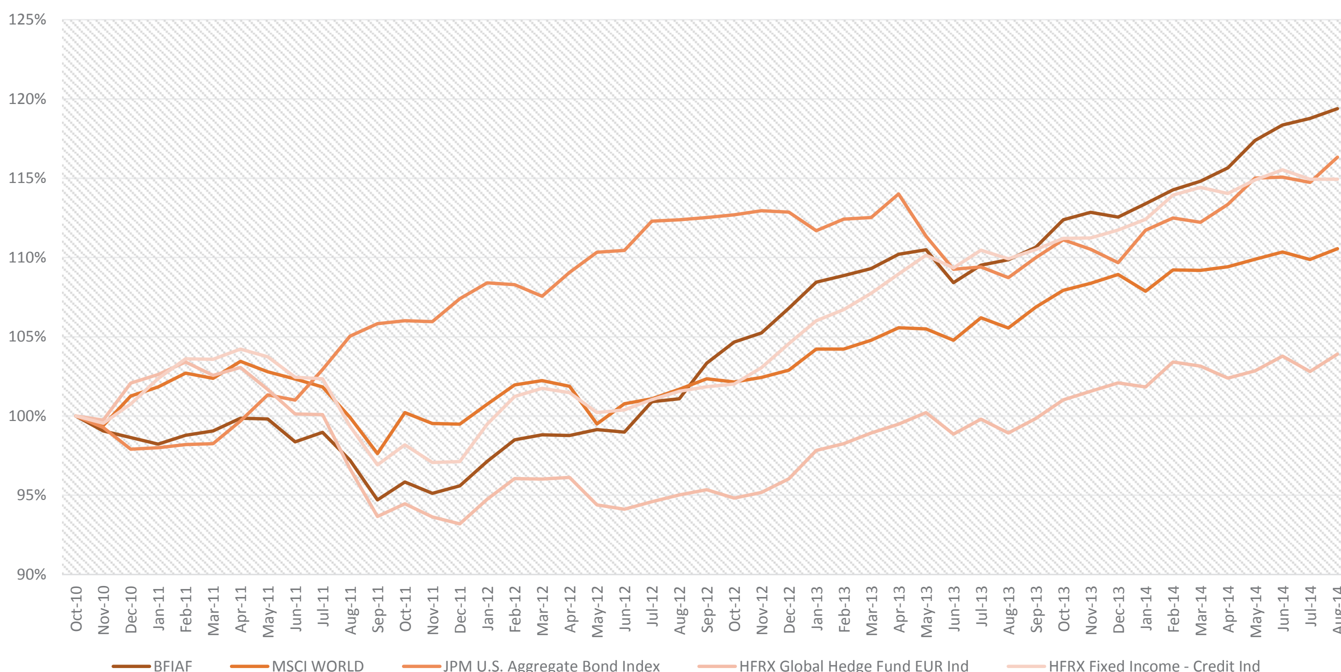

Chart 1: Risk Adjusted Returns