Best Performing Relative Value - Fixed Income (incl. Credit) Fund Byron Fixed Income Alpha Fund

BYRON | CAPITAL PARTNERS (CYPRUS)

Fund manager: Byron Capital Partners (Cyprus) Ltd.
Portfolio managers: Theo Costeas and Panos Choutris

Byron Capital Partners (Cyprus) was the first Cyprus-based manager to launch a UCITS umbrella fund, having taken the view that UCITS would increase in importance and likely become a cornerstone of the European fund management industry. The Irish UCITS is regulated by the Central Bank of Ireland. The Byron Fixed Income Alpha UCITS IV, which follows a core/satellite methodology to generate an efficiently optimized allocation, has generated most of its 7.43% returns in 2012 from credit selection. But it was risk-adjusted returns that secured the award, due to low volatility: annualising at 1.83%, this was even lower than the fund's 2.5% target level.

Portfolio manager Theo Costeas, who has eight years' experience in managing credit, says carry income now is running at about 4%, before fixed costs. Institutional-class fees are relatively low at 0.5% management and 5% performance. But carry is only one component of returns and should not be seen as a prediction of annualised returns. Last year most of the profits came from trading, with 72 out of 76 holdings profitable.

Although the JPM GABI can be seen as a loose benchmark, in contrast to traditional fixed income funds, the strategy has not shown any meaningful correlation to that index: between November 2010 and December 2012, the correlation coefficient of -1.05% was very close to zero. There is no limit on how underweight or overweight the fund can be relative to any component of the index. European credit is presently the biggest overweight, with Treasuries the biggest underweight. The managers' broad-based experience in global debt allows them to cast the net wide when searching for value. Right now the managers think that the rally in European credit has run its course. Better value remains in other global idiosyncratic opportunities. The managers are concerned that many securities with yields near all-time lows could be vulnerable. The tail-hedging programme can address these risks. Tail hedges can sometimes have a critical impact, due to spikes in volatility of certain asset classes. These hedges should have a high enough correlation with core holdings

Neil Griggs, Partner, Hedge Funds, BDO presenting to Theo Costeas, Portfolio Manager, Byron and Panos Choutris, Quantitative Analyst, Byron

to be reliable. Tail hedges have included credit indexes, exchange traded funds or options. Last year hedges have focused on the junior part of the capital structure, limiting the max drawdown to 0.43%. Going forward hedges will address the tail risk of interest rate spikes.

Thorough risk management is core to the Byron offering. Risk managers Dr Dimitris Mantafounis and Panos Choutris estimate both Value at Risk (VaR), and individual holdings' contribution to portfolio risk. The overall VaR measure is decomposed into these marginal pieces, to identify where risk is concentrated in the portfolio. Several forward risk calculation methodologies are used. The software used is proprietary and coded with MATLAB programming language.

The strategy fits very well into a UCITS framework, as the securities, including exchange traded funds (ETFs) are liquid. The portfolio holdings easily correspond with the weekly liquidity profile of the fund. The team is using a network of more than 20 financial institutions and brokers for efficient trade execution.

Key winning trades of 2012 included a junior subordinated tier one security from BNP Paribas that was called at par ahead of being phased out under new Basel III rules. A relative value trade involved identifying paper from a German utility that was trading at wider spreads than sector peers. When the yield reverted to the sector average level, profits were taken. Quasi-sovereign debt has also been picked up by Byron's radar screens: International Petroleum Investment Corporation was trading at an unjustifiably wide spread over its owner, the Emirate of Abu Dhabi.

Ultimately the success to date is a team effort with significant contributions from members of the investment committee, risk oversight and due diligence departments – supported by a rigorous and robust infrastructure, legal and operational framework centred around the company's dual hubs in London and Cyprus. **THFJ**