Altana Investment Thoughts by Lee Robinson

Opportunities and Ideas

With liquidity drying up and markets falling, investment opportunities are coming thick and fast. We'd like to highlight some of the best ideas we are investing our own capital. Should you wish to participate alongside us, we can structure a co-investment in most cases.

Three Credit Opportunities

As you know we scan and plunder the secondary credit market taking advantage of other funds' inability to easily sell larger blocks or buy from forced sellers. Often that means buying the same credit with a much shorter duration and higher yield than the issue price. For example, our corporate bond fund with under two year duration has typically been able to purchase good credits at 4% carry but currently has a 6% carry book. There is a short term mark to market risk but all positions have short maturities so there is a natural exit. Clearly that means the risk will amortise to zero.

Credit Opportunity #1 – Brexit Risks overdone?

Many companies that are headquartered in the UK yet have either global sales or are pure UK businesses have seen their credit spreads widen. Take McLaren who sell supercars all over the world. Competitors such as Aston Martin, a listed company valued around €4B or Ferrari at nearly €20B. Is McLaren worth less than the level of their debt which relates to £550 million bonds priced just below par? Is McLaren worth less than 15% of Aston Martin and 3% of Ferrari? It's hard to believe that, given their large order book. Yet the bonds have widened from 5% issue yield to nearly 8% with under three years left to maturity.

Currently a basket of 12 names we are buying personally is yielding 7-13% and blended yield around 10.3% and duration of 2.7 years. Most have GBP risk but returns will be 1-1.5% higher if hedged into USD due to interest rate differentials. Post any Brexit resolution - except hard Brexit - we expect them to tighten. But regardless, all are current pay companies with a strong likelihood of being refinanced before maturity, so likely duration will be under two years.

Credit Opportunity #2 – AT1/COCOs

We don't particularly like the bank AT1 structures. These are the lowest credit structure other than equity for banks. However, there are many top tier names that are still too big to fail – despite what the regulator says - including HSBC, UBS and Credit Agricole, etc. which are callable in 2019-21. They are quoted at an attractive yield to call of more than 6%. They have large issue sizes of EUR 1.25-2 billion but market makers only trade in as little as 500,000 in secondary during times of market stress. During the recent sell off as large bond funds had redemptions these bonds took a hammering. You should invest in the very best names and only in those names with the closest call dates and high coupon resets.

We picked up a bond in a top 10 European bank with 6% yield callable in March 2019 [with call notification by mid Feb 19] at a price of 95%. So if it is called, we pick up over 6% including the carry for the risk that a top 10 European bank goes bankrupt by mid-February. Overall our favourite 14 names yields 600 bps over and we'd look to get involved on bad days to achieve +650-750bps over. Call dates are 2019-21 so the portfolio will pay a yield and amortise to cash as bonds are called.

Credit Opportunity #3 – Oil and Gas Servicers

Finally, the oil and gas services sector has some attractive oil and gas services bonds trading 8-12%. We own them in our distressed fund. We are activist in two situations with other holders and hold some in corporate bond fund, as well as our oil and gas Special Sits fund. Durations are longer, typically two-five years but many have restructured with no short term debt liabilities and thus long runways. Of particular interest are two to three names that are convertible into equity. They yield 8-10% with a free option on the equity recovery and no substantial debts maturing before these bonds. Less diversity than opportunity #1 but could be combined to give an extra 7-8 names to your income basket.

Dividend opportunities

It is not well known but investors can buy futures on SX5E, S&P 500 and FTSE 100 index dividends.

For example, the S&P paid out 57 points last year and the futures are pricing in a growth due to inflation of around 1.8% per annum. However, due to the larger structured notes business in Europe, whereby banks sell notes that pay higher rates if the various indices don't fall 30-50%, this causes demand from banks to sell the dividend futures. This demand increases as the market falls as the indices get closer to the knock in levels. Hence the European and UK dividend futures trade at 4-5% per annum lower than current dividend yields. If you factor inflationary growth of 1-2%, then the return is likely to grow to nearer 6%. Don't forget that these indices have survivorship bias, so the stronger stocks stay in which are likely to pay higher dividends. You can see the current curve below for Eurostoxx 50. E.g. over the next 5 years the futures are pricing a fall to 97.1 or to fall 4.5% per annum.

Current curve for Eurostoxx 50 dividends *(Source: Bloomberg)*		
		IRR
2018	126	actual
2019	120.9	4.46%
2020	119.3	2.84%
2021	112.5	3.92%
2022	106.2	4.42%
2023	101.2	4.53%
2024	97.1	4.48%
2025	94.5	4.22%
2026	91.8	4.06%
2027	89	3.96%
2028	85.3	4.00%

If this were to happen, it is unlikely that the equity market is higher nor that bond yields will rally. Unlevered both SX5E and FTSE 100 futures trade to yield more than the standalone index with considerably less market risk. Margin for the futures is typically under 10% but, we would not be that levered. We recommend twice levered to return 9-12% IRR. There is mark to market risk but very little chance they fall dramatically to these levels or lower. We will buy different futures and optimise between FTSE 100 and SX5E.

Bitcoin

After very little investor interest from February to August last year, interest has picked up. Why?

1) **Institutional interest.** Yale has committed $400m to the space, Fidelity are pushing storage solutions and three high profile asset managers are launching Fund of Funds with their own money
2) **The asymmetric profile.** If Bitcoin rallies and then hits the old highs of $19,600, few people think it stops there and probably goes to $30-40,000. Thus, at under $4,000 today that is pricing in a low probability of that happening. There is more upside than downside by a considerable quantum
3) **Only top 5-8 currencies are tradable.** Almost all other currencies and especially ICOs are no longer tradable in any size. Most have fallen 90% and capitulated
4) **Event driven trade.** Bitcoins released every 10 minutes halves again in Jul 2020. Institutions and investors will pre-position Q4 2019 or Q1 2020

Hence, we think now is a good time to start nibbling away and again when it breaks out above resistance levels around 5,600. Alistair Milne, the founder of the Altana Digital Currency Fund, has just added and we plan to do the same.

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Protecting your portfolio

We are renowned as derivative experts. We use many overlays to protect the downside. One of our favourites is to buy zero cost collars. For example, we buy a 5% out of the money put and finance it with a 3-4% out of the money call, so have zero up front cost. This allows us to maintain a long bias but with significantly lower risk.

Take the S&P during 2006-2017:

	IRR	Drawdown
S&P	6.6%	57%
S&P with collar	6.1%	30%

This demonstrates that you can receive almost the same return for half the risk. We advocate that all passive equity and some active equity investments should have this type of added protection.

Even better is our Protective Alpha Strategy. This returns over 10% IRR but with less than 10% drawdown and a significant negative correlation to the equity indices it trades.

It is a beautiful trade but has very limited capacity. Every day we go short an index future and long another with a knock out option, we pay no upfront premium. If the market moves upwards or falls less than a set amount, say 1%, then you remain flat and with no market exposure. However, if the market falls by more, say 3%, then you are stopped out at -1% on your long with no slippage (including overnight gaps), but remain up 3% on your short. We then cover the short either with a profit target, a stop loss level or if neither then at the close of business so you are flat market exposure again. This works really well in falling markets to add performance and is essentially flat in rising markets - hence its beauty - as it gives returns when you really need them. Given you can trade this with margin only, then returns on capital can be double to triple so 20-30% per annum.

Many of you can execute these trades through your trading accounts but to trade them efficiently and at best execution involves monitoring prices throughout the day, leaving orders and transferring margins. We do this often with automated systems, so should achieve much better execution even after fees.

If you have further interest please contact us at investorservices@altanawealth.com

Yours sincerely,

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