

# Atlantic's fixed-income focus lets it master capital preservation and income generation

A sole strategic focus and a full spectrum of fixed-income products gives Atlantic a competitive advantage in its field, setting it apart from its peers

Positioned as a dedicated macro fixed-income boutique, Cape Town-based Atlantic Asset Management has made good progress in its first five years, offering a range of funds to an established investor base, including institutions, consultants and IFAs.

Started in 2007 by CIO Arno Lawrenz, former head of fixed income at Old Mutual, and managing director Murray Anderson, previously head of collective investments at Cadiz, Atlantic now has R3.1 billion (US\$400 million) under management, the bulk in long-only mandates with around 10% in alternative strategies.

The highly skilled team of six includes fixed income strategist Erik Nel, previously co-head of global fixed-income sales at RMB, and quant analyst Albert Botha, who was previously with Sanlam and Glacier Financial Services. Colin Olivier is the dedicated operations manager, previously with Maitland Fund Services, where he was an administrator and client manager, while Sharon Kelly, ex-Coronation, is business manager. Former Old Mutual managing director Roddy Sparks is Atlantic's non-executive chairman.

"As a fully fledged asset manager, product diversity is key for us," says Anderson. "Not many managers are providing the full spectrum of fixed-income products, and the barriers to entry have grown for new entrants, so we were fortunate to start Atlantic when we did. The regulatory landscape has



Murray Anderson and Arno Lawrenz

changed and hence establishing your business now takes much longer and has more onerous requirements. We are of the opinion that to focus only on fixed income is a form of competitive advantage, since we are not trying to be all things to all people."

Atlantic's funds are focused on capital preservation and income generation, with three long-only collective investment vehicles covering the fixed-income risk spectrum. Atlantic also manages a range of fixed-income segregated mandates for institutional clients including multi-managers and pension/provident funds.

The Atlantic Cash Plus Fund aims for a money-market type return, higher than bank call rates and the average money-market funds. It is suitable for investors with short-term investment horizons, and due to its low-risk nature offers little prospect for capi-

tal growth but is focused on delivering maximum interest-income returns. Launched in January 2009, it has returned 6.83% annualised over two years compared with 6.56% from short-term fixed interest rates (STeFi).

The Atlantic Enhanced Income Fund has a 12-36 month time horizon, looking to deliver a higher total return than pure income funds, with moderate capital growth by actively allocating and diversifying between various interest-bearing asset classes and listed property. Launched in November 2007, it has gained 8.55% annualised against a 9.3% gain in the hurdle rate benchmark ALBI one- to three-year total return index, with much lower downside risk. This fund specifically allocates between fixed-income assets to provide capital stability and a high level of interest income to satisfy investors' income requirements.

The Atlantic Real Income Fund has a 36-month time horizon, aiming to deliver inflation-beating returns over time, and is suitable for investors seeking a higher total return. It has gained 8.12% annualised since launch in January 2009, compared with a 7.47% hurdle of CPI plus 3% over the same period. The portfolio is an actively managed inflation fund, investing in inflation-linked bonds and listed property, with the inclusion of some equity that is determined by a quantitative and thematic process.

Furthermore, Atlantic also offers the Atlantic Point Hedge Fund, which employs a multi-strategy approach to delivering absolute returns in the fixed-income asset class. The team's newest product is the Atlantic Total Return Fund, a hybrid long-only/alternate product, one of the first of its kind in the country (see panel).

From a macro perspective, Atlantic CIO Arno Lawrenz says low interest rates and low bond yields are the order of the day in developed markets, and will be the dominant theme for fixed-income investors for some time to come.

Lawrenz notes that the United States risks "being sucked into a Japan-type environ-

## FUND FACTS

### Atlantic Point Hedge Fund

**Fund inception date:** September 2009

**Strategy:** multi-strategy fixed income hedge fund

**Managers:** Erik Nel, Albert Botha

**Assets in strategy:** R100 million

**Prime broker:** RMB Prime

**Administrator:** Maitland

**Open to investment:** Yes

## FUND FACTS

### Atlantic Total Return Fund

**Fund inception date:** July 2011

**Strategy:** fixed income absolute return

**Managers:** Erik Nel, Albert Botha

**Assets in strategy:** R200 million

**Prime broker:** RMB Prime

**Administrator:** Maitland

**Open to investment:** Yes

ment" as deleveraging continues.

"Some people have speculated that bond yields will rise. We believe the US and Europe will become more like Japan, which has shown that you can have massive debt issuance and counter-intuitively, low bond yields," he says. "For example, 10-year yields in Japan have been in a roughly 1%-2% range for the last 13 years and their debt-to-GDP ratio is over 200%. It becomes a debt trap for a country when you can't afford for bond yields to rise because in that scenario the interest payment costs go up and wipe out a significant component of the budget revenues."

He says current events are showing that the austerity route being taken in Europe was not the right way to go, with the economic rescue being stymied by interest rates already at close to zero. "There is no further possibility for monetary stimulus. As the private sector deleverages they need fiscal stimulus to replace that private-sector expenditure. Trying to cut debt through an austerity

approach at the same time as private-sector deleveraging will not work."

A prominent example is Greece, which is suffering a "reverse-multiplier effect", with austerity crimping government spending, lowering public-sector expenditures and translating further to lower tax revenues, which only exacerbates the budget deficit.

"So with austerity it is possible to end up in an even worse debt-to-GDP situation," says Lawrenz.

With the US Federal Reserve committed to low rates for two years, where does South Africa sit in the global picture? Lawrenz says that while yields are low in the developed world they are relatively high in developing markets, meaning the carry trade is alive and well.

"South Africa has had huge inflows in the bond space for the last two years. That has helped the bullish fundamentals. But since October 2010 there have been two major episodes of risk aversion where the carry trade has reversed and the rand has been hard

hit. Nothing fundamental changed though, just the risk-on, risk-off sentiment. So unless fundamentals change for the developed world we are likely to see a continuation of foreign inflows into our markets, interspersed with such episodes."

He adds that bond yields are likely to remain supported even if inflation goes up moderately over the next six months.

"Emerging markets are better positioned fiscally and are likely to continue attracting capital," says Lawrenz. "But, having said that, real yields are not particularly attractive. And of course, there may be periods of severe volatility as occurred in September."

On the domestic side, the Atlantic team is keenly watching the medium-term budget policy statement, due out in late October. "South Africa does have more funding requirements, for example providing for National Health Insurance. Just how these will be funded is a key concern for the fixed-income markets," says Lawrenz.

## Atlantic Point and Total Return navigate choppy markets

"Fear doesn't ride into town on a tortoise," says Atlantic's Erik Nel, describing the trading conditions of recent months, during which a lack of liquidity and severe market moves have made life particularly difficult for fund managers.

Despite the tough environment, the Atlantic Point Hedge Fund has made good gains this year. In the two years since inception it has comfortably exceeded returns from cash, bonds and stocks.

The fund takes a multi-strategy approach to generating returns, exploiting investment opportunities across three horizons: strategic, tactical and trading. It uses a risk-constrained approach, looking to provide a fairly high degree of certainty of liquidity, with significant limits on shorting and leverage.

The fund is now at around R100 million under management, down from R190 million at its peak, as new regulations have prompted portfolio changes amongst South African pension funds. The short-term realignment has had a positive spin-off for Atlantic, however—the team launched its latest product in July, a Total Return Fund that is a hybrid long/alternate product.

The Atlantic Total Return Fund has a wide mandate and can make use of leverage and some hedging tools, with a key differentiator being that it may not be net short. Over time, it may include offshore assets. It has R200 million under management and capacity available, outperforming its benchmark in the three months since inception.

"It is very early days with the new fund, which we launched in response to investor demand. We are starting to see fixed-income hedge fund managers move into



Albert Botha and Erik Nel

the absolute-return space on the long-only side, which could increase demand for these types of products," says Nel.

The Atlantic Point Hedge fund aims to not lose money over any rolling three-month period, which Nel says has been a challenge in volatile markets. The fund has tighter mandate constraints than most in the market, with relatively low gearing (at five times versus a market average of 10 times), strict stop-loss requirements, and tight value-at-risk restrictions. Its best month so far was a 4.13% gain in April, while a decline of 3.04% last November was the worst month in its history.

Nel acknowledges that tight liquidity in a risk-off environment has been tough for South Africa's small pool of fixed-income hedge fund managers.

"With liquidity at present a fraction of what it is during more normal market conditions, it is key to understand the reaction function of the Reserve Bank. Given the nature of South African assets to be overtraded by an unnaturally large pool of investors relative to most other emerging markets (a function of very efficient market making), the risk will always exist that risk-off periods become particularly

tough to navigate for leveraged players.

"Structurally the world remains in trouble," adds Nel. "The rand clearly remains at risk until a longer-term, workable solution is found for the Eurozone's sovereign debt issues. But a combination of record-low developed market interest rates and an ever-growing gap in pension under-funding will see the appetite for emerging market debt maintained."

Nel, who besides managing the alternative funds is also Atlantic's strategist, was negative on equities at the start of the year (the 2011 house view was for a mid-cycle slowdown by the second half). Unfortunately, the nature of very poor sentiment (driven in part by policy inaction and political infighting) has brought "self-perpetuating negative feedback loops" into play in global markets, an environment that remains challenging for equities.

"Globally, earnings forecasts are problematic," he says. "In some instances these are based on historical evidence. We believe the fourth quarter may still be good for fixed income while in 2012 we may see an asset-allocation shift from fixed income into equities as the global economy starts the long way back to recovery."

Despite the tricky conditions, Nel sees ongoing opportunities for Atlantic's funds, which cater to different client requirements.

He believes the hedge fund's more dynamic mandate should stand it in good stead when interest rates eventually start to rise. "The ability to use both leverage and net short positions are luxuries that do not necessarily exist in the more traditional long-only space. And this explains the increase in demand for total-return strategies."