

BARRON'S Hedge Funds

A Monthly Report

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Talking With **Hanif Mamdani**

Portfolio Manager, PHN Absolute Return Fund

A Stellar Performer

by Eric Uhlfelder

AERONAUTICAL ENGINEERING GOT HANIF MAMDANI'S BLOOD FLOWING WHEN HE WAS AN undergrad at Cal Tech. He interned with professors who were working with NASA's Jet Propulsion Laboratory. "I love complex mathematical problem-solving, and space offered some awesome challenges," says Nairobi, Kenya-born Mamdani. He went on to earn a master's degree in mathematics and applied science at Harvard in 1988.

But another universe, Wall Street, offered its own mathematics problems—along with the prospect of a better paycheck than most academics can only dream of. On graduation, Mamdani put his skills to work, first for Salomon Brothers and later Credit Suisse, devising ways for companies to make better use of their capital structures.

After a decade, though, Mamdani was eager to switch to money management because he felt it would give him "greater control" of his "own destiny." He also wanted to be closer to his mother, who lived in Vancouver, where he had grown up. So he took an offer from Phillips, Hager & North, one of Canada's oldest independent investment firms, and moved back across the continent to Vancouver to run PHN's corporate-bond operations. As he says, it has proved to be a "good fit."

By the time Royal Bank of Canada bought the firm in 2008, Mamdani was one of its biggest shareholders, head of investments, and manager of the strongly performing PHN Absolute Return fund. RBC Global Asset Management made him head of alternative investments, and he still oversees the fund, which today has 735 million Canadian dollars (US\$736 million) in assets.

Mamdani, now 46, has posted a stellar record among multistrategy hedge funds. His 10-year annualized return through September was 14.85% in Canadian dollars. Because of the local currency's strong gains, the fund is up an average of 20.49% a year in U.S. dollars. That's more than 13.5 percentage points higher than the average hedge-fund return tracked by research firm BarclayHedge.

And Absolute Return has generated these gains without bouncing all over the place. Mamdani's trailing one-year return was 12.8% in Canadian *continued on page 42*

dollars, and his three- and five-year annualized gains hit 15.4%. On a monthly basis, Absolute has been up more than 80% of the time, helping explain why he feels he's reached its capacity and has closed it to investors.

The fund is notable for other reasons. In a market known for its avarice, Absolute Return doesn't charge the standard "2 + 20" fees (2% of assets and 20% of gains). Instead, it has a 1.45% management fee. It also features daily pricing and 30-day redemptions for its very conservative investor base. As he says, "Charging a management fee motivates us to perform for the long-term rather than swing for the fences."

Mamdani still runs two big bond funds, and that expertise informs all his work. He likes securities, purchased at a good price, that produce a steady payout, which he believes is the most reliable source of absolute returns and a buffer in tough times. In addition, Absolute Return keeps an ongoing stake in various market-neutral strategies, playing price anomalies among convertible bonds, stocks, other sorts of debt, commodities, and merger situations. Mamdani isn't afraid to take sizable positions in unique situations, which can involve elements of long, distressed, and event-driven investing. His goal is to move "adeptly across asset classes" to find the best risk-adjusted returns.

One example of the fund's approach came a year ago when the credit markets took a hit. Mamdani's team, which includes analysts Emil Khimji and Justin Jacobsen, discovered a **Goldman Sachs'** (ticker: GS) subordinated bond denominated in Canadian dollars that was due in 2017 and trading at 650 basis points (a basis point is a one-hundredth of a percentage point) above Canadian government bonds. That was nearly as wide a spread as the Goldman bond had during the financial crisis, even though "there's been dramatic improvement in the bank's credit quality since," says Mamdani.

Mamdani put 4% of his portfolio into the Goldman bonds at an average price of 88 cents on the dollar. The bonds have since rallied to 98.5 cents, and the spread has narrowed to 420 basis points. Mamdani hasn't sold, betting he'll be able to add to what's already an 18% return.

Absolute Return waited almost four years for one of its other opportunities to emerge. In October 2007, **Loral Space & Communications** (LORL) and one of Canada's largest pension funds did a leveraged buyout of Telesat, a global satellite service operator that was a part of **BCE** (BCE), Canada's largest telecom. But by the spring of 2011, Telesat was recording strong revenue growth and improved margins, delivering Ebitda (earnings before interest, taxes, depreciation, and amortization) gains of 50% over 2007 levels.

Leverage as measured by the multiple of its debt to Ebitda had been cut nearly in half, to 4.5, or about half its peers' average.

Mamdani believed Telesat would retire its expensive debt as quickly as possible. The first call date for C\$693 million of junk-rated 11% senior bonds due in 2015 was in May 2012. So he bought C\$87 million of the bonds, even though they were trading C\$2.30 above their call price of C\$105.50.

As he expected, Telesat called the bonds. The investment itself returned 6.7% (interest of 8.8% minus a capital loss of 2.1%) and the leverage he employed bumped up the net gain to 9.8%.

The fund complements these core income positions with market-neutral trades that arbitrage price differences among a wide variety of assets. They can compromise 10% to 30% of the fund. But they, too, sometimes require patience.

In the middle of last year, **Cogeco Cable** (CCA.Canada), a Quebec-focused cable company with a market value of C\$1.8 billion, said it was going to buy a U.S. cable company for C\$1.3 billion. Cogeco didn't have a great track record in these sorts of purchases, and the market drove the shares down from C\$44.50 to C\$37.90 on the day of the announcement. Mamdani shared investors' concerns but believed knocking 15% off the market valuation of an undervalued stock was too much. The acquisition would be earnings accretive in the first year, and was priced in line with other recent cable acquisitions. So he bought a C\$35 million position at an average cost of less than C\$39, and hedged it by shorting Canada's two largest operators—**Rogers Communications** (RCIB.Canada) and **Shaw Communications** (SRJB.Canada).

Both sides of this trade, however, have moved against Absolute Return so far.

Mamdani responded by doubling down; Cogeco now represents nearly 9% of the fund. Today it trades at a 2013 enterprise value/Ebitda multiple of just 4.9, versus rivals' roughly seven times. Its forward price-earnings ratio is very low: 9.1 against peers' ratios that run from 12 to 21. "This may make the company the cheapest cable stock in North America," says Mamdani. He adds, "Despite being our biggest trading loss of the year, the stock remains our favorite."

Up to 10% of Mamdani's portfolio is devoted to opportunistic plays like Canada's **Yellow Media** (YLO.Canada). In the middle of 2011, senior bonds of the Canadian Yellow Pages publisher sold off after Standard & Poor's downgraded its senior debt from BBB- to BB+, or junk-bond status, due to deteriorating operating performance and a costly bank-loan renegotiation. As Mamdani notes, "When managers can no longer hold a bond because it has become sub-investment grade, it often sets up buying opportunities, since

such selling pressure tends to push prices well below their fair value." Various pieces of Yellow Media's debt dropped by half, to 40 Canadian cents on the dollar, and he started buying. The company, he notes, had C\$70 million in cash, projected 2012 Ebitda of C\$650 million, and C\$200 million in free cash flow.

The market ultimately agreed with Mamdani. He realized a total return of 35%.

The manager concedes that such opportunities are harder to come by these days. "The easy trade for corporate bonds is over now that this is a universally loved asset class.

One has to be more selective to find the odd gem in the corporate-bond universe," he says.

While Mamdani believes central banks will likely keep interest rates low over the next several years, he's concerned that an eventual interest-rate rise will more than wipe out gains from high-grade bonds.

Will he venture to Greece or Spain for higher yields? No. "I am a staunch advocate of Warren Buffett's principle that you stay within one's circle of competence," says Mamdani. So he'll keep exploring among U.S. and Canadian assets for the best returns. ■

Still a Tough Go

There were some winners in agriculture plays and India, but hedge funds continued to struggle in September.

BEST	% Returns					Assets (mil)	Strategy
	September	YTD*	1-Year	3-Yr Cum.	5-Yr Cum.		
Stratton St Asia Synth Warrnt USD	28.3%	6.6%	33.2%	72.0%	95.3%	N/A	HF Asia/Pacific Lg/Sh Eq
Blackhorse Emerg Enterprises	18.9	32.9	26.4	56.5	3.9	21.0	HF Asia/Pacific Lg/Sh Eq
Sather Agriculture LP	18.7	45.7	46.3	126.1	N/A	6.9	HF U.S. Lg/Sh Eq
RAM Aggressive	17.8	56.3	48.2	116.7	296.8	N/A	HF Systematic Futures
APS Greater China Long/Short A	17.5	19.9	16.3	33.6	33.3	25.3	HF China Lg/Sh Eq
IW Alternatv SIF-Commod PEUR Acc	16.5	N/A	N/A	N/A	N/A	25.1	HF Multistrategy
India Capital A2	15.5	18.4	-6.6	-13.8	-40.5	N/A	HF Emerg Mkts Lg-Only Eq
Northwest Warrant Ltd USD	14.7	11.3	-6.9	-41.9	-77.1	13.4	HF Emerg Mkts Lg/Sh Eq
KARMA SELECT (Karma LP Srs B)	14.6	14.2	-9.4	-6.0	-30.6	N/A	HF Emerg Mkts Lg/Sh Eq
KARMA STAR (Karma LP Srs A)	14.6	13.4	0.1	9.2	1.3	20.5	HF Emerg Mkts Lg/Sh Eq
WORST							
Vol Edge A	-36.2	-76.9	-83.5	-94.3	-86.5	87.4	HF Volatility
Vol Edge B	-34.8	-77.2	-84.1	-95.0	N/A	6.8	HF China Lg/Sh Eq
Euronova Smaller Cos - CI 2	-33.8	-28.0	-28.9	-26.6	-39.7	N/A	HF Volatility
Euronova Smaller Cos - CI 4	-26.6	-20.1	-21.2	-19.7	N/A	N/A	HF China Lg/Sh Eq
Devon	-22.0	-1.2	27.1	N/A	N/A	0.1	HF China Lg/Sh Eq
Galaxy C EUR	-19.1	-12.5	-11.9	-9.4	N/A	5.1	HF Emerg Mkts Lg/Sh Eq
CFP IQS	-15.7	-11.6	-13.9	-25.2	-8.5	73.9	HF China Lg/Sh Eq
RAB Special Situations Ltd USD	-12.9	-3.4	-0.7	-28.8	-78.4	N/A	HF China Lg/Sh Eq
RAB Special Situations Ltd EUR	-12.5	-3.3	0.0	-30.2	-80.4	N/A	HF China Lg/Sh Eq
Friedberg Currency	-12.5	-21.3	-29.2	-1.4	8.7	2.9	HF China Lg/Sh Eq
BIGGEST							
Bridgewater Pure Alpha Strat 18% Vol	1.9	1.1	1.2	87.1	111.8	24535.0	HF Global Macro
Bridgewater Pure Alpha Strat 12% Vol	1.3	0.6	0.6	50.9	68.8	10423.0	HF Global Macro
Millennium International Ltd	0.4	4.2	7.6	32.7	49.5	10409.0	HF Diversified Arbitrage
Winton Futures USD CIs B	-2.2	-3.3	-3.4	18.7	42.8	10307.4	HF Systematic Futures
Transtrend DTP - Enhanced Risk (USD)	-3.1	4.4	4.3	2.8	35.9	7403.5	HF Systematic Futures
Bridgewater All Weather 12% Strat	1.3	14.6	21.1	69.6	48.0	6307.0	HF Global Macro
EnTrust Cap Diversifd Ltd - C	0.7	3.5	6.1	18.2	11.8	4892.1	HF of Funds - Event
Renaissance Inst Diversifd Alpha	0.1	N/A	N/A	N/A	N/A	4859.4	HF Multistrategy
Permal Macro Hldgs Ltd USD A	0.4	0.2	-1.2	4.2	11.2	4702.0	HF of Fds - Macro/Systmtc
Millennium USA LP	0.4	4.5	8.0	33.4	49.2	4695.0	HF Diversified Arbitrage
Permal Fixed Inc Hldgs NV USD A	1.4	6.4	6.1	16.0	17.8	4095.0	HF of Fds - Debt
ACL Alternative	-3.8	-3.7	-8.3	-3.2	44.6	3986.3	HF of Fds - Macro/Systmtc
Pine River Fixed Income	3.8	28.7	20.5	94.3	N/A	3321.6	HF Debt Arbitrage
MFS Investment Globl EqTUKGBP	0.8	12.2	22.0	N/A	N/A	3186.3	HF Lg-Only Eq
Aurora Offshore Ltd	0.8	3.7	0.8	8.2	2.5	3168.0	HF of Funds - Eq
FTM	0.2	5.5	7.9	N/A	N/A	2946.0	HF Lg/Sh Debt
CSIMF Swiss Bonds CHF F	-0.1	2.1	3.1	13.6	27.3	2464.4	HF Lg-Only Debt
Aurora Offshore Ltd II	0.8	3.6	0.6	7.7	0.5	2331.0	HF of Funds - Eq
Pinnacle Natural Resources LP	-2.6	2.3	3.5	13.6	47.9	2206.0	HF of Fds - Relative Value
Lighthouse Diversified Ltd	0.6	5.4	5.1	12.7	7.9	2190.0	HF of Fds - Multistrategy

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