

The Interview - Jeff Peskind, Phoenix Investment Adviser: “As with many distressed-focused managers, 2008 represented the best and worst of times”



[Phoenix Investment Adviser...](#) [1]

Phoenix Investment Adviser, which focuses on investing in the bonds of out-of-favour companies whose securities' prices have declined substantially, recently opened to outside investors a fund investing in the equity of the same 'stressed' companies. Founder and chief investment officer Jeff Peskind says such stocks may have significant upside potential in an environment of economic recovery where companies continue to have access to capital via the high-yield market.

GFM: What is the history and background of your company, principals and funds?

JP: I founded Phoenix Investment Adviser in 2003 and act as chief investment officer, managing the firm's three funds. After more than 15 years working in stressed and distressed credit at Harvard Management, Morgan Stanley and Bank of America, I launched Phoenix with my own capital as well as friends and family money. Mike Donoghue joined the firm in 2006 as President after 19 years in stressed/distressed credit trading at Morgan Stanley, where he and I first met in 1987. Today Phoenix manages more than USD300m.

The firm focuses on out-of-favour companies, where securities' prices have declined substantially. We believe that these discounted securities can be significantly mispriced and deep value, fundamental research enables Phoenix to purchase significantly undervalued bonds and stocks.

Phoenix Investment Adviser is the management company for three funds with different risk/return profiles, all within the inefficient stressed universe. The flagship fund, which was launched in 2003 and has approximately USD290m in assets, focuses on junior bonds at these stressed companies.

The second fund, focused on the equity of the same stressed companies, was started in 2009 and has some USD15m in assets. The third fund, which was launched in January this year, focuses on the senior part of stressed companies and uses hedging strategies to mitigate downside volatility. This fund currently only has partner capital, and has USD3.5m in assets.

GFM: Who are your main service providers?

JP: Phoenix has its prime brokerage relationships with Morgan Stanley. SS&C provides administration and valuation services, US counsel is Sadis & Goldberg and offshore counsel is Walkers. The auditor is EisnerAmper.

GFM: What is your distribution strategy and client base?

JP: We have maintained, especially since 2008, a focus on long-term investors that understand our strategy and returns. We have all types of investors in the fund, but more than 60 per cent are family offices, wealth advisors and high net worth individuals. Other investors include insurance companies, and we have some institutional and fund of funds money as well. The firm's employees currently represent more than 10 per cent of assets under management. Roughly 75 per cent of assets are from US investors, with the remainder from Europe.

GFM: What impact has the recent global financial crisis and economic downturn had on your business?

JP: Along with many credit- and distressed-focused managers, 2008 represented the best and worst of times. If you had capital to deploy and could stay invested throughout that period, you were likely to be significantly rewarded. However, for managers using leverage with difficult-to-unwind derivatives, it potentially severely hampered their ability to stay invested.

Fortunately for Phoenix, we have never strategically placed leverage on our portfolio. Because of our deep-value focus on identifying companies with ample cash, significant covenant runway and bonds trading below their intrinsic value, we were able to outperform many of our competitors who were forced to reduce leverage or shut down altogether.

Our business has just recently returned to our previous assets peak of USD300m, and we have a strong queue of interested prospects that have indicated intent to invest with our firm. Throughout the financial crisis we have never had any turnover among our staff, and now have 13 full-time professionals, including six dedicated investment professionals.

GFM: Please describe your investment process.

JP: Our process is entirely bottom-up -- we simply wait for companies or industries to trade down significantly in price. When looking at companies, we employ a private equity or strategic buyer-type analysis. We are looking for three things in our process: liquidity, covenant runway, and a 20 to 25 per cent discount to intrinsic value. If a company can meet those criteria, it will be considered for an investment.

When bonds trade down to deep discounts of between 30 and 75 cents on the dollar, it provides us an opportunity to profit in two ways. We have meaningful upside as each company owes us USD100 at maturity, typically four years hence, and we collect a very high current yield, today more than 11 per cent. On the downside, historically even in bankruptcy bonds have recovered up to around USD45, so the risk/reward balance of owning bonds at deep discounts can be skewed in our favour.

GFM: How do you generate ideas for your funds?

JP: We do not employ any top-down screens or targets, we simply wait for the market to bring ideas to us. When companies and industries begin to trade down significantly in price we will begin our investment process. Examples would be homebuilders in 2007-09, mortgage insurers in 2009-10, and paper manufacturers in 2010. These industries all presented us with misunderstood and undervalued opportunities. Even in good and improving market environments, there are always individual companies that are out of favour.

GFM: What is your approach to managing risk?

JP: Risk is a difficult thing to define and differs according to your perspective. We have never attempted to manage volatility on a month-to-month basis. Our investment philosophy is to buy companies that are significantly undervalued. Our bonds and stocks may move up and down in price because there of macroeconomic events, but if we are comfortable that these companies will not go bankrupt, we will continue to own the investment. Our portfolios are long-biased, but we short equities, bonds and indices. We also recently implemented a tail-risk hedging programme that

should dampen volatility if there is a major shock.

GFM: How has your fund performed?

JP: Many hedge fund performance databases have us ranked as one of the top distressed credit managers over one-, three- and five-year periods. Our goal has always been to generate equity-type returns in the bond market without using leverage. We believe we have achieved this goal in the past and expect that to continue in the future.

GFM: Are you looking at any particularly attractive opportunities right now?

JP: We are still bullish on our flagship fund's opportunities in the stressed bond niche, but we do have plans to soft-close the fund should we reach around USD500m in assets, with a likely hard close around USD600m. We do not want to grow the product simply to gather assets, but to generate 15-plus per cent unleveraged returns. If we continued to grow beyond USD1bn, it would inhibit our ability to generate those types of returns in our niche.

Our fund that focuses on stressed equities of the companies we have followed and owned in the bond fund. This fund has the same type of investment philosophy as a private equity vehicle, but invests in public equities of stressed companies with the five-year (or more) lock-up that private equity funds have. We believe the economy is slowly improving, and companies continue to have access to capital via the high-yield market. In this environment, stressed equities may have significant upside potential.

GFM: What developments do you expect to see in your investment sector or industry field in the coming year?

JP: We continue to see major investment houses launching multi-billion-dollar credit products. Without reliance on leverage or opaque structured products, we are not sure how well these funds will perform.

We think the smaller, nimbler and more focused funds will really have the opportunity over the next few years to differentiate themselves, and many of the largest managers will look more like index trackers rather than true alpha providers. Many investors are starting to look at some of the managers they own and are questioning the value they add.

GFM: How will these developments affect your firm and the performance of your funds?

JP: We think these developments should affect us positively. Investors are starting to look for smaller managers that have a niche focus and should be able to outperform.

GFM: What do investors currently expect from managers?

JP: We are seeing an environment where investors are really scrutinising managers. There is a much more rigorous due diligence process in place and much greater emphasis on transparency. Background checks, service provider checks, investor references and portfolio transparency are all very common requests we get and are happy to oblige. We have always treated our clients as we would like to be treated, and look to build longstanding relationships.

GFM: What differentiates you from other managers in your sector?

JP: Our focus on the stressed bond niche is our key differentiator - we believe we are one of the few managers that focuses exclusively on stressed bonds. One reason for this is assets under management. There is no doubt in our mind that managers running USD1bn or more would have significant difficulty accessing this niche, which is why we will cap the size of the fund to the opportunity set. As of April 1 this year there was only USD25bn worth of bonds trading below USD80. The entire high yield market has more than USD1trn in assets, so few investors focus on this small subset.

GFM: How do you view the environment for fundraising over the coming 12 months?

JP: We have seen great momentum over the past six months and believe that will continue for the foreseeable future. Many investors who have sat back for the past few years now need to find investments that can give them real returns. The hedge fund industry is starting to grow again, and more and more of that money is starting to flow to smaller managers.

GFM: Do you have any firm plans for further product launches?

JP: We recently opened to outside investors our fund that focuses on stressed equities, which we would like to grow to USD100m over the next 12 to 18 months. We are also considering launching an absolute return credit strategy that would target returns of 8 to 12 per cent with minimal downside risk.

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