The Interview – Sergey Grechishkin, Alcantara Asset Management: “Our strategies are designed to profit from our detailed knowledge of issuers in Russia and the CIS”

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GFM: What is the background to your company and fund?

SG: Founded in March 2008, Alcantara Asset Management is a management company authorised and regulated by the UK Financial Services Authority that manages the Cayman-based and CIMA-registered Alcantara Russia and CIS Fixed Income Opportunities Fund.

The fund applies a combination of actively-managed long-only and relative value strategies to fixed-income instruments from Russian and other members of the Commonwealth of Independent States, the exact mix depending on the economic, political and market situation.

The fund applies stringent risk management policies combining traditional value at risk-based quantitative approaches with qualitative assessment, and provides full transparency to investors exceeding industry standards.

Alcantara was running its investment strategy on a managed account basis between December 2008 and July this year, delivering an annualised net return of 41 per cent, and launched the fund in August. The fund aims to produce an annualised return on capital of 20 per cent to investors over the 2009-11 period.

The firm’s principals, Andrei Taskin and myself, have a strong combination of experience and knowledge of emerging market debt issuers and markets, paired with distinctive experience in trading fixed-income markets and applying proven relative value investment strategies. We have more than 20 years of combined experience in debt origination, trading, restructuring and quantitative risk management, and have known each other for seven years, having worked together at JP Morgan.

Until 2008, I was the president and head of investment banking and brokerage at KIT Investment Bank, one of the largest investment banking and specialised finance groups in Russia. Previously I spent eight years in the City of London and held various managerial roles at Merrill Lynch and J.P. Morgan, where I was head of the CIS debt capital market for five years and also of the private equity group. My track record includes more than 25 debt capital markets transactions and more than 20 in private equity.

Andrei was a key team member of Capula Investment Management, one of the largest fixed-income managers in London with more than USD4bn in assets under management, where he was responsible for developing relative value strategies in commodities markets and trading the index-linked book. Previously he worked in the proprietary positioning group at J.P. Morgan for two years. Between 1999 and 2003 he was a member of the modelling and analytics group at CSFB in New York.

GFM: Who are your key service providers?

SG: Our accountants are Harris & Trotter and legal counsel is Cummings Solicitors. The fund’s administrator is AIS Fund Administration, the auditor is Kinetic Partners Cayman, and the prime broker and custodian is Raiffeisen Zentralbank.

GFM: How and where do you distribute the funds? What is the profile of your current and targeted client base?

SG: Our current client base is dominated by family offices and small private investment companies. We expect institutional investors to start coming in in late 2009.

GFM: What is your investment process?

SG: Our investment strategies are designed to profit from our detailed knowledge of issuers in the Russia and CIS economic areas, which helps us to identify investment opportunities in the government and corporate bond space, both in Eurobonds and in local currency issues.

As the global macroeconomic situation improves and capital is reallocated to riskier assets, the attractiveness of some of the long trades will diminish, but at the same time financing will become more readily available, increasing the economic attractiveness of relative value opportunities with acceptable risk/return characteristics.

Our actively-managed long strategies take advantage of trending markets when associated with economic recovery, as well as market positioning. Our relative value strategies generally benefit from a high-volatility environment, when the relative mispricing between instruments is at its highest.

Our investment process starts by locating opportunities with good risk/reward characteristics where the price is often driven not by the credit risk, but by liquidity constraints in specific instruments or the relative-value abnormalities.

Once the opportunity has been identified, we use market intelligence and our knowledge of the issuers (often close personal relationships with key management) in due diligence to ensure that the investment opportunity stands up.

We then apply a second level of analysis to ensure that the macroeconomic situation, expected instrument liquidity, financing situation in the market and the existing fund portfolio composition support the investment. Before the final go-ahead we run a series of worst-case scenarios.

GFM: How do you generate ideas for your funds?

SG: We use a combination of approaches including desk research, field visits and conversations with market participants.

GFM: What is your approach to managing risk?

SG: While we consider value at risk to be fundamentally the right measure for the amount of risk in the portfolio, the recent crisis has demonstrated that its reliance on historically observed correlations and magnitudes of market moves tends to significantly underweight, or even completely ignore, the critical 'tail' events that are often well understood by traders and risk managers but have not necessarily revealed themselves in the past.

For any debt instrument, we consider sources of risk including sovereign term structure of interest rates, term structure of spreads over sovereign for the company representing the issuer's industry benchmark, an issuer-specific spread to its industry benchmark and currency risk.

At the moment, we do not rely on the concept of Z-spreads to Libor swaps popular in the emerging markets industry because Libor has lost its historically stable link as a proxy for financing costs, as well as the extent to which exotics hedging at the end of 2008 has been able to disconnect completely the Libor swaps curve from the G7 treasuries curves.

We rely on our close ties with the issuers to estimate conservatively the probability of default and the debt recovery rate for each instrument in our portfolio. We also consult (but do not rely on) the rating agencies' forecasts for these metrics.

Our approach of separating the overall risk into several components makes it possible to perform accurate stress-testing of the fund's portfolio with respect to both historically observed market disruption events as well as potential market disruptions in the future that can be formulated in terms of moves in our risk factors. We prefer this approach to traditional VaR analysis, which relies on historical correlations between the factors and therefore rules out events that did not occur in the past.

We use the risk metrics obtained to estimate the amount of risk capital allocated to the various components in our portfolio. The fund aims to keep at least 30 per cent of capital allocated to trades that are leveraged as unencumbered cash.

We recognise that different investors may have different risk appetites or subjective views on the likelihood of various market outcomes. Our approach allows us to consider risk scenarios suggested by our investors and to incorporate them into individual investors' reports.

GFM: What opportunities are you looking at right now?

SG: Cautiousness and scepticism about the end of the recession were driving our investment strategy in August. Large portions of the assets in the portfolio mature within the next six months, and the longer-maturity issues are highly liquid.

For now we are staying away from Kazakhstan, and are sceptical about prospects for the Ukrainian economy in the longer term. We are actively managing our short-maturity positions in high-quality credits from Ukraine, the majority being foreign- or sovereign-owned, more than half of which will redeem within three months, and from Russia, where the majority of exposure is to well-performing and highly-liquid leading banks.

GFM: What events do you expect to see in your sector in the year ahead? How will these developments affect your own portfolio?

SG: We see a correction in the second half of 2009, and stability and 'normalisation' in 2010. We will be looking at the environment and managing the duration of the portfolio and exposures to specific names.

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

SG: We have a very strong regional focus with full dedication, very close personal knowledge of the issuers and the market players, and superb trading technologies. Alcantara provides a balanced selective approach to liquid instruments through an actively managed long strategy in its portfolio, while also looking for attractive relative value opportunities.

Existing emerging market fixed-income funds have been following two main approaches, namely "carpet bombing"– being long with leverage on almost every reasonably liquid international issue from the CIS region – and leveraged focus on one or two macro- or event-driven situations. Both strategies suffered during the third and fourth quarters of 2008.

Andrei and I have worked on placements of the debt securities in which the fund invests and in the majority of cases have close relationships with the management of the issuers. The fund is overweight on personal issuer knowledge.

GFM: How do you find the environment for fundraising in 2009? How does this affect your funds?

SG: The environment is difficult, but not affecting us much as we do not have a history and come to investors with new strategy in a clean history-free execution environment.

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