The Interview – Nicolas Galperin, Onslow Capital Management: “There is too much debt of all kinds out there”

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Nicolas Galperin, founder of Onslow Capital Management and principal portfolio manager of the Onslow Macro Fund, says the firm’s ‘option-like’ strategy and portfolio structure puts less emphasis on market direction and more on delivering the right risk-return relationship across a range of idiosyncratic themes.

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

NG: I founded Onslow Capital Management in early 2007 after spending 12 years at Morgan Stanley. During my time there I traded different fixed-income credit products including US and European high yield as well as sovereign and corporate emerging market debt. In my last role I was managing director and head of emerging market sovereign debt trading in Europe.

Unlike many other firms, over the past three years Onslow has followed a patient strategy of assembling the right people, developing and fine-tuning the strategy for the Onslow Macro Fund, and only then going out to raise money.

Today we have four partners with a combined 75 years of experience in emerging markets and credit-sensitive fixed-income products. Assets under management exceed USD100m, with more than 50 per cent contributed by the partners and their families. The global macro strategy being implemented is quite different from other strategies in this space and would work effectively for an amount up to USD600m. The intention is to keep the fund size below this level.

GFM: What is the structure of your fund?

NG: The Onslow Macro Fund is a Cayman Islands-based corporation utilising a master-feeder structure including a US onshore and offshore feeder with US dollar- and euro-denominated share classes. It is managed by Onslow Capital Management, which is authorised and regulated by the Financial Services Authority in the UK.

GFM: Who are your key service providers?

NG: The prime broker is Morgan Stanley, while the fund is administered by Quintillion in Dublin and audited by KPMG. Our UK legal counsel is Cummings and Cayman counsel is Conyers Dill and Pearman.

GFM: Have there been any recent changes to the management team?

NG: Filippo Nencioni and Jason Maratos joined in 2009 to complement the two portfolio managers, Esteban Klein and myself. Filippo is a strategist and idea generator, while Jason is responsible for risk management.

GFM: What is the profile of your client base?

NG: A significant portion of the assets belongs to the partners and their families, and we have a number of European and Latin American family offices on board. We are comfortable with our investor roster, especially the long-term nature of their commitment to the fund, and intend to keep it that way.

GFM: How would you assess the impact of the recent global financial crisis and economic downturn on your business?

NG: The financial crisis will ultimately change the way all participants approach the market. There will be winners and losers, but overall business will be more challenging and certainly many things that have been taken for granted should no longer be so.

As a newer fund we like to think we can be thoughtful and flexible in this new environment. For example, we use little or no leverage and we have no set target return. We think an approach that 'forces' managers to put on more leverage to achieve certain targets will increasingly be proven difficult and full of risk. Our returns show that we will extract attractive returns when they are there to be extracted. There will be other times, though, when not losing money should be enough. In the medium term, consolidation will accelerate.

The critical variable for us will continue to be a solid track record while running the business in a world-class institutional fashion: small in size but deep and solid in terms of business risk mitigation, capital and service providers.

GFM: What is your investment process?

NG: We perform fundamental top-down macro analysis on a limited number of countries. We have a strong emerging market bias. We identify a number of themes that can be focused on credit, interest rates, foreign exchange and equities. When looked at in aggregate they allow us to construct a balanced portfolio that relies more on idiosyncratic as opposed to market risk to deliver returns. We use a number of filters to ensure that all trades contribute to the portfolio delivering an asymmetric risk-return profile.

GFM: How do you generate ideas for your funds?

NG: Our portfolio is constructed around relatively few ideas, which are debated and evaluated extensively, internally and externally. Our focus is on identifying three or four ideas that will generate the returns we are aiming to capture over the next 12 to 18 months. This process takes time as ideas are tested and re-tested; it is not a question of generating five or 10 ideas a week.

GFM: What is your approach to managing risk?

NG: We like to think that we have a common-sense approach to risk management founded on our collective experience. Our risk management framework lays out the parameters we use to monitor risk at a position and a portfolio level. We try to keep things simple, pay a lot of attention to liquidity, and we try to stay on the right side of 'gap' risk. We do not use value at risk-based models, but we do stress test our portfolio against different market scenarios.

GFM: How has your recent performance compared with your expectations and track record?

NG: We are satisfied with our recent performance. In 2009 we were up 37 per cent, and in 2010 we were up 6.25 per cent to the end of April. We were less satisfied with 2008 (down 7 per cent) but we feel we learned the right lessons from that and have taken clear steps to make sure the same mistakes are not repeated in the future. Our performance has validated our strategy, which is why we felt ready to open the fund to external investors.

GFM: What opportunities are you looking at right now?

NG: We are primarily focused on sovereign debt valuations in Europe and Latin America. We have some exposure to corporate credit, foreign exchange and interest rates.

GFM: What events do you expect to see in your sector in the coming year?

NG: It is well documented that there is too much debt of all kinds out there. Debt levels were central to the 2008 crisis. The politicians' solutions involved transferring debt to safer hands, but most of the debt still needs to be serviced and repaid.

Although central banks continue to supply the system with liquidity, there is a danger that the price of credit, and thus debt-servicing costs, will continue to creep higher. Politicians are again trying to impose solutions on the markets and we will see whether they will be successful. The world will need to grow out of this problem, and it remains to be seen if there is enough political will to find and bring about the right solution.

GFM: How will these developments affect your own portfolio?

NG: There are parts of the world where we are more optimistic and others where we are less so. Our returns will show if we have picked our spots and themes correctly.

GFM: How do you assess investors' current expectations?

NG: Investors understand how difficult and complicated the current environment is and expect a responsible and thoughtful approach to managing money.

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

NG: Our 'option-like' strategy and portfolio structure puts less emphasis on market direction and more on delivering the right risk-return relationship across a range of idiosyncratic themes. We thrive on volatility. We are small and flexible and intend to remain so.

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

NG: The environment will remain good for hedge funds, albeit perhaps more difficult for smaller funds, but performance will always make the difference.

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