

Being long credit doesn't pay right now



Jonathan Berger
Born: New York City
Lives: New York City
Educated: Wharton School, University of Pennsylvania
Hidden talent: backgammon (but doesn't get much time to play)

Jonathan Berger is the founder, chief executive and chief investment officer of Birch Grove Capital, a New York-based alternative credit manager he set up in 2013.

The firm applies an opportunistic, flexible approach to credit investing and portfolio construction across corporate and structured credit.

Berger was previously the president and chief investment officer of Stone Tower Capital, prior to its acquisition by Apollo Global Management in 2012.

Birch Grove Capital is owned by its management team and began trading with \$300 million in capital in August 2013. It now has approximately \$450 million in assets under management.

The fund has a similar strategy to the alternative funds that Berger ran at Stone Tower Capital.

You run a credit fund that can be net long or net short. Which way are you positioned today?

Today, I am close to market neutral. With yields at historic highs, you are not adequately compensated for the risk of being long. But I am not a fan of getting short the market at the moment. Funds are still flowing into credit and frothy retail money may push spreads even tighter.

The trigger to go net short will be when there is a significant increase in mark-to-market leverage in the credit market.

What are the best credit trades at the moment?

We look for idiosyncratic situations that provide opportunities to make money from long or short trades. On the long side, we see the best opportunities in the senior secured debt of companies with capital structures below \$500 million that are going through some type of event that will create near term change.

On the short side, we look mainly for capital structure arbitrage situations among lower quality investment grade and higher quality high yield companies that are subject to event risk.

What is the best credit trade you have ever made?

Post-financial crisis, we invested in a number of event-driven situations, primarily through secured floating rate debt.

At the time, there was still a tremendous amount of volatility in the credit market, defaults were on the rise and the equity market had not yet reached its lows. We invested in the senior secured debt of large companies, such as Smithfield Foods, and smaller companies, such as El Pollo Loco. We outperformed the broader market with high double-digit returns. More importantly, on a risk-adjusted basis we generated these returns in the senior secured part of each company's capital structure.

And the worst?

Many years ago I was involved in an investment in the mezzanine tranche of a mall-based apparel retailer as part of an exit financing from bankruptcy.

For the first year after emerging, the company's fundamentals continued to improve. Our firm had the opportunity to exit the position at a substantial profit within the first year. However, we opted to hold the investment. In the end, the company filed for bankruptcy a second time and our profit was lost.

As a result of this experience, one of the key tenets of my investment philosophy is to exit investments when a target return is met or when the thesis changes. This may seem obvious, but it is amazing how frequently investors fall in love with names and positions, obscuring their ability to perceive risks as situations evolve.

What was your first job in credit?

I worked on the high yield desk at Salomon Brothers in the early 1990s. It was an interesting, high pressure environment where I learned a lot. Salomon was at the cutting edge in the credit markets, and there is still a great network of ex-Salomon people that I do business with today.

What issue makes you bang the table?

One thing that concerns me is that investors often chase short-term trends rather than investing for the long term.

Right now, I see a lot of money flowing into European mid-market credit. It is an interesting opportunity but it is a market where you need the right infrastructure and fund structure. Some managers do not have those things in place.

Similarly, there is a lot of money going after European distressed credit. Europe has never seen a distressed cycle with non-bank investors, so it is a very unpredictable market.