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## Alternatives

# Alts managers moving into credit strategies following the meltdown

By Christine Williamson  
and Douglas Appell

Alternative investment managers are sifting through the wreckage of the money management industry, seeking once-brilliant diamonds roughed up by last year's market meltdown — good credit portfolio managers and/or firms.

Citadel Investment Group LLC, Chicago, is adding traditional fixed-income investment strategies for institutional investors, the hedge fund heavyweight's first foray into long-only management. The new business is headed by James Kauffmann, who left ING Investment Management, Americas, New York, after the firm's Dutch parent ran into credit problems and received a Dutch government bailout package in 2008 and subsequently restructured the investment unit's U.S. bond team.

Private equity and hedge fund manager Fortress Investment Group LLC, New York, sees the "mess" that is the investment management business "as an opportunity" and is actively talking with both traumatized companies and investment teams to work out an acquisition or a deal, Daniel H. Mudd, CEO and director, told investors during the firm's Nov. 6 third-quarter earnings

call. One strong acquisition possibility, said investment banking sources, is a long-only fixed-income shop.

Citadel and Fortress are the most recent alternatives managers to publicly state their intention to diversify and reduce the volatility of their businesses by adding long-only, institutionally oriented investment strategies to secure steadier income streams, said investment banker Aaron Dorr, New York-based managing director of Jefferies Financial Institutions Group.

Attracting significant assets from institutional investors may not be easy, given that the market is dominated by a small, tightknit club of large bond managers, said Daniel Celeghein, director, Casey Quirk & Associates LLC, Darien, Conn.

"It's going to be a big challenge to go up against the industry's two huge fixed-income machines — Pacific Investment Management Co. and BlackRock Inc. Besides having gigantic investment capabilities and infrastructure, they both have large, sophisticated, smooth marketing and client service machines that permit them to spend a lot of time with each of their clients. The deck will be stacked against Citadel, Fortress and anyone else who has to face these big bond managers in finals



James Kauffmann

searches," Mr. Celeghein said.

Citadel executives are interested in building one of the industry's best fixed-income shops, not the biggest, said Mr. Kauffmann, who joined the firm in mid-November as managing director and head of the firm's fixed-income long-only strategy. Citadel has "a commitment to be an exceptional money manager, rather than the largest asset-gathering machine," he said.

Mr. Kauffmann has a long institutional pedigree: for 13 years, he had oversight of domestic bonds for institutional investors, ultimately totaling \$40 billion, as both head of fixed income and senior vice president at ING Investment Management, Americas.

In an interview from his New York office,

Mr. Kauffmann said he and other high-level investment executives from ING's U.S. bond team left the firm in January after a major restructuring of the fixed-income unit and then spent six months talking to potential partners.

At the same time, Citadel founder and CEO Kenneth C. Griffin was looking for ways to broaden the company's investment strategies, said spokeswoman Katie Spring. "Building a long-only fixed-income business is consistent with Citadel's DNA, part of the way the firm has added businesses over the years," Ms. Spring said.

## Creating a lineup

Mr. Kauffmann is building a traditional fixed-income strategy lineup by drawing on Citadel's existing New York-based rates and structured mortgage teams and the credit investment team based in both Chicago and London. He said Citadel's first long-only strategies likely will include traditional fixed-income strategies but eventually will include core and core-plus bonds; short-duration Treasury inflation-protected securities; global bonds; and liability-driven investment approaches. The investment strategies likely will launch sometime in the second quarter of 2010.

The expertise in managing alternative investments of Citadel's existing fixed-income teams will be important to Mr. Kauffmann's unit.

"When you've honed your investment skills in alternatives, as the Citadel team has, it's powerful when you apply some of that alpha-generating capability to traditional fixed-income management," Mr. Kauffmann said.

In Citadel's favor when it comes to attracting institutional investors is Mr. Kauffmann's long institutional career and track record managing core and core-plus bonds at ING.

"Jim Kauffmann is well known in the consulting community and it will not be a big marketing challenge for Citadel to get him in front of consultants and clients," Mr. Celeghein said.

Unlike Citadel's trench-digging approach to adding traditional fixed-income capabilities, Fortress executives have scented fresh blood and are actively tracking acquisition possibilities.

As with Fortress' acquisition earlier this year of now-shuttered D.B. Zwirn & Co.'s \$2 billion hedge fund family (P&I Daily, June 2), Mr. Mudd told analysts on the third-quarter earning call that firm officials have found similarly attractive "business units that would be complementary to our scope of activities. They have good (investment) teams, good management and good track records, but they are often trapped in a corporate business structure that's not sustainable. We're looking at those." Among the acquisition targets Fortress' management team may be eyeing are long-only credit-focused shops — such as Logan Circle Partners LP and Seix Investment Advisers LLC — as well as structured product firms such as Aladdin Capital Management LLC.

Over the last couple of months, Fortress "has been in dialogue with everyone on the street," and fixed income is "absolutely on their shopping list," said an investment banker who asked not to be identified.

"They've started looking at potential targets," in search of "another scalable

fee-based business" to make their business model less volatile, agreed another investment banker, who likewise requested anonymity.

## Bitter taste

One banker noted that finding an acquisition with the right cultural fit for Fortress — a firm that has a particularly pungent brand of "Kool-Aid" that any target company would have to drink — could prove tricky.

Fortress managed a total of \$32 billion as of Sept. 30, broken down into private equity (45% of assets), hedge funds (14%) and hybrid funds that combine elements of both asset classes (41%). Lilly Donohue, Fortress' managing director, investor relations, declined to comment.

The time could be ripe for new players to enter fixed-income management.

Institutional investors and their consultants will be less inclined "to buy IBM" when it comes to hiring large fixed-income managers in the face of what is shaping up to be a difficult environment for bonds in coming years, said Theodore "Ted" L. Disabato, managing director, Disabato Advisors LLC, Chicago.

"There is absolutely nothing good about this market for traditional U.S. bonds. Forward-thinking institutions are seriously considering their options ... (in coming months) ... Investors can't buy and hold U.S.-dollar denominated bonds in a time of this kind of fiscal stress. They will be looking for bond managers with more flexible investment strategies," Mr. Disabato said. ■