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MontLake Fund in Focus: Ronit Global Opportunities UCITS Fund

A discussion with Edward Misrahi from Ronit Capital

Interview

The Ronit Global Opportunities UCITS Fund launched on the MontLake UCITS Platform in December 2016 and provides investors exposure to global emerging markets via an alpha focused, non-directional approach. The UCITS fund is run in a very similar manner to the Ronit offshore strategy which has been live since 2013.

The UCITS fund has daily liquidity and is available in EUR, GBP and USD.

Kevin Ewer, MontLake's Head of Research sat down with Ronit Founder and Chief Investment Officer, Edward Misrahi to discuss the strategy and the opportunities in Emerging Markets.

Kevin Ewer (KE): Edward, you started your career in 1991 at Goldman Sachs, before leaving to join a group that established Eton Park in 2004 and then setting up Ronit in 2012. What was your vision for Ronit when you established the firm, and could you touch upon the important lessons you have learnt in setting up a hedge fund business and what advice you would give to anyone else considering doing the same?

Edward Misrahi (EM): I had the opportunity to work in two high quality places at Goldmans and Eton Park and was able to develop and approach to investing that worked, was tested and that I felt comfortable with. I finally felt in 2012 that it was time for me to go out on my own, rather than work inside a larger group. I believed I had the ability to compound people's money over time in a fairly differentiated way that would add value to their portfolios. Starting your own firm means taking a lot of risk – both financially and reputationally – but my approach is very disciplined, and it was part of showing investors how much I really believed in what I was doing. My goal for the firm was to build a successful business by focusing on generating returns for investors rather than trying to build a big fund and simply gathering assets. And that would be the advice I would give to anyone looking to do this – be focused on performance first, because in the end that's what really counts. Some people are fantastic at raising assets, but in the end the great hedge funds are all great because they have performed and that is what we should all be trying to emulate. If performance is good, the money will eventually flow.

KE: I think that's excellent advice. So, if you have an investor coming in to meet with you, what is the one main thing that you would like them to remember about Ronit when they leave?

EM: Well I think it would be that within our focus on emerging markets its that we are willing to be independent thinkers -

- a little bit different in our approach and not afraid to go against the grain if necessary.

KE: So, would you describe yourself then as a contrarian investor?

EM: Not contrarian by design, no. But I think it's a good thing to have a predisposition that if something is well understood by many people, its highly unlikely to be priced incorrectly. How then do we gain an edge in such a position, why would we own it? So maybe that is something that creates a bit of a contrarian feel to what we do. By the way, just because something is popular is not enough of a reason not to do it – it may be that it is still a very good thing to invest in. We are just sceptical about these things because how do we add value? My biggest surprise in markets is when the biggest companies in the world – that everyone knows well - go up the fastest and furthest, because I go "how is it possible if it's the company that everyone knows, how is it possible that there is something that nobody knew?". Look it's also important to understand that we are comfortable not being in something – I don't suffer from investment FOMO. There may be an interesting trend in something, but if I'm concerned about the pricing, we just won't be in it. I'm happy to take a zero position and find something else I can get an edge in.

KE: If I look at the average hedge fund that invests in emerging markets, it tends to be typically a high beta approach that is very correlated to emerging market indices. What you are doing is a much more alpha based approach. Why do you think there is a great alpha opportunity for investors in emerging markets?

EM: I think there are two key things that really create alpha opportunities in emerging markets for an investor like Ronit, and one often touted reason that no longer really exists, except in some frontier markets. Let's deal with the latter first, which is the informational advantage. When I started back in the early 1990s, you were able to visit these countries and be in a position to know companies and what was going on better than the rest of the market. That maybe still exists in places like Sri Lanka and some other frontier markets if you are there 6 times a year, but across more mainstream emerging markets, information flow is too fast and transparent. So, I would say then that nowadays the alpha opportunity comes firstly because you have investors that care mainly about growth and are more momentum-oriented macro

KE: On the macro point, you are a bottom up fundamentally driven stock picker, but you do factor in the macro economic situation into your portfolio construction. Can you comment on this?

EM: Its factored in from a risk management perspective. The more constructive we are on a country or region from a top down basis, the more aggressive we can be on the price we are prepared to pay for an asset there and the more conviction we can impose via our weighting. And if we are really worried about developments in a country, we may choose to avoid it completely. It's a bit like finding the perfect house, but in a neighbourhood that's going downhill – under those circumstances being a great house isn't enough to make it a great investment idea. In those places it's about avoiding discontinuity risk that can overwhelm the best ideas.

KE: And I imagine that a lot of what you term discontinuity risk relates to political risk in many of these countries?

EM: Well yes, and there has always been big political risk with investing in emerging markets. Of course, nowadays there seems to be big political risk everywhere, so to a degree that's become more of a mainstream concern as well. In emerging markets significant swings in the direction of economic policy especially in terms of views on things like privatisation, utilities, the banking sector are possible at any time. So, you need to be acutely aware of what is going on. Its not a day to day thing, but just very much part of your analysis into how you think of an idea.

KE: If we can turn to what you actually invest into in the fund. Its essentially an equity focused fund, but you talk on your marketing documents about taking a cross capital structure approach. Can you discuss why you do that and what that means in practice?

EM: I think investors should think about us as an equity-oriented fund first and foremost, as the bulk of the risk we put on the portfolio is in equities. But I was taught early on in my career that you create a view on the company and its value and then look for the best instrument to express your view. In many situations the equity is going to be the best instrument, but there are selected situations where it may be better to use a derivative strategy to get the best risk/reward payoff, or a credit instrument offers the best value. Its important to understand that when we make an investment through a credit instrument, we are not doing it with a view on carry or interest rates, but rather because its offering us equity like returns from the instrument. Just because a bond is 100 bps wide, and we may be getting overpaid to own the credit, is not enough for us, if there is not the potential equity like kicker to the return.

KE: The other key part to the way you construct positions and the portfolio payoff is that you look to build in tail risk protection. Can you explain how you go about doing this and why you are prepared to pay money for tail risk?

EM: Philosophically our portfolio is always long volatility. I've always believed in my investment career that you need to be in a situation where you are long volatility because unexpected events can and do happen, things get dislocated and its vital at the moment of dislocation that you are in a position to take advantage of it and not be the source of it. If you are on the wrong side of things, you are forced to do transactions that are not driven by the intrinsic value of the company. So, people are forced sellers of positions and you want to be on the other side of that. The key to this is construction and we achieve this in a variety of ways – sometimes we will just be straight up long volatility, we may structure individual trades with options, or we may have overlay options on the whole portfolio.

The more heavily the portfolio is invested, the more we are prepared to spend on premium to create the long volatility profile. Early on in my career I was taught that there will be good investments that take unexpected turns and one needs to be able to not be put out of business by those that go wrong.

I've seen people make money for long periods who then go out of business in basically a two-day period. For our investors we want to be the opposite and be that fund that is in a place to take advantage of times which others find difficult.

KE: From a return perspective, what expectations should an investor have of Ronit? I feel this is the type of strategy that will tend to have the payoff profile of not doing much and then exploding upwards when ideas pay off. Is that a fair assessment?

EM: I would like to make 1.5% every month, but this is not possible, and you should never invest with anyone who says it is! So yes, I think in the type of market we have, where people are constantly changing their views, our returns are likely to be quite lumpy. We underwrite investments for 18-24 months and need to be patient to realise the return. Its not something we try to do as we would prefer a smooth ride, but ultimately, we have to believe in our positions, avoid chasing returns and having FOMO, and this can lead to the return pattern you describe.

KE: And for an investor trying to understand risk in your portfolio, what's the key metric they should be looking at? With long/short equity funds, the net exposure is often the metric that people seem to focus on.

EM: Well I think something like net exposure is obviously a sensible metric for people to look at as it gives a rough sense of the sensitivity of the portfolio to the market. However, with a fund like Ronit, I think they should focus on what our gross exposure is as that is going to provide them with much more information. We are taking idiosyncratic longs and shorts, so these can move very independently. Under normal market conditions, the higher our gross, the more risk is in the portfolio, irrespective of whether our net is lower. Both are important though as in the situation of a sharp market sell-off its not unreasonable to expect correlations to go to 1 and the net exposure being a good indicator of portfolio movement. But ultimately the gross exposure is telling you how much conviction we have in our positioning.

KE: If we turn to UCITS – is there anything that you do in your Cayman strategy that can't be incorporated in the regulated fund? Given you run the portfolio as a very liquid portfolio, I imagine that's no issue?

EM: The strategy in our Master fund is very liquid and has always been run that way, which has been one of our commitments to those investors. So, the transition into the UCITS space from that perspective was very easy and philosophically, we run the portfolio in the same way. Obviously UCITS has certain restrictions in terms of concentration and the use of ETFs for overlays that may cause some minor differences, but essentially, it's the same, very liquid portfolio.

KE: Lets finally turn to the portfolio as it stands today. Can you talk about some of the interesting ideas currently on the portfolio and whether there are any particular themes on the portfolio?

EM: At the moment its really a portfolio of idiosyncratic longs and shorts, with no major themes. Last year we had a strong bias towards Brazilian assets because we thought many were mispriced, but this year it's a far more diverse set of ideas. We are still long certain Brazilian state-owned enterprises and think that there could be a significant re-rating in these. An example would be a power utility like Cemig or something like Petrobras as we think the full benefits of the reform package there will particularly benefit state owned entities, especially those with potential privatisations. Then we are also more constructive on Chinese consumer related names, primarily because we think while the tone has been driven by the trade talks, some of the secular themes happening in Chinese dynamics remain intact and these are still high growth companies that have been de-rated for political reasons, but fundamentally it is unwarranted. If we look at areas we are less constructive on, we are not convinced by the growth potential in the payment processing industry. We understand the move to a cashless society and especially how this could play out in emerging markets, but just think that people are too focused on the high-level growth and not what the likely earnings growth is going to be and can see that disappointing relative to expectations.

Overall we are running the portfolio with lower risk as we think there is too much complacency in the market and we are not convinced that such dovish central bank action is firstly warranted and then if it is, we are not so sure it is such a good thing. Clearly this year that hasn't been the right position so far, but we still feel very strongly that this is the right philosophy.

As with everything Ronit does, we do the work, have conviction in our ideas and are confident enough to be against the wind for a period if needs be.

KE: Thanks Edward. MontLake looks forward to continuing working with Ronit on your fund and seeing it deliver high levels of alpha to help diversify investor portfolios.

Biographies

Kevin Ewer

Head of Research

Kevin is the Head of Research at MontLake. Kevin began his career in South Africa at Sanlam Asset Management in 1998, before departing in 2000 to co-fund RisCura Solutions, one of South Africa's leading risk and asset consulting firms. Having established a business servicing the risk management requirements of the hedge fund industry, he moved to Blue Ink Investments in 2006 to manage their range of award-winning fund of hedge fund portfolios. Following corporate action which saw Blue Ink bought by Sanlam Investment Management, Kevin was asked by the Sanlam group to move to London in 2010 and re-establish their institutional asset management presence. As a director of Sanlam International Investments, he managed both fund of hedge fund portfolios and global balanced portfolios for the group. He also worked for Skybound Capital as a portfolio manager prior to joining MontLake. Kevin holds a degree in Finance, Accounting and Computer Science from the University of Natal and is a CAIA charter holder.

Edward Misrahi

Founding Partner, Chief Investment Officer

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Ronit Capital was founded in December 2012 by Edward Misrahi, who has been investing in Emerging Markets for over 25 years.

Prior to starting Ronit, Edward was a founding partner of Eton Park in 2004 and subsequently managed public and private Emerging Market and European investments for the firm over the following eight years. Edward was a member of Eton Park's Operating Committee as well as its Best Execution Committee and Risk Committee.

Between 1991 and 2004, Edward worked for Goldman Sachs & Co., becoming a partner in 2000, where his role included Financial Analyst in Structured Finance, Member of Equities Arbitrage Group, Member of Global Emerging Markets Committee, Co-Head of Latin America for the Firm, Chief of Staff of the Equities Division and Head of Equities macro trading group.

Edward graduated from Princeton University with highest honours, Phi Beta Kappa with a Bachelor's of Arts in Economics.

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