Odeon Capital: Year-old firm positive on high yield, even amid uncertain market conditions

By Paul Deckelman

New York, May 25 – The spring of 2009 may not have seemed like the most propitious time to launch a new fixed-income broker-dealer shop – after all, Wall Street was still reeling from what had occurred in 2008, one of the most disastrous years in the U.S. financial services industry within recent memory. Two venerable and once seemingly indestructible old-line investment banks, Bear Stearns Cos., Inc. and Lehman Brothers Holdings Inc., had disappeared forever, while other formidable financial giants like Merrill Lynch & Co., Inc., Wachovia Corp. and Washington Mutual, Inc.'s vast branch network were swallowed up by other institutions. Numerous smaller financial companies also bit the dust, and many financial companies, big or smaller, that did survive wallowed in red ink and were forced to eliminate, consolidate or downsize divisions and pink-slip untold numbers of financial professionals.

But at the New York-based start-up known as **Odeon Capital Group, LLC**, "we never had any doubts coming out, whether we started in the up-cycle or the down-cycle, that we would have a chance to be successful," declared one of the company's founding partners, Mathew Van Alstyne, who noted that "Goldman Sachs started in the middle of the Great Depression," at least in the form we know it today, after the company avoided bankruptcy in 1930 and reinvented itself as an investment bank. "Sometimes, you don't get to pick the timing – the timing picks you."

In an interview Tuesday with *Prospect News*, Van Alstyne, who holds the position of head of research at Odeon, said that the company's view is that "a value-added product can be successful in any market condition. As long as people are trading, buying and selling, as long as there are markets to be made, there's a place for participants like us."

Eventful first year

Odeon this week is marking its first birthday, touting its growth from a six-person shop to a growing boutique firm employing some 40 bankers, traders and sales and research professionals. In the year since its inception, it has traded over $2.5 billion of corporate, asset-backed and other types of securities. The client list, Van Alstyne said, "crosses the entire spectrum of the largest asset managers in the United States to small hedge funds that are running tens of millions of dollars. We've traded with municipalities and multi-billion-dollar corporations. There is no peg that fits our box – we try to just be value-added."

A typical client, he said, "is someone who has high-yield exposure or wants to gain high-yield exposure but doesn't have the specific product expertise that we can bring to the table. [We can] educate and teach them about a product that might be interesting to their portfolio or try to market a product out of their portfolio to other investors."

With the recent disruptions in the high-yield market – which had been going along swimmingly until around the end of April, with well over $100 billion of new issuance and robust secondary market returns fueled by a seemingly endless flow of liquidity into Junkbondland – Van Alstyne said that a lot of those clients now "are taking a fresh look at their portfolios and saying 'what's my upside? What's my downside? Which names am I in love with? Which names am I a little skittish about? It's time to reassess everything.'"

Market woes make impact

That, in turn, can make it difficult for would-be bond issuers, "especially if they're new to the market, like **Allegiant** [**Travel Co.**], rather than a seasoned issuer who has a ready clientele who've already invested in them." Van Alstyne said that companies like the Las Vegas-based vacation destination airline operator, which announced on Monday that it would discontinue its planned sale of $250 million of seven-year notes due to worsening market conditions, making it the latest of several prospective borrowers to drop out of the primary market, "have even a more difficult challenge when people are reassessing."

In the secondary market, meantime, what he called the "million-dollar question" is: "Is the market just taking a breather? Or this a re-set? The answer is probably somewhere in between."

Right now, he said, "there's a lot of good entry points for names that you've liked in the past or want to double down on – but if it's something that you weren't really comfortable with, you're probably selling out of it, or trying to sell out of it, or reassessing."

Not a replay of February

While the high–yield market did experience a downturn over the course of three or four weeks from late January to mid-February before recovering its lost ground after that and resuming its upward push, Van Alstyne is of the opinion that "we're in a period that's not comparable to what happened in February. Whereas February might have been more technical, this is more fundamentals-driven."

He said that the world "is a very different place than it was in February." This time around, "the euro crisis is something that very few investors had on the top of their radar, and obviously, the international relations arena has some new things going on, especially in Korea. And financial regulations, which seemed to go away throughout all of 2009 when the health-care bill was at the forefront of Washington's mind, has kind of come roaring back, and there's a lot of uncertainty there. Uncertainty in the market obviously adds risk, and the risk is something that's detrimental to long-term value in anyone's

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model."

Given current conditions, "the type of investments you want in a volatile market, especially in high yield, are ones that match your holding period. If you know that your holding period investment horizon is one to two years, then you want shorter-dated paper. If you have a longer investment horizon, then you have to think of different things, like interest rates and the broader economy."

Secured paper shines

At Odeon, "we really like stuff that's collateralized, paper that has assets behind it rather than unsecured paper." While noting that there are exceptions to the rule, Van Alstyne opined that "you can still find lots of value in mortgage-backed securities, with different duration periods that will match your investment horizons, and then there's lots of secured paper in the corporate market that you would also find attractive, a one-to-two-year investment horizon with a mid-teen yield that is collateralized."

Another area, he suggested, "would be aircraft [backed] paper, or student loans. What you really want at the end of the day is someone that's paying down the debt, or there's an asset behind the debt, rather than unsecured paper, so that in a worst-case scenario, you just hold it to maturity and you're confident about recovering the price you paid and getting your money back."

Energy, autos and finance

He said that various sectors can be attractive to high-yield investors but also have their downsides. For instance, "there's a few things that you can rely on in the world – one is that people need to eat and the world needs energy, so [energy] is typically a fairly safe sector to have long-term confidence in, but on a name-by-name basis. Obviously, there's going to be lots of volatility, and just like any other commodity-based sector, it can have huge highs and low lows."

On top of that, "you also have regulatory risk" – particularly in the aftermath of the oil-spill disaster in the Gulf of Mexico – and the energy bill is something that is on Obama's agenda, so there's a lot of risk there. But oil names tend to trade with the economy, and so it's more of a broad-market call."

Autos, he said, have the advantage that "especially on the debt side of things, you probably like to invest alongside Uncle Sam, so there's a floor and a lender of last resort that you can rely on from a safety perspective." However, he also cautioned that "if the economy doesn't really have the full steam behind [autos] that maybe we've been thinking [it has] for the last couple of quarters, it's one of the areas that can have a lot more volatility than some of the more safe consumer sectors."

As for financials – which collectively so far have been among the strongest industry groupings in terms of year-to-date return – "we saw with **CIT** [**Group Inc.**] pre-bankruptcy that it's kind of a call on the government – who's too big to fail and who's not big enough to be saved?" He said that with "a lot of the names here, you have a lender of last resort, it's a place where you pick up yield. It's not the worst place to be."

However, Van Alstyne also warned that "a lot of these names right now are going to be performing very well because their borrowing costs are at record lows and have been there for a while – so you're going to have lots of profits that could be threatened if and when interest rates come back to match growth levels."

High marks for high yield

Even with the currently unsettled market conditions though, the Odeon research chief asserted that "high yield is always a great sector. One thing that you get out of high yield that you wouldn't get out of equities is good strong current income on a broad perspective – but you have to be nimble and know what you're investing in, to know the underlying assets and the underlying credit quality of the names you're going to be picking.

"But broadly, high yield is always a place where there is lots of opportunity and just rewards the nimble investor."