

# Schroders FundFocus



## Schroder GAIA II NGA Turnaround

Offers investors access to a long short liquid distressed debt and equity strategy. George Putnam, President and Portfolio Team Leader at New Generation Advisors, explains how the strategy works and what it can offer investors.

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### Can you tell us a bit about New Generation Advisors and how the team is involved with this fund?

New Generation Advisors is a specialised distressed securities manager with around \$800 million\* under management. Established over 25 years ago, the firm has one of the longest and most successful track records in the sector, investing over three full credit cycles, and delivering strong risk-adjusted returns since inception. The firm is 100% employee owned, and focuses entirely on distressed securities. We have deliberately limited our assets under management so that we can take advantage of the full range of opportunities in the distressed sector.

I founded the firm in 1990, and I currently head an investment team of six\*, which collectively has more than 100 years of experience in distressed investing. We work together as a single team allowing us to benefit from the complementary expertise of our colleagues.

### What does Schroder GAIA II NGA Turnaround offer investors?

The fund offers investors a focused and relatively liquid way to invest in distressed securities, managed by one of the most experienced firms in that asset class. Distressed securities can be a valuable addition to an investment portfolio for two reasons. First, because of the specialist knowledge required, the sector represents a relatively inefficient niche in the securities market, and this inefficiency can lead to abnormally high returns. Second, because the returns on individual distressed securities are ultimately determined more by the outcome of the particular company's restructuring proceedings than by market movements, distressed securities tend to have a low correlation to other asset classes.

Our approach, which emphasises diversification and liquidity, is quite unusual among distressed securities managers, and allows us to offer investors access to the distressed sector through the Schroder GAIA II platform. Schroder GAIA II NGA Turnaround offers investors the returns and diversification benefits of the distressed securities sector in a relatively liquid structure.

### What is the fund's investment universe?

There is no strict definition of "distress" but the companies we look at are always suffering from some form of financial, operating or legal trouble, or have recently recovered from such trouble. These companies may have defaulted on their debt, have filed for Chapter 11 bankruptcy protection or just be very troubled. We consider both the debt and equity securities and look up and down the capital structure for the investment opportunities with the best balance between risk and return.

We focus on North American companies because the bankruptcy and restructuring laws in the US and Canada are favourable for distressed investing. The fund has no sector bias and seeks to take advantage of both sector wide and company-specific distress situations. As a result, the fund is diversified across industries and companies to reduce risk.

### How do you generate new ideas and what is your investment process?

Our ideas come from a number of different sources. We monitor all of the defaults and bankruptcy filings by public companies in the US, and, to a lesser extent, outside the US. We undertake capital structure screens, monitor the "Biggest Losers" lists from the stock, bond and bank debt markets and use research from brokers and investment banks to identify potential opportunities.

Once we identify a potential opportunity, we dig into the company's fundamentals. We typically try to calculate the company's value under two different scenarios: 1) it is able to fix its problems and continue as a going concern or 2) it cannot successfully reorganise and will be liquidated. Most of the time the greatest potential value comes from the going concern value, and so we build detailed financial models to predict the company's post-restructuring performance and valuation. The liquidation value generally represents our downside risk, but occasionally we find companies that are worth more dead than alive – in other words, their assets are worth more than the company's ongoing business.

We then look at the company's capital structure to determine how far down the capital structure the value will go. In other words, will there be enough value to satisfy senior creditors, junior creditors and stockholders, or will only a few of those stakeholders get paid? Often the best investment opportunity is found in the most junior class that will get paid. This is sometimes referred to as the "fulcrum" security.

After we identify the fulcrum security, we will look at its current trading price to determine whether it is under- or over-valued. We will buy the security if we think it is sufficiently undervalued to offset the risks in the particular situation. Weighing risk versus return is always a key part of our investment process.

We make all of our investment decisions as a team to take advantage of the deep experience of the team members.

### How do you construct the portfolio?

The portfolio is constructed security by security from the bottom up, based on our evaluation of the risk versus reward in each individual



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situation. We apply limits on exposure to individual companies and industries to ensure portfolio diversification. We do not employ any sort of market timing or macro view in building the portfolio.

### How do you manage risk in the portfolio?

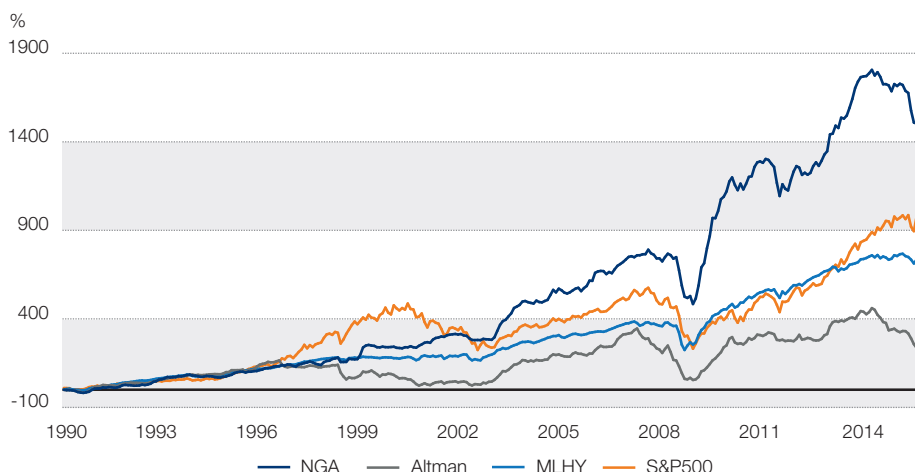
Diversification is our principal tool for managing risk. We have strict portfolio limits in place that manage risk at both the portfolio and security level and these limits are monitored daily. Our portfolio is constructed to be well diversified across sectors, the capital structure and individual securities. Diversification is monitored through pre-trade compliance software and reviewed by our Chief Risk Officer.

Monitoring the liquidity in all of our positions is also an important part of our risk management process. We want to be sure that there is an active market for all of the securities in the portfolio so that we will be able to sell any security at the price we expect. To this end, we continually monitor the number of dealers making markets in each security we hold, as well as the trading volume in that security.

### What persuaded you to partner with Schroders?

Schroders has a terrific reputation in the investment management business, even on our side of the "pond". Moreover, we were very impressed by Schroders' capabilities in the liquid alternatives space on both the operational and distribution fronts. The Schroder GAIA II platform seemed like the ideal vehicle for offering our distressed securities strategy to investors around the globe.

### Performance track record of NGA strategy



Source: Schroders, NGA as at 31 December 2015.

### Why is distressed debt a good strategy to invest in?

Distressed securities have historically provided high absolute returns with low correlation to other asset classes, making it a valuable form of asset diversification.

We believe the opportunity set for distressed securities is currently as attractive as it has been at any time, at least since the 2008/09 financial crisis. After seven years of unprecedented growth in high yield and leveraged loan issuance, investors are finally waking up to the risk that many of these debt issuers will not be able to refinance their debt when it comes due over the next few years.

Moreover, low global oil prices and fluctuations in demand from China have created extreme turmoil in energy, mining and metals securities.

This has led to a massive sell-off in distressed securities in 2015, and the amount of debt trading below 50 cents on the dollar at year end reached levels not seen since early 2009. Historically, whenever there has been a decline of this magnitude in the distressed market, it has been followed by a sharp and rapid rebound. We believe the current conditions make this an extremely interesting time for investors to consider adding distressed exposure to their portfolio.

## Performance Summary

	1 Year	3 Years	5 Years	Since Inception*
<b>NGA**</b>	-18.3%	2.2%	1.8%	11.1%
<b>Merrill Lynch High Yield Index</b>	-4.6%	1.6%	4.8%	8.4%
<b>Altman-Kuehne Defaulted Debt Index</b>	-39.7%	-12.2%	-7.7%	3.8%
<b>S&amp;P 500 Total Return Index</b>	1.4%	15.1%	12.6%	9.7%

\*Common inception has been used for all above data of 1 May 1990.

Source: Schroders, NGA as at 31 December 2015. \*\*NGA Flagship Fund is New Generation Turnaround Fund Limited, which launched in September 1996. \*\*Performance from May 1990 to August 1996 is provided for New Generation Limited Partnership, a substantially identical fund. Performance is shown net of fees. Indices used are Bank of America Merrill Lynch High Yield Index (J0A0), Altman-Kuehne Index of Defaulted Public Bonds and S&P 500 TR.

## Fund Manager Biography

**George Putnam** founded New Generation Advisors in 1990 and New Generation Research, Inc. (publishing affiliate of New Generation Advisors) in 1986. Prior to founding New Generation, he practiced law with Dechert LLP in Philadelphia, PA. He also serves as a trustee of the Putnam Group of Mutual Funds. BA, MBA and JD from Harvard University.

**George Putnam – President of NGA and Portfolio Team Leader, Schroder GAIA II NGA Turnaround**

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