Bloomberg BRIEF

Hedge Funds

01.28.14
TUESDAY

SPOTLIGHT Bank Regulations Causing Less Efficient Pricing in Mortgage, Credit Markets, Says Vranos

Michael Vranos, chief executive officer at $6 billion **Ellington Management Group LLC**, spoke to Bloomberg's Kelly Bit about where in Europe the Old Greenwich, Connecticut-based firm is finding opportunities. Its Ellington Credit Opportunities fund rose 16 percent last year.

Q: What are Ellington's strategies?

A: Most of what we do is in the residential real estate market, so we invest in securities, loans and properties. Within commercial real estate it's much of the same. We have a few specialized strategies in each of those markets. In the residential market we have a private REIT that invests in homes and rents them and we also have funds, such as this REIT, which invest in non-performing small-balance commercial loans and non-performing residential loans. We're also relatively active in the commercial real estate securities market. Our portfolio manager is Leo Huang, who co-ran origination at Goldman on the commercial side for 10 years. Our residential securities strategy invests in credit-risky RMBS and in mortgage-backed derivatives, such as IOs and inverse IOs. We have very few multi-investor funds. We manage multi-investor funds in mortgage-backed derivatives, mortgage-backed credit, stat arb and systematic global macro. We also have two public vehicles: Ellington Financial and Ellington Residential Mortgage REIT, an agency REIT.

Q: What opportunity holds the biggest focus for you right now?

A: We're still very excited about our mortgage derivative and credit securities strategies. As the Street has shrunk in these markets due to Dodd Frank and Basel, we see less efficient pricing and total return opportunities that are very attractive. In terms of areas where we're focused on expanding, the U.S. non-performing loan supply is very large, and has been increasing steadily over the last year. The states with non-judicial foreclosure processes have tended to resolve their non-performing issues more quickly. If you see what's for sale by HUD, for example, the percentage of notes backed by the states in judicial areas is increasing. You've seen a lot more New York and New Jersey loans for sale.

Q: What about Europe?

A: The full effect of the Basel implementation is taking longer than it did for U.S. banks. We're now seeing a pickup in sales of all assets. We recently opened a London office and have begun deploying capital into European securities markets. We're finding some interesting opportunities in the non-ISIN/CUSIP space, particularly in real estate.

Q: In what countries?

A: The U.K., Spain and Portugal mostly. There is this mandate to have banks sell non-core, non-domestic assets first. We recently saw a residual on a U.K. securitization owned by a French institution. This is residential. The commercial transactions we've seen are mostly performing and non-performing note investments. In France and Spain, we're seeing opportunities in commercial real estate. The banks haven't taken enough pain in a way that would suggest this will be over quickly.

Q: How big are these deals?

A: Most of the securities aren't huge blocks, maybe $5 million to $10 million. On the loan side, banks have so much to sell that they try to sell bigger portfolios.

Q: What about other opportunities?

A: The commercial mortgage new issue market is growing. It was pretty vibrant last year and seems like it'll be even more so this year. We are particularly active in some of the lower-rated credit tranches. The idea this year is to think about risk. We will be in a good spot if rates rise again because we can fight from an offensive position since we're hedged. Other players sometimes have to lick their wounds if rates go up. We've been in a 30-year bond rally until very recently, and I don't have a strong view about what rates will do this year, but I do know that if short rates rise quickly, it will be quite painful for many market participants.

Q: How do you hedge that exposure?

A: In the mortgage-backed derivatives market you have interest rate risk and prepayment risk. We choose to take prepayment risk because we model that and that's how we derive our alpha. On the interest rate side, we choose not to take that risk. So what we do is we hedge that exposure. The hedging takes place along the whole yield curve. The portfolio has sensitivities to both short and long rates. We use mortgages, swaps, treasuries, Eurodollar futures, and options to hedge interest rate risk.

Q: What advice would you give other managers as Ellington marks its 20th anniversary this year?

A: An asset management firm must find its competitive edge and strive to keep that edge while still remaining client-focused. There aren't many careers where you can get better as you get older, but I believe asset management is one of them.

AT A GLANCE

Age: 52

Education: Harvard College. AB Math, Magna Cum Laude.

Professional Background: Kidder Peabody, 1983-1994, CEO Ellington Management Group, 1994-present.

Family: Married with three children.

Charitable Work: Hedge Funds Care board of directors, Boys and Girls Harbor, Hopkins School, Waterside School, Harvard Stem Cell Institute, Stamford Shelter for the Homeless.

Favorite restaurant: Pasta Nostra, Norwalk, Connecticut

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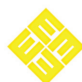

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