SPOTLIGHT

Napier Park's Jim O'Brien on Opportunities in Regulatory Relief Trades

Jim O'Brien, senior managing partner at **Napier Park Global Capital LLC**, spoke to Bloomberg's Kelly Bit about the firm's views on fixed-income markets and a new "best ideas" fund it plans to launch this year. New York-based Napier Park was spun out of Citi Capital Advisors and manages $5.6 billion in credit and special situation strategies.

Q: What strategies does your firm's mandate encompass?

A: About 80 percent of our assets have a tenor of two and a half years or longer. We cover corporate credit in the U.S. and Europe, distressed credit, mortgage credit, municipal credit and structured products in a variety of different forms. We also have a private investing business focused on the financial sector. We have an event equity business. We don't tend to borrow a lot of money. Where we use leverage, we tend to use structural leverage in the form of derivatives and securitized structures.

Q: Do you have a fund that spans all those strategies?

A: We have a single-investor strategy that invests in mortgages, European credit, U.S. structured credit and distressed. That's our single biggest investor; we've managed the fund for three and a half years. We've had a dialog with a number of institutions who would like us to do a similar strategy in a commingled format. We're working on putting that together and launching it in the first half of this year. It would be a best ideas strategy. Our CIO John Dorfman will manage it and he will allocate capital to the various managers based on his views on return and risk. We'll get something off the ground in the first quarter and get a scale product launched in the second quarter. That has the potential to become our flagship product on the credit side.

Q: What are the firm's macro views?

A: We have a global market with improving economic data in developed markets, a little more patchy in emerging markets. The deleveraging cycle in the U.S. is well advanced. We see a decrease in fiscal drag in the U.S., Europe and Japan and some very positive signals that make us feel comfortable about intermediate-term growth. You see corporations, particularly in the U.S., improve balance sheets dramatically. Idiosyncratic volatility will be driven by the fact that companies have stronger balance sheets and are becoming much more shareholder friendly. Equities have become more of an income asset class; more dividends are being paid, more buybacks are going on.

Q: What are the risks?

A: What we see that's quite worrying as a result of regulatory actions is a continued risk of liquidity interruption. The regulatory rules regarding capital and inability of banks to engage in proprietary trading has eliminated a lot of the buffer that would absorb volatility in specific asset classes. You clearly have to start factoring in the risk of rising rates. The market will start pricing in higher rates in the future. You'll start seeing that playing through to asset prices. 2014 is a very large election cycle globally. There's a lot of social unrest in emerging markets. You'll see some volatility driven by change in government, change in policy, populist moves for politicians to get reelected. In that kind of environment, we see things like securitization markets shrinking, so less ability to absorb opportunities off of balance sheets as loan books and mortgage books begin to grow again.

Q: How does Napier Park incorporate these views into its portfolio?

A: The biggest theme is that the markets are most challenged by regulatory change including increase in capital charges. There's a lot of activity going on in the structured credit market around banks hedging loan exposures to get capital relief. We've been able to take advantage of that in short tenor, as short as 12 months, as long as three years, providing risk appetite for banks that need to offload either corporate or mortgage credit risk in derivative form. We've been very focused on things that provide us interest-rate dampening characteristics and sensitivity to inflation. We did a railcar lease transaction in 2013. We like the leasing market because you have contractual cash flows. Leases for industrial equipment in particular tend to be highly correlated to inflation. As economies grow and inflation goes up, the uplift in lease prices tends to occur. The combination of cash flow, hard assets and inflation sensitivity is a hot button for institutions. That railcar transaction is a $375 million strategy that we raised and was primarily insurance company money. The cash flows from interest-only bonds and mortgage servicing rights extend because they don't pay down as quickly as the market might think or default at the rate the market expects. We really like that market.

AT A GLANCE

Hometown: Cranford, New Jersey **Age**: 53

Education: Seton Hall University, B.S. in finance, 1982

Professional Background: Merrill Lynch (1983-1986), Morgan Stanley (1986-2005), Carlton Hill (2006-2007), Citi Capital Advisors (2007-2013).

Family: Married for 31 years, four children, one grandson

Mentors: John Havens, Bill Comfort

Favorite Restaurant: Cafe Boulud, New York

Charitable Work: Seton Hall (board of regents); Team Walker (board member); Pullum Community Arts Center (chairman); Center for Hope Hospice (former board member); Berklee College of Music, American Heart Association, YCS/HAPI, Columbia Children's Hospital, Wounded Warrior Foundation (benefactor).