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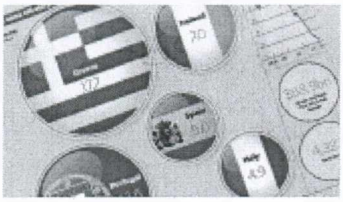
Few hedge funds gain in Greek bond saga

By Sam Jones

It was a high-risk, speculative bet in Greece's tumultuous bond market: a wager that would pay off if the Greek government faltered in its landmark bond restructuring at the final hurdle.

The gamble was thought to have been popular among the hedge fund denizens of well-healed Mayfair and leafy Connecticut – that Greece would be forced into an embarrassing repayment of its €14.4bn March 20 bond. But it was taken, at great cost, by Teaypoik, a Greek pension fund, overseeing the retirement funds of, among others, white-collar workers in the ministry of finance.



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For hedge fund managers, who for months have been said to have had their fingerprints all over the Greek crisis – be it through bond market machinations such as buying the March 20 bond, or efforts to drive up prices on credit default swaps – it is something of an ironic, if grim, vindication.

Few winners have emerged from the world of trading in Greek bonds, where some of the speculators have turned out to be banks, insurance companies and even pension funds, and the cash-keen risk avoiders, for the most part, the high-rolling hedge funds.

The completion of the bond restructuring on Monday has been welcomed in all quarters, but with an overriding sense that disaster has been averted, rather than fortunes made.

"[The outcome] is pretty much as expected – [Greece] should fade as an issue for a period of time," says the head of one multi-billion dollar macro hedge fund, a specialist in trading around global economic events.

"[The restructuring] has gone more or less as expected," echoes another hedge fund manager, who focuses more narrowly on trading debt. "Obviously the triggering of the CDS, which wasn't certain, was pretty eventful," he adds. "Though it looks like that's going to go smoothly too."

So where were all the hedge fund "sharks"?

One clue lies in the data on the total net notional value of CDS written against Greek bonds. A value of zero would indicate that, overall, the credit default market – where CDS are traded as protection against such an event – was balanced, with an equal value on contracts betting for and against default.

The total net notional CDS on Greek bonds has been on a steady downward slide for the past two years, having peaked in late 2009. In aggregate, the CDS market has gone from being directionally short Greece, to being more neutral. Part of the reason would appear to be that hedge fund managers, who had driven the speculative spike in CDS positions in 2009, began to close their shorts in 2010 and 2011 by either buying Greek bonds, or else writing CDS protection to new, less far-sighted investors who had suddenly woken up to their over-exposure to potentially toxic peripheral eurozone debt.

More recently, however, it has been market volatility that has kept hedge funds away.

"Managers haven't really had the ability to put on significant directional positions," explains Andrew McCaffery who runs a $5bn portfolio of investments in hedge fund managers for clients at Aberdeen Asset Management. "Where anyone has made any money, it has been incremental."

One trade that has worked for some hedge funds has been in exploiting the difference between Greek bond and Greek CDS prices.

"In January there was a very decent basis between CDS and some bonds," says Galia Velimukhametova, head of GLG Partners' European distressed debt fund. The arbitrage has since closed.

Longer-dated bonds were trading for significantly less than shorter-dated bonds, reflecting the views of investors such as Teaypoik.

"Prices were inverted," says Ms Velimukhametova, allowing some funds to construct low-risk trades designed to profit from them equalising in the event of the restructuring playing out to schedule.

Beyond the Greek market itself, Greek bonds, trading at highly distressed prices, have also become attractive as a hedge for funds looking to profit from further deterioration in the prospects of other peripheral European bond markets.

"Most hedge funds have moved on from any directional trades on Greek debt some time ago," says Jeff Holland, managing director at fund of hedge funds Liongate, but there are funds buying them for "trades between Greek debt and other European sovereigns", he adds.

Greek bonds offer short-term protection for traders looking to express negative views about the pricing of other European peripheral debt, such as that of Portugal, Spain or Italy.

Having fully priced in a restructuring, Greek bonds are unlikely to sink further in price, traders reason.

Holding them alongside a short position against, say, Portuguese bonds, protects against Europe-wide upside risks, without limiting the downside opportunity.

In the long term, however, few in the hedge fund community have any doubt that Greece's travails are far from over. Greece has undertaken its first debt restructuring, but there may well be more.