

Talking With **Robert Koenigsberger** Managing Partner Gramercy

## The Debt Doctor Is In

By **Erin E. Arvedlund**

Emerging-markets followers are familiar with Robert Koenigsberger: Nearly a decade ago, the distressed-debt manager pushed Argentina to restructure its overwhelming sovereign-debt load. More recently, he counseled the resurgent country to re-enter the capital markets, which it did successfully last year. The veteran of emerging-markets crises now suggests that some European countries need a similar treatment. Without it, they face the same crushing social and economic problems – and eventual default – that Argentina endured.

European countries, particularly ailing ones such as Portugal, Italy, Ireland, Greece and Spain, the so-called PIIGS, don't seem to have learned much from the painful experience of Argentina, says the founder of Gramercy, a \$2.1 billion hedge fund in Greenwich, Conn. "Europe is the second-slowest train wreck in history. We've seen this movie before; we've seen the warning signs. Europe has no experience with default, and they need a Brady plan," he says.

**Koenigsberger, 46, got his first-hand** knowledge working to secure backing for Argentina's historic swap of 92.4% of its nearly \$100 billion in debt from a 2001 default. Following a massive restructuring, the country paid investors roughly 25 cents on the dollar. The default followed years of political and economic turmoil that harmed both Argentina and investors. Life for both has improved substantially since.

Koenigsberger's flagship fund, Gramercy Emerging Markets, has returned an average of 10% a year since its creation in 1999. Like emerging markets, Gramercy has provided its share of thrills. In 2008 it lost about 47% of its value, before rebounding by 40% in 2009 and gaining another 10.5% in 2010. Gramercy now manages 12 long-only and long-short hedge funds.



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Gary Spector for Barron's

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Argentina's revival symbolizes the maturation of the emerging markets that are a big part of Gramercy's portfolio. "Emerging markets have emerged. Developed markets are submerging," says Koenigsberger, a former distressed-debt specialist at Lehman Brothers.

The younger, faster-growing markets have "better economic fundamentals and demographics, higher currency reserves and better government policies" today. In contrast, the biggest economies, known as the G-10 nations, "are now the world's problem, not the solution," says the hedge-fund manager. In emerging markets, debt amounts to an average of about 30% of GDP. In developed markets, it is closer to 100%.

"The PIIGS already trade like emerging markets used to trade," Koenigsberger says. "We consider Greece an emerging market [based] on a debt-to-GDP ratio."

That is why Europe needs to avoid the mistakes of the past. Supranational lenders such as the International Monetary Fund and the European Union, he says, shouldn't demand draconian national-austerity programs that ensure their repayment but not the long-term health of countries. "I advocate marrying aid with the re-profiling of debt further out on the yield curve," he says, meaning extending debt maturities. "That gives a higher probability of success than aid stapled to austerity."

For instance, he suggests using the European Union funds as backing to extend the maturity of the debt of such countries. They would serve as collateral so these countries could pay lower interest rates, fulfilling a function akin to Brady Bonds in the late 1980s. Named for then-Treasury Secretary Nicholas Brady, these bonds were backed by U.S. Treasuries and replaced billions of dollars of emerging-markets debt. Investors were willing to forgo uncertain immediate claims on sovereign borrowers of the day, in return for guaranteed payments over a longer time period.

A similar program in Europe might push sovereign-debt maturities out to 2040 from 2010. European lenders "need to use official aid as part of a holistic solution, not just a Band-Aid," Koenigsberger says.

The EU should be working on re-scheduling debt now and doing what it can to encourage private investors to participate, he adds.

**In light of its founder's views**, it isn't surprising that Gramercy was short bonds of western European countries in the first quarter. It was also short Japanese bonds and the U.S. dollar.

Gramercy's flagship fund owns South Korean and Turkish equities, among others, and is bullish on emerging-markets stocks generally. South Korea, Koenigsberger says, remains a paragon of Asian growth, while Turkey's economic data and political stability are impressive. He expects that Turkey's Justice and Development Party will win re-election, leading to further gains. Turkey has weathered the financial crisis well "because it has a history of weathering internal crises," he says.

Gramercy also owns Argentina's debt, a bet on the country's continued progress. Argentina's sovereign debt yields six percentage points more than Brazil's; its 2017 bonds trade at a 9.5% yield, compared with Brazil's 3.5% yield. Koenigsberger expects that spread to narrow to two percentage points in the next year. Although it might not match Argentina's gains, Brazilian debt still looks attractive to Gramercy. Another favorite: Turkish bonds.

**Gramercy is a big player** in credit-default swaps around the world. It views CDS as a cheap form of portfolio insurance that it can use either as a hedge or an outright bet. It has bought CDS on Belgian debt amid concerns about recent secessionist moves within that country. Koenigsberger calls Belgium "Yugoslavia with chocolates." If the Belgians were poor, he says, "they would be at war right now."

The firm also views the Belgian CDS as protection if European debt problems spread elsewhere on the continent.

More recently, Koenigsberger has seen value in CDS on Brazilian and Mexican debt, mostly because the swaps were very cheap. "It's not so much a view on the countries as bringing cheap insurance

into the portfolio," he explains. That said, he has mostly steered clear of Mexican markets because of the rising narco-terrorism in that country.

Gramercy's one big Mexican play is in Industrias Unidas, a manufacturer in default on some senior notes. The hedge-fund firm is leading the workout. Another distressed investment is Tristan Oil, a Kazakhstan outfit whose government owners have alienated bondholders by not paying interest on \$420 million in eurobonds and threatening nationalization. "It is another classic distressed situation," Koenigsberger says. "It has a government agency managing the assets."

Koenigsberger doesn't think recent unrest in the Middle East will spread to places such as Saudi Arabia. He believes much of the problem is tied to high food prices. The fund owns corporate bonds issued by companies in Saudi Arabia, Qatar and the United Arab Emirates.

Gramercy also owns Ivory Coast debt, despite the country's political upheaval. It trades for 35 cents on the dollar, and Koenigsberger sees "limited downside."

Last week, Standard & Poor's warned that it might downgrade U.S. sovereign debt, but Koenigsberger says that the market doesn't take credit ratings too seriously these days. Besides, the U.S. has an advantage over European countries such as Greece, in that it can print dollars, while individual countries in Europe can't print euros. Printing more currency will allow the U.S. to avert default, but could fan inflation, as he fears will be the case.

What worries Koenigsberger most is the market's complacency about interest rates. "In 1994, everyone was concerned about credit, and then the Fed raised rates," he says. "That could happen again, especially since we're seeing inflation globally."

In addition, the dollar continues to weaken. Investors didn't care much for the rate hike in '94, and chances are they wouldn't react positively now.

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