Ahead of the pack

BY JADE HEMEON

HANIF MAMDANI, LEAD MANager of PH&N High Yield Bond Fund and *Investment Executive*'s 2011 Fund Manager of the Year, refuses to overpay for securities, no matter how attractive they may appear. His willpower, discernment and keen sense of timing have propelled the PH&N fund's returns in the challenging world of high-yield corporate bonds.

Mamdani, 45, a strict value manager, has achieved a sparkling record of success with the $2.8-billion PH&N High Yield Bond Fund, sponsored by Vancouver-based **Phillips Hager & North Investment Management.** For the 10 years ended Oct. 31, 2011, the fund had a 10-year average annual return of 8.5%, handily beating the 6.3% return shown by the benchmark global high-yield bond index and even besting stock market returns for the same decade.

The S&P/TSX composite index achieved a lesser average annual gain of 7.6% over the same period, while the U.S.-based S&P 500 composite index lost 1.1% annually (in Canadian dollars).

Mamdani and his team, who are based in Vancouver and have managed the high-yield fund since inception in 2000, can take full credit for the long-term winning performance. The 11-year-old fund hasn't experienced a single losing year, even though most of the bonds in its portfolio rank below BBB (investment-grade).

"One of the most important aspects of managing money is to have a strong and clear investment philosophy," says Mamdani, vice president of fixed-income and head of alternative investments with **Royal Bank of Canada**'s global asset management arm, which manages PH&N and RBC's investment assets. "We like to buy securities that are high in quality as well as inherently undervalued. That combination is the holy grail for us. High in investment quality does not necessarily relate to credit rating. The bonds we hold must be able to deliver a high return, and a big part of that is buying when they are undervalued. We look for quality, but we won't overpay for it."

Mamdani and his team, which includes analysts Justin Jacobsen and Emil Khimji, employ a three-part process in picking bonds, primarily U.S. and Canadian bonds, for the PH&N high-yield fund. It begins with a top-down assessment of the global economy and big-picture trends. It's important to determine the tilt and stage of the economic cycle, says Mamdani, and whether it's a time to play defensively or aggressively, and this leads to a determination of which industry groups look attractive.

"We are not Noah's ark; we don't need two of every animal," says Mamdani. "There are certain industries that do not have a good history in corporate bonds, like airlines. Others have a good record of avoiding stress and defaults. We particularly like industries that have a recurring revenue stream, such as cable and wireless communications."

The No. 1 characteristic of an attractive corporate bond is the ability to pay interest and redeem the bond at maturity, and this requires healthy cash flow, Mamdani says. The bonds of companies that have a steady, repeatable business — rather than depending on commodities prices, new discoveries or the development of a new technology — are good candidates.

Top bond holdings in the PH&N fund include Quebecor Media Inc., Videotron Ltd., Qwest Communications International Inc. (now owned by U.S.-based CenturyLink Inc.) and Ford Credit Canada Ltd.

Once Mamdani has identified the industries and companies he likes, the next step is selecting the specific bond issue among several that may be available from the same corporation. At this stage, the work is in the small details, identifying the bonds with best risk/reward characteristics and most attractive valuations.

"Sometimes, we play higher up in the capital structure, seeking securities that have first call on assets although a lower yield than lower-ranking bonds; sometimes, an unsecured or subordinated security makes sense," he says. "If you buy an overvalued bond, the portfolio will underperform, even if you're right about the economy, the industry and the company itself."

Mamdani says corporate bond selection, like stock-picking, involves a lot of bottom-up analysis. That means modelling corporate cash flows, examining balance sheets and income statements, and interviewing management. Mamdani is also lead manager of

MUTUAL FUND MANAGER OF THE YEAR

KIM STALLKNECHT

"One of the most important aspects of managing money is to have a strong and clear investment philosophy," says Hanif Mamdani, lead manager of PH&N High Yield Bond Fund. That philosophy has paid off for Mamdani, who is *Investment Executive*'s Fund Manager of the Year. Mamdani has managed the PH&N fund since its inception in 2000 — and it has not experienced a single year of losses.

PH&N Absolute Return Fund, a multi-strategy hedge fund. There is, he says, some cross-pollination of ideas. (Both funds have been closed since 2010.)

When picking bonds, he views companies through a "different lens" than an equity fund portfolio manager. "A company could discover a new mine or develop a technology," Mamdani says, "but more important than growth is the ability to repay principal. It's a negative art — we're concerned about downside and look at what might go wrong, while the equities investor is often looking at the upside potential, and how good it might be. Growth never dominates our thinking, although it may ultimately improve a company's cash flow and credit rating."

Because there is always the potential for things to go sideways or turn down at any company, it's necessary to diversify, Mamdani says. Typically, no single security makes up more than 3% of the high-yield fund's assets under management, while multiple bonds from one corporate issuer usually make up no more than 5%, although the fund occasionally will exceed these parameters. Mamdani also likes to monitor industry exposure, with no more than 25% of AUM exposed to any single industry. He holds 40 to 60 names in the fund's portfolio.

The fund is currently running with a 4% cash position, waiting for an opportunity to buy when there's heavy selling. The portfolio is designed so a portion of bonds mature every year, supplying cash to snap up opportunities without having to sell other holdings.

"It behooves us to have some dry powder," Mamdani says. "If Europe takes a turn for the worse and there is a liquidation of assets, we want to be able to scoop up high-yield bonds at attractive prices."

Mamdani set out to be an aeronautical engineer, completing his undergraduate degree at the California Institute of Technology in Pasadena. As one of his electives, he took a corporate finance course with a visiting professor from the University of Pennsylvania's Wharton School, which altered his career's direction: "I found finance fascinating. The analytical situations dealt with business and economic issues that I found more interesting and stimulating than designing an airfoil."

Mamdani went onto Harvard University, where he earned a master's degree in economics, then headed to Wall Street.

Mamdani spent 10 years in the heat of the action, working for Salomon Brothers Co. (now part of Citigroup Inc.) and Credit Suisse in New York. He worked in investment banking, corporate finance and sales, ultimately becoming a bond trader. The time on the trading desk sharpened his ability to assess good trades, he says, and he "knows all the tricks."

Mamdani then returned to his hometown of Vancouver, where he joined PH&N as manager of a high-yield institutional pooled fund. He oversees about $20 billion in corporate bonds in various managed products, including PH&N High Yield Bond Fund. "It's more intellectually stimulating to be trading bonds for clients who are long-term investors," he says, "rather than simply being an intermediary on a trading desk, buying and selling over the course of a few hours." **IE**