

STRATEGIES

Trade Secrets: Fixed Income

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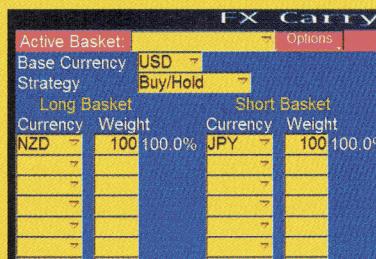
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Active Basket:		FX Car		
Base Currency	USD	Strategy	Buy/Hold	
Long Basket		Short Basket		
Currency	Weight	Currency	Weight	
NZD	100	100.0%	JPY	100
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-

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Betting on the Real

Arthur Steinmetz's Oppenheimer International Bond Fund tops the international debt fund rankings thanks to getting in early on Brazil's bond rally.

By Oliver Ludwig

ARTHUR STEINMETZ'S BETS on Brazil have helped his Oppenheimer International Bond Fund rack up the best returns of any U.S.-based international bond fund this year. "Right now is the golden age of bond investing in Brazil," Steinmetz said in May.

The senior vice president at New York-based OppenheimerFunds Inc. also said Brazil's golden age was closer to its end than to its beginning. "I would also say we're in the seventh inning, not in the first inning," he said. "A large part of our performance success is that we got in this game in the second inning."

The \$7 billion fund returned 5.4 percent this year as of June 6, the best result among 20 mutual funds that buy debt globally, according to data compiled by Bloomberg. The Brazilian real's 81 percent increase against the U.S. dollar since Dec. 30, 2002, helped propel Steinmetz's fund to an average annual return of 14 percent in the five years ended on June 6. That return also ranks No. 1 for the period.

"The currency is really where the interest is," Steinmetz, 48, says. "You don't get the benefits of going international if you buy a hedged fund."

The Pimco Foreign Bond Fund (U.S. Dollar-Hedged), which is hedged against declines in local currencies, was down 0.7 percent this year through

June 6, ranking 17th among its peers, according to Bloomberg data.

In May, the real was the Oppenheimer fund's third-largest currency position in terms of value at risk. Steinmetz says that because the fund invests in derivatives as well as cash bonds, he keeps track of the fund's exposure to changes in currencies, interest rates and spreads with a proprietary value-at-risk program. Value at risk is a statistical measure of how much the fund could theoretically lose during a given period. Derivatives are contracts whose value is derived from stocks, bonds, loans, currencies and commodities or is linked to specific events such as changes in interest rates or the weather.

THE FUND'S BIGGEST currency position was in euros, and its second biggest was in yen. That's not because Steinmetz likes those currencies more, he says. It's because the fund's benchmark, the Citigroup Non-U.S. Dollar World Government Bond Index, contains a lot of euro- and yen-denominated securities, and the fund can't deviate too much from its returns. In May, a so-called one-sigma move in the Brazilian currency during one week would have re-



'The currency is really where the interest is,' **Arthur Steinmetz** says.

Arthur Steinmetz

OppenheimerFunds

Senior vice president

Current job: Oversees \$18.6 billion in eight funds, including the \$7 billion Oppenheimer International Bond Fund.

Background: Earned a bachelor's degree from Denison University in Granville, Ohio. Served in the U.S. Air Force. Earned an MBA from Columbia University in New York. Joined Oppenheimer in 1986.

Personal: Age 48. Married, with four children. Home-brews award-winning beer.

varies from the mean of a probability distribution. (A basis point is 0.01 percentage point.)

Steinmetz uses the Bloomberg application programming interface to download data for proprietary quantitative analysis that he does in Microsoft Excel. "I have quite a few spreadsheets open on my desktop all day long that are linked to Bloomberg," Steinmetz says. He also draws on the data to test potential trades. "I have a trade on where I'm long the Russian ruble against a basket of currencies that I think proxy the official Russian basket but have much higher carry," he says. He keeps tabs on that strategy with a so-called dashboard in Excel that summarizes its performance. Type BBXL <Go> for information on using Bloomberg data in Excel.

BRAZIL IS THE only emerging economy in Steinmetz's top-five country allocation. His stake includes corporate and government debt as well as structured securities issued by investment banks.

President Luiz Inácio Lula da Silva's central bankers cut interest rates to a record low of 12 percent at the bank's June 5–6 meeting after annual inflation slowed to about 3 percent through mid-

May. The Brazilian bond rally will continue as the gap between official interest rates and inflation narrows, Steinmetz says. Most of the Brazilian debt in the fund is denominated in reais, meaning investors in those securities benefit from the currency's advance against the dollar.

Steinmetz uses the Percent Change: Currencies (WCRS) function to check overnight currency moves. Type WCRS <Go>, tab in to the RET PERIOD field, enter 1 and press <Go> to see the ranked one-day returns of a selected group of currencies against a base currency.

Even Brazilian debt denominated in U.S. dollars has outperformed most bonds sold by developed nations. Brazil's 8.875 percent 15-year bonds, Steinmetz's biggest public holding in the country, returned an average of 18 percent a year as of June 6 since they were issued in October 2004.

Steinmetz also owns bonds in local currencies from Argentina, Colombia, Malaysia, Peru, Russia, Turkey and Uruguay. He's also invested in African countries such as Cameroon, Ghana and Nigeria. "My own personal approach to investing is to always push the envelope a little bit," he says. When Russia defaulted on its debt in 1998 and emerging-market bonds tumbled, the Oppenheimer fund had its only losing year since it opened in 1995. The fund fell 5.3 percent, more than 93 percent of rivals, exposing the risks of unhedged funds.

"The way we see this fund is that it's more aggressive, and that's clearly been beneficial over the long term," says Andrew Gunther, an analyst at Chicago-based Morningstar Inc., which tracks the fund industry. "You've had to hold on tight a few times here and there. It's not for everyone." The fund had Morningstar's highest rating of five stars as of June 6.

Inflation in Brazil topped 6,800 percent in 1990, half a decade after a military regime ended. The country is still racked by poverty, and Lula has employed conservative economic policies to create greater wealth. Investors require higher yields on the debt because of concern the government will lose its fiscal discipline, Steinmetz says.

A commodities boom, a surge in foreign investments and a stronger currency have stabilized the economy. "Brazil should have real interest rates that are much lower," Steinmetz says. "We think that's going to happen, but the reason why those rates are so high is because investors are backward looking." ♦

With reporting by ADRIANA BRASILEIRO in Rio de Janeiro and FÁBIO ALVES in Brasília.

Press <Help> twice to send a question to the Bloomberg Analytics help desk.

Percent Change: Currencies		Page 1		
Total: 72 Currencies	Ref Period	Region	Base Curr	USD
Best Performing Vs. USD				
World Currencies				
Start Date	End Date			
5/28/07	5/29/07			
10 HAITI GOURDE				.75
2 CANADIAN DOLLAR				.62
3 BOLIVIAN BOLIVIANO				.54
4 SWISS FRANC				.39
5 TAIWAN DOLLAR				.28
6 CROATIAN KUNA				.27
7 NEW ZEALAND DOLLAR				.27
8 DANISH KRONE				.27
9 EURO				.27
10 CZECH KORUNA				.27
- .21				
- .22				
- .24				
- .29				
- .30				
- .33				
- .36				
11 MALAYSIAN RINGGIT				
12 KENYAN SHILLING				
13 SOUTH AFRICAN RAND				
14 CHILEAN PESO				
15 PARAGUAY GUARANI				
16 POLISH ZŁOTY				
17 BOLIVIANOS PESO				

>Percent Change: Currencies

Type WCRS <Go> to display a ranking of the 10 best- and worst-performing currencies against a base currency during a selected period.