

## Green's Acer

How Byron Green's high-yield fund stays high even when junk bonds tank.

By Bennett Voyles

May 19, 2005- The phrase high-yield bonds may bring back memories of Michael Milken and other eighties high-fliers. But Byron D. Green Jr. of Fort Worth makes his high-yield bond investment sound about as risky as buying a Treasury bond.

Maybe even less risky: Green, the president of Green Investment Management, argues that investing in B-grade bond funds can be even less risky than Treasuries, since the Treasury market is much faster-moving. He might say that in the volatility department, junk beats blue-chip stocks too: over the past three years, the fund has had a 5.04 percent standard deviation, compared to 15.40 percent for the S&P 500 Index.

Slow and steady? Not really. Although the returns of the \$50 million Green Investment Management Guardian Fixed Income Allocation have been steady, they have also been anything but slow. "We have a fraction of the volatility [of the S&P], and yet our returns - shoot, you look at our long-term returns - we've had about 9.44 percent since inception, and that will be 14 years here come June," says Green. Over the same period, he says, the S&P has returned 10.56 percent per annum. "So we've had about a third of the risk of the S&P and ... probably 80 percent of the return," he says.

What's the secret? Rated four-stars by Morningstar's Principia service, Green's fund isn't kept fully invested in the high-yield market. Instead, by shifting allocations between high-yield corporate bonds, cash, and government bonds, Green tries to maintain what he calls "an all-weather portfolio."

Green says that because high-yield bonds behave in ways that are more like equities than bonds - bad news for the stock market is typically bad news for high-yield bonds too - government bonds offer a perfect way to hedge their risk. "The two go together perfectly, because at the very time that the high yields would in the most extreme environments be the least attractive, that's the very environment where the government bonds would be

most appealing," he says. And in more uncertain times, there's always cash.

If Green held bonds directly, it would be hard to adjust allocations so often. Instead, he works with a half-dozen institutional funds that don't mind his extreme tinkering.

Green invests across a broad spectrum of high-yield funds. "We do pick specific managers but we mostly just make sure we have broad exposure," he says. The funds he chooses don't buy convertibles, no preferred bonds, and very little emerging market paper, nothing but plain-vanilla domestic, high-yield bonds. "We understand that market and know how it moves," he explains.

As with the 11 other styles of managed accounts Green runs, allocation decisions for the high-yield account are based on how the firm's models read the market.

The models are at the heart of the firm's method. Green began developing his algorithms 25 years ago, when he was a young stockbroker at Loeb, Rhoades, Hornblower. "As a broker, I had some clients that were very successful investors - for a time," he says. But when the market went into a new phase, none of them were able to adjust their strategies in a way that took advantage of the new environment.

Green says he wanted to find ways to help his clients make better transitions as the market moved from one cycle to the next. Using programming skills he'd picked up as a salesman for Burroughs Corporation in the late 70s, he back-

tested stock and bond performance through various economic and business cycles. He says he tried to "figure out what makes things work and why some periods were better than other periods." Then, he designed asset-allocation software that used that information to improve the success of his clients' portfolios.

Encouraged by fellow Loeb broker Guy Cumbie, now a prominent Fort Worth financial adviser, Green opened his own firm in 1984, using the models he'd developed.

A little later, Green found another influence in the writings of Martin Zweig, a legendary money manager and author of the 1986 book *Winning on Wall Street*. "His book got me thinking



Byron Green

about the ways the markets could be studied and how disciplined strategies could be developed to aid in portfolio management," Green recalls.

Zweig advocated making trading decisions based on a mix of macroeconomic and technical indicators, particularly monetary policy and market trading volume. His mantra: "The market is smarter than I am so I bend."

In the fixed-income sleeve, Green says, the model's most important factors include the stock earnings outlooks, since high-yield performance tends to track equity performance. The spread between low-quality and high-quality bonds is another important indicator. "If we see those spreads lagging, it's obviously increasing or showing or reflecting rising concerns by investors," he says. For similar reasons, the model also incorporates the Chicago Board Options Exchange's Volatility Index (VIX), which according to the CBOE's Web site primer, "measures the market's expectation of 30-day volatility implicit in the prices of near-term S&P 500 options."

Finally, he says, the model looks at the macroeconomic picture. Right now, those indicators seem to be trumping other factors. At the moment, the fund is 90 percent in cash, according to Green, the first time it's been at that level since around 9/11. However, Green says, he expects the allocation will change in the next few months, once managers get more of a sense of whether the Federal Reserve will be able to contain inflation and how weak or strong the economy will be after that.

After 21 years in the business, Green has about \$140 million under management. His firm has 11 employees, three of whom are involved in managing the money. His son, Trey, 21, a student at the University of Texas at Arlington, and daughter Andrea, 18, a student at nearby Tarrant County College, work in the firm part time. But while each of his children is interested in business generally - Trey is majoring in communications and advertising, Andrea is pursuing a business degree - the veteran forecaster

doesn't seem to have developed a model regarding the likelihood that they'll join the family business.

"I guess most men think they would like for that to happen, and I would be in that camp too, but usually the kids don't think that way. It's anybody's guess now. I would say if you were to ask my kids they'd say no, but who knows what might develop," he says.

Such openness to surprise seems to be as much a part of Green's professional outlook as in his family life. In spite of the work he's put into developing his models, Green says he really uses them as a kind of barometer to suggest what should be done with an allocation, not maps to be followed mechanically.

When it comes to executing the model's strategy, Green seems equally open to new ideas. At the moment, he is watching several new high-yield funds that have come on the market. One in particular that he thinks may prove useful for his firm: Profunds' new reverse high-yield fund, which is designed to move opposite to the high-yield market. He says that if the reverse-fund performs as promised, it will make it easier for him to reduce exposure to an active institutional fund without being disruptive to that fund's manager.

Green works entirely on a wholesale basis, through independent advisers. Minimums are only \$20,000, extremely low by typical managed-account standards. The funds carry an annual fee of 2 percent for smaller accounts, half of which is shared with the adviser who has signed his client up for the service.

Selling a high-yield bond fund that's 90-percent cash might seem like a challenge, but Green says assets have actually grown rapidly over the last few months. Advisers who invest understand his firm's investment philosophy, he says. He also speculates that high-yield bonds may seem like better bets than equities in an uncertain market. "It may be a more comfortable way to participate in equity-like investments when the equity market is in turmoil," he says.