HOLLIS PARK PARTNERS: PROTECTING CAPITAL IN A TURBULENT MARKET

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When Troy Dixon decided to launch a hedge fund firm, he wanted to give it a name that represented his life's journey while also symbolizing the hard work and determination that was required to be in a position to start such an enterprise. He decided on Hollis Park Partners, which paid tribute to his lower-middle-class upbringing in Hollis, Queens, as well as his coveted address near Duane Park in Manhattan's chic Tribeca neighborhood.

With more than 20 years of trading experience within structured products, the Founder and Chief Investment Officer oversees a portfolio of mortgage-backed securities: Collateralized Debt Obligations, Collateralized Loan Obligations, Asset-Backed Securities, Commercial Mortgage-Backed Securities, Non-Agency Residential Mortgage-Backed Securities, Agency Residential Mortgage-Backed Securities, and other structured products.

"That universe is almost $13 trillion worth of assets so it's the biggest fixed income product set by a long shot," says Dixon, whose firm launched in 2014 and received $50 million in seed capital from GCM Grosvenor. "When we look at our asset class, we look across a broad array of products and where the opportunities sit in one may be very different than where the opportunity may sit in another."

One of Hollis Park's primary focuses is on a prepay relative value strategy where the firm buys mortgage-backed bonds that have some prepay protection – those in which homeowners (for various underlying reasons) are most likely to not prepay as fast as others. "Simply put, we try to buy things that we think are going to prepay slower than the world does and short, or hedge with things that we think are going to prepay way faster than the market does," Dixon explains.

The firm has three investment vehicles: an absolute return, a private credit, and daily liquidity. "I'm a mortgage guy by trade and in my time at Deutsche Bank – my last stop before I started my firm – I co-ran structured product trading," says Dixon. "And through that experience, I felt like we could create a durable investment process that can withstand drawdowns in a much more thoughtful way and is much more protective of capital if you adjust the liquidity and risk in the right manner."

HITTING THE RESET BUTTON

Dixon says entrepreneurship is in his blood and anticipated that his professional career would head in this direction early on. "As I advanced in my career, I looked around and said, 'who in the minority space could actually launch an alternative asset manager and/or hedge fund?'" But he learned that going from a large global firm to an entrepreneur is never an easy undertaking. "I was naive about a lot of things, but the core thesis of it was to lay the framework for people of color to follow suit in an industry that had created a plethora of wealth for people that don't look like me."

A former Managing Director and Head of RMBS Trading Group at Deutsche Bank where he led a top-ranked group of 70 investment professionals, Dixon was confident he had the investment acumen and relationships to get a firm off the ground. "One of the things I said to myself was, 'whether I win or lose at this, at least it will be on my terms." Dixon came to realize he was wrong in that assessment. "Absolutely nothing is on your terms. There are many more things on your terms when you work under a big infrastructure than when you don't."

Dixon describes the shift to entrepreneurship as hitting a reset button on his career. “I had achieved a fair amount of success. I had a fair amount of cachet with our account base and with my senior leadership, then you basically take that currency and you burn it and for all intents and purposes, restarting from scratch,” he recalls. “That has been the most humbling part of the entire process – building up a reputation over 20 years and kind of going back to where you’re unproven again.”

LOWER RATES, HIGHER RETURNS

One of Hollis Park’s alpha-generating deals came by way of the 2018 market slump brought about by the US-China trade war. “We came into 2019 understanding that our overall economy couldn’t withstand higher interest rates and the economy was forcing interest rates lower.” The lower the interest rates, the more incentivized homeowners are to refinance at the reduced level and retire their prior mortgages, making it more attractive to sell or hedge with an asset that prepays faster.

The team noticed the majority of the other players in the market were using a 2016 model to determine prepay levels. Hollis Park believed this model to be outdated as 2016 saw an all-time low in the 10-year yields due to Brexit – conditions unlikely to be repeated in 2019. “They were literally taking prepay models and regressing them to 2016, which we thought was a massive error in large part because the majority of the universe in 2016 was serviced by the large center city banks,” Dixon says. Due to penalties that the government levied on the banking system as a result of the financial crisis, most of those banks stepped away from offering mortgages to focus on refinancing their customers.

This created an opportunity for non-banking entities to fill the void – Quicken and PennyMac for example. These smaller entities had business models predicated on refinancing everyone they can and issuing mortgages to attempt to have the property owner refinance at a later date. “What the models were missing is that the servicing had gone from the JPMorgans, and the Bank of Americas to the Quickens and the PennyMacs whose business models are completely and utterly different,” Dixon explains.

Hollis Park then bet that 2019 prepays were going to be significantly faster than in 2016, and when the Federal Reserve ended up cutting rates three times in 2019, homeowners with at least a decade of home value appreciation quickly took advantage and jumped on the refinancing bandwagon, retiring their existing mortgages. “You had a massive amount of origination in 2018 who are now going to be back at the trough to try to refinance because their ducks were all in place,” Dixon recalls. “As a result, prepayments exceeded the models by 30% in most cases.” All told, the hedge helped the firm generate 955 net basis points on the year, outperforming the majority of its peers.

OPPORTUNITIES IN TURMOIL

Amid the turbulence of the 2020 financial markets are also opportunities. “There is going to be a lot of principal forgiveness and it’s going to create unique opportunities again with regards to the agency mortgage market,” says Dixon. “Those are some of the plays that we’ve had and focused on within our book.”

With the U.S. government buying public securities, its footprint on the public market is going to last at least a decade, according to Dixon. “I think understanding nuances around how a particular resource that the government is using to implement their programs will react will serve investors well,” he explains. “The second thing is understanding that this is a work in progress and there are no set rules just yet, so you have to be cognitive about it as you take risk, understanding that the sizing and exposures that you want to have in markets really don’t have full-fledged answers, no matter what level of research you have at your disposal.”

In the meantime, Dixon and the Hollis Park team are focused on understanding this new landscape, how best to implement strategies to capitalize on government actions and their potential effect on the common homeowner in America. “We are hopeful that this shakeup in the markets will identify us as a protector of capital within our competitive landscape.”