Secrets From the Brewer-Bond Manager

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FUND TRACK

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Strategic Income Fund Has a Global Flavor; Bargains in Subprime?

By MICHAEL A. POLLOCK

NEW YORK – Hunched over a small table in a bar in New York's Greenwich Village, Art Steinmetz lifts a small glass of amber beer and savors the aroma.

The imported brew, sour and nearly flat, is fermented in open vats in the attic of a Belgian brewery. That permits airborne yeast, bacteria and perhaps an occasional spider to drop in, adding to the flavor, he says.

Mr. Steinmetz, who manages bonds at New York-based mutual-fund firm OppenheimerFunds Inc., is as fascinated by the process as the result. He brews his own beer – having won a local competition with a German-style entry – but likes to sample the imports at this city tavern for comparison.

Art Steinmetz

Bond Fund on Tap

In his day job, Mr. Steinmetz has been brewing a standout bond fund, Oppenheimer Strategic Income Fund. Its 9.21% return last year was among the top-performing funds in its category. Mr. Steinmetz and colleagues were named finalists for research firm Morningstar Inc.'s 2007 bond manager of the year (won by Bill Gross of Pimco Total Return fund).

Over the past 12 months, investors have poured $1 billion into the Oppenheimer fund, helping to boost assets 30% to $9 billion. Still, Mr. Steinmetz believes strategic income funds aren't well-appreciated, much as conglomerates baffle investors because of the variety of markets they compete in.

"Everyone wants to reduce complexity, and that sort of forces mutual funds into style boxes," Mr. Steinmetz says. "We don't fit into a style box."

Indeed, based on style, strategic income bond funds resemble hedge funds – roaming nearly anywhere in the world in search of undervalued securities that might produce outsize returns. The key differences are that hedge funds charge double-digit management fees and use leverage – borrowing against the assets they own – to buy more securities to pump up returns.

Unlike many hedge funds, Oppenheimer Strategic Income has been around for nearly two decades. "Hedge funds are like Manhattan restaurants," contends Mr. Steinmetz. "Nine out of 10 are going to disappear within a year."

After it opened in the late 1980s, Strategic Income was one of the first mutual funds to shop for value abroad. The fund today has about half of its portfolio in the U.S., but the rest is scattered around from Peru to Russia.

Russian History

A major position in Russian bonds slammed the fund's returns back in the late 1990s, helping to prevent its assets from reaching $10 billion. Mr. Steinmetz has fared much better overseas since. Last year, thanks mainly to currency gains, his Turkish holdings surged about 45% in value while his Brazilian position gained more than 30%.

Illustrating its range of holdings, the fund also owns some so-called catastrophe bonds, which can pay juicy returns if their issuer isn't beset by a specified natural disaster. Some bonds it owns are pegged to earthquake risk in Tokyo and the threat of wind damage in Europe.

Amid credit-markets woe, Mr. Steinmetz is focusing more closely than ever on U.S. markets – such as mortgage securities – that were battered in the rush away from anything connected to subprime.

"Subprime is going to be a terrific asset class in 2008," Mr. Steinmetz says, though declining to elaborate on where he sees most value. "There are surely bargains in some riskier pieces of structured securities, but it's going to take a lot of homework to find them."

Meantime, Mr. Steinmetz is planning a new brewing set-up in the basement of a house he and his wife have built in exurban New Jersey. Regrettably, he says, it won't be a suitable place to brew anything like what comes out of musty Belgian attics.

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