



Interview with Todd Gorelick, Managing Partner of Gorelick Brothers Capital

EurekaHedge

Gorelick Brothers Capital, established in 2003, manages the Morrocroft Special Opportunity Fund I, a hybrid fund of funds with a private equity structure, focused exclusively on real estate credit strategies. The firm's investment team has decades of experience in subprime consumer lending, residential mortgage information and settlement services, structured credit securitisation and trading, and commercial real estate investment and analysis. The firm also manages the Morrocroft Diversified Fund, a multi-strategy fund of hedge funds launched in 2005 with a wealth preservation mandate.

Todd Gorelick is one of the firm's managing partners. Todd's background includes commercial mortgage brokerage and consulting, and subprime mortgage lending. From 1991 to 2003, Todd was managing partner of Atlantic Assurance Group, a national mortgage information and settlement services business.

1. Could you tell us your rationale of launching a fund of funds that invests in hedge funds allocating to US mortgages? Do you suppose the worst is over for this sector of the market?

We are convinced the best way to address the "distressed mortgage" opportunity is through a combination of distinct systems, experience, infrastructure and relationships. There are more than a dozen non-agency investment strategies. Even within each strategy, there is a variety of trading styles, collateral preferences and investment philosophies with diverse risk/reward profiles. This is an abruptly emergent new asset class. Most strategies, if executed by capable managers, will have upside, but identifying those that will drive outperformance is less clear. Diversifying among top-tier managers for *upside* exposure makes a lot of sense, and covering the waterfront of opportunities requires *at least* eight managers. Entry timing is important. There have already been several false bottoms in mortgage securities, and the worst is ahead for whole loans. That's why gradual, phased capital deployment is essential. Given all of these considerations, we felt a broadly diversified, multi-manager vehicle with private equity structure was the most prudent way to take advantage of the dislocation in mortgage credit.

2. What different types of mortgages and mortgage-related securities do your portfolio constituent funds invest in? And on what basis do you diversify your investments across each of these types of securities?

Our managers can buy residential and commercial mortgage-backed securities across the capital structure and senior or second lien whole loans, both performing and non-performing. Our goal is to cover the entire range of opportunities over time with the bulk of exposure residential. Generally, we want to be overweight senior while home prices are still declining at a rapid clip. As time passes, we will migrate exposures both down the capital structure and closer to the real estate. These are general guidelines, though, and we will sometimes allocate to an extraordinary manager even if timing is not ideal.

3. Manager selection may be a key determinant of the performance of your fund. In that context, what are the eligibility criteria that make a hedge fund suitable for consideration to be in your fund's portfolio? Could you walk us through your manager selection process?

For securities strategies, managers must have meaningful prior experience analysing and trading seasoned asset-backed cash flows. That is relatively rare. Even less common are teams that have worked together for a long time using systems developed and enhanced over many years. In whole loan strategies, we're looking for experience in loan origination, trading and servicing, and we will only consider managers with dedicated servicing capacity, and increasingly, affiliated origination capability. Given the illiquidity and price volatility of MBS and whole loan assets, we prefer funds which limit the risk of liquidity mismatch through long lock-up or private equity structure. For the same reason, we also want to see extremely conservative or no use of leverage.



- 4. Besides the research done by hedge fund managers, do you also directly engage in in-depth research and analysis of instruments within the US loan and mortgage markets? If so, what kind of qualitative and quantitative research do you perform on the sectors?**

We stay in touch with many dozens of mortgage credit managers, and they share an extraordinary amount of information with us. We are also avid readers of published research both from the broker/dealer community and from independents. In addition, through our network of contacts, we track a number of "on-the-ground" factors like foreclosure extension time or the pull-through rates for cold calls on borrowers who are prospects for FHA refinancing. Given the speed at which this asset class is evolving and its special sensitivity to exogenous factors, you really can't have too much information.

- 5. On average, how many hedge funds is your fund's portfolio comprised of? Also, do you have a cap in place, on the maximum exposure you can have to a single hedge fund?**

So far, we have committed capital to six managers. We expect eventually to have about a dozen in the portfolio. Individual positions will range from 8% to 15%, and there is a hard cap of 35% to any manager.

- 6. What has your long to short exposure to the underlying markets (through hedge funds) been over recent months? Do you foresee any significant shift in that ratio over the months to come?**

Our mortgage credit portfolio managers' strategies are predominantly long or long only. We will have very modest exposure to relative value trading strategies. Given long holding periods and limited or no leverage, most managers see no need to hedge volatility.

- 7. How frequently do you monitor the performance of hedge funds that you invest in? What risk management measures do you have in place for your fund?**

We talk with our managers and monitor risk exposures at least quarterly, and generally much more frequently. We visit them at least annually. That said, we are investing in very long locked-up or closed-end vehicles. Understanding existing risk exposures generally enables us to shape future allocations, not resize prior investments.

- 8. The EurekaHedge Distressed Debt Fund of Funds Index has shed 5.3% for the six months ended September 2008. Could you give us an indication of your fund's performance since it launched in March this year?**

Through September, the fund was down about 9% on drawn capital and 3.7% on committed capital. Less than 50% of capital has been invested to date. Managers are prepared to buy and hold high quality assets to maturity and generally regard downticks as a signal of greater opportunity, not permanent loss.

- 9. What investor classes do you mainly intend to cater to with this fund? And what are the types of investors that have shown interest in your fund since its inception?**

The fund's current investors are largely high net worth individuals, most of them long-time mortgage or securitisation industry professionals. In addition to high net worth families, we are in due diligence with, and have seen meaningful interest from, pension and endowment consultants, RIA's and multi-family offices.



10. And lastly, could you share with us your medium-term outlook of the US mortgage markets? Also, are there any particular mortgage-related securities in the region that you are currently bullish on?

The primary driver of fundamental performance in mortgage securities is home price decline, and our managers generally believe home prices will decline an additional 10-15% from here. Increased unemployment will undoubtedly compound the foreclosure problem, and that is likely to extend and deepen the housing downturn. As a counterweight, we expect government programmes to continue to expand dramatically. In this environment, we like top of the capital structure securities with high current cash yields and significant insulation from loss.

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