Fund Nets $2 Billion Trade

Och-Ziff, With Strategy from a 30-Year-Old Debt Specialist, Racks Up Big Score

By GREGORY ZUCKERMAN

A 30-year-old hedge-fund trader last year racked up gains of almost $2 billion through bets in exotic debt markets.

Now some wonder if the new star's strategy is still a winner.

James Levin, of Och-Ziff Capital Management LLC, OZM +0.61% made a wager in 2012 of more than $7.5 billion on "structured credit" debt investments. That amount represented about a quarter of the money the firm managed when the investments were made.

The bet paid off. Mr. Levin's group scored 2012 gains of nearly $2 billion, or about 25%, before fees—likely making it one of the top trades on Wall Street last year. The credit team, with 14 members, accounted for more than half of the 468-person firm's $3.4 billion trading gains last year, according to people close to the situation.

Mr. Levin and Och-Ziff aren't the only boldfaced investors who scored large gains last year buying investments such as residential mortgage-backed securities and collateralized loan obligations, among others, many of which were crunched in the financial crisis.

The prices of these instruments rallied in 2012 amid the U.S. housing rebound and the hunger by investors for debt with sizable yields, and have risen further in 2013.

Seth Klarman's Baupost Capital, Jeffrey Gundlach's DoubleLine Capital LP and Greg Lippmann's LibreMax Capital LLC are among those who saw hefty returns in 2012. Dozens of smaller hedge funds also racked up sizable gains, as did SkyBridge Capital, which invests in various funds.

None of these investors are believed to have put as much in the trade, or made as much money from it, as Och-Ziff and Mr. Levin.

"It's not a one-man show, but we think he's a star," says Timothy Walsh, director of New Jersey's Division of Investments. The pension-fund manager invested over $500 million in a customized account managed by Mr. Levin's group that bought bank loans and scored gains of over 35% in 2012.
Mr. Levin didn't respond to requests for comment.

Mr. Levin, who goes by Jimmy and is described as outgoing and thoughtful, works closely with David Windreich, Och-Ziff's head of U.S. investing, and Daniel Och, the firm's founder, according to people close to the matter. Mr. Levin first got to know Mr. Och when he taught Mr. Och's son to water ski at summer camp several years ago, before Mr. Levin completed a degree in computer science at Harvard University.

Mr. Och helped him find his first job at Sagamore Hill Capital Management, according to someone familiar with the matter. After a stint as an analyst in the distressed debt and statistical-arbitrage group at Dune Capital, Mr. Levin joined New York-based Och-Ziff in 2006.

Structured credit is something of a catchall for a variety of securities with claims on a stream of cash flows, such as mortgage, credit cards and car-loan payments, as well as corporate loans. These payment streams are sliced into securities, such as mortgage-backed bonds, with various levels of risk and corresponding yields.

In past years, traditional buyers of this debt, such as trading groups within banks, would have benefited from the rally. But many banks have shut or curtailed their proprietary-trading groups on the heels of the financial crisis and pending limits on bank risk-taking. As a result, the top beneficiaries have been hedge funds and some big mutual funds, according to traders.

"A whole area of competition for hedge funds is gone," says Ray Nolte, SkyBridge's chief investment officer. In some ways, Mr. Levin's strategy was riskier than some rivals' because he did less hedging, or protecting against the downside, than some others, according to people close to the matter. Mr. Levin's team was an especially big buyer of investments tied to residential and commercial mortgage-backed securities, traders say.

Lately, some big investors have cashed in some chips from their own holdings of structured credit, arguing that these investments no longer have the same upside potential they did a year ago and could suffer if interest rates jump or the economy hits trouble. Some also worry that this market could become hard to exit if the market weakens.

Some investors say they've become concerned that these investments have been so hot that they now offer less-attractive yields. One large player, Paul Singer's Elliott Associates LP, is among those who were early buyers of structured-credit investments but has since trimmed positions, according to people close to the matter.

Despite that caution, Och-Ziff, which now manages nearly $33 billion, kept 24% of its money in these investments at the beginning of 2013, according to filings, barely less than the firm's allocation much of last year.

Other bulls say the market remains liquid enough to allow them to get out if they choose. Mr. Nolte of SkyBridge, which has 40% of its assets in structured credit, up from about 13% at the beginning of 2012, says there is "still room for the market to improve." He notes that whether structured-finance investments rise or fall in value over the coming months, "they're still throwing off attractive" yields for investors who hold them to maturity.

"Some institutions are going to move on, and we'll start seeing some chips taken off the table," says Patrick McMahon, co-founder of hedge fund MKP Capital, which manages nearly $7 billion and has done some selling of its own. "But the sector has stable-to-improving fundamentals and appears to offer attractive yields relative to other credit instruments."

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