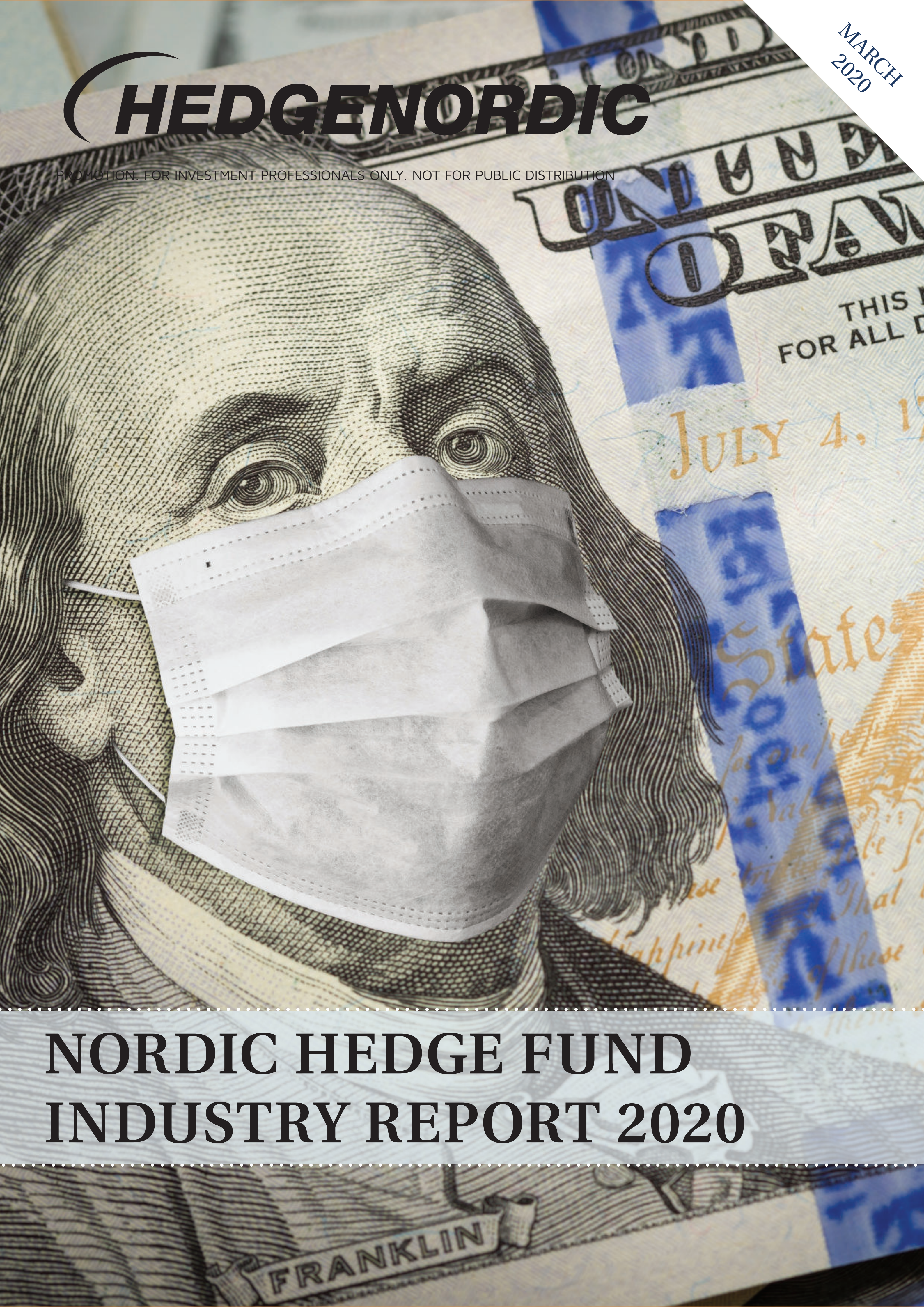
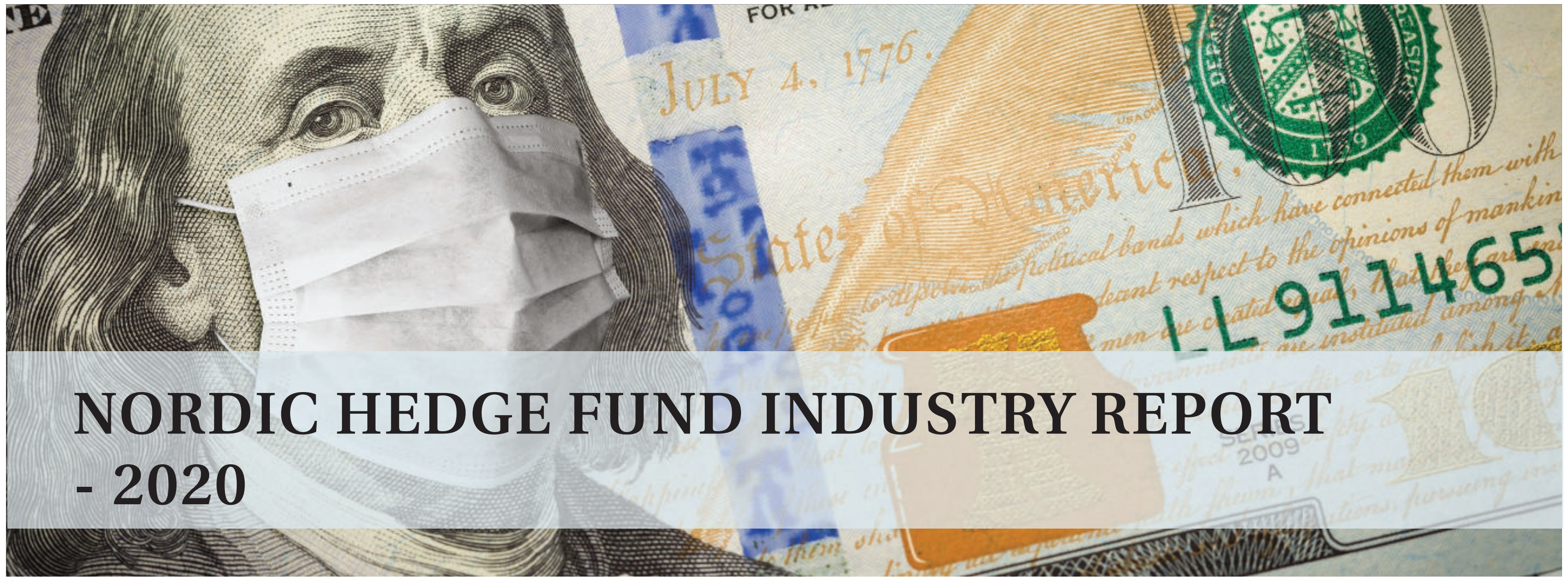
MARCH
2020

HEDGENORDIC



NORDIC HEDGE FUND INDUSTRY REPORT 2020



NORDIC HEDGE FUND INDUSTRY REPORT - 2020

Contents

HEDGENORDIC

INTRODUCTION

HedgeNordic is the leading media covering the Nordic alternative investment and hedge fund universe. The website brings daily news, research, analysis and background that is relevant to Nordic hedge fund professionals from the sell and buy side from all tiers.

HedgeNordic publishes monthly, quarterly and annual reports on recent developments in her core market as well as special, indepth reports on "hot topics".

HedgeNordic also calculates and publishes the Nordic Hedge Index (NHX) and is host to the Nordic Hedge Award and organizes round tables and seminars.

PUBLICATION PLAN 2020:

March:	Nordic HF Industry Report
June:	Systematic Strategies
September:	Private Markets
October:	Diversifying Portolios
November:	Alternative Fixed Income
December:	Megatrends

CONTACT:

Kamran George Ghalitschi
Nordic Business Media AB
Kungsgatan 8
SE-103 89 Stockholm, Sweden
Corporate Number: 556838-6170
VAT Number: SE-556838617001

Direct: +46 (0) 8 5333 8688
Mobile: +46 (0) 706566688
email: kamran@hedgenordic.com
www.hedgenordic.com

Picture Index: IlkerErgun---shutterstock.com, niroworld---shutterstock.com, symbiot---shutterstock.com, ©-flyfisher---Fotolia.com, Michal Damkier---shutterstock.com, osteriori---shutterstock.com, Tashatuvango---shutterstock.com, Pinkyone---shutterstock.com, urbans---shutterstock.com, nito---shutterstock.com

Editor´s Note...

Low Terrain - Pull Up!

I love airplanes; and everything around them. I always have and always will. As a kid, natrually, I wanted to be a pilot. (Sitting in sweatpants, quaranteed to a home office while writing about hedge funds somehow did not come to mind at the time).

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet.

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet.

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet.

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet.

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet.

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet.

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet.

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet.

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet.

Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero eos et accusam et justo duo dolores et ea rebum. Stet clita kasd gubergren, no sea takimata sanctus est Lorem ipsum dolor sit amet. Lorem ipsum dolor sit amet, consetetur sadipscing elitr, sed diam nonumy eirmod tempor invidunt ut labore et dolore magna aliquyam erat, sed diam voluptua. At vero

KAMRAN GHALITSCHI
CEO & PUBLISHER HEDGENORDIC

NORDIC
HEDGE
AWARD
A NORDIC BUSINESS MEDIA BRAND

Update on Nordic Hedge Award

COVID-19 and health and safety measures to contain the virus and protect public health is bringing public Europe to a near standstill. With increasing corporate and government restrictions on travel and gathering becoming more severe and also individuals practicing social distancing, we are very sorry to conclude that the Nordic Hedge Award cannot go ahead as scheduled and planned on April 22nd.

The announcement of the winners and the hand out of prizes will instead be done virtually, on April 22, 2020 and first published on https://hedgenordic.com

We aim to schedule a come together of the Nordic hedge fund community after the summer, so the situation allows, when I am sure we will have some great war stories to tell.

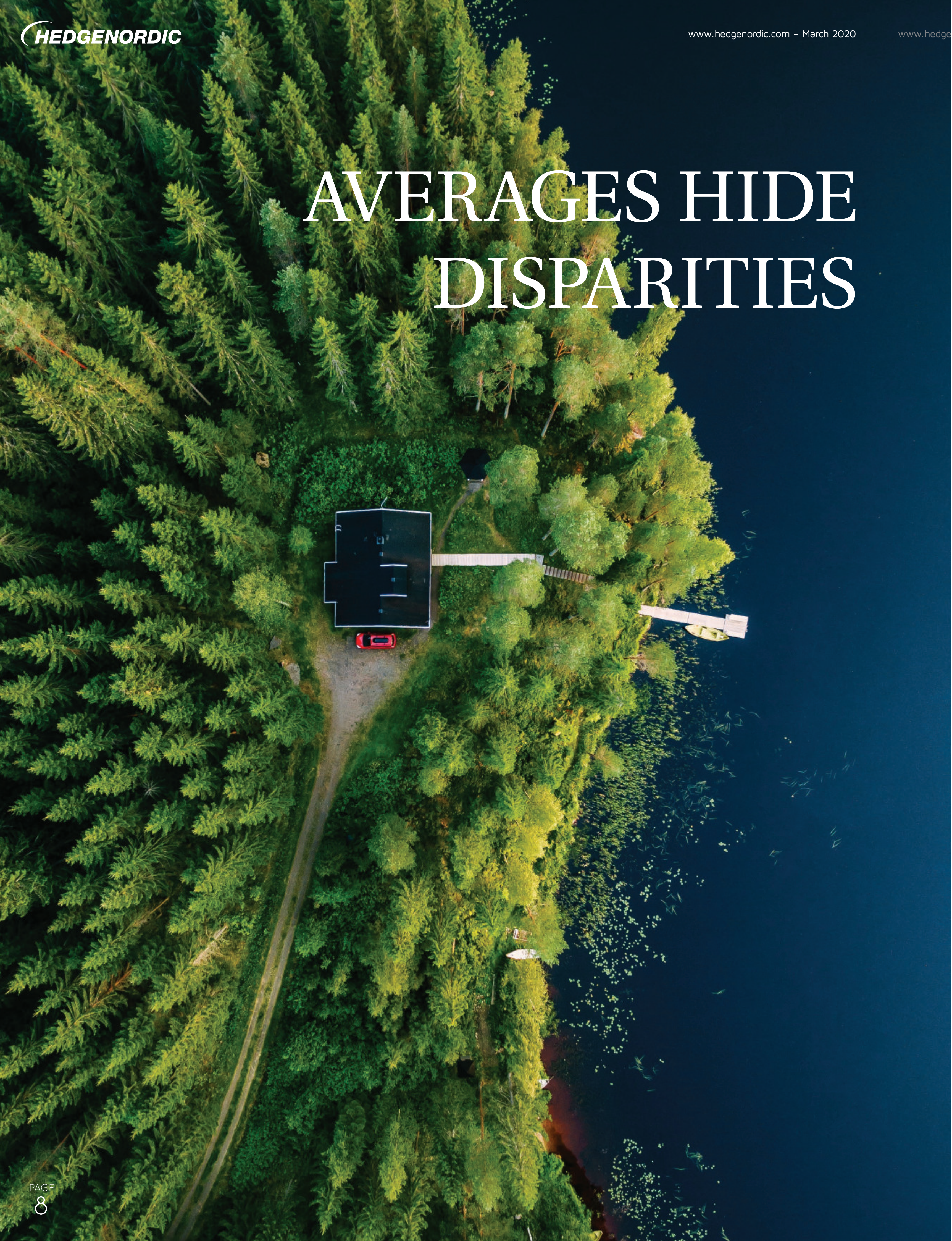
All sponsors and partners to the Nordic Hedge Award have been hugely encouraging and supportive in these trying times. A massive thank you for the guidance and support!

While it is a shame and disappointment we will not be able to gather and celebrate the Nordic hedge fund industry together in April, at the end of the day, our health and wellbeing may be the biggest prize of all.

Very best regards and wishes. Stay safe in these trying times!

Kamran Ghalitschi

AVERAGES HIDE DISPARITIES



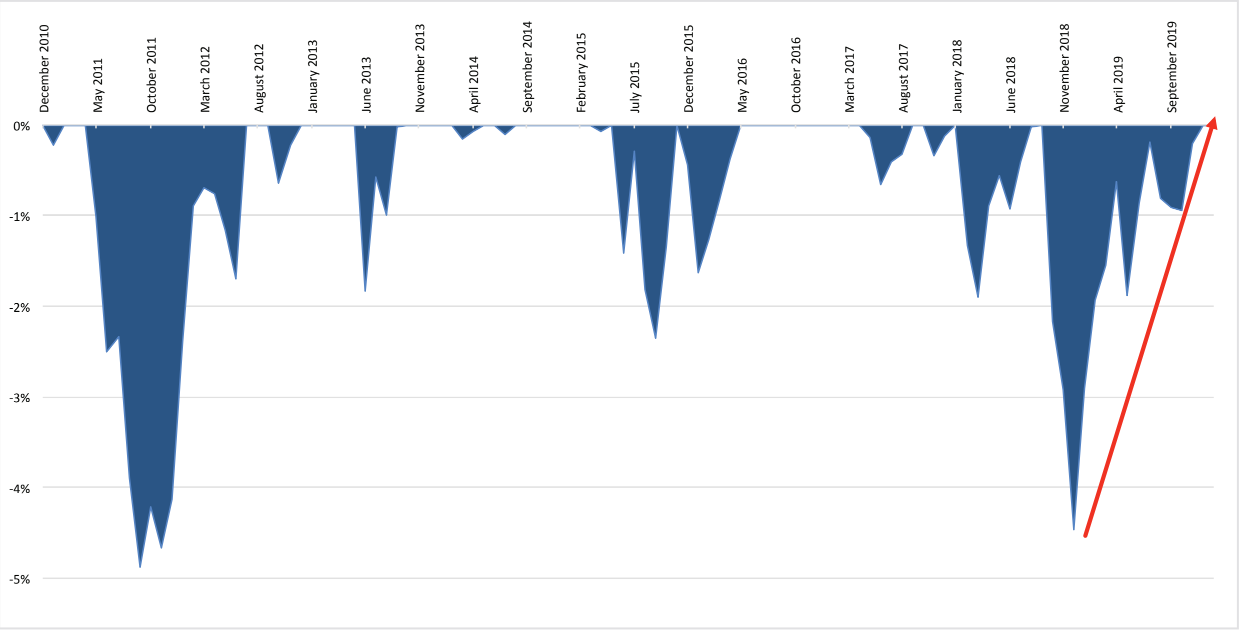
The Nordic Hedge Index (NHX) gained 5.4 percent in 2019, its strongest annual performance in six years. Viewed on a standalone basis, 2019 was a historically strong year for the Nordic hedge fund industry. At the beginning of 2019, markets, hedge funds and investors were coming off a rough, volatile fourth quarter, when stocks declined sharply in response to increasing investor concerns over global trade and slowing economic growth. For the Nordic hedge fund industry, 2019 was mostly a period of recovery from injury in the final quarter of 2018, when Nordic hedge funds lost 4.5 percent on average, to full recovery.

The NHX had its third-worst drawdown in the final quarter of 2018, when global stocks suffered the biggest quarterly fall since the third quarter of 2011 triggered by the eurozone debt crisis. In the last three months of 2018, the drawdown for the Nordic Hedge Index reached 4.5 percent. Drawdowns, a decline from the highest high (peak) to the lowest low (trough), usually occur much quicker compared to the recovery period lasts. Drawdowns are peak to trough, what about climbing out from the trough back to a new peak? How long did it take for the Nordic hedge fund industry to recover from its third-worst drawdown? The recovery from the valley of the index to a new high lasted exactly 12 months. For the Nordic hedge fund industry, 2019 could be viewed as a recovery year, recovery from its third-worst drawdown.

The NHX Overcomes the Survivorship Bias

Hedge fund indices are often (perhaps wrongfully) associated with exhibiting "survivorship bias," which reflects the tendency of certain data providers to solely reflect the returns only generated by existing funds by ignoring the performance of already-defunct funds. With no less than 30 Nordic hedge funds delisting from the NHX, either closing down or merging into other funds last year, an inappropriate calculation methodology for the Nordic Hedge Index could have resulted in significant survivorship bias.

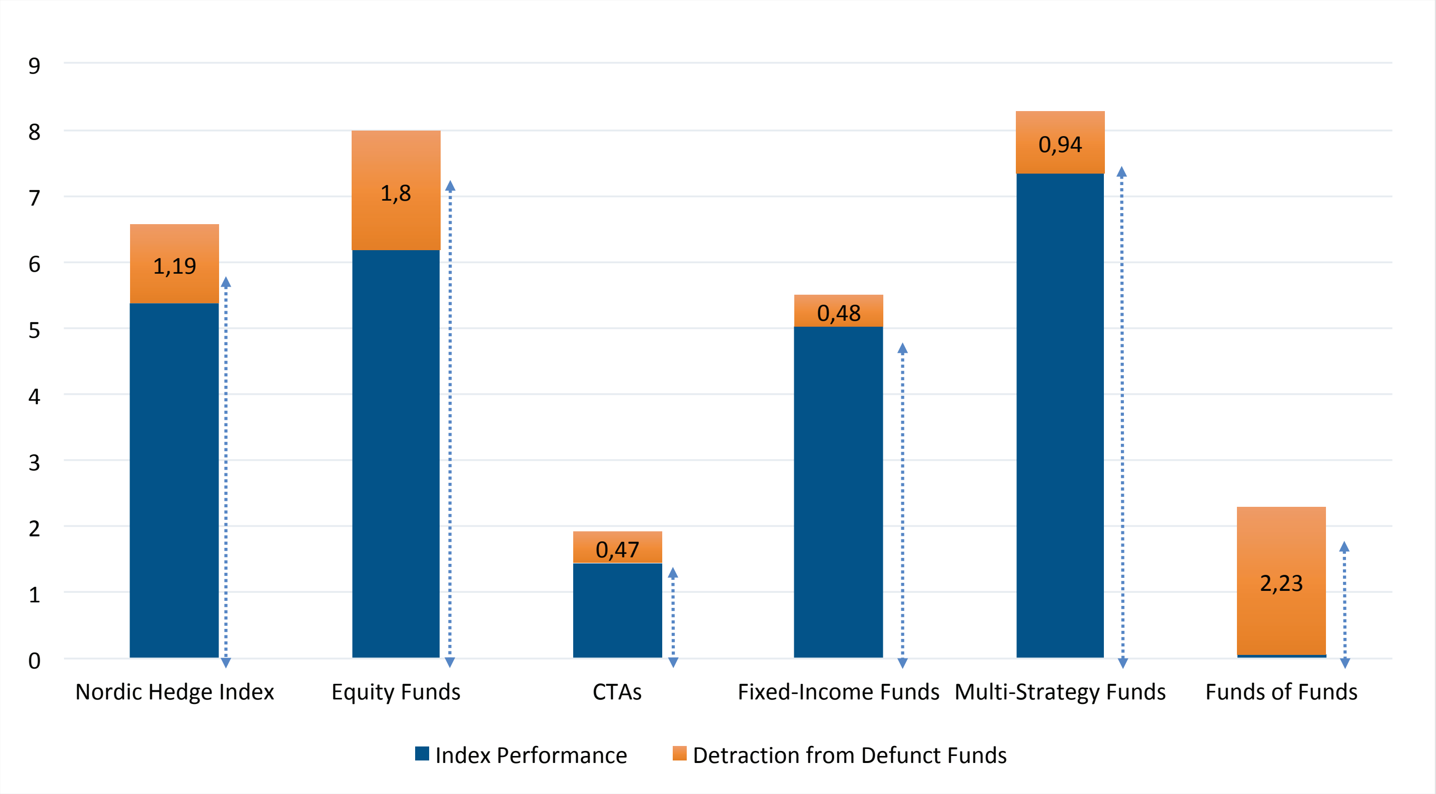
NHX DRAWDOWNS SINCE 2011



Source: HedgeNordic

The Nordic Hedge Index, however, tackles this bias by reflecting the aggregate performance of both defunct and up-and-running funds. The index was up 5.4 percent last year, but the 155 active Nordic hedge funds returned 6.6 percent on average last year. The 120 percentage points-difference reflects performance detraction from the funds that closed during 2019 (which, unsurprisingly, performed worse than the up-and-running funds).

SURVIVORSHIP BIAS IN THE NHX



Source: HedgeNordic

The most noticeable difference between the performance of an index and the performance of active funds underlying that index is observed in the NHX Fund of Funds. The ten funds of hedge funds composing the Nordic Hedge Index gained 2.3 percent on average in 2019, while the NHX Fund of Funds was up only 0.1 percent as nine members of this sub-index closed down last year.

Up-and-running Nordic equity hedge funds returned 8 percent on average last year, whereas the NHX Equities was up 6.2 percent. This 180 percentage points-difference stems from the worse-than-average performance of the 11 equity hedge funds closed down last year. Similarly, the existing multi-strategy funds in the Nordic Hedge Index were up 8.3 percent last year, while the NHX Multi-Strategy, which reflects the performance of defunct funds too, gained 7.3 percent.

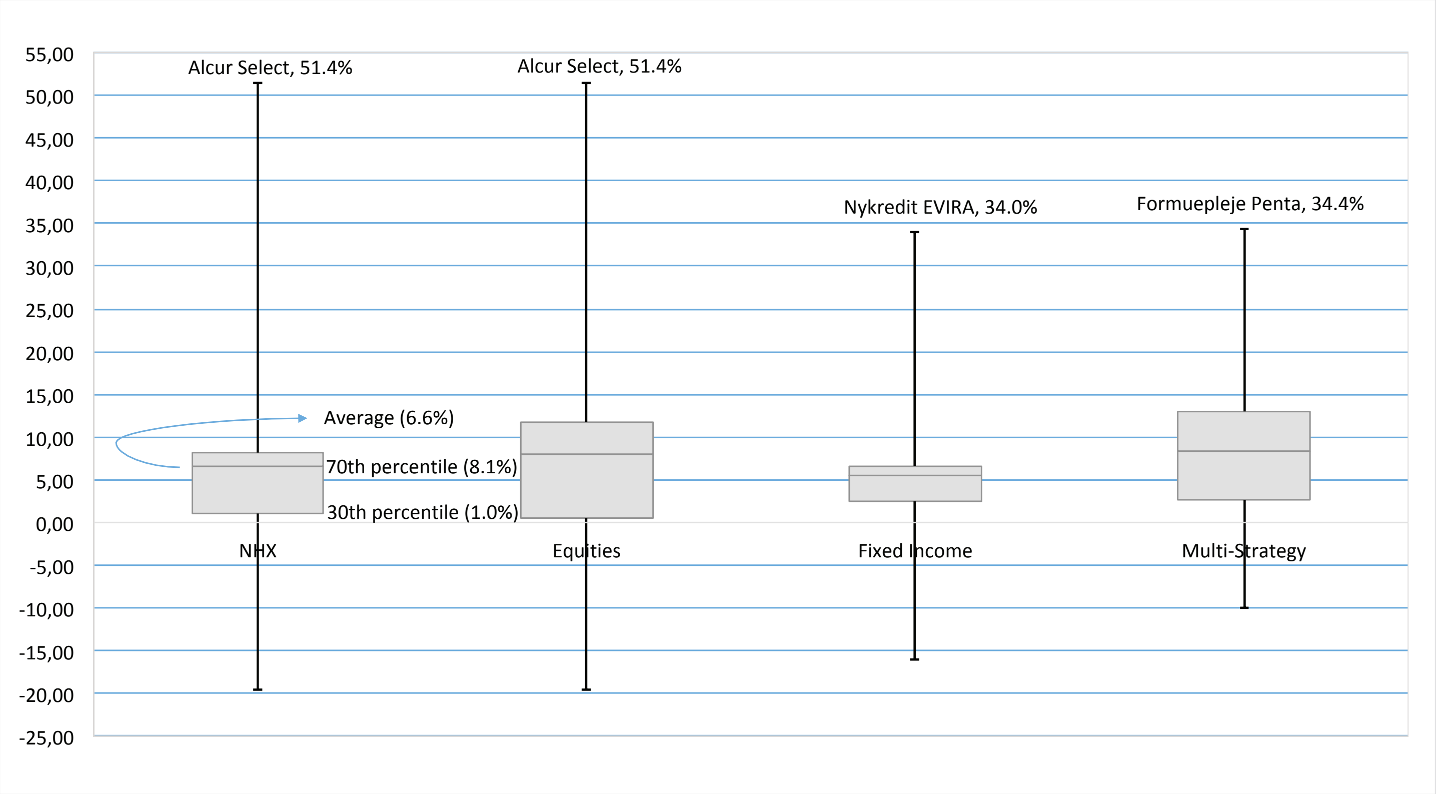
Averages Hide Disparities

The Nordic hedge fund industry gained 5.4 percent in performance last year and active Nordic hedge funds were up 6.6 percent on average. While these average figures are useful for comparison, averages do hide disparities. With a return of 51.5 percent, Alcur Select was last year's best-performing member of the Nordic Hedge Index. The worst performing member of the index, meanwhile, was down about 20 percent. The dispersion between last year's best- and worst-performing hedge fund was wide, in fact very wide.

The top 30 percent of all members of the Nordic Hedge Index gained just over 20 percent on average, whereas the bottom 30 percent was down slightly over 4percent. The top 20 percent, meanwhile, gained 25.4 percent last year and the bottom 20 percent lost 6.3 percent on average.

In the graph below, the grey boxes show that the Nordic hedge funds that were not in the top and bottom 30 percent in terms of performance returned between one percent and 8.1 percent last year. A third of all members of the Nordic Hedge Index achieved a return higher than 8.1 percent in 2019, while 20 percent returned above 13.0 percent. Ten percent of all members returned above 22.7 percent last year.

FIVE-NUMBER PERFORMANCE SUMMARY OF THE NHX



Source: HedgeNordic

About 12 percent of Nordic equity hedge funds outperformed the MSCI World Index which returned 27.7 percent last year, but one should not forget that most equity hedge fund maintain a net market exposure below 100 percent. Some members of the NHX Equities employ a market-neutral approach to investing, and some even maintain negative net exposure to the market. The average equity hedge fund in the Nordic Hedge Index was up 8.1 percent last year, but, again, the average hides wide disparities.

The top 20 percent of performers in the NHX Equites returned 33.2 percent on average last year, while the bottom 20 percent was down 9.9 percent on average. The equity hedge funds that were neither in the top 30 percent nor in the bottom 30 percent returned between 0.5 percent and 18.3 percent. In a similar fashion, the great majority of fixed-income hedge funds returned between 2.5 percent and 5.5 percent last year. The top 20 percent, meanwhile, were up 17.1 percent on average, whereas the bottom 20 percent lost 3.2 percent on average. The majority of multi-strategy hedge funds, meanwhile, returned between 2.6 percent and 8.3 percent.

Country-by-country Stats, Lifespans

With 87 funds, Swedish hedge funds unsurprisingly represent the largest portion of the Nordic Hedge Index despite experiencing the closure of 22 funds during 2019. The number of closures was offset by the launch of seven new Swedish funds.

The 87 active Swedish hedge funds returned 4.8 percent on average last year, underperforming Danish,

COUNTRY-BY-COUNTRY STATS	SWEDEN	DENMARK	NORWAY	FINLAND
Number of funds	87	39	15	14
New launches in 2019	7	3	0	2
Closures in 2019	22	2	3	3
Average 2019 return	4,76%	9,30%	9,90%	6,64%
Proportion of gainers	69%	82%	87%	79%
Proportion of young funds (between 0-5 years)	41%	46%	27%	36%
Proportion of mid-aged funds (between 5-10 years)	21%	23%	27%	29%
Proportion of old funds (over 10 years)	38%	31%	47%	36%
Average annualized return since inception	4,12%	5,36%	7,37%	4,11%
Average annualized standard deviation	7,33%	7,30%	9,62%	9,07%

> “Global hedge funds have an average lifespan of about five years. Nordic hedge funds, however, have seem to have a much longer lifespan than their global peers.”

Norwegian and Finnish hedge funds. Danish hedge funds, traditionally heavy on fixed-income strategies, were up 9.3 percent on average in 2019. Norwegian hedge funds were the best-performing group with an average return of 9.9 percent in 2019.

Based on estimates, global hedge funds have an average lifespan of about five years. Nordic hedge funds, however, have seem to have a much longer lifespan than their global peers. The average lifespan of all active hedge funds in the Nordic Hedge Index is about eight years. The average lifespan of all Nordic hedge funds that have been closed down since the beginning of 2015 (98 funds) stands at more than seven years. In Norway, for instance, almost half of all active funds have been operating for more than ten years. Around 38 percent of active Swedish hedge funds are in business for more than ten years.

AP3´s Torbjörn Hamnmark on the Difficulty of Sticking to Your Guns

By Pirkko Juntunen – HedgeNordic

> “Market forces were basically put out of play and were not allowed to function in their natural rhythm because of extreme monetary policy.”

Hindsight is always 20/20 but it is harder to look ahead with the same certainty. A safe bet is perhaps to say that the next decade will be different from the previous even if some people are always adamant that plus ça change.

One of those that argues that while every decade has its charms, a lot of things can change in 10 years, particularly when it comes to economic and investment environment is Torbjörn Hamnmark, head of strategic asset allocation at AP3, one of the Swedish national buffer funds. At least keeping an open mind about would be prudent, he suggested.

“The next decade will be determined by different fundamental drivers compared to the decade

TORBJÖRN HAMNMARK
HEAD OF STRATEGIC ASSET ALLOCATION
AP3

since the global financial crises, be it Modern Monetary Therory (MMT) or a different political landscape," he said.

The dent left by the crisis over a decade ago was enormous not least because of the subsequent quantitative easing (QE) programmes adopted by central banks around the globe. "Market forces were basically put out of play and were not allowed to function in their natural rhythm because of extreme monetary policy," he said.

This disrespect for the economic machine has left a lot of stones in this well-oiled machinery such as trade-wars and continued extreme monetary policy. "It is not these policies, as a result of politicising the central banks that have improved the lives of the average person in the past decades. It is globalisation and digitalisation that has enabled this economic boom," he said.

This environment that some have called the 'new normal' with QE and historically low interest rates has in particular had an impact on global macro managers, trying to navigate these waters and questioning whether or not these are permanent or temporary changes.

To many global macro strategies encapsulate the essence of hedge funds because of the raft of instruments they utilise in trading global markets combined with their ability to use leverage and go long and short. This is also the hedge fund sector that often hits the news, for good or bad and where careers are made and ruined. Of course this is a superficial look and global macro managers are no more homogenous than any other strategy and the dispersion in the field is not only noticeable from their returns but also the varied investment philosophies adopted.

"Macro managers are fundamentally dependent on the fact that the market makes mistakes. This natural market mechanism has not been allowed to play out for the past decade or more. Even if you were the smartest global macro manager in the 10 years prior to the crisis, it would not have worked as long as the central banks refused to let the market move in a natural way", Hamnmark said.

One of the reasons for adhering to the extreme monetary policies, according to Hamnmark, is the obsession among central banks, such as the European Central Bank, with hitting their inflation targets 'no matter what it takes' despite having a 20-year low unemployment level, he noted.

> "It is quite difficult to stick to your guns and models and at the same time keeping an open mind in a changing world."

This has not made it for an easy environment to be a global macro managers, he said. "Low interest rates and difficult trends to predict or follow combined with the fact that you are stuck with your choices is a hard place to be. It is quite difficult to stick to your guns and models and at the same time keeping an open mind in a changing world," he said.

Hamnmark said AP3 is less dependent on external macro hedge funds than 10 years ago. Poor performance and high fees lead to a reduced exposure and more self-reliance. Another change that AP3 is making is leaving factor exposure behind and focusing instead of asset classes, he noted.

"The market is quant driven with fewer people and more machines. This leads to better decisions and a more efficient market. You have to accept this development. You have to have a clear allocation, which is a very important part of the information flow," he said.

A decade ago AP3 moved into factor investing or risk buckets where the entire portfolio was viewed through risk factors and factor risks, thereby dividing the portfolio into risk classes instead of asset classes.

AP3 is now stepping away from this to a degree, partly because of the difficulty of building a diversified portfolio which could be a challenge for the future even if it is not today, Hamnmark said. Having built diversified portfolios around risk premia through very specific risk premia exposures is taking AP3 back to the classical asset class, at least when you are looking at the portfolio as a whole.

AP3 with assets of SEK393.7 billion as at year-end 2019, had its second best year ever in 2019, returning 17.6%. The strategy seems to be working as 2019 was not just a fluke as the fund has returned 7.4% on average over 10 years and 8.5% over 5 years,

Looking ahead Hamnmark cannot see the concerns for trade-wars diminishing. "China will get more powerful in the 20s with continued growth and a population of 1.4 billion potential consumers. US will be increasingly under pressure. And for the rest of the countries? You pick a side," Hamnmark said.

Despite Brexit and regular disgruntlement among the citizens of the European Union, he sees the EU as the dark horse in the superpower game with surveys continuously showing that the majority are pro-EU among the member states, he added.

Hamnmark said that as central banks fiscal stimulus packages play out their role, other drivers than monetary policy will take over which will be beneficial for macro managers for instance. "MMT use of fiscal policy would have a different effect on the bond markets than monetary policies have," he concluded.

It is anyone's guess what the future holds but keeping an open mind about changes is probably sound advice, even for macro managers.

About the Interviewee:

Torbjörn Hamnmark is Head of Strategic Asset Allocation at the Third Swedish National Pension Fund, AP3. AP3 is a USD 40 Billion sovereign wealth fund serving as a buffer fund in the state income pension system. He has been with AP3 since 2010 as Senior Strategist with responsibility for portfolio construction.

Since October 2014 he is Head of Asset Allocation. Torbjörn is also a member of the investment committees for Mistra (The Swedish Foundation for Strategic Environmental Research) and WWF Sweden.

He has an MBA in Finance and International Business and an Executive MBA in Leading Innovation, both from the Stockholm School of Economics. Before joining AP3 he was Head of Fixed Income at DnBNOR Asset Management in Stockholm for ten years.

Hamnmark started his career in 1989 as an options specialist with Arbitech. His options career continued with Citibank in Frankfurt and London, where he was based 1995-1998.

Arne Hassel
Chief Executive Officer
IPM – Informed Portfolio Management

IPM Raising its Game

Expanding While Waiting for Fundamentals to Stage a Come-Back

By Hamlin Lovell – HedgeNordic

> “You need to be strong on what I call the five “P’s” – Philosophy, Process, People, Performance, and Parent.”

IPM may now be the world’s second largest systematic macro manager, after Bridgewater. Its new CEO, Arne Hassel, who joined the firm in July 2019, has ambitions to expand asset class coverage for the flagship strategy, introduce new quantitative strategies and bolster teams including the investment research group.

Hassel has had a remarkably broad range of experience over his 30-year career. He has traded most asset classes as a macro manager, worked as a fixed income and foreign exchange manager, and allocated across asset classes and managers via fund of funds. He has overseen discretionary and systematic approaches through multiple market cycles at firms including investment banks, asset managers, pension funds, funds of funds and hedge fund managers.

Focusing on IPM’s specialty – systematic macro investing – Hassel worked closely with the teams that built quantitative models at Goldman Sachs Asset Management and once set up his own quantitative macro strategy. He continued to use models to inform decision making in his recent roles as Co-Head of Multi-Asset Allocation at Universities Superannuation Scheme (USS), the UK's largest pension fund, Head of Investments at Coutts Private Bank and Chief Investment Officer of Barclays Investment Solutions.

Hassel's framework for assessing external managers over the years can be condensed into a five stage process that he also applied before joining IPM. In the 2019 annual letter he states: "To deliver on a mission like this, you need to be strong on what I call the five "P's" – Philosophy, Process, People, Performance, and Parent. And before joining, I did my homework.

What I found was a firm with: A simple but powerful philosophy centred around the long-term relationship between fundamentals and asset prices. A strong investment process developed and incrementally improved over decades. People with solid academic and professional backgrounds, many from engineering, economics, and finance, all with a focus on innovation. Long term strong and competitive performance with a track record that shows near zero correlation to anything else – be it asset classes, factor exposures or almost all other managers. Finally, a committed parent or majority owner with deep understanding of the industry and a view to create value over the longer term".

Hassel, whose academic background is in science and economics, was particularly attracted to IPM by its fundamental research philosophy: "There is a strong emphasis on how the economic machine works. Models are based on intuitive relationships with strong theoretical support", he says. Indeed, IPM is distinguished by an opportunistic approach both to overall exposure, and to its five families of models and 95 sub-factors. "Allocations are based on the opportunity set rather than on traditional optimization. This approach, combined with filters against market and factor concentration, tends to produce more robust outcomes", he says.

The investment philosophy is differentiated, and so too is the return profile, with near zero correlation to traditional asset classes, factor exposures and almost all other managers. This means that IPM can perform strongly when others are struggling, like in 2008-09. But it can also lead to IPM losing money in a year like 2019 when many other managers profited. The flagship strategy, which trades currencies, bonds and equity indices, saw a performance setback in 2019, its second ever negative year, though the pure currency strategy had a good year. Relative value bonds, relative value equities, and the directional sleeve all lost money in 2019.

Sentiment Driven 2019

2019 was a good year for directional trend followers but not for fundamental, relative value investors. And diversification did not help in a market where the tide was lifting all boats within asset classes. "Periods when sentiment drives markets rather than fundamentals can be tough for us. Last year the equity rally was mainly based on multiple expansion rather than earnings growth. And bonds with negative yields continued to rally, causing losses for some of IPM's short bond positions within the directional bucket", he says. IPM's contrarian short in Australian Government bonds, based on its interpretation of valuation and macroeconomic data, was also wrong footed as they continued to move higher. IPM's relative value trade of being long European equities and short US equities was also a source of losses as the divergence between the two continued to widen.

Improving Opportunities

Going forward, Hassel is constructive on the opportunity set: "Countries' economic policies are diverging and central banks are becoming less independent. Fundamentals should be re-asserted over the medium to long term. We are also looking to apply our approach to additional promising opportunity sets" he says. "We thrive on differences between countries and markets by focusing on the most important fundamentals to capture medium to long term alpha", he says.

IPM is contemplating adding emerging market government debt to its flagship program, which means that emerging markets as an area could also be offered on a pure play basis in response to client demand. "The results look very promising and as markets have developed it has become easier to fit them into the strategy", he says. The manager is also closely monitoring emerging markets equity indices in search of instruments that are sufficiently liquid for the strategy. Equity sectors are not explicitly traded, though relative value equity trades between countries do imply sector biases that IPM is cognizant of.

> "Periods when sentiment drives markets rather than fundamentals can be tough for us."

Currency Alpha

IPM's currency strategy, which has run since 2005, is part of the flagship strategy but has also been offered on a standalone basis as a response to client interest. In a space where many FX managers have disappeared, IPM has shown more consistent results over time and is now one of the best performing managers in the space. The strategy is run as a carve out using 35 of the 95 factors of the flagship macro strategy to trade 20 currencies: 10 in developed markets and 10 in emerging markets. Last year, the emerging markets currencies contributed the most. In terms of factors, valuation and risk premia that were the strongest performers.

Recruitment

Hassel has held both CIO and Head of Investment roles before. The CEO position at IPM was logical move as his career has increasingly entailed executive and business management as well as investment management. On the recruitment side, one of his first moves at IPM was to hire a new COO with a strong technology background, who previously worked at Brummer Fund Services and started in November 2019.

"The new COO role has a broader remit than previously, including operations, technology and finance", he says. The company has also hired a Head of Data Management, and expects to over time bring on board senior investment staff in IPM's Stockholm and potentially also in the London or the recently opened New York office.

Though IPM, in common with many hedge fund managers, saw net outflows of assets in 2019, Hassel is optimistic over the medium-term for IPM's distinctive strategy offerings. "Strategies offering true alpha are hard to come by and will continue to be an important addition to traditional asset class portfolios."

Jonas Martenson
Sales Director and Founder
Resscapital

The Secondary Life Insurance Market and its very Different Risk/Return Set

By Eugeniu Guzun – HedgeNordic

Many retirees in the United States choose to sell their life insurance policies in the secondary market for life insurance for a lump sum payout to enjoy the accrued capital. This opens up a market for specialised managers that seems to benefit the entire chain of parties involved, from the person insured and seeking to benefit from their policy still during their lifetime, to the end investor in such vehicles.

In this market, players such as Stockholm-based fund manager Resscapital AB buys policies from individuals who no longer need their life insurance and want an up-front cash payment that is generally higher than the surrender value offered by their insurance companies. "Most individuals selling their life insurance are above the age of 70, are fairly wealthy on aggregate and are generally quite healthy," explains Jonas Mårtenson, the founder of Resscapital. "The reason retirees are selling is that they want to avoid paying premiums for many, many years to carry life insurance."

> "Longevity is the key risk for the strategy of buying life insurance policies."

FOUR OPTIONS FOR POLICYHOLDERS

Life insurance protects a policyholder's dependents – the beneficiaries of the life insurance policy – in the case of his or her death. The insured generally face four alternatives when deciding on what to do with their policies. "The first option is that the insured continues to pay the premiums and the beneficiaries receive the policy payout," says Mårtenson, with the payout being a fixed dollar amount stipulated in the insurance contract.

The second option is that the insured stops paying premiums and the policy lapses within two months, "which is the worst option" according to Mårtenson. "The third option involves the sale of the policy to the life insurance company for the surrender value." The last option is selling to funds such as Ress Life Investments, managed by Resscapital, which " usually pay more than life insurance companies." By paying more than the surrender values, these funds "add value for the insured."

CONSERVATIVE APPROACH TO BUYING POLICIES

When acquiring a policy, Ress Life Investments becomes the new beneficiary and continues to pay premiums to the insurance company until the insured passes away and the fund collects the predefined life insurance amount. By buying no-longer needed life insurance policies at a discount to face value, Ress Life Investments aims to deliver an annual net return of seven percent in U.S. dollars. To achieve its objective, the team running the fund "takes a very conservative view."

To start with, "we require two expert opinions on life expectancies for each policy we buy," explains Mårtenson, "one of which comes from our preferred medical underwriters." This approach enables Ress to accurately estimate one of the main risks associated with its investment strategy: longevity. "Longevity is the key risk for the strategy of buying life insurance policies, which stems from the fact that people live longer than predicted," explains Mårtenson. If actual life longevity is longer than the original life expectancy estimate, "we have to pay premiums for a longer time, and the policy pays out later in time."

MITIGATING THE LONGEVITY RISK

"Our strategy to mitigate longevity risk is to be selective when choosing policies, look for policies with low premiums and look for policies of individuals with long life expectancies," explains Mårtenson. The team has reviewed over 10,000 policies since Ress Life Investments was launched in April 2011. Only about three percent of those policies made it to the fund's portfolio. As of the end of December, Ress Life Investments owns 265 life insurance policies with a total face value of $578 million. The ability to build a portfolio with the most attractive policies represents a key attribute that distinguishes Ress from other players in the secondary market for life insurance, reckons Mårtenson.

Ress is also distinguished by its focus on policies from healthy retirees with long life expectancies. "It is very difficult for us to buy policies from individuals with a very short life expectancy," says Mårtenson. "An individual with a four-year life expectancy can easily live five, eight or more years," which represents a significant risk in the business of buying discounted life insurance policies. "It is challenging even for doctors to assess that a 78-year old has a life expectancy of only four years, even if they have a number of ailments." To mitigate the risk, Ress Life Investments focuses on longer life expectancies that are associated with more accurate life expectancy estimates. "All in all, our strategy has been to mitigate the longevity risk by buying very few policies, being very selective, and choosing long life expectancies."

Given the recent coronavirus-fuelled uncertainty in financial markets, "we get many questions about credit risk," acknowledges Mårtenson. "Are you worried about life insurance companies going belly up?" is one of the questions the Ress team faces. "The answer is no. Insurance will have a tough time, indeed," reckons the founder of Resscapital, "but they are heavily regulated and backed up by state-guaranteed funds." Furthermore, the coronavirus crisis "is not a financial crisis . It is an economic crisis", he argues Speaking of the coronavirus, Mårtenson does not expect an increase in payouts because of the spread of the virus. "It may affect one or two policyholders," he says, "but statistically speaking, our portfolio is too small for the coronavirus to have a meaningful effect on payouts."

> "Statistically speaking, our portfolio is too small for the coronavirus to have a meaningful effect on payouts."

SOURCES OF RETURN AND UNCORRELATION

Resscapital's approach to investing in life insurance policies seeks to deliver an annual return of seven percent after fees. The return can be seen as arising from three sources, explains Mårtenson. The first source is realized returns stemming from the "policy paying out in cash, which generates a surplus because purchased policies are usually worth much less than the payout amounts." The second source is the aging effect. "As times goes by, each policy increases in value since we approach the payout day." The third source comes from the mark-to-market adjustment resulting from a change in discount rates, which are, in turn, determined by market conditions. "Just like a bond, the values of policies are revalued based on current market conditions" twice a month.

"The main risk factor in a life insurance portfolio – longevity – is fundamentally uncorrelated to other major asset classes," argues Mårtenson. This enables Ress Life Investments to generate returns that are uncorrelated to traditional asset classes. Since its inception, the fund's correlation with the MSCI World, for instance, stands at 0.04. The fund has generated an annualized return of 3.4 percent since inception with an annualized volatility of 3.4 percent, which results in an inception-to-date Sharpe ratio of one.

This track record, however, also covers the first few years of operations when the fund was busy buying discounted policies (which were not meant to pay out instantly) and had relatively higher fixed costs in relation to assets under management. In the past three years, however, Ress Life Investments delivered a juicier annualized return of 8.3 percent.

According to Mårtenson, the secondary market for life insurance is estimated to have an annual volume of policies sold between $4 to $5 billion, whereas the total market size of outstanding life insurances stands at $20.5 trillion. "It is a drop in the ocean," highlights Mårtenson. The gradual increase in the supply of policies in the secondary market enables Ress Life Investments to continue purchasing more policies with attractive risk-reward profiles and generate attractive risk-adjusted and uncorrelated returns to investors.

Tommi Kemppainen, 1st degree connection, CEO - Helsinki Capital Partners

By Eugeniu Guzun – HedgeNordic

No Guessing Games

The ability of central banks to reverse an economic downturn appears limited as the global economy approaches the ends of both the short-term and long-term debt cycles. “Since interest rates have been cut down to zero or even below zero, the maximum work has already been done to get everyone – governments, companies and individuals – loaded up with the maximum amount of debt,” warns Tommi Kemppainen, the CEO of Finnish asset manager Helsinki Capital Partners.

"While many market participants are very much aware of the shorter-term debt cycle, extremely few seem to be aware of this much longer debt cycle coming to an end," reckons Kemppainen. The high debt load of many developed countries along with ageing populations pose a significant risk to the economies of those countries and the global economy as a whole. With workers ageing out of the workforce and fewer people contributing to economic growth, there is no obvious solution for how to generate economic growth to work that debt off. "There is no natural growth in the gross domestic product if the workforce is shrinking," explains Kemppainen. The ability to pay off debt, therefore, decreases as a result of changing demographics and subdued productivity growth.

According to Kemppainen, major developed countries "are facing the same phenomena Japan has been struggling with over the past three decades." An unprecedented monetary expansion after the 2008 financial crisis fuelled what is now considered healthy economic growth. "The hardest thing for investors is really to go back to the fundamentals of the global economy and understand that a huge chunk of the GDP growth in the past decade is artificial in the sense that the growth was built by borrowing more money."

Credit expansion plays an essential role in driving economic growth and does so by increasing the amount of debt in the system. As the debt cycle inverts at some point, lower levels of credit leads to lower consumption and investments, and economies slow down. HCP Black, a multi-strategy, multi-asset fund investing across a range of non-correlated alternative assets, "has been positioned to protect capital against the consequences of a potential depression."

A Little Bit of Everything

Kemppainen allocated HCP Black's assets under management to a select group of alternative investments, allotting only a small part to stocks through investments in the other two long only equity funds under the umbrella of Helsinki Capital Partners: HCP Focus and HCP Quant.

Discussing the most attractive alternative assets from a risk-reward standpoint, Kemppainen says that "none of the alternatives is a no-brainer, because absolutely all of them exhibit risk."

> "Regardless of which valuation metrics I look at, I expect zero annualised returns on equities for the next twelve years forward."

To protect against a potential or even imminent economic downturn, "one would maintain a collection of different kinds of alternatives that do not get in the same trouble exactly at the same time," he argues. "This is the key in my active diversification." At the end of 2019, HCP Black had about 27 percent of its managed assets allocated to trend-following strategies, 26 percent invested in insurance-linked securities, 11 percent in real estate, and 10 percent in physically-backed gold. The remaining capital was invested in HCP Focus, HCP Quant, silver, tail-hedge and equity special situation strategies.

"Instead of trying to get exposure to as many alternative assets as possible, we focus on analysing the fundamentals of each asset to select investments that are as different from each other as possible," explains Kemppainen. "Considering the set of risks in the world today and that the entire economic system and individual economies are fragile, having some real assets that have some positive value regardless of what happens is a prudent way of allocating capital."

Institutional investors use trend-following strategies as a tool to collect "crisis alpha" in times of turmoil, which is why HCP Black has roughly one-fourth of its assets invested in this type of strategies. Explaining the relatively high exposure to trend-following, Kemppainen says that "it is almost by definition that financial assets are going in one and the same direction for long periods of time when you have a financial crisis of any sort." Investors, however, should not expect a smooth ride from trend-followers, warns Kemppainen.

"When markets start to sink fast, trend-followers do not typically deliver good performance at the beginning of the phase, but later on, as trends become more established, trend-following strategies generate strong returns," explains Kemppainen. "The same goes for gold," he adds. With central banks around the world keen to inject more stimulus to offset any slowdown risks, the environment remains bullish for gold. "There are a lot of questions marks over more or less all currencies everywhere," argues Kemppainen, who adds that "it is possible that gold will have a really good run."

Kemppainen, however, emphasises that "it is the combined allocation maintained by HCP Black that is attractive and not any asset class in particular." His approach to allocating capital is not a guessing game, he stresses. "Trying to guess when the recession will unfold or how financial markets will react is just very hard, I am not equipped to predict the next moves," acknowledges Kemppainen. "But I see the root cause of the problems in the global economy and understand that the economy is fragile, so I do my best to position HCP Black wisely and accordingly." The CEO of Helsinki Capital Partners says that "HCP Black's current allocation is the best way I know how to invest when there is anxiety over a recession, depression and the end of a long debt cycle."

Invert, Always Invert

Instead of looking for the most attractive alternative investments, Kemppainen starts from the opposite end and tries to find and avoid the least attractive investment opportunities. "I see the least attractive risk-reward opportunities in equities and bonds," points out Kemppainen. "Regardless of which valuation metrics I look at, I expect zero annualised returns on equities for the next 12 years forward." Equity valuations, therefore, would have to drop to some extent in order for investors to be able to receive the equity premium that compensates them for the risk associated with holding equities. "The least interesting risk-reward is equities."

Bonds are not appealing either, reckons Kemppainen. "Looking ahead for the next 12 years, I do not expect lower interest rates than the current level," he adds. "If one sees a higher probability of rising interest rates over the next 12 years, then everyone holding a fixed-rate bond of any sort or form will be losing money." The process of inverting a problem helps Kemppainen find the most suitable investment opportunities for HCP Black, his asset management firm and investors. "It is easier for me to say what I am not touching at all."

Kemppainen puts his own and his company's money where his mouth is. "All of our company's money is currently invested in HCP Black," he says. "We are in the business of asset management, which is a really cyclical business, especially considering that two of our three funds are long-only equity funds." With all the company capital invested in HCP Black, "we want Helsinki Capital Partners to do well in bad times too." Kemppainen concludes by saying that HCP Black is a suitable alternative for "all investors who already have enough risk on other fronts and are looking for a vehicle that would maintain the buying power even in nasty markets."

Yield-Starved Institutional Investors Look to Private Markets

By Eugeniu Guzun – HedgeNordic


PETER RAGNARSSON
HEAD OF ALTERNATIVE INVESTMENTS
PRI PENSIONSGARANTI

Identifying attractive sources of returns is part of the daily business for investors. In today's environment, with market returns on stocks and bonds over the next decade expected to fall short of historical averages, that search has become even harder. Institutional investors, such as insurance companies, pension funds and other institutional investors are ever more turning to alternative investments – private equity, real estate or hedge funds – to bullseye their return targets.

Traditional public fixed-income investments are a mainstay of most institutional portfolios. The portfolio guidelines imposed at Swedish insurance company PRI Pensionsgaranti, for instance, require exposure to fixed-income investments between 40 and 65 percent. "PRI Pensionsgaranti has always had a large presence in liquid fixed-income markets, due to our somewhat uncertain liability side," explains Peter Ragnarsson, Head of Alternative Investments at PRI. PRI Pensionsgaranti provides credit insurance for the pension commitments of policyholding companies. Since PRI's insurance risk is tied to the insolvency of policyholding companies, the insurer's credit losses largely depend on the business climate.

With interest rates at historic lows and the prospect of rising rates, institutional investors are trying to reposition their portfolios for a possible rising rate cycle. "A large challenge today is how to think about portfolio allocation as we are getting closer to the end of the cycle," points out Ragnarsson. "Equity valuations are stretched, we have low interest rates and can't rely on diversification from the fixed-income portfolio in the next downturn."

AFA Insurance provides insurance coverage to 4.7 million Swedish employees and faces a similar challenge but at a much larger scale. AFA maintains an investment portfolio worth SEK 195 billion, of which 41 percent constitute fixed-income investments and 31 percent stocks. According to Mikael Huldt, Head of Alternative Investments at AFA Insurance, the biggest challenge in today's low-return environment is "finding relevant investment opportunities that have attractive risk-return characteristics and that are not too short-term in nature."

Institutional investors are increasingly turning to alternative assets to better navigate an environment characterized by low expected returns from bonds and stocks, geopolitical concerns and a growing set of risks such as, most recently, the coronavirus. PRI Pensionsgaranti and AFA Insurance are no exception. Permitted to maintain an allocation of between 10 and

> "By going for illiquid investments, we should be able to create higher returns than from public markets. Although with a different risk profile."

30 percent to alternative investments, PRI increased its allocation to alternatives from eight percent at the end of 2013 to 24 percent at the end of 2019, close to the upper end of the range. AFA Insurance's exposure to alternative investments, excluding real estate, doubled from six percent at the end of 2013 to about 12 percent at the end of 2019.

> "With the increased focus on alternative and illiquid investments, it is important not to get too carried away. There are several risks that need to be remembered."

The Benefits of Alternatives

PRI Pensionsgaranti's increasing allocation to alternatives has two primary purposes in the current environment. "First, we see our portfolio of alternative investments as a return enhancer in today's low interest rate environment," explains Ragnarsson. "By going for illiquid investments, we should be able to create higher returns than from public markets. Although with a different risk profile." Second, Ragnarsson views alternative investments as "a risk mitigation tool, both in terms of diversification created by our hedge funds and volatility dampening stemming from our private market investments."

"Alternatives have grown in importance for most asset allocators," emphasizes Huldt. This development is attributable to "a combination of attractive historical returns and fundamental shifts in market dynamics supporting the promise of strong future performance." On the equity side, "more companies choosing to stay private combined with fewer IPOs and public companies" represents one such fundamental shift that leads to the expansion of private equity as an asset class. On the credit side, "regulations have forced banks to reduce activities in some market segments, opening up for others including institutional investors," argues Huldt. This development, in turn, is fuelling the growth of private credit.

Opportunities in Alternatives

Huldt reckons that "there are many attractive opportunities in the alternative credit space." He points out that "the supply and demand dynamics are still quite favourable and the markets, especially in Europe, are quite nascent." Ragnarsson corroborates Huldt's observation, accentuating that "we still think we can find attractive investments in the credit space compared to our liquid portfolios, both in direct lending and structured credit." Ragnarsson stresses that "manager selection becomes even more important when we are late in the cycle."

MIKAEL HULDT
HEAD OF ALTERNATIVE INVESTMENTS
AFA INSURANCE

Aside from opportunities in the credit space, Huldt also sees "attractive opportunities in other areas such as private equity, real estate, infrastructure and so on." However, he emphasizes that "some of these markets tend to be more competitive and are, in many cases, suffering from a large inflow of institutional capital in recent years." Ragnarsson, meanwhile, adds that "the hedge fund space is starting to look interesting again."

With currently around 24 percent exposure to alternative investments, PRI Pensionsgaranti plans to increase the allocation to alternatives to 30 percent, "mainly by increasing our presence in private markets." At the end of last year, about one-third of the insurer's allocation to alternatives comprised hedge funds, with the remaining two thirds equally divided between real estate and private credit. In the past two years, PRI "also added private equity and infrastructure to the portfolio, with the aim to grow meaningful allocations over the next few years," states Ragnarsson. However, "the commitments made are still very early in the investment periods and so far, have not had a major effect on the portfolio allocation."

AFA Insurance, meanwhile, maintains a current allocation to private equity between eight and nine percent, and three percent to private credit. The Stockholm-based insurer has also boosted its portfolio of alternatives by adding infrastructure. "We recently started to build an exposure to infrastructure, which initially is also targeted to be around three percent," says Huldt. The underlying rationale behind the increasing exposure to infrastructure is "the ability to diversify the portfolio and leverage off our ability to take on illiquidity."

Biggest Challenges

While alternative investments are becoming increasingly popular among institutional investors, there are certain challenges and limitations associated with investing in alternative asset classes. "With the increased focus on alternative and illiquid investments, it is important not to get too carried away. There are several risks that need to be remembered," warns Huldt. Whereas many investors focus on the relative attractiveness of alternative investments compared to more liquid and traditional asset classes, "one cannot lose sight of risk and returns on an absolute basis."

The expected future returns for some strategies and asset classes "may be meaningfully lower than historical," points out Huldt. He recommends investors to ask themselves "whether the strategy at hand is still sufficiently attractive to compensate for the inherent risks." In addition, "operational risks tied to alternatives are easy to underestimate, especially for new entrants," Huldt believes, as well as "new issues such as fraud and ESG-risks coming up as the alternative asset classes grow."

Ragnarsson and his team at PRI are confronting several challenges in their pursuit of increasing the allocation to alternative investments. "When building up a new portfolio within private markets, it is always a challenge to be selective and have patience," points out Ragnarsson. Another hurdle involves the "need to model future cash flows and understand the amounts you have to commit to being able to reach your target allocation over a five-year horizon, for instance." Due to the nature of many strategies in the alternatives space, investors "often have to "over-commit" to be able to reach the exposure they want in the portfolio." Another challenge for PRI revolves around liquidity or the lack thereof. "A challenge for us is also to give up liquidity and understand how that potentially is effecting our liability side," concludes Ragnarsson.

Conclusion

In an environment of low interest rates, weak growth and low expected returns from traditional asset classes, institutional investors are finding it increasingly challenging to earn reasonable rates of return without an unacceptable increase in risk. As a result, institutional investor appetite for alternative asset classes has been on the rise, as more investors are turning to alternative investments such as private credit, private equity and infrastructure in search of returns. Yet, money managers with extensive experience in the space are warning against the unreasonable extrapolation of historical returns into the future and the underestimation of operating and liquidity risks inherent in alternative investments.

> "With the increased focus on alternative and illiquid investments, it is important not to get too carried away. There are several risks that need to be remembered."

Mattias Gromark
Portfolio Manager
Pacific Precious

Fed Turns to Unlimited QE. Time for the Next Gold Rush?

By Eugeniu Guzun – HedgeNordic

Gold may be yo-yoing just like everything else in turbulent market environments, but there is still a long-term investment case for holding the yellow metal as a strategic safe-haven asset. "You need an asset that stores value and that cannot be diluted like fiat currencies due to central banks ramping up the printing presses", says Mattias Gromark, who manages the precious metals-focused fund Pacific Precious.

"We have just entered the third financial crisis of the 21st century after the burst of the dot.com bubble in the early 2000s and the subprime crisis in 2008," notes Gromark. The response to each of these crises has been an injection of more debt into the financial system.

"Instead of implementing proper reforms to solve the underlying problems of the global economy, the ailing infrastructure and our addiction to fossil fuels, we pump in billions of new money to plug the holes in a ship that is massively overloaded with debt already," he argues.

The global economy might muddle through this incoming recession by injecting more debt in the system, "but this will not come without a cost," considers Gromark. "The value of paper money must and will continue to lose value compared to hard assets." As renowned hedge fund manager Ray Dalio puts it, "cash is trash." Cash may well be king in the current market environment, acknowledges Gromark, "but you cannot hold cash for the long term when the money printing gains speed." Gold is one place to park capital, but so are companies set to benefit from higher demand for gold and other precious metals.

PACIFIC PRECIOUS

Gromark, a former Naval Officer in the Swedish Armed Forces, manages a multi-strategy fund that provides exposure to the price development of precious metals such as gold, silver, palladium and platinum. Pacific Precious "aims to offer diversified exposure to gold and precious metals over the whole spectrum," explains the fund manager. "Now, when gold is most likely to be in a multi-year bull market, we want exposure to both the metal itself and high-quality companies sitting on the asset."

Pacific Precious currently allocates half of its portfolio to exchange-traded commodities backed by physical assets in the precious metals sector. The other half of the portfolio is comprised of high-quality public companies active in the mining, exploration or funding of exploration projects in precious metals. "It is important for us that all our investments have as much exposure to the physically-backed precious metals as possible," emphasizes Gromark. On aggregate, Pacific Precious currently maintains an exposure of 75 percent to gold, ten percent to silver, and an additional ten percent to platinum and palladium. About five percent of the portfolio sits in cash.

As "we aim to catch the long-term trends in precious metals," Pacific Precious employs a long-term-oriented, long-biased approach to investing. "That can change when the market outlook changes," highlights Gromark. The fund has a long-time horizon for its investments, with the holding period "hopefully lasting as long as the currently-shaping bull market in gold," says the fund manager. "But of course, we reallocate and tweak positions as market conditions change, and adjust our equity holdings depending on how they develop."

GOLD AS SAFE-HAVEN STATUS

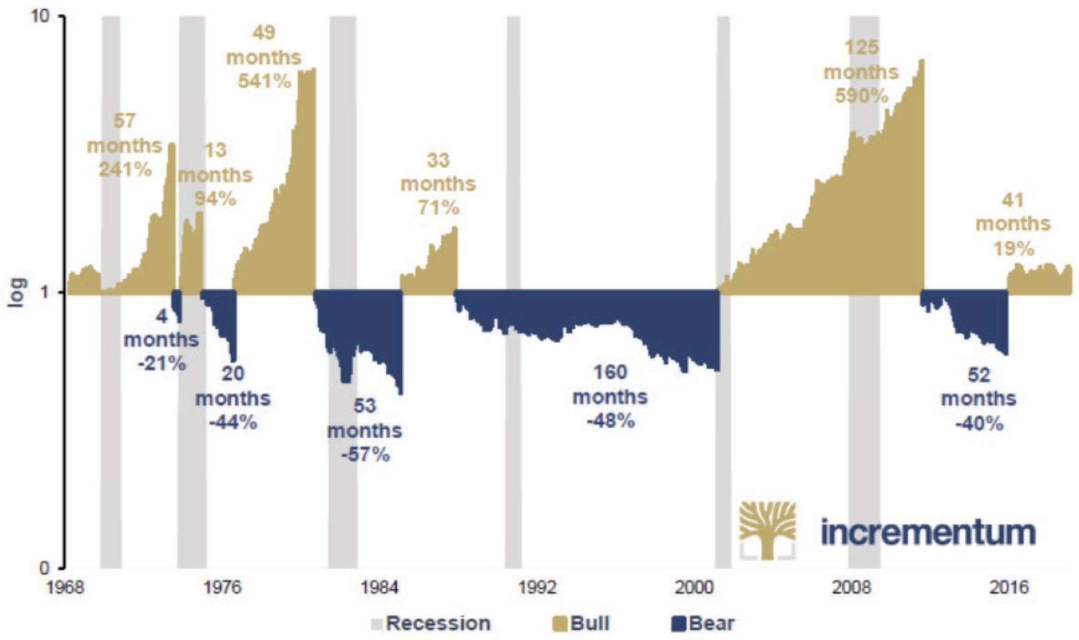
Gold's status as a haven asset has certainly been questioned by some recently, as it has been whipsawed alongside other asset classes in the recent market turmoil. Gromark, however, is confident that gold can cement its safe-haven status in the longer term. "During more normal market pullbacks, gold and stock markets tend to move in opposite directions," says Gromark, adding that this divergence "is good for improving an investor portfolio's risk-return profile."

Sometimes however, "particularly when panic strikes financial markets, all assets start to correlate and move in tandem." The increased correlations apply to "all risky assets when investors are in need of cash." Gold failed to act as a safe haven in the vicious market moves of late February and throughout March, with Gromark suggesting that "a combination of too much leverage among gold-related leveraged products and investor need for cash to cover margin calls" put downward pressure on the price of gold. "When banks send margin calls to their clients in a market panic, you sell what you can."

FORWARD-LOOKING PERSPECTIVE

"It has been quite popular to dismiss the benefits of gold in portfolio diversification," reckons Gromark, who adds that "many investors see the metal as an outdated asset and do not hold any gold in their portfolios." Bitcoin and other exotic alternatives have been preferred instead. However, "adding gold to a traditional portfolio can increase risk-adjusted returns," argues Gromark. The allocation to gold in investor portfolios is low. Based on some estimates, "the price of gold could rise in the range of $2,000 to $3,000 per ounce if all portfolios added a one percent-allocation to gold." The price of gold is "very sensitive to an increase in demand because of the flat or even declining supply."

GOLD IN BULL AND BEAR MARKETS, IN % (LOG), 04/1968-05/2019



Source: Bloomberg, Incrementum AG

> "The money printing will go on, but the trust in the U.S. dollar will be questioned at some point."

Regardless of whether investors add gold to portfolios or not, "one must realize that the debt problem the world faces will not go away, especially in the United States," warns Gromark. "The money printing will go on, but the trust in the U.S. dollar will be questioned at some point." Investors, therefore, need an asset that stores value. "If history is any guide, the bull market for gold has a long way to run," says Gromark. The current bull market is still in its early stages.

Gromark's outlook for gold and other precious metals is optimistic, and so is his outlook for companies active in the mining, exploration and funding of mining projects in precious metals. "This segment may have hit a rough patch because of excessive leverage and a need to raise cash fast," acknowledges Gromark. "When the dust settles, companies in this sector will most likely have a good shot at increasing earnings." Last year's fourth-quarter earnings for the gold mining sector were up 60 percent year-over-year. Gromark expects the same outcome for the first quarter of 2020. "Few sectors will exhibit earnings growth in the coming quarters," so investor interest in gold mining companies and other related companies will increase. "Pacific Precious offers the whole package" allowing investors to capitalize on a long-running bull market for gold, says Gromark, "with both exposures to the metals and the best quality names in the precious metals business."

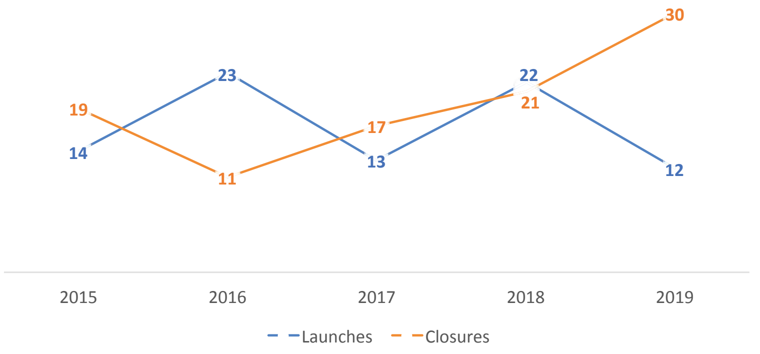
In Focus:

More Graves Than Cradles For Nordic Hedge Funds

By Eugeniu Guzun – HedgeNordic

A whopping total of 98 Nordic hedge funds tracked by HedgeNordic closed down or merged into other funds in the past five years between 2015 and 2019. The industry recorded more closures than launches in three of the past five years, with 2019 being one of the most painful years in terms of closures. No less than thirty funds were liquidated during 2019. In contrast, only 12 new funds were launched last year, the lowest annual number of launches in the past five years.

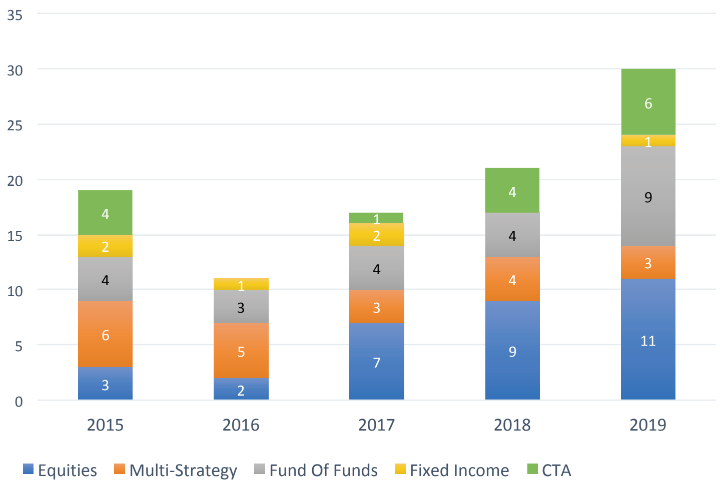
NUMBER OF HEDGE FUND CLOSURES AND LAUNCHES IN THE NORDICS



Orbituaries

Of the 98 Nordic hedge funds that shut their doors during the past five years, 32 used equity strategies and 21 employed a multi-strategy approach to investing. On average, over the past five years, equity hedge funds accounted for about 37 percent of the Nordic hedge fund industry, whereas the fraction of closures in this strategy group out of the total number of closures over the past five years equals 33 percent. Multi-strategy funds, meanwhile, constituted about 22 percent of the industry on average, while the number of closures for this strategy group accounted for roughly 21 percent of all closures. Given the relatively high number of Nordic hedge funds categorized as pursuing equity and multi-strategy approaches to investing, the number of closures in these two strategy groups is not surprising.

HEDGE FUND CLOSURES IN THE NORDICS BY STRATEGY



The picture becomes grimmer for funds of hedge funds and CTAs. The number of active funds of hedge funds in the Nordic declined in each of the past five years, from 31 funds at the beginning of 2015 to only ten funds at the end of 2019. Over the past five years, a total of 24 Nordic funds of hedge funds closed down, with nine of those closures taking place in 2019 alone. The business model of funds of hedge funds has long been challenged because of high the double feelayer and underwhelming performance.

Based on the NHX Fund of Funds, which reflects the aggregate performance of both defunct and up-and-running funds of hedge funds in the Nordics, the group delivered an annualized return of about 0.1 percent in the past five years. On average, funds of hedge funds provided a negative cumulative return of 4.8 percent over the past three years. In contrast, the ten up-and-running members of the NHX Fund of Funds returned 4.4 percent on average during the past three years.

The Nordic hedge fund industry is housing some of the world's largest, oldest and best established CTAs, including Lynx, SEB Asset Selection, Estlander & Partners and IPM (who´s systematic macro strategies are included in HedgeNordic´s CTA sub index). Following several years of poor performance for Nordic CTA, the number of funds using this approach declined from 22 at the beginning of 2015 to 16 at the end of last year. A total of 15 CTAs closed down during the past five years, with the industry recording four closures in 2018 and six closures last year.

The Danish dominated segment of the Nordic hedge fund industry focusing on fixed income instruments and strategies has been in a very healthy state for several years, as reflected by performance figures, the number of new launches and the number of closures (or the lack thereof). The fraction of fixed-income hedge funds out of the total number of active funds increased from about 14 percent at the beginning of 2015 to 20 percent at the end of last year. The total number of closures in this strategy category amounted to six in the past five years, with only one closure recorded in the past two years.

It´s a new Hedge Fund!

Hedge fund closures outpaced launches over the past five years, but there have been new launches in the Nordics too. While only 12 new hedge funds were launched in 2019, which is the lowest number of launches in the past five years, a total of 84 funds kicked off operations during that timeframe.

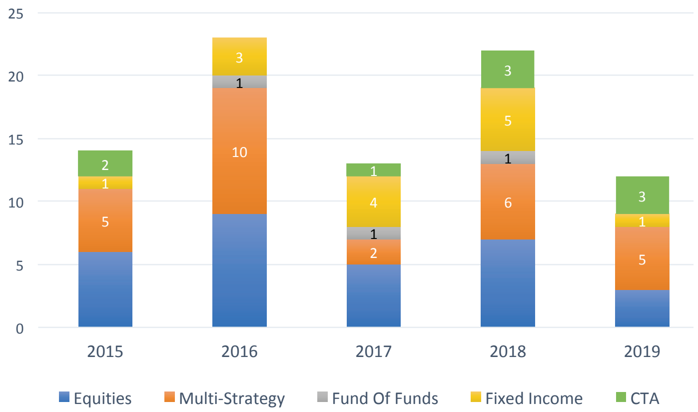
Five of the 12 funds launched last year set sail in the first quarter of last year, the busiest in terms of new launches. The second and third quarters saw two new launches each, while the final quarter of the year registered three new launches. Danske Bank Asset Management launched one multi-strategy and one equity hedge fund to complement its strong range of fixed income vehicles. Stockholm-based systematic manager Lynx Asset Management launched its third investment product since its inception in 1999. Lynx Constellation, powered by a pure machine learning strategy, was the biggest vehicle in terms of assets under management among last year's new launches.

Origin and Strategy of New Launches

Swedish hedge funds account for the largest portion of the Nordic Hedge Index, with more than half of existing constituents being based in Sweden or having Swedish origins. Seven new Swedish hedge funds joined the Nordic hedge fund arena last year, making this the largest group among the Nordic countries. Three Danish and two Finnish hedge funds picked up operations last year. No Norwegian fund was launched in 2019.

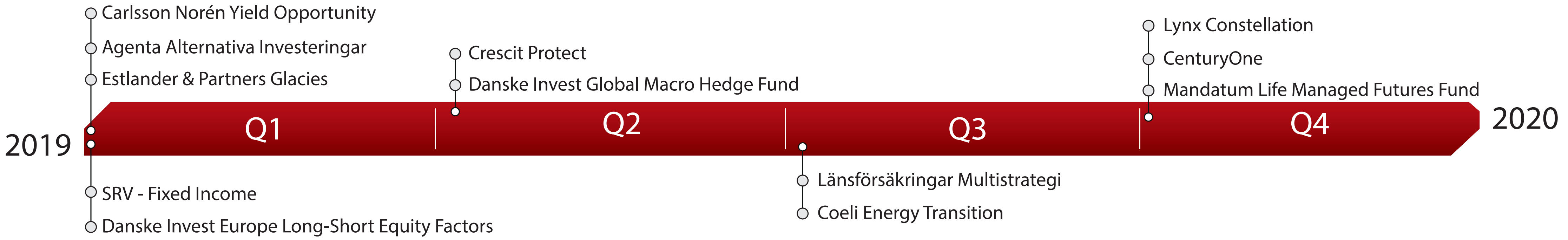
Of last year's 12 new launches, five vehicles employ a multi-strategy approach to investing. Three of the new launches invest mainly in equity markets, and one new vehicle invests in fixed-income markets. Three new trend-following CTAs were launched last year, while no new funds of funds joined the Nordic hedge fund universe.

HEDGE FUND LAUNCHES IN THE NORDICS BY STRATEGY



Performance, Fees and Size

Estlander & Partners Glacies, a futures-based cross-asset multi-factor vehicle, returned 10.3 percent since launching in February 2019. Carlsson Norén Yield Opportunity, an alternative fixed-income fund focusing on hybrid securities, is up 8 percent since the fund launched in January of last year. Multi-strategy fund Agenta Alternativa Investeringar, meanwhile, gained 7.8 percent inception-to-date since its January launch.

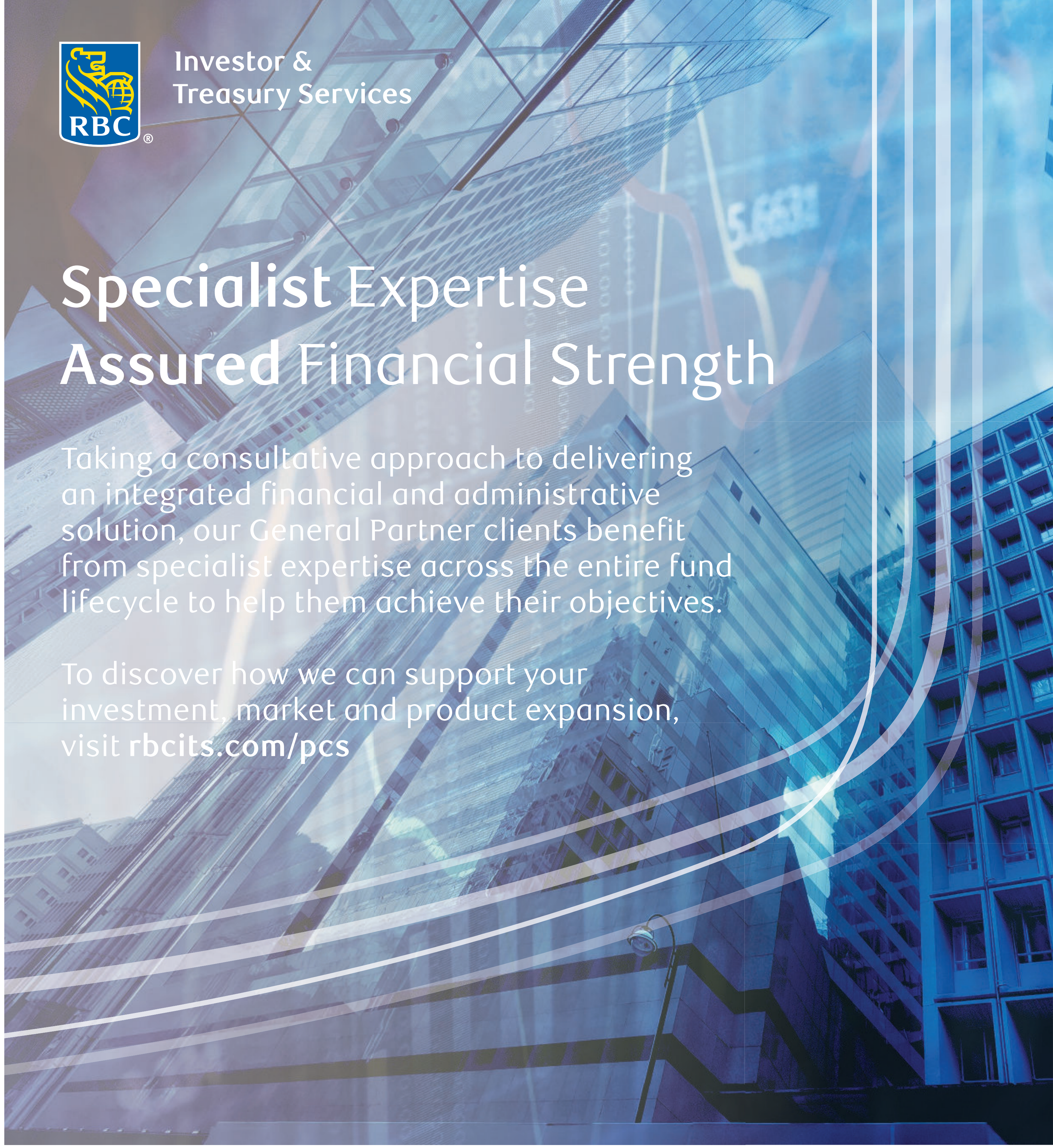


FUND	INCEPTION TO DATE RETURN	PERIOD
Estlander & Partners Glacies	10,27	FEB 2019 - FEB 2020
Carlsson Norén Yield Opportunity	8,03	JAN 2019 - FEB 2020
Agenta Alternativa Investeringar	7,78	JAN 2019 - FEB 2020
SRV - Fixed Income	2,98	FEB 2019 - JAN 2020
CenturyOne	2,89	OCT 2019 - JAN 2020
Lynx Constellation	2,19	OCT 2019 - FEB 2020
Coeli Energy Transition	1,31	AUG 2019 - FEB 2020
Länsförsäkringar Multistrategi	0,55	JUL 2019 - FEB 2020
Mandatum Life Managed Futures Fund	-0,71	DEC 2019 - FEB 2020
Crescit Protect	-1,32	APR 2019 - FEB 2020
DANSKE INVEST EUROPE LONG-SHORT EQUITY FACTORS	-2,00	MAR 2019 - FEB 2020
DANSKE INVEST GLOBAL MACRO HEDGE FUND	-3,98	MAY 2019 - FEB 2020

Most of the hedge funds launched in the Nordics during 2019 use a "one and 20" fee structure. The average management fee charged by the 12 funds launched in 2019 equals 0.87 percent. This group also charges investors an average performance fee of 12.9 percent. It is important to note, however, that these quoted fees are associated with the main share class of each fund, which can include institutional or seed-investor share classes that may exhibit lower fees.

Several of last year's rookie hedge funds currently oversee more than €50 million in assets under management. Lynx Constellation has €160 million in assets as of the end of January, while Copenhagen-based SRV – Fixed Income oversees €98 million as of the end of last year. Danske Invest Europe Long-Short Equity Factors managed about €54 million at the end of February, and Coeli Energy Transition had €46.3 million in assets under management at the end of January. The nine funds of the 12 rookies with reported AUM data in the HedgeNordic database collectively manage close to half a billion euro in assets.

On the following pages, HedgeNordic is introducing three of the years´ new launches, taking a closer look at the strategy and team behind it: Scandinavian Factoring Fund, Proxy Renewable Long/Short Energy and HP Hedge Fixed Income.



RBC®
Investor &
Treasury Services

Specialist Expertise
Assured Financial Strength

Taking a consultative approach to delivering an integrated financial and administrative solution, our General Partner clients benefit from specialist expertise across the entire fund lifecycle to help them achieve their objectives.

To discover how we can support your investment, market and product expansion, visit **rbcits.com/pcs**

REAL ESTATE | INFRASTRUCTURE | PRIVATE EQUITY | PRIVATE DEBT

RBC Investor & Treasury Services™ is a global brand name and is part of Royal Bank of Canada. RBC Investor & Treasury Services is a specialist provider of asset servicing, custody, payments and treasury services for financial and other institutional investors worldwide. RBC Investor & Treasury Services operates primarily through the following companies: Royal Bank of Canada, RBC Investor Services Trust and RBC Investor Services Bank S.A., and their branches and affiliates. RBC IS Bank S.A. is supervised in Luxembourg by the CSSF and the European Central Bank. In the UK, RBC I&TS operates through RBC Investor Services Trust, London Branch & Royal Bank of Canada, London Branch, authorised and regulated by the Office of the Superintendent of Financial Institutions of Canada. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. RBC I&TS UK also operates through RBC Europe Limited, authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Additionally, RBC I&TS' Trustee and Depositary services are provided through RBC Investor Services Bank S.A., London Branch, authorised by the Commission de Surveillance du Secteur Financier (CSSF) and European Central Bank (ECB) and subject to limited regulation by the Financial Conduct Authority and Prudential Regulation Authority. Details about the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request. In Australia, RBC Investor Services Trust is authorized to carry on financial services business by the Australian Securities and Investments Commission under the AFSL (Australian Financial Services Licence) number 295018. In Singapore, RBC Investor Services Trust Singapore Limited (RISTS) is licensed by the Monetary Authority of Singapore (MAS) as a Licensed Trust Company under the Trust Companies Act and was approved by the MAS to act as a trustee of collective investment schemes authorized under S 286 of the Securities and Futures Act (SFA). RISTS is also a Capital Markets Services Licence Holder issued by the MAS under the SFA in connection with its activities of acting as a custodian. In Guernsey, RBC Offshore Fund Managers Limited is regulated by the Guernsey Financial Services Commission in the conduct of investment business. Registered Office: PO Box 246, Canada Court, St Peter Port, Guernsey, Channel Islands, GY1 3QE, registered company number 8494. In Jersey, RBC Fund Administration (CI) Limited is regulated by the Jersey Financial Services Commission in the conduct of fund services and trust company business in Jersey. Registered office: Gaspé House, 66-72 Esplanade, St Helier, Jersey JE2 3QT, Channel Islands. Registered company number 52624. In Hong Kong, RBC Investor Services Bank S.A. is a restricted license bank and is authorized to carry on certain banking business in Hong Kong by the Hong Kong Monetary Authority. RBC Investor Services Trust Hong Kong Limited is regulated by the Mandatory Provident Fund Schemes Authority as an approved trustee. ® / ™ Trademarks of Royal Bank of Canada. Used under licence.

Slim Tail´s Refreshing Take on Past Performance

Lauri Vaittinen, Investment Solutions – Mandatum Life Insurance

By Eugeniu Guzun – HedgeNordic

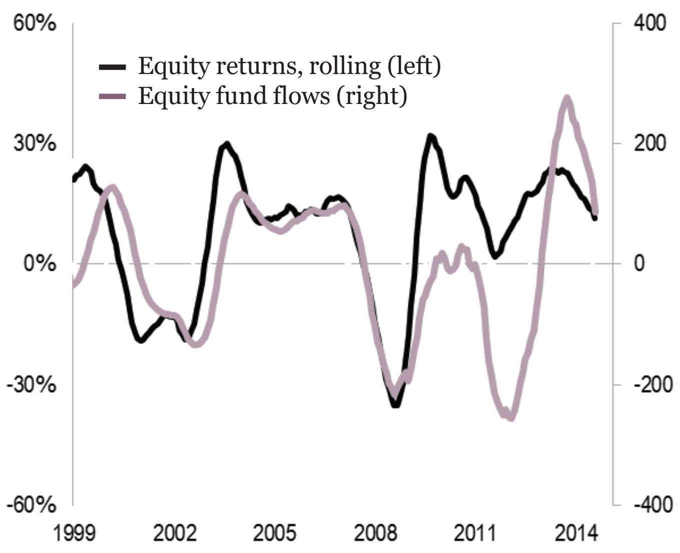
Staying invested in stock markets over the long term (many, many years) has historically paid off, but occasional bear markets are ugly and painful for many investors. In cooperation with Matti Suominen, Professor of Finance at Aalto University, Finnish insurance firm Mandatum Life has developed a systematic strategy – branded Slim Tail – that provides positive exposure to equities in bull markets and limited or even negative exposure in bear markets.

Mandatum Life Slim Tail US Long/Short Equity is one vehicle powered by the Slim Tail strategy. "We want to have long exposure to equity markets most of the time and maintain low exposure during bear markets, which are often significantly shorter than bull markets," explains Lauri Vaittinen, who has developed systematic strategies with Suominen for nearly 20 years. The Slim Tail strategy leans strongly on the academic research they conducted together.

WHAT DOES THEIR RESEARCH PREACH?

There is quite a refreshing spin to the dull disclaimer lingo "past performance is no guarantee of future results used prominently in Mandatum´s communication. Citing previous research, Suominen points out that "past six-to-12-month equity and bond returns significantly predict future equity returns," mainly because past returns "predict investors' arrival to the market, predict future fund flows and predict investors' use of leverage." In short, "past returns from equities and bonds predict future investor behaviour," summarizes Suominen. Because "past equity and bond returns drive fund flows and vice versa," Mandatum Life Slim Tail US Long/Short Equity uses a systematic approach that "alters the exposure to equity markets based on estimates of future capital flows," according to Vaittinen.

> "Past six-to-12-month equity and bond returns significantly predict future equity returns."



Flows drive markets and vice versa. Source: Mandatum Life.

“Equity returns are very correlated with fund flows,” explains Vaittinen, “but flows usually lag behind.” Instead of waiting for lagging data on fund flows to adjust exposure, the systematic Slim Tail strategy “tries to proxy fund flows using cross-asset signals from bonds such as yield curves and time-series data such as equity prices,” says Vaittinen. “The fundamental idea is that we try to be ahead in the decision-making process by estimating a proxy for fund flows.”

Since “there is a positive carry from equities over the long term,” Mandatum Life Slim Tail US Long/Short Equity will maintain long exposure to equities about 85 percent of the time “with varying degrees of net exposure.” According to Vaittinen, “our systematic model is designed to calibrate normal economic cycles and not just price movements,” which implies the strategy does not seek to capture shorter-term moves in equity markets. “Both bull and bear markets are driven by more longer-term, gradual shifts in share price development, fund flows and leverage levels,” finds Vaittinen, who emphasizes that “we try to focus on much longer time horizons and longer market cycles.”

“Our strategy does not go short every time stock prices go down,” highlights Vaittinen. But when markets become more volatile, Mandatum Life Slim Tail US Long/Short Equity reduces the net market exposure and “becomes more tactical by engaging in shorter-term trading.” This shorter-term tactical approach revolves around the so-called turn-of-the-month phenomena, which exhibits strong and highly predictable return patterns around the turn of the month due to monthly flow cycles. These cycles reflect many large flows such as salaries, pensions, dividends, mutual fund distributions, fund redemptions.

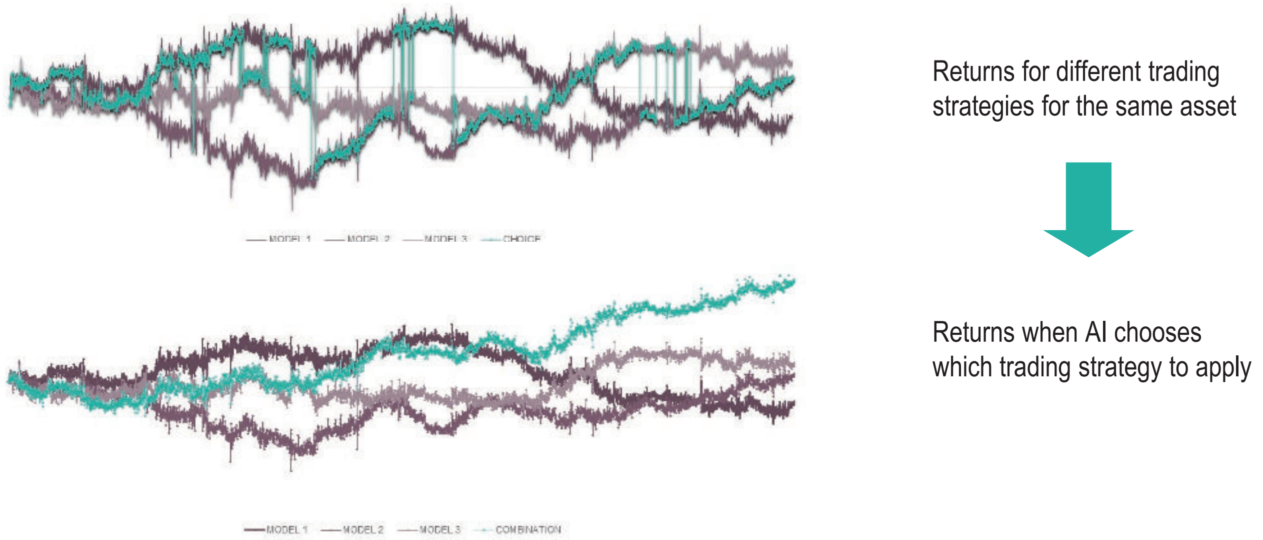
THE TURN-OF-THE-MONTH PHENOMENA

Research conducted by Suominen and Vaittinen finds “systematic patterns in institutions’ trading” around the turn of the month. According to the research, there is “a large systemic liquidity demand in the economy at the month-end,” which triggers increased liquidity-driven trading. Their research shows that at T-4 (four days before the end of the month) or earlier, “pension funds and other institutions liquidate their stock holdings to guarantee cash at the end of the month.” More interestingly, up to 40 percent of month-end returns between T-3 and T are attributable to reversals from price pressure from mutual fund outflows, which implies that “these returns are predictable and high in bear markets.”

During the Lehman crisis, for example, cumulative returns were exceptional low between T-8 and T-4, amounting to a negative 30 percent. The cumulative returns between T-3 and T, however, were exceptionally high at 40 percent. “During times when there are a lot of outflows and negative market movements, markets are short of liquidity and the turn-of-the-month phenomena is much stronger,” explains Vaittinen.

“If equity markets fall, the net market exposure will be fairly low and most of the trading will likely be concentrated towards the end of the month to capture the turn-of-the-month phenomena.” When the Slim Tail strategy becomes defensive and carries ample cash around, “there are high returns to end-of-month investing.”

“We combine the turn-of-the-month trading with the longer-term Slim Tail strategy,” clarifies Vaittinen, who emphasizes that “the way we combine the two strategies is unique.” Although the two strategies can be seen as two distinct pillars of the fund, “they both rely on the large flows of investor capital in or out of the market.” The strategies “work quite well when combined together.”



Returns for different trading strategies for the same asset

Returns when AI chooses which trading strategy to apply

Choosing the right trading model. Source: Mandatum Life.

EVER-ADJUSTING NET EXPOSURE

By combining Slim Tail and turn-of-the-month strategies, Mandatum Life Slim Tail US Long/Short Equity adjusts its net exposure to the S&P 500 between -50 percent and 100 percent using listed index futures. “Depending on market conditions and fund flows, the systematic approach adjusts the market exposure using futures on a daily basis,” explains Vaittinen. “We aim to create a product that is negatively correlated to traditional asset classes during bear markets.”

Mandatum Life Slim Tail US Long/Short Equity delivered an annualized return of 7.7 percent since launching in February 2016, and recorded positive performance in each of the past four years. The fund achieved an inception-to-date Sharpe ratio of 0.87. “While the fund is not a typical hedge fund that seeks to capture alpha opportunities, the product aims to offer investors exposure to equities in bull markets and protection of capital in bear markets.”

ANOTHER DOWNTURN-PROTECTION VEHICLE

Towards the end of last year, Mandatum Life launched a trend-following fund powered by machine learning algorithms designed by artificial intelligence firm PROWLER.io. “While the performance of traditional trend-following strategies has declined significantly over time different types of trend-following models performed well during particular periods” argues Vaittinen Shorter-term-oriented trend-following strategies performed strongly during certain periods of time, whereas medium- or longer-term-oriented strategies performed well in other periods.

Mandatum Life Managed Futures uses artificial intelligence to “pick and choose the right strategy depending on the market environment,” explains Vaittinen. “The fund changes from running shorter-term trading models to longer-term ones depending on which types of strategies the machine learning algorithms believe are more suitable to the current environment.” Instead of employing a fixed strategy with “returns that are zig-zagging around zero over the years,” Mandatum’s trend-following vehicle relies on machine learning to select the right combination of trading models for a given environment.

“Without sophisticated enough models, one cannot capture the appropriate models for each regime,” argues Vaittinen. “This is very difficult to capture for humans running either qualitative or quant-based strategies.” According to Vaittinen, the core of Mandatum Life Managed Futures is choosing the right trend-following model at a given time and optimizing returns at scale across a wide universe of liquid, exchange-traded futures contracts. Whereas Vaittinen reckons Mandatum Life Managed Futures has a competitive advantage over traditional trend-followers due to its “regime-shifting” properties, “traditional CTAs will likely see better performance ahead compared to the recent past too.”

FREDRIK SJÖSTRAND
CIO AND FOUNDING PARTNER
SCANDINAVIAN CREDIT FUND

Kreditfonden Taps Into Nordic Factoring Market

By Jonathan Furelid – HedgeNordic

> “We bring the direct lending asset class through NFF to a wider audience and offer a Nordic touch to the investment.”

Since launching its first fund in 2016, Skandinaviska Kreditfonden AB has become a significant player in the market for direct loans to Nordic companies. Currently managing in excess of 5 billion SEK, the specialist asset manager looks to expand further through the launch of additional fund products, the most recent being the Nordic Factoring Fund – a fund that taps into the Nordic market for factoring loans. But there is more to come.

“We are constantly looking for new ways to build on our core competence within direct lending and the unique network we have in the Nordics. The factoring market is a well-established source of financing for companies in the region but has traditionally been in the hands of so-called financial institutes. We want to become a real contender in this field while at the same time broadening our offering of funds and financing solutions”, says Fredrik Sjöstrand, founder and CIO of Kreditfonden.

The Nordic Factoring Fund, or NFF as it is commonly referred to, has been running since June of last year and has already attracted a lot of interest from existing investors in the Scandinavian Credit Fund I – Kreditfonden’s flagship fund. But Sjöstrand believes that NFF will appeal to new groups of investors as well.

"The NFF offers a product with a higher expected return for those that are willing to accept a less liquid option", says Sjöstrand referring to the fund's liquidity terms that are somewhat more constrained compared to the monthly dealing offered by Scandinavian Credit Fund I.

As for NFF, subscriptions are being accepted monthly, but redemptions are limited to year-ends with a three-month pre-notice. Both funds are traded through so-called profit shared loans on the Nordic Growth Market (NGM). NFF aims for a yearly return (net of fees) of 6 percent, which is in the lower range of the target return for Scandinavian Credit Fund I, which is set to 6-8 percent.

Buying Invoices at a Discount

Factoring is a means for companies to strengthen their liquidity in the short term by selling its account receivables (invoices) to a third party. For example, a company with strong seasonality effects in earnings can smooth out income streams through selling its invoices in order to free up cash.

The price for receiving money now rather than later is the interest paid to the buyer (the factoring company), which translates into the invoice being sold at a discount. The factoring company is then responsible for collecting the payments in full, typically taking on the credit risk in the transaction.

NFF follows the same business model used by traditional factoring companies, but rather than acting as a direct counterparty to the seller of the invoices, the fund uses factoring companies as an intermediary in order to generate returns.

"We are buying invoices through factoring companies that have established relationships and administrative processes in place for collecting payments from the invoiced clients. The returns that the fund generates are the net proceeds from our deal with the factoring company", explains Sjöstrand continuing:

"The invoices bought then serve as a pledge in the name of the fund, and we use a credit insurance in order to protect the fund from being exposed to major credit losses should the invoiced client fail to meet its payment obligations."

The returns generated in the fund can be explained in a five-step model.

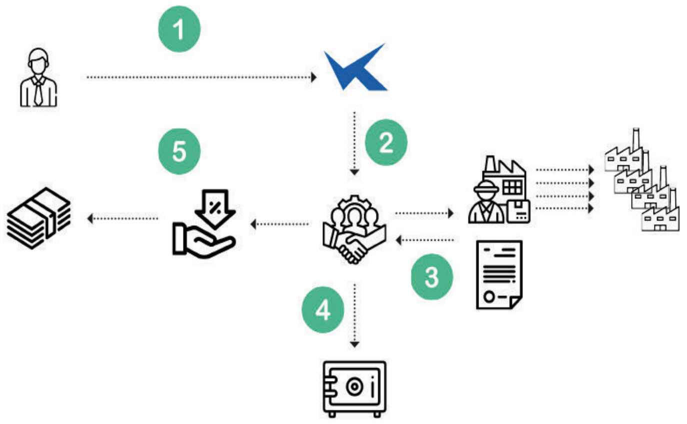
1. The investor buys the fund

2. The fund has agreements with a number of operators or factoring companies that are financed through the capital invested in the fund

3. The factoring companies purchase invoices from companies approved by the fund via factoring

4. The invoices are pledged in the fund's name and serve as collateral

5. The factoring companies make sure that the invoices are paid by the companies to which the invoices are issued, and the fund receives interest on the capital invested.



According to Sjöstrand, there is no similar fund accessible for retail clients in the Nordics, although some of the world's major financial institutions have been offering funds built on the same idea through speciality finance products.

"These funds target an institutional or high net worth individual audience and has a global focus. Much like we did with the Scandinavian Credit Fund I, we bring the direct lending asset class through NFF to a wider audience and offer a Nordic touch to the investment."

This allow the investor to tap into a fund that could bring steady income streams over time while supporting the Nordic business climate through providing short to medium-term financing to companies in the region.

> "There is never a lack of new ideas at Kreditfonden. There are no limits as to what we can do in the direct lending space."

Growing on all Fronts

Since launching in 2016, Kreditfonden has grown significantly on all fronts as investors have searched for alternative ways of generating returns in the current low interest rate environment. As the Scandinavian Credit Fund I has delivered on its promises of a yearly return of 6-8 percent annually, investors have flocked to the product bringing its AuM to close to 5 billion SEK.

"We had an initial target of reaching 3 billion SEK, which was later revised to 5 billion SEK, at one point last year we closed the fund for new investments as we needed to make sure that we had enough capacity to meet the need for new loans in the portfolio. But as we have grown in size, we can now compete for larger deals which means that our capacity can also be higher going forward. We expect that the Scandinavian Credit Fund I can grow to 7 billion SEK and we will cater for additional capacity through the NFF as well as through new products in the near future."

Sjöstrand reveals that an institutional fund following a similar strategy as the Scandinavian Credit Fund I will be launched within short. The fund, dubbed the Scandinavian Credit Fund II, will have a lock-up of several years and target loans that are larger in size. The fund will be offered to institutions in the Nordics and globally with a fee structure and minimum investment that is adapted to the requirements of an institutional audience. He also says that other product ideas are evaluated continuously.

"There is never a lack of new ideas at Kreditfonden. There are no limits as to what we can do in the direct lending space", Sjöstrand says but highlights that growth will never be accepted at the cost of quality.

In order to support the continued growth efforts, Kreditfonden is therefore expanding its team of analysts and debt capital markets originators.

"We have two new senior analysts joining the origination team in the coming months, both having extremely strong profiles. As we grow in size, as well as in the number, size and complexity of deals, we need to make sure that the organization keeps up with the demands that comes with it. The only way we can keep on delivering on our performance targets while making sure credit risks are being managed properly is to have world class employees sourcing and evaluating the loans. I would say we are well underway reaching that goal but it is always going to be work in progress."

> “We use custom-built software to monitor the entire Danish mortgage and government bond market to maintain an overview of the relative attractiveness of bonds across the chosen universe.”

Henrik Fournais
CEO and Chief Portfolio Manager
HP Fonds

Old, New Player on a Market that has not seen Defaults in 200 Years

By Eugeniu Guzun – HedgeNordic

One of the notable characteristics in the Nordic hedge fund industry is the strong range of Danish-originating fixed-income funds that often focus on the domestic mortgage market. One of the most prominent recent fund launches in this corner of the industry is HP Hedge Fixed Income, the second hedge fund by Copenhagen-based HP Fonds.

HP Hedge Fixed Income, launched in October 2018, seeks to identify and take advantage of market moves exacerbated by the reduced capacity of risk absorption of market-making banks. “New regulations have forced banks to scale down trading books and risk-taking considerably following the financial crisis in attempts to sanitize balance sheets of financial institutions,” explains CEO and Chief Portfolio Manager Henrik Fournais. “The number of banks making markets in Danish mortgage bonds has dropped from 20-25 down to only a handful.”

The Core

The primary strategy employed by HP Hedge Fixed Income involves the purchase of Danish callable mortgage bonds below par and non-callable mortgage bonds. According to Thomas Loldrup Kjaer, Partner and Senior Portfolio Manager, “the majority, a minimum of 70 percent, of the fund’s long positions will always be in Danish mortgage bonds.” The team at HP Fonds predominantly seeks to “make a profit on the spreads between Danish mortgage bond yields and the fund’s borrowing rate.” This carry trade approach involves borrowing at low rates – currently between a negative 0.35 percent and negative 0.1 percent – and investing in mortgage bonds yielding between 0.3 percent and 2.25 percent.

While HP Hedge Fixed Income can use as much as 12 times leverage through borrowed capital or repo transactions to multiply the spreads, the HP team takes a more defensive approach and uses lower leverage than many peers. The fund’s leveraged portfolio of selected Danish (and Swedish) mortgage bonds can provide investors net returns of at least five percent after costs over a longer-term horizon. The Danish mortgage bond market has not seen a single default in its over 200-year history, which makes it an attractive asset class for the use of leverage.

“Danish mortgage bonds are of extremely high credit-quality, and there has not been even a single default during the 200-year history of the system, a period including the bankruptcy of Denmark in the early 19th century, the great depression in the wake of World War I, and more recently the sub-prime crisis in 2008,” highlights Fournais. Despite this “virtually non-existent default risk, Danish mortgage bonds still offer considerable pick-up relative to Danish government bonds."

In terms of risk premia, "HP Hedge Fixed Income seeks to harvest carry and redemption risk premia from Danish callable mortgages, and roll down premium from adjustable-rate mortgages," explains Loldrup Kjaer. Danish mortgage bonds with pre-payment options are particularly attractive in the current interest rate environment, offering attractive spreads due to the option feature. These spreads can be considered a combination of the carry and redemption risk premia – additional sources of return unrelated to the credit risk.

To isolate these risk premia and prevent the fund's performance being significantly affected by yield trends, HP "seeks to minimize the interest rate risk on the bond portfolio through sale of futures, interest rate swaps and other financial derivatives or by short selling Danish government and mortgage bonds." According to Loldrup Kjaer, "while the net interest rate risk is hedged away, the fund can still harvest yield curve premia from exposures to different moments of the curve."

The Second Leg

At the end of February, HP Hedge Fixed Income had 85 percent of its long positions in Danish mortgage bonds. Depending on the set of opportunities, the fund can also invest in Swedish Böstader property-backed bullet bonds and floaters, senior non-preferred bonds issued by Danish and other Nordic systematically important financial institutions (SIFIs), as well as European government and corporate bonds.

HP Hedge Fixed Income was solely exposed to the Danish securities at the end of February, as the remaining 15 percent of its portfolio was comprised of senior non-preferred corporate bonds issued by Danish SIFIs. In senior non-preferred bonds, the fund mainly seeks to harvest credit risk premium. However, "the allocation changes over time as opportunities arise," explains Loldrup Kjaer. "We pursue an active investment strategy seeking to pick the market positions expected to yield the best return relative to the risk profile."

Finding Opportunities

The strategy of HP Hedge Fixed Income was built on the resources and experience accumulated during the 12 years of managing HP's award-winning fund, HP Hedge Danish Bonds. "We use custom-built software to monitor the entire Danish mortgage and government bond market to maintain an overview of the relative attractiveness of bonds across the chosen universe," Fournais describes their approach to finding opportunities. Only the best risk-reward opportunities may enter the fund's portfolio.

"Each individual bond is modelled and priced using various assumptions regarding future interest levels and pre-payment rate levels, as well as tested for its impact on the return and risk characteristics of the entire portfolio," says Fournais. Whereas the carry trade approach resembles a "buy-and-do-nothing" strategy, the team at HP Fonds always keep their eyes and ears on the market.

"We receive daily research and data from all Danish and several foreign financial institutions, monitoring reported trades," Fournais describes the research that goes into their decision-making process. "Views are discussed daily with market makers and bond dealers from all Danish banks, and publications of official figures are closely watched, and continuously analyzed and used to update pre-payment expectations," he adds.

There is no Free Lunch

Just as any other investment approach, the strategy employed by HP Hedge Fixed Income does come with some risks to deal with. Some of the risks HP Hedge Fixed Income is confronted by may be unlikely to materialize (yet worth mentioning), but others are more material. One of these is that the Danish and Swedish covered bond markets lose their AAA rating, highlights Fournais. "As foreign investors are very important in both these markets, a change in their behavior could hurt these markets," he points out another risk his team is keeping a close eye on.

The more realistic risks that keep hunting the team at HP Fonds and other fixed-income hedge funds in the space include "redemptions in high-coupon bonds and spreads going the wrong way, which implies that the mortgage spreads to government bonds widens." However, the well-equipped team at HP Fonds believes it has accumulated enough experience to account for these risks and find the best risk-reward opportunities in their investment universe.

The Importance of Relative Value in Credit

Sandro Näf, Portfolio Manager, CEO
Capital Four Management Fondsmæglerselskab

René Kallestrup, PhD, Portfolio Manager
Capital Four Management Fondsmæglerselskab

By Eugeniu Guzun – HedgeNordic

Capital Four Credit Opportunities of Danish sub-investment grade credit manager Capital Four has reached its ten-year anniversary at the beginning of the new decade, with the fund achieving an annualized return above 10 percent over the past decade. While happy with the performance, Sandro Näf, the CEO and co-founding partner at Capital Four, reckons that the way returns are achieved matters more than the level of returns delivered. "Instead of focusing on achieving a certain level of returns, the fund mostly focuses on the quality of returns," explains Näf. "The strategy aims to achieve a good combination of attractive returns at optimized risk levels and with risk that is significantly lower than high yield."

When explaining the investment strategy of the Credit Opportunities Fund, Portfolio Manager René Kallestrup highlights two main aspects of the strategy. First, "the fund has the flexibility to look for alpha opportunities across the entire spectrum of credit markets." Second, "this is an all-cycle strategy that should do well both in up and down markets," adds Kallestrup. "Over the last decade or so, we have shown that we are able to do just that."

Capital Four Credit Opportunities invests dynamically across the entire credit universe, specifically considering relative-value features across bonds, leveraged loans, structured credit, bank capital, derivatives and various types of other credit-related instruments. In addition to focused asset allocation, Capital Four conducts fundamental credit analysis to identify investment opportunities and build long/short positions to exploit those opportunities through detailed and disciplined bottom-up analysis. Capital Four has an army of investment analysts to search for and examine opportunities others may not be able to access. "If you are a company that has a big invested asset base and is a recurring investor and partner with other parties that are relevant in the credit formation process, it is much easier to get access to opportunities over the entire economic cycle," explains Näf.

Whereas some managers are more focused on specific corners of credit markets, Capital Four Credit Opportunities "has a quite diversified portfolio within sub-investment grade credit" that is enriched both by the flexibility of the fund allowed by its mandate and the size of Capital Four's platform and network. With about €530 million in assets under management, the fund is relatively small compared to the firm's asset base of over €13 billion. "This allows us to be super selective in building a focused portfolio," emphasizes Näf. "This fund would have never generated the return it did over the last ten years if it was not for the network and presence we have in the market that allows us to access these opportunities."

EXPANDING UNIVERSE AND OPPORTUNITY SET

The pool of investment opportunities in the sub-investment grade spectrum has expanded significantly over the previous years. Describing how the investment universe has evolved over the past decade, Kallestrup says that both the universe and the opportunity set have expanded significantly. “There have been a lot of new issuances since the financial crisis, creating a lot of opportunities in European and U.S. markets both on the long and short side.” The founding partner and CEO of Capital Four, meanwhile, points out two important secular trends that contributed and continue to contribute to the expansion of the opportunity set.

“At Capital Four, we believe that we are in a secular bull market for credit formation outside the banking sector,” outlines Näf. In Europe, banks have dominated the financial sector and had a primary role in financing the corporate sector. “For decades, Europe has been lagging the U.S. in connecting investors directly with end markets in credit,” highlights Näf, who adds that “we are starting to pick up in Europe and the banking crisis in Europe has accelerated that.” The second development, which relates to the sub-investment grade space in particular, has been the spread of “focused ownership companies over the broadly diversified ownership model.”

The flood of private equity firms and the mounting dry powder in their hands has facilitated new credit formation. “Many institutional investors have increased allocations to private equity or focused-ownership type of funds,” says Näf. “And increasing allocations to private equity need to be supported by more credit formation to facilitate this type of companies with concentrated ownership,” he emphasizes. “We have two strong secular forces that continue to supply us and our clients with investment opportunities.”

As the opportunity set has continuously expanded, the team at Capital Four has grown as well. “Ten years ago, when Capital Four Credit Opportunities was launched, we had six people,” says Näf. “Now we are 90 people with a large majority being investment professionals.” A team focused on sub-investment grade credit needs the depth and breadth of knowledge and capabilities to spot and analyze investment opportunities. As Näf explains, “in addition to having the opportunity set and being able to access it, you need the right team to capitalize on those opportunities.”

There is a lot of expertise required to understand when to invest, in which part of the capital structure (mezzanine, senior, etc.) to invest, and what level of leverage to employ. Around 40 people work on the investment side and this team has to understand all nuances related to investing in the sub-investment grade credit and beyond. “Having the opportunity set, being able to access them, and then finding the right opportunities at the right time are the three layers that translate into good risk-adjusted returns,” argues Näf.

> “There have been a lot of new issuances since the financial crisis, creating a lot of opportunities in European and U.S. markets both on the long and short side.”

INCREASING INTEREST IN STRUCTURED CREDIT

Faced with low interest rates and large allocations to low-yielding assets, institutional investors on the quest for solutions and yield have turned to structured credit, one of the most underappreciated asset classes in credit, according to Näf. A structured credit product operates “like a very simple bank,” according to Näf, “serving as a mechanism to access the leveraged loan market.” Structured credit products are created through a securitization process that packs financial assets such as loans into interest-bearing securities backed by those assets. “Now the leveraged loan market is predominately funded by structured credit, and investors should think of structured credit as a vehicle used to fund the formation of loans,” explains the CEO of Capital Four.

Capital Four’s clients have been able to access the structured credit market for more than a decade by investing into Capital Four Credit Opportunities. “But in the last couple of years, we have received more and more requests from clients to have dedicated vehicles to access this market,” says Näf. In response to increasing investor demand, Capital Four is soon launching a dedicated Structured Credit Opportunities Fund. “The strategy would mostly be investing in the mezzanine and equity tranches of collateralized loan obligations (CLOs), but we also think it makes sense for certain types of investors to access the least risky, senior or investment-grade tranches of CLOs.”

Sandro Näf identifies two main reasons why investor interest has increased in recent years. The relative value between certain tranches of the CLOs and the underlying investments with equivalent ratings being one. “The historical default rates on BBB-rated tranches of CLOs have been lower the default rates of BBB-rated direct investments, but the spreads are higher on CLOs than on underlying instruments with similar ratings,” explains Näf. “You don’t have to be a genius to figure out that something with lower risk and higher expected returns will attract investor interest.”

> “The structured credit markets offer fantastic transparency and you have a very clear transfer mechanism of risk and a very robust type of solvency regime.”

The second reason for the increased attractiveness of structured credit “has to do with the floor mechanism of CLOs.” When investing in BBB-rated corporate bonds offering a spread of 20 basis points, investors receive 80 basis points over Euribor or other reference rates, explains Näf. “But if you invest in the AAA-rated tranche of a CLO, the 90 basis points investors get is over zero, not some reference rate.” If Euribor is negative in the range of 45 to 50 basis points, “CLOs offer an additional spread component that makes the asset very attractive.” According to Näf, “in this current environment, being able to buy AAA-rated at a spread of 130 to 140 basis points versus other AAA-rated assets is mindbogglingly attractive.”

Describing the essentials for being a successful investor in structured credit, René Kallestrup outlines three main areas. First, “you need to be good at manager selection.” Capital Four has a dedicated team focusing on interviewing all asset managers running CLOs. Second, granular analysis of individual credits is important, according to Kallestrup, who emphasizes that “we have to know the underlying names going into each structured credit product.” Third, the understanding of the CLO capital structure is paramount. “If you combine these three areas, you have a very strong platform to add value in structured credit.”

Näf concludes by saying that “it is important for investors to realize that there are no hidden secrets or mysteries about structured credit. “The structured credit markets offer fantastic transparency and you have a very clear transfer mechanism of risk and a very robust type of solvency regime. We are able to fully utilize our credit platform’s synergies to analyse each underlying individual loan in the structures.”

www.hedgenordic.com – March 2020

Jonas Dahlqvist
Portfolio Manager
Proxy P Management

Dan Lindström
CEO
Proxy P Managemen

by Eugeniu Guzun– HedgeNordic

DRIVING AND RIDING THE ENERGY TRANSITION

Megatrends – powerful, transformative forces making monumental shifts to the global economy, business and society – have been changing the way we live for centuries. While there are different interpretations of megatrends, there is wide agreement that one of the megatrends shaping the modern world is the gradual, unstoppable transition from fossil-based fuels to more sustainable and renewable sources of energy.

The finite supply of fossil fuels, large emissions of greenhouse gases such as CO2, and geopolitical tensions that go hand in hand with the sourcing and production of oil and gas are the main catalysts behind this transition. Renewable energy technologies – which range from wind and solar to hydroelectric, geothermal and biomass – are not just clean. They are also increasingly a cheaper form of power generation, creating a fertile ground for viable businesses to create substantial value for shareholders.

Launched at the end of December 2018, Proxy Renewable Long/Short Energy is an emerging global equity fund that seeks to capitalize on the opportunities crafted by this transition from traditional fossil fuels to new technologies and renewable energy sources.

According to Dan Lindström, the CEO of Stockholm-based asset manager Proxy P Management, this energy transition represents "a highly disruptive force paving the way for companies within the renewable energy sector" to create significant value for shareholders, stakeholders and the environment. "There will be significant growth and value creation related to the energy transition, and important destruction of value associated with legacy energy infrastructure and systems." The Proxy P investment team managing the long/short equity fund "has demonstrated that they can successfully extract value from the energy transition theme," Lindström points out. And indeed, so far, the fund has generated a strong track record.

Proxy Renewable Long/Short Energy returned 48.6 percent since launching in December 2018 through March 1, outperforming both broader equity markets and renewable energy-related stocks as a group. The fund helmed by CIO Jonas Dahlqvist was 2019's second best-performing hedge fund in the Nordics. The excess returns generated over the market "come from our ability to identify the winners and losers or laggards related to energy transition," emphasizes Lindström. To distinguish between winners and losers, the team relies on a combination of top-down and bottom-up approaches that are part of an "iterative loop."

Top-Down, Bottom-Up, Repeat

Proxy P Management uses a four-step investment process, which begins with a top-down thematic approach that identifies the most attractive existing and future themes shaped by the energy transition. The next step involves categorization, which aims to identify companies expected to benefit from or be impacted by a specific theme. As Dahlqvist explains, "we connect individual companies or baskets of companies with a specific theme identified by the top-down approach." According to Dahlqvist, "in the end, we are aiming to find growth companies with a strong tie or connection with a specific energy transition theme."

By tying companies to a specific theme, the portfolio managers increase the likelihood of finding companies that grow for the right reasons. In this step, "we try to understand if these growth opportunities are a result of a specific theme or not," explains Dahlqvist. "If we are successful in identifying the right themes globally, connecting companies with these themes, and then stripping out companies that are not likely to generate earnings growth going forward," Proxy Renewable Long/Short Energy should perform strongly in the long term.

> "There will be significant growth and value creation related to the energy transition, and important destruction of value associated with legacy energy infrastructure and systems."

Bottom-Up in Focus

After identifying major energy transition themes and tying companies to those themes, the team employs "deep classical bottom-up analysis and spends a lot of time analysing growth opportunities of individual companies." Despite chasing high-growth opportunities, the team view the quality of a business and its valuation as two essential fundamental aspects that need to be considered in the selection process. "The value and quality are extra layers that enable us to improve alpha," highlights Dahlqvist.

"We are growth investors, but we pay a lot of attention to the valuation component," underlines the chief investment officer. To illustrate the importance of valuation, Dahlqvist puts forward the following example. "If you have two equally fantastic companies that trade at different valuations, the cheaper one will most likely outperform the expensive one."

The team also allocates a great deal of time analysing the quality characteristics of a business. "We are looking at the operating cash flows, leverage, and ESG footprint to assess the quality of a business," explains Dahlqvist. "Quality companies of the sort we like have positive operating cash flows and show an ability to turn their earnings into real cash," says Dahlqvist. Proxy P seeks to avoid businesses with leveraged balance sheets, which could "face real challenges in a higher interest rate environment."

ESG Sustainable in the Long Run

As for the environmental, social and governance (ESG) considerations, Dahlqvist and his team mostly look for companies "with an above-average absolute ESG score, and that experience an improving ESG rating." As Dahlqvist explains, "in the long run, companies with a weak absolute ESG score and a weakening score will face challenges one day because of their ESG footprint." All in all, "a portfolio of higher-quality companies will perform better during rainy days than a portfolio with companies that have less impressive quality characteristics" even if both portfolios share the same growth potential.

Shorts – Source of Alpha, Advanced Database

Proxy Renewable Long/Short Equity currently maintains a portfolio of about 30 long positions and 20 short positions. "We do not use shorts to hedge market exposure," emphasizes Lindström. "We use shorts for alpha generation." However, most of the short positions are paired with long positions, which "represents a more low-risk approach to shorting." The team predominantly looks for "high probability" pairs. "For example, going long the best-positioned wind turbine producer and shorting one struggling to scale production or its technology" represents one such high probability pair.

The team behind Proxy P Management consists of both traditional fundamentalists and quants. Over several years, they have been building and relying on a proprietary "in-house-developed portfolio and risk management system that spans from being an advanced database, filter and scenario tool to a risk and portfolio management system." This database assists the portfolio managers in all parts of the investment process, starting with identifying the themes related to energy transition and categorising companies to each of the identified themes.

The data science enables the portfolio management team to focus on core activities where they add the most value, argues Lindström. "There is no way one can cover the entire global space as a fundamental and discretionary manager, especially a fast-evolving industry such as the renewable energy space," reckons Lindström. Proxy Renewable Long/Short Equity is a global sector fund. "To be able to have truly global coverage, we require and have built a system that is scalable and can process and filter large quantities of data."

A Postcard from Stockholm

By Aaron Overy
Senior Director at The Asset Management Exchange

Aaron Overy
Senior Director at The Asset Management Exchange

In 2019 the team at The Asset Management Exchange (AMX) identified the Nordics as a region where the pensions industry is on the brink of far reaching changes. Over the past 12 months, the team has met with many providers across the region and identified four key issues that will impact the industry in 2020.

1. Institutions for Occupational Retirement Provision Directive

The goal of the Institutions for Occupational Retirement Provision Directive, or IORP, is to facilitate the development of occupational retirement savings and to provide sustainable and adequate occupational pensions for European citizens. IORP II is the most recent second iteration of the European Union's sweeping reform of pension fund legislation. It came into force on 13 January 2019 and added 43 new articles to the original IORP directive and put a renewed focus on governance and communication standards.

These changes particularly impact Sweden, as Norway, Finland and Denmark generally have assets in other pension vehicles. As a result the Swedish pension market is in a state of flux, with smaller providers struggling to meet the costs of adapting to IORP II, leading to mergers and takeovers within the industry.

Separately, the IORP II implementation bill passed in Sweden on 15 December 2019. This will allow insurance companies and workplace pension savings institutions to be converted into occupational pension companies, as long as they meet certain requirements. This means a move away from tough Solvency II capital requirements. The gold plating in the IORPs transposition into national law has led to concerns about the possibility of poorer outcomes for savers, due to higher costs without a corresponding increase in consumer protection.

In 2020 we expect to see insurance companies making the move to become IORPs but then also examining their cost base and how they implement investor decisions in the most cost-efficient way.

2. Fund structures for ex Nordic distribution

Domestic funds generally work well for domestic investors. Danish funds for the Danes, Swedish special funds for the Swedes. However, outside of home markets investors and consultants typically look to mutual funds from familiar global fund centres like Luxembourg and Ireland. However, we're now also seeing demand rise for the right type of fund. For withholding tax reasons, corporate fund types are not suitable for tax exempt investors like pension funds when invested into global equities.

This year, we are working with Nordic managers in helping them set up suitable collective investment schemes to distribute their skill throughout the world.

3. Swedish Pension Fund Authority Changes

The funded part of Sweden's first pillar Premium Pension System (PPM) is being revamped during a complete regulatory review. The aim is to improve standards and increase investor protection following some scandals and poor performance. The number of funds available is being rationalised with minimum requirements being placed on investment managers.

We expect future plans to include a greater role for AP7, the default fund, a focus on manager selection and a more guided approach to providing saver solutions.

4. Platform Infrastructure

Insurance companies are looking at how they manage the assets of their end-savers in the most efficient way. Many conducting root and branch reviews on how they digitalise and how they offer cost effective funds.

As these reviews conclude we expect to see a shift away from the internal delivery of fund infrastructure and towards the use of specialist partners.

By Eugeniu Guzun – HedgeNordic

Merger & Acquisition in the Nordic Hedge Fund Space

Hedge funds were once able to escape regulatory scrutiny. But the hedge fund industry has undergone major changes since the financial crisis of 2008, with the industry becoming more institutionalized with increased transparency and regulation. In a world where fund fees are under never-ending pressure, and stricter regulation extends the operational demands on hedge fund managers, growing consolidation in the industry comes as no surprise. The Nordic hedge fund industry has not been spared.

The result: Consolidation. Economies of scale. Rightsizing.

In the Nordic hedge fund industry, we observe three main types of consolidation: horizontal integration, minority stakes and fund range rightsizing. Difficulties in raising assets, fee compression, and higher operational costs have collectively or separately led to horizontal integration in the Nordic asset management industry. The Nordic hedge fund industry witnessed several “horizontal integration” deals in 2019.

In early November last year, Stockholm-based asset manager East Capital announced an agreement to acquire hedge fund firm Adrigo Asset Management, the manager of two hedge funds that are part of the Nordic Hedge Index. East Capital's outright acquisition of Adrigo was meant to "strengthen its offering in absolute return and specialized investment strategies." As of the beginning of April 2020, both Adrigo Hedge and Adrigo Small & Midcap L/S operate under the umbrella of East Capital under the brand "Adrigo Asset Management" and will benefit from additional management expertise, organization and distribution channels.

Around the same time of the year, hedge fund house Atlant Fonder acquired its sister, Pacific Fonder, and its range of funds: three equity funds and two hedge funds. Atlant Fonder partly owned Pacific Fonder before the acquisition, so the deal was mostly aimed at strengthening "its management organization, its marketing organization and its fund offering." Soon after the acquisition was consummated, Atlant Fonder started a process of streamlining the acquired fund range by liquidating two of the three equity funds due to a small volume of assets and merging the two hedge funds.

At the beginning of April last year, Stockholm-headquartered asset manager Coeli Asset Management took over the management of Merrant Capital's two funds of hedge funds. After managing the two Merrant Alpha Select funds for about a decade, Ulf Sedig and Rolf Hagekrans, the founders and portfolio managers of the market-neutral funds of hedge funds, handed over the torch to Coeli Asset Management. The two funds were later closed down. Coeli had earlier already been in buying mode, for instance with their takeover of Accum´s fund range and client base.

Minority Stakes

Another strong trend in the wave of consolidation in the Nordic hedge fund industry has been the buying of equity stakes in hedge fund businesses. One simply cannot talk about this "partnership concept" without mentioning Brummer & Partners.

Brummer & Partners has been at the forefront, maybe the inventor, of the partnership concept in the Nordic hedge fund industry. The hedge fund house has expanded significantly over the years by partnering up with talented, at times emerging hedge fund teams, where each team has its own management company. Brummer & Partners acquires significant minority stakes in each company, allowing the hedge fund teams to grow their funds using the infrastructure developed by Brummer & Partners. To nurture the partnership concept, each hedge fund team holds a significant equity stake in their fund management companies.

Brummer & Partners owns part or all of about ten hedge fund firms under its umbrella and runs a multi-strategy fund that deploys capital to each of the single-strategy hedge funds run by those firms. After buying a minority stake in AlphaCrest Capital in August 2018, last year Brummer & Partners acquired a 49 percent stake in Frost Asset Management, which manages a relative value hedge fund focusing on Scandinavian fixed-income markets. The Frost Fund is managed by former employees at the now-closed Nektar. Johanna Ahlgren is the manager´s CEO, Martin Larsén was former deputy chief investment officer at Nektar, and Anders Augusén was a portfolio manager at Nektar for over ten years.

In July of last year, Mangold Fondkommission announced an agreement to acquire a 25 percent-stake in QQM Fund Management, a Stockholm-based asset manager running systematic market-neutral fund QQM Equity Hedge. According to Ola Björkmo, the CEO of QQM, the long-term partnership with Mangold, an independent Swedish securities broker with a successful private banking business aimed at company owners, individuals and foundations, "will strengthen our distribution capabilities and generate growth."

Mangold previously made similar acquisitions of the same size in two other Nordic alternative asset managers, Skandinaviska Kreditfonden and Resscapital. Skandinaviska Kreditfonden manages several direct lending funds in the Nordics, whereas Resscapital oversees Ress Life Investments – an alternative investment fund investing in the secondary market for U.S. life insurance policies.

In April of 2019, another Swedish asset manager, Crescit Asset Management, announced the launch of its second hedge fund with over SEK 1 billion in assets and simultaneously welcomed a new shareholder. Finnish insurance firm Mandatum Life Insurance, the new shareholder, acquired a 19.9 percent-stake in Crescit Asset Management as part of an international growth strategy. The co-operation between Mandatum Life and Crescit was meant to reinforce the Finnish firm's institutional wealth management networks in the customer arena in Stockholm.

In July of 2018, Nordea Asset Management announced an agreement to acquire a 40 percent-stake in Stockholm-based hedge fund manager Madrague Capital Partners, which manages global long/short equity fund Madrague Equity Long/Short. Nordea Asset Management also launched a UCITS-structure that mirrors Madrague's original strategy. According to the announcement, "the partnership combines Madrague's well-regarded hedge fund investment competence with the strong Nordea Asset Management distribution network in the Nordics." The new fund also supplemented and enhanced Nordea's product offering. The ongoing trend of minority stake deals may well continue going forward in the Nordics, in ways that satisfy both buyers and sellers.

Fund Range Rightsizing

Some hedge fund firms choose to offer a limited range of funds, sometimes one or two, while others aim to offer investors one-stop shopping by managing a wide range of funds. Some consolidation in the Nordic hedge fund industry has taken the form of fund range streamlining, which generally seeks to improve management efficiency and reduce costs. For instance, alternative asset manager Optimized Portfolio Management (OPM) merged two of its funds of hedge funds at the end of August. Trend-follower Nordea 1 - Heracles Long/Short MI Fund was merged with Nordea 1 - Alpha 15 MA Fund during the summer too. In March, Guide Hedgefond was merged with long/short equity fund Guide Avkastning.

Conclusion

Hedge fund operators in the Nordics have been pairing up or selling to larger rivals, as it has become harder for smaller hedge funds to raise assets under management, and deal with increasing operating expenses stemming from increased regulation. Larger hedge fund firms already have the infrastructure to attract large institutions and can achieve economies of scale by acquiring or partnering up with smaller rivals. There is a wave of consolidation in the Nordic hedge fund industry and all the arguments for doing so are well-thought-out. A little bit of consolidation does no harm and is probably a positive development for the hedge fund industry.

GENERAL TERMS AND CONDITIONS

These are the terms and conditions which govern the use of „HedgeNordic Industry Report", an online magazine edited and distributed by electronical means and owned, operated and provided by Nordic Business Media AB (the "Editor"), Corporate Number: 556838-6170, BOX 7285, SE-103 89 Stockholm, Sweden.

DISCLAIMERS AND LIMITATIONS OF LIABILITY

1. The Content may include inaccuracies or typographical errors. Despite taking care with regard to procurement and provision, the Editor shall not accept any liability for the correctness, completeness, or accuracy of the fund-related and economic information, share prices, indices, prices, messages, general market data, and other content of „HedgeNordic Industry Report" ("Content"). The Content is provided "as is" and the Editor does not accept any warranty for the Content.

2. The Content provided in „HedgeNordic Industry Report" may in some cases contain elements of advertising. The editor may have received some compensation for the articles. The Editor is not in any way liable for any inaccuracies or errors. The Content can in no way be seen as any investment advice or any other kind of recommendation.

3. Any and all information provided in „HedgeNordic Industry Report" is aimed for professional, sophisticated industry participants only and does not represent advice on investment or any other form of recommendation.

4. The Content that is provided and displayed is intended exclusively to inform any reader and does not represent advice on investment or any other form of recommendation.

5. The Editor is not liable for any damage, losses, or consequential damage that may arise from the use of the Content. This includes any loss in earnings (regardless of whether direct or indirect), reductions in goodwill or damage to corporate.

6. Whenever this Content contains advertisements including trademarks and logos, solely the mandator of such advertisements and not the Editor will be liable for this advertisements. The Editor refuses any kind of legal responsibility for such kind of Content.

YOUR USE OF CONTENT AND TRADE MARKS

1. All rights in and to the Content belong to the Editor and are protected by copyright, trademarks, and/or other intellectual property rights. The Editor may license third parties to use the Content at our sole discretion.

2. The reader may use the Content solely for his own personal use and benefit and not for resale or other transfer or disposition to any other person or entity. Any sale of Contents is expressly forbidden, unless with the prior, explicit consent of the Editor in writing.

3. Any duplication, transmission, distribution, data transfer, reproduction and publication is only permitted by
   i. expressly mentioning Nordic Business Media AB as the sole copyright-holder of the Content and by
   ii. referring to the Website www.hedgenordic.com as the source of the information.

   provided that such duplication, transmission, distribution, data transfer, reproduction or publication does not modify or alter the relevant Content.

4. Subject to the limitations in Clause 2 and 3 above, the reader may retrieve and display Content on a computer screen, print individual pages on paper and store such pages in electronic form on disc.

5. If it is brought to the Editor's attention that the reader has sold, published, distributed, re-transmitted or otherwise provided access to Content to anyone against this general terms and conditions without the Editor's express prior written permission, the Editor will invoice the reader for copyright abuse damages per article/data unless the reader can show that he has not infringed any copyright, which will be payable immediately on receipt of the invoice. Such payment shall be without prejudice to any other rights and remedies which the Editor may have under these Terms or applicable laws.

MISCELLANEOUS

1. These conditions do not impair the statutory rights granted to the readers of the Content at all times as a consumer in the respective country of the reader and that cannot be altered or modified on a contractual basis.

2. All legal relations of the parties shall be subject to Swedish law, under the exclusion of the UN Convention of Contracts for the international sale of goods and the rules of conflicts of laws of international private law. Stockholm is hereby agreed as the place of performance and the exclusive court of jurisdiction, insofar as there is no compulsory court of jurisdiction.

3. Insofar as any individual provisions of these General Terms and Conditions contradict mandatory, statutory regulations or are invalid, the remaining provisions shall remain valid. Such provisions shall be replaced by valid and enforceable provisions that achieve the intended purpose as closely as possible. This shall also apply in the event of any loopholes.