Benefiting from corporate events while mitigating market risk

Stockholm (HedgeNordic) – Carl Anderén is the portfolio manager of Coeli Norrsken, a niche player in the event driven hedge fund space. The fund looks to profit from the price action that follows when a company announces a new share offering. At the same time, the strategy aims to be indifferent to market risk by holding a dollar neutral portfolio.

The strategy behind the Coeli Norrsken fund was set up already in 2001. In a nutshell, it seeks to benefit from the risk premium that develops when a listed company goes to the market to seek new capital. This premium is the result of the overreaction and discounting that often follows when a company announces its ambition to raise capital.

”We only trade in companies that are raising capital from the equity markets. Our universe consists primarily of companies listed in the U.S. that either issue new shares or sell out shares from existing owners of the company.” Anderén says. ”The way it works is that a company announces a share issue. Then they need to tell the market what they plan to do with the funds. When this takes place you introduce a new uncertainty and this uncertainty is discounted by the market. The goal of the fund is to capture this “uncertainty premium” and profit as the discount dissipates,” Carl Anderén explains.

The time it takes for the stock to converge varies says Carl, but as the effects of the transaction dissipates, i.e. when the transaction is priced and uncertainty is no longer present, the company’s stock price goes from being somewhat decoupled from the overall market to being more aligned or more correlated with the market again. Because of this realignment, over time, it is important to have a market neutral approach. ”We are only interested in capturing the premium, not having unwanted overall market risk, as a result, a market neutral strategy comes naturally, Anderén says. The way the strategy hedges out market exposure is through holding a dollar neutral portfolio of using broad equity indices, Carl emphasizes that the dollar neutral approach is much more stable than a beta neutral approach for a strategy such as that employed by Norrsken.

”We are religious when it comes to hedging. Given that we hold a fairly concentrated portfolio, the dollar neutral approach is our choice to maintain market neutrality. Beta neutral strategies tend to work less well in transition periods when markets become more volatile. It is harder to forecast how the portfolio will behave in these scenarios.” Our research that we have done over the last decade is fairly clear, predicting future correlation is extremely difficult. This is especially important when you have relatively narrow portfolios.

Given that you cannot predict future correlations a beta neutral portfolio will either become over or under hedged in transition periods, which are typically when you need the market hedge the most. In any given year, Carl and his team participates in around 150 transactions, the investment process is systematic on the initial screening process with a discretionary overlay on final decisions. The execution has evolved over time into what today is a systematized way of detecting opportunities in what is referred to the market for secondary offerings. Carl highlights that the process is very strict as to which transactions the fund enters into.

To read the whole interview in the HedgeNordic Special Report on market neutral strategies, please click here: Market Neutral Strategies