

Health Care - a great place to be market neutral!

Stockholm (HedgeNordic) - For the Norwegian based management team of the Sector Health Care fund, the idea to launch a product with a market neutral strategy in the healthcare space was born on the back of some rather simple considerations.

While the team had all the confidence in being good stock pickers, they did not want to be relying on beta or timing skills. There would be plenty company specific risk factors and dispersion in the healthcare space to make attractive returns in a market neutral setup with limited exposure towards systematic market risk factors.

Trond Horneland, co-portfolio manager of the \$660 mill. healthcare strategy, said the healthcare sector is particularly well-suited for a Market Neutral strategy. "The healthcare sector is dominated by company-specific factors, such as new product launches, as well as the inherent cyclicity caused by individual patent expirations. Given the dynamic nature of the industry, it has historically been an attractive universe for active stock selection strategies". The healthcare sector consists of large and liquid companies with high historic return dispersion and low correlations. Currently there are well over 3000 listed healthcare companies in developed markets, with an aggregated market value of well over 6 trillion Dollars - about 27 times the value of the Norwegian stock market. The large, liquid and de-risked portion

of this healthcare universe, consists of roughly 350 companies with an aggregated market value of well over 5 trillion Dollars. "When we first launched our fund 10 years ago, we had about 220 companies in our core investment universe. This has now expanded to well over 350 companies despite a very active mergers and acquisitions environment during the last ten years. This is a good illustration of how dynamic the overall healthcare universe has been historically.

Market neutrality is achieved by trading on the long or short side of bottom up, fundamentally driven

single stock ideas and no options or futures are used. "On a few occasions we have turned to liquid ETFs when we found no suitable short right way, but that has historically not been more than around 5% gross exposure of the short book."

Merger and acquisition activities are a big topic in the industry, and the fund has historically benefited from being on the right side of M&A situations. However, the team tends to avoid merger arbitrage situations, as Horneland does not like the risk reward pattern of these deals having a fixed upside but open downside risk. "We have not been too keen on those arbitrage situations and tend to stay away from them. In general, Sector Health Care does not enter into pair trades, but likes each position to stand on its own merits."

The team historically has been able to extract alpha from both the long as well as the short book. Alpha from shorting has proved more challenging in the healthcare bull market experienced during the last five years, but this year Horneland estimates that 30% of the fund's alpha has come from the short side. Since the inception of the fund, the short book explains nearly 40% of the historic alpha.

The fund has proven its claim to have an uncorrelated return profile and more than stands its ground in periods of significant market stress. In 2008, the fund returned 11 percent. The fund has

also had a good period during the last 3-4 months at the same time as the broader healthcare sector had

a correction of over 15 percent from peak. “We think our history of doing well in periods of market stress is due to a disciplined risk construction framework as well as an active management of all systematic risk elements. Our contrarian tilt has also proven valuable in these periods since crowded positions often take outsized losses in flow driven market selloffs”

Sector Healthcare’s two founding investment managers, Trond Horneland and Trond Tviberg, launched the fund in 2005. Currently, the investment team consists of 5 experienced healthcare investment

professionals that invest globally in developed markets and across most sub-sectors of healthcare, including pharmaceuticals, medical technology, healthcare services and developed biotech. The team manages the market neutral Sector Healthcare Fund as well as the long only UCITS fund, Sector Healthcare Value Fund. The latter was launched five years ago, and is largely a replication of the long book of the market neutral hedge fund.

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