

Nykredit MIRA Hedges Danish Callable Bonds Market

Stockholm (HedgeNordic) – Nykredit MIRA, the \$250 million hedge fund of Nykredit Realkredit A/S, Denmark's biggest mortgage lender, is a relative value fund investing in fixed income with a focus on Danish mortgage bonds. The objective of the fund is to generate high absolute return using trading strategies that include leverage, short selling and derivatives. According to a profile by Bloomberg, it has found a way to deliver double-digit returns on AAA-rated bonds by taking advantage of mispriced call options, which has allowed it to deliver 11% on average since inception in 2008, returning 6.38% so far in 2017 alone (0.68% in April according to the NHX).

"One of the things we constantly do over and over again is to look at different measures showing whether the market is paying too much or little for the prepayment risk," Henrik Jorgensen, head of fixed income at Nykredit Asset Management, told Bloomberg's Jonas Cho Walsgard in an interview. "So it's really about knowing every corner of this constantly changing market."

Callable bonds make up about one third of the Danish market, where Danes have a tradition of checking the price of bond-backed mortgages to decide when to exercise call options that let them buy back debt and refinance it at better rates. Jorgensen's team try to assess the probability of prepayment, using leverage and hedge positions as risks change.

"When you have prepayments it's human behaviour. It's not a machine telling people what to do with their loans. This gives opportunities for investors, but on the other hand, debtors have historically been extremely effective regarding prepayments, so risk on your positions in Danish callable bonds can change fairly quickly," Jorgensen said.

The fund minimises exposure to general market risks such as interest and currency risk. Instead, its primary value driver is spreads between long and short positions, where it typically makes bets three to six months into the future and then invests in what it judges to be the underpriced corners of the market.

"Currently 1.5% coupons with 20-year maturities still look extremely good. Carry positions in 3% with 30-year maturities is still a big place for us to be," Jorgensen said. There is room for performance in the market even though bond spreads have narrowed in the current low-rate environment, he added. "There's low issuance in the market and we see there's more demand for Danish mortgage bonds and its primarily coming from foreign investors."

Nykredit MIRA is designed for investors with the necessary experience and knowledge to understand the risk involved with hedge funds, suitable only for investors with the appropriate risk profile, time horizon and investment strategy that includes hedge funds.

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