

# Interview: Marcus Wahlberg, Elementa

Stockholm (HedgeNordic) – Elementa, a niche long/short equity fund specializing in Nordic small and mid-sized companies, returned 34.08% since its inception in early March 2015. The fund launched and managed by Marcus Wahlberg enjoyed a wonderful rookie year, delivering a return of 15.02% in 2015, followed by an equally-exceptional 2016 in terms of performance (13.88%). However, the fund's investors have not been as handsomely rewarded thus far in 2017, with the fund returning 2.36% since the start of the year through the end of August.

Given the exceptional performance of Elementa in 2015 and 2016, coupled with the relatively underwhelming performance so far in 2017, HedgeNordic sought to find Marcus Wahlberg's thoughts on the current state of equity markets, as well as obtain some comments on the fund's 2017 performance. The HedgeNordic team also sought to find out whether the fund's strategy, fee structure, or other fund characteristics have evolved since our 2015 interview.

HedgeNordic: Our Swedish readers may already be acquainted with Elementa after reading our 2015 interview in Swedish, so can you start off by introducing the fund you manage to our international readers?

Elementa is a niche long/short equity fund, targeting to generate high absolute returns over time independent of general market cycles. The fund specializes in Nordic small and mid-sized companies, both for longs and shorts. Elementa proactively seeks "x factor" opportunities with tangible growth prospects, business model scalability and strong cash flow generation, or the opposite for the short book. The fund leverages a research intense investment approach to identify and develop investment ideas. Elementa's primary focus is equities, but the fund may also opportunistically invest in corporate bonds in situations offering attractive "equity like" return dynamics.

HedgeNordic: Has Elementa's philosophy or strategy evolved since our 2015 interview?

The strategy stands firm. It's based on fundamental research and long-term thinking.

HedgeNordic: Elementa might have unintentionally set the bar in terms of performance expectations too high after delivering two great years of performance. What did Elementa investors originally expect from your fund, what do investors expect now, and how do you deal with those expectations?

Our goal is to deliver at least 12% annually, on average, over time. That we have been able to do so far, converted to annual returns we are above 12% since inception. Put in relation to the fund's volatility, our investors have received very good returns. When we have to choose between lower volatility or higher returns we choose the latter, although our goal is to have a lower volatility than the general equity market.

HedgeNordic: What has been hurting Elementa's performance in 2017?

Almost every quarter since inception the fund has had a positive alpha for its long and

short positions. However, the short positions struggled with a slightly negative alpha during Q1 and Q2 2017. The fund's return will vary. Every position is taken from a long-term perspective, hence it is nothing out of the ordinary that some positions will not deliver each individual period.

HedgeNordic: Elementa's fee structure stipulates a fixed fee amounting to 1.5% and a variable fee amounting to 25% of the profits generated above a benchmark rate of 5%. Considering that the average hedge fund may be struggling to even reach the benchmark rate of 5% and taking into account the current low interest rate environment, are you pondering a fee structure change? Can you briefly discuss the fee structure you maintain?

We and our seed investors think it is a sensible approach that we must deliver a certain return before we receive a performance fee. The fund is taking on risk and we estimate the 5% hurdle to be reasonable. In this way, the fund is investor-friendly. For other funds, other risk levels apply and 5% may be too high or too low. One could argue that if we maintain this low standard deviation, then the hurdle should also be lowered. At the same time, our standard deviation will vary over time.

HedgeNordic: Elementa is a long-term-oriented investor with an investment horizon of 3 to 5 years, which implies strong emphasis on long-term returns rather than short-term performance. Nonetheless, your fund has been consistently delivering positive returns on a monthly basis? How does Elementa achieve this?

We have found a number of investments, of which we were part as investors quite early, that have delivered good results and have also received multiple expansion. These investments have driven the return for a long time. In addition, we adjust the positions size after valuation, which has led to a more stable return with the risk of giving away a part of the upside by not having the same position we otherwise would have had. In other cases, we could instead increase the investment when the stock for some reason went down during a period of time.

HedgeNordic: Back in May 2015, you were saying that it was getting harder and harder to find good companies at reasonable prices. How appealing are company valuations at the moment?

Then it was still possible to find interesting investment opportunities even though it became harder and harder. As the market declined between April 2015 and February 2016, the valuations were significantly lower and we could find new investments and increase in our existing ones. Now the valuation situation is even worse than in the beginning of 2015 and we have therefore sold or decreased in many of our long positions while we have a larger short side. It is value-driven. We think long-term when we invest but if the market for some reason value a company to a level, that from our point of view is not sustainable, we have no problem in exiting a great investment.

HedgeNordic: What are your general thoughts on the market and the state of short-selling at the moment?

We have no thoughts on the market in general but allow valuation levels and investment opportunities to decide our exposure. It is almost always possible to short-sell if you choose the right company to short-sell. The purpose of our shorts is to deliver positive returns and we spend a lot of time for analysis even for our short positions. We don't treat them as a hedge to our long positions. The shorts shall deliver on their own merits. We have had positive alpha for our shorts six out of the last nine quarters. The corresponding for the long positions are nine out of nine quarters with positive alpha. The coming nine quarters may be the opposite where the short positions have more positive alpha than the long positions.

HedgeNordic: How do you generate investment ideas? Please describe your investment process.

We have a gross list of ideas generated from fundamental analysis, financial screenings and responses from our network of highly skilled people. These are then processed internally and the investment hypotheses that are presented are tested on target companies and people with knowledge of the industry. We are value-driven in the way that the upside should be large in relation to the potential. We have no problem in paying more for a well-positioned company with an estimated strong future. We avoid companies with structural or other issues that may look cheap on paper.

HedgeNordic: How many holdings does your fund's portfolio currently comprise?

Reducing the number of holdings is our current challenge. For the long side, our goal is 15-25 positions, of which a majority are core investments with long-term horizon and some more short-term where the opportunity for improvements are available in short- to mid-term horizon, but not necessarily such companies we would like to own in 3-5 years. Today we have about 35 long positions. On the short side we have more positions to reduce the risk level (M&A etc.) but we let the best ideas earn a greater percentage of the fund's NAV. On the short side we currently have about 80 positions. The number of shorts will be reduced in due time. However, as mentioned earlier, we find it much easier to find interesting shorts with great potential which of course is reflected in the high number of short positions.