Incentive’s Value Approach Delivers Real Alpha

Stockholm (HedgeNordic) – Value investing strategies typically struggle in bull markets similar to the one investors have enjoyed in the past several years. However, Incentive Active Value, a value-oriented fund primarily investing in the under-researched mid-cap segments of European equity markets, managed to deliver since its inception in mid-2014.

The Oslo-based fund managed by Svein Høgset, Niklas Antman, Mikael Berglund and Alexander Kopp has generated a compound annual return of 9.7% since July 2014, gaining 9.1% last year and an impressive 22.0% in 2015. In an interview with HedgeNordic, Svein Høgset, the man at the helm of Incentive Active Value, reminds us about the investment strategy and philosophy employed by his team and discusses the current valuation of equities.

HedgeNordic: *To start off, can you tell us if your strategy has evolved since 2014?*

Svein Høgset: Not much has changed, to be honest. When we established Incentive in 2014, we planned to build a concentrated portfolio of investments in companies we thought would produce substantial returns for our investment partners over the long term. Many of the investments we made during the first months after launch in July 2014 are still large investments in our funds, and we expect it to remain like this, going forward as well. Our investment horizon is long-term, so when we invest in a company, we expect to hold on to the shares we buy for several years.

We continue to spend most of our time looking for investment opportunities across the Nordic region, the UK and in Germany and other Northern European markets. Northern Europe is an attractive region for us to invest in: the investment universe is large and diverse, corporate governance works, and it is relatively straightforward to establish an active dialogue with the companies we consider for investment, which is important for us. Lastly, we still find most of our investments in the mid-cap space and a typical investment for us will be a company in the €1 billion to €3 billion market capitalisation range. Within this segment of the market, competition is less intense than in the larger cap universe and it is therefore easier (although not easy) to find high-quality companies with good prospects for earnings and free cash flow per share growth, trading at bargain valuations.

HedgeNordic: *In addition to managing Incentive Active Value, you and your team also manage a long-only fund. What are the main motivations behind the decision to run both a long-only and a long/short fund?*

Svein Høgset: Shortly after we launched Incentive Active Value, we learnt that several of the US investors we aimed to partner with wanted us to manage capital for them on a long-only basis. This was the main motivation behind the launch of Incentive Active Value Long Only. The main driver of returns for Incentive Active Value was always going to be stock selection on the long side of our portfolio, and when we launched the Fund in 2014, we viewed the ability to make short investments as an additional tool we could use, both to produce returns and to manage risk. Incentive Active Value Long Only Fund owns the same long portfolio as Incentive Active Value and is 100% invested at all times. In the long/short fund, we have more flexibility to manage both gross and net exposure, but at the end of the day, if one of the funds does well, so will the other, given the similarity between them.

HedgeNordic: *Incentive Active Value has delivered a total return of 38.4% since July 2014, what part of that performance would you attribute to real alpha linked to your value-based approach?*

Svein Høgset: Stock selection has been good throughout the period since launch, in particular on the long side. Since we started managing capital on a long-only basis in February 2015, our long portfolio has generated a total net return of just over 48% whereas the Stoxx Europe 600 index returned just over 10% during the same period. Most of this difference represents real alpha I believe since our portfolio hasn't been more volatile than overall markets during this three-year period. Short investments and the use of put options diluted returns for our long/short investors during 2017. During 2015 and 2016, shorts worked better for us, so all in all, there has been good alpha generation so far, in both of our funds.

HedgeNordic*: With equity markets looking expensive by historical standards across the board, in what sectors can you still find cheap, high-quality companies?*

Svein Høgset: I wouldn't say we find that a particular sector stands out. We see good companies at cheap valuations in many areas, in particular when we go "off the beaten track" and spend our time researching companies who receive little attention from other investors, for reasons we understand and are comfortable with. One of the first questions we ask ourselves when we evaluate an investment is: Why is this cheap? If we can answer this question and perhaps even get the conviction that the reason for cheapness will disappear over time, then we may be on to something exciting.

HedgeNordic: *In your view, will Europe's MiFID II rules lead to less analyst coverage in the already under-researched segments of equity markets and more concentration of coverage on large and mega-cap stocks? Will the rules create more opportunities for your fund?*

Svein Høgset: MiFID II will make it harder for investment banks to justify continued research coverage of companies that fall outside the mandates of large asset managers around the world. It will also make life harder for many of the smaller local brokers in the markets where we are active. Over time, this will make markets less efficient than today and will make it harder for small and medium-sized companies to attract risk capital on competitive terms. For us as an investor within this landscape, I believe it will create more opportunities and better prospects for good returns, provided we do our job well.

HedgeNordic: *Last but certainly not least, with so many hedge funds available in the market, what makes Incentive Active Value different from the rest? What is your edge in terms of strategy?*

Svein Høgset: Our long-term approach differentiates us from most funds out there, I believe. When we invest in a company, we plan to be around for years, not months. Our ability and willingness to own companies for the long term represents a competitive advantage, in particular, relative to investors only focused on the next quarter or two. Portfolio concentration represents another advantage, and we've designed an investment process that helps us sort through and select only a small number of investments out of the relatively large number of opportunities on our list of ideas at any given point in time. This process, coupled with a mandate that enables a highly concentrated portfolio, represents a significant competitive advantage.

Also, since we focus on mid-caps, it is easier to develop a meaningful active dialogue with management teams and board members of companies we invest in. We take full advantage of this and aim to add value whenever we can, through active engagement. By and large, management teams welcome our engagement, and this too is a differentiating factor. Last but not least – we are a team of four experienced investors spending all our time managing one portfolio. One of the most pleasing aspects of the first few years at Incentive is the way the four of us have come together to become one well-functioning investment unit. I truly believe our one portfolio approach where all four engage in every investment opportunity we work on will help produce better results for our investment partners over time than the more “siloed” approach I have seen elsewhere.