

HP Hedge Reaches Important Milestone

Stockholm (HedgeNordic) – Danish fixed-income fund HP Hedge has achieved an important milestone: the fund reached DKK 1.04 billion in assets under management at the end of the summer. This marked the first time the hedge fund capitalizing on yield spreads in Danish bond markets surpassed the one-billion mark since its inception in March 2007.

HP Hedge's solid performance in recent years, reflected by the cumulative return of 31.6 percent earned in the past 36 months, has partly been responsible for the 53 percent rise in the fund's asset base since the end of 2017. In an interview with HedgeNordic, the fund's four-member portfolio management team led by Henrik Fournais explains the strategy employed by HP Hedge in more detail, discusses potential risks associated with the strategy and touches upon the reasons behind the fund's sharp increase in assets.

Fund Strategy in Detail, Difference from Peers

As Henrik Fournais explains, HP Hedge employs two different strategies. The primary strategy involves investing in high-coupon Danish mortgage bonds, whereas the secondary strategy focuses on low-coupon and noncallable mortgage bonds. The primary strategy currently accounts for 75 percent of the fund's long positions. Hedging against adverse interest rate movements in the basket of high-coupon bonds is non-mandatory due to the callability of the bonds, explains Fournais. However, HP Hedge always hedges the interest rate risk that exists in the portfolio of low-coupon and non-callable bonds. "The aim is to have a fully hedged portfolio against the interest rate risk", says Fournais.

The Danish mortgage bond market is one of the largest and most liquid markets in the world. Because of the one-to-one relationship between a loan and the bonds issued by mortgage banks to fund the loan, Denmark's mortgage bond market exhibits a very low systematic risk. The market dates back to 1797 and, yet, there is no record of a single default several hundreds of years later. Danish mortgage bonds, therefore, offer attractive yields at low risk. Speaking of liquidity, around 50 percent of HP Hedge's portfolio could be liquidated in a week according to portfolio manager Michael Nielsen, with the fund having five days' notice for redemptions. Based on estimates, the total portfolio could be liquidated in a period of only two weeks.

Despite the trivial degree of liquidity risk, there are several risks associated with the fund's strategy. "The predominant risk within our strategy is the risk of premature redemption," says Nielsen. "Continued and increased foreign acquisition of Danish bonds could result in further reduction of yield spreads," he adds. Banks and insurance companies have been increasingly motivated to buy Danish mortgage bonds in order to fulfil regulatory requirements following new regulation passed by the European Union.

Partly because of the unique Danish mortgage system, almost half of the Danish hedge funds included in the Nordic Hedge Index (NHX) employ fixed-income strategies. There are 16 Danish fixed-income hedge funds in the NHX. However, HP Hedge is differentiating itself from peers by maintaining a high degree of focus on the high-coupon segment of its strategy. The fund's leverage usually varies between 300 percent and 700 percent, with the level of leverage depending on inflows and outflows, as well as the availability of bonds at reasonable prices. "It is imperative to be patient and not act too aggressively in less liquid bonds," explains portfolio manager Thomas Loldrup Kjær.

HP Hedge's Team, Reaching New Milestone: DKK 1 Billion

HP Hedge is managed by a team of four members led by Henrik Fournais. Prior to joining HP Fondeinvest A/S in 2004, where he currently serves as chief executive officer and portfolio manager, Fournais worked as a portfolio manager at Dexia Bank Denmark for 16 years. The other three members of the four-member team include Michael Nielsen (joined HP in 2008), Thomas Loldrup Kjær (joined HP in 2015) and Mark Gerts Rentzmann Jøns (joined HP in 2010).

The fixed-income hedge fund oversees DKK 1.04 billion in assets under management as of the end of August, after having reached the one-billion mark for the first time since its inception. Speaking about investor interest in HP Hedge and the fund's sharp increase in assets, portfolio manager Mark Gerts Rentzmann Jøns told HedgeNordic that "the increase in prices in most asset classes has prompted demand for hedged investment instruments," with investor interest for HP Hedge coming from private as well as corporate and institutional investors.

HP Hedge generated a cumulative return of 168.8 percent since its inception in March 2007, corresponding to a compounded annual return of 9.0 percent. The fund gained 4.1 percent year-to-date through the end of August, after having returned 8.4 percent last year and 13.9 percent in 2016. The average annual return of 9 percent looks like a pretty decent figure, mainly considering that HP Hedge had to navigate through the financial crisis of 2008.

Picture source: borsen.dk