A Value Approach with Incentive

Stockholm (HedgeNordic) – Want to take a guess which of the Nordic hedge funds launched in the last five years performed best? Guess again. Of the 70 or so Nordic hedge funds launched since 2014, value-oriented fund Incentive Active Value Fund achieved the highest cumulative return. This feat has been achieved by running a concentrated, value-oriented portfolio of under-researched European mid-cap stocks.

Geographic and Segment Focus, Stock Selection Process

After spending most of their careers in London, Svein Høgset *(pictured)*, Niklas Antman, Mikael Berglund, and Alexander Kopp returned to Norway and Sweden to launch a value-oriented investment firm. Incentive runs Incentive Active Value Fund, a long/short equity fund employing a high-conviction value investing approach, screening opportunities in the Nordic region, the United Kingdom, Germany, and other Northern European markets. The team also manages Incentive Active Value Long Only Fund, which invests in the same long portfolio. "Northern Europe is an attractive region for us because the investment universe is large and diverse, the corporate governance framework is efficient, and importantly, offers a straightforward way to establish an active dialogue with the companies considered for investment," reasons CEO and CIO Svein Høgset.

Incentive Active Value Fund focuses on the mid-market segment of equity markets, with around three-quarters of the fund's current long portfolio invested in mid-cap companies with market capitalizations between €500 million and €7.5 billion. "Competition within this segment is less intense than in the larger-cap universe, which makes it easier to find high-quality companies with good prospects for earnings and free cash flow per share growth trading at attractive valuations," Høgset explains the segment focus.

The four-member team led by Svein Høgset usually finds good companies at cheap valuations particularly "when we go 'off the beaten track' and spend our time researching companies that receive little attention from other investors." Speaking of the kind of businesses his team favors, Høgset says "we invest in high-quality businesses with cash flow-generating business models trading at attractive valuations."

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High-quality businesses seldom trade at bargain prices. But when such opportunities arise, the team does not jump into buying each seeming bargain straight away. "One of the first questions we ask ourselves when we evaluate an investment is: Why is this cheap?" explains Høgset. "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."

Portfolio Concentration, Investment Horizon, and Short Exposure

Portfolio concentration is an important aspect of Incentive Active Value Fund's investment strategy. At any given point in time, the portfolio consists of 10 to 20 long investments, often complemented by a handful of shorts in addition to put options purchased to protect the portfolio against sharp market declines. During its first five years, Incentive Active Value Fund's net exposure ranged between 50 percent and 75 percent, while gross exposure typically does not exceed 110-120 percent.

"We have 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," explains Høgset.

“This process coupled with a mandate that enables a concentrated portfolio represents a significant competitive advantage.”

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Another equally important feature of Incentive’s strategy stems from the team’s long-term orientation. “When we invest in a company, we plan to be around for years, not months,” says Høgset. “Our ability and willingness to own companies for the long term represents a competitive advantage.” Incentive rarely makes substantial changes to its holdings, which demonstrates the firm’s long-term orientation. “Many of the investments we made during the first months after launching the fund in July of 2014 are still large investments in the existing portfolio today, almost five years later,” adds the CIO.

Long-Term and 2018 Performance, Strong Team

Incentive Active Value Fund delivered annualized returns of 9.8 percent since launching in mid-2014, including a gain of around two percent last year and 9.6 percent in the first two months of this year. Commenting on last year’s performance, Høgset says “in a year where equity markets fell by more than 10 percent in Europe, we are satisfied with a modest positive return in 2018. With this said, we are not thrilled about an annual return of two percent, and clearly aim for more when we make investments”.

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Beyond the long term, value-oriented investment approach and a mandate that enables to maintain a concentrated portfolio, Høgset believes that the Incentive team has at least one additional ingredient for long term success: “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,” reckons Høgset. “I truly believe our one portfolio approach where all four engage in every investment opportunity will help produce better results for our investment partners over time than the more “siloed” approach I have seen elsewhere,” he concludes.