A Yin-Yang Approach to Credit Investing

Stockholm (HedgeNordic) – **Nordic Cross Credit Edge** was among the best-performing fixed-income hedge funds in the Nordics last year after gaining 8.2 percent. The fund managed by a trio consisting of **Emil Nordström** *(pictured)*, **Magnus Nilsson** and **Fredrik Tauson** was last year's best performing non-Danish fixed-income hedge fund in the Nordics.

Launched during the summer of 2018, Nordic Cross Credit Edge seeks to generate alpha by opportunistically buying high-quality corporate bonds trading far below par during a liquidity squeeze caused by worrying investors. As opportunities instigated by liquidity squeezes may not occur frequently enough, Nordic Cross Credit Edge gets exposure to high-yield credit via call options to harvest credit risk premium from the space. Because the approach of gaining exposure to the high-yield space via call options requires little cash, the fund always holds a massive cash reserve that can opportunistically be deployed in the corporate bond market when opportunities arise.

As "2018 ended with a sell-off in equities and certain parts of the credit market," the team managing Nordic Cross Credit Edge "took the opportunity to add some bonds that were trading at a discount," Nordström tells HedgeNordic. "As market turbulence diminished, we got a flying start to the year in 2019." Since volatility in credit markets was relatively low throughout 2019 and low realized volatility makes options relatively cheap, the fund increased its derivatives-based exposure to high yield. "The ability to act opportunistically in ineffective markets and keep high market exposure in a low volatility environment is more or less the essence of the fund," explains Nordström.

Discussing the performance attribution for 2019, Nordström says that "approximately three-quarters of the gross performance was generated by the derivatives portfolio." The remaining quarter "was mainly generated by the opportunistic investments that were closed out in January and February." As Nordström explains, the corporate bond market is characterized by long periods of tranquillity and steady performance, as well as short periods with larger drawdowns. "This pattern mainly contributes to poor liquidity, which, combined with low turnover, makes volatility artificially low." But when risk aversion spreads across the market, volatility increases sharply due to the number of sellers massively outnumbering the buyers.

In essence, Nordic Cross Credit Edge seeks to harvest the credit risk premium from the high-yield credit space through options and stands ready to opportunistically buy discounted bonds in times of distress and increased volatility. "In short, you want to be exposed to the market during the long periods of low volatility, and you want to combine that with an opportunistic strategy during turbulence," explains Nordström. "That's the core strategy of the fund – to be able to deliver and act in both kind of markets."