

The Story Behind CABA's March Performance

Stockholm (HedgeNordic) – The Nordic hedge fund industry has taken a hit in the broad sell-off across markets in March, with the Nordic Hedge Index on track for the biggest monthly decline on record. Some hedge funds, however, have performed very well amidst the carnage. Copenhagen-based fixed-income hedge fund **CABA Hedge** navigated well through the storm, gaining 5.6 percent in March.

Calm Before the Storm

Launched in mid-2017 by Carsten Bach and Niels-Ulrik Moustén, CABA Hedge is a hedge fund seeking to capitalize on the spreads between Scandinavian mortgage bonds and government bonds. The Copenhagen-based fund was launched with an absolute return target of 8 percent per year over a five-year horizon, but the target was subsequently lowered “as risk premiums within the investment universe continued to decline in the hunt-for-yield era,” according to Kristian Myrup Pedersen, Chief Product Manager at CABA Capital. “The fund managers did not want to increase the level of beta-risk to keep on track to hitting the original return target,” explains Pedersen.



Kristian Myrup Pedersen, Chief Product Manager at CABA Capital.

The lower return target enabled the fund managers to run CABA Hedge with relatively low risk, “when risk was not adequately rewarded on a forward-looking basis.” As the beta exposure was scaled down, the team behind CABA Hedge decided to scale up the focus on alpha generation. The low risk premiums in the Danish and Swedish mortgage markets made it “less costly” to stay out of the market and “less risky” to take on short positions, according to Pedersen. “The mindset of the fund managers was well-gearred for building up protective positions and shorting parts of the market during the events of March.”

The Storm is Coming

“Following the strong performance of Danish callable mortgage bonds in December of last year, CABA Hedge reduced its exposure to the asset class to zero in January,” Pedersen tells HedgeNordic. Instead, the fund started building positions in Swedish covered bonds on relative value considerations during January and February. As the team began to realize that the coronavirus

“would be causing serious trouble for the global economy,” CABA Hedge changed course by “taking on several protective positions.” The Danish hedge fund started “buying government bonds versus swaps, buying out-of-the-money call options on bund futures, and building a small short in Danish callable mortgage bonds.”

As the impact of the coronavirus on the global economy started to unfold, CABA Hedge reduced its exposure to Swedish covered bonds and closed several of the protective positions to lock in profits. “As the panic started to hit financial markets and Danish callable mortgage bonds continued to be expensive, the fund managers scaled up their short position in the asset class,” elaborates Pedersen. The short position was unwound by mid-March at a profit too. “This is a real-life example of how active risk management and alpha generation go hand in hand,” says Pedersen.

Keep Walking Through the Storm

“The volatility across asset classes is expected to continue at elevated levels for the foreseeable future, as the Corona crisis is still unfolding on a global scale,” Pedersen comments on the team’s outlook. CABA Hedge, therefore, “went into the second quarter with only limited positions” as the team “prefers to keep their powder dry in these times of extraordinary uncertainty.” According to Pedersen, “making forecasts and scenario analyses in this environment is almost impossible.” The investment team comprised of Carsten Bach and Chris Nygaard Sørensen (*pictured*), therefore, “are unusually cautious in their risk-taking” and “now, more than ever, rely on their deep investment experience” to generate attractive returns.

CABA Hedge’s performance in March “should be seen in the context of the preparation and the resolute actions taken as the storm approached,” points out Pedersen. “Only time will tell what happens next, but we have the room for maneuver to benefit from upcoming turbulence in these stormy times.”