Positives Amid an Epidemic of Unknowns

Stockholm (HedgeNordic) – The first quarter of 2020 was difficult for most investors, including large pension funds such as **AP1**, the first Swedish national pension fund. AP1's hedge fund portfolio, however, managed to dampen the impact of the market volatility caused by the Covid-19 pandemic. "Despite the fact that March saw one of the largest and fastest market declines in history, AP1's hedge fund portfolio held up well and managed to protect the downside," **Helen Idenstedt** *(pictured)*, Head of External Partnerships and Innovation at AP1, tells HedgeNordic.

AP1, one of the five pension funds in the Swedish national income pension system, implemented the bucket of idiosyncratic alternative investments (IAI) in mid-2018 to "add diversification by building a portfolio with strategies that deliver unique and idiosyncratic return streams," according to Idenstedt. Part of the SEK 366 billion-portfolio managed by AP1, the IAI portfolio currently allocates 17 percent to credit strategies, 19 percent to equity long/short strategies and 13 percent to global macro strategies. The remaining 51 percent is allocated to relative-value strategies that feature event-driven, statistical arbitrage, multi-strategy and volatility-arbitrage strategies.

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The first quarter was an unprecedented period for financial markets across numerous dimensions. "To say that the first quarter was challenging is an understatement," says Idenstedt, who previously worked as portfolio manager of idiosyncratic alternative investments at AP1 before being promoted as Head of External Partnerships and Innovation. The new branch brings together a four-member team responsible for overseeing AP1's externally-managed investments in private equity, private credit, hedge funds, high-yield, U.S. small-cap and emerging market stocks.

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"Since the pandemic hit financial markets, we have seen extreme levels of volatility," Idenstedt tells HedgeNordic. "Investors sold almost all risky assets, which created a difficult environment even for hedge funds managers." AP1's hedge fund portfolio was down less than three percent in the first quarter, compared to the broader hedge fund industry's decline of about eight percent.

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"The month that followed turned out to be the best month since the start of the portfolio in 2018," points out Idenstedt. "Most strategies recovered from a difficult March as rising equity markets, the recovery in credit markets and also modest recoveries in intra-market spreads were favourable for the managers in the portfolio," she adds. "To some extent, the managers managed to keep pace with the sharp rebound across markets even though the portfolio's beta is below 0.2." The portfolio's momentum carried into May, albeit in smaller magnitude compared to the prior month. "The positive performance continued in May, which has moved the portfolio closer to positive territory for the year," Idenstedt tells HedgeNordic.

"There is almost an epidemic of unknowns right now, which, of course, makes any predictions or forecasts difficult, but we could very well be entering a lucrative environment for idiosyncratic returns," points out Idenstedt. "I do feel excited about the IAI portfolio going forward." Although the spread of Covid-19 has had a devastating effect on the world, many investment opportunities have emerged along the way. “It was a very long time since I heard discretionary equity and credit managers have this level of enthusiasm over the opportunity set going forward,” says Idenstedt.

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Commenting on the opportunity set created by Covid-19, Idenstedt says that “there will be an increased focus on the solvency of companies.” Although the number and magnitude of defaults have not been high shorter term, “what will happen in the medium term?” ponders Idenstedt. As poorly-capitalized companies may eventually go out of business, “the fundamental game of finding long-term structural winners” is essential for generating returns.

“The IAI portfolio also holds exposure to private and opportunistic credit,” highlights Idenstedt. “The timing of this allocation is more luck than skill, but the deployment rates in the structured credit and stressed/distressed credit strategies have been much faster than anticipated given the large dislocations following Covid-19,” she continues. Given the expanding opportunity sets faced by many managers in AP1’s portfolio of idiosyncratic alternative investments, Idenstedt is “optimistic that the IAI portfolio can continue to produce positive returns and deliver diversification to AP1’s equity holdings.”