

The Aggressive High-Quality Investor

Stockholm (HedgeNordic) – Many hedge fund managers steer clear of large- and mega-cap stocks and mostly go for the under-researched corners of equity markets in pursuit of alpha. Bård Johannessen and Oddmund Nicolaisen Enæs (*pictured*), who manage long-biased equity long/short fund **Pareto Total** out of Oslo, find attractive risk-reward opportunities even among the biggest of all mega-caps. The common belief that “there are no opportunities in large- and mega-caps” is misplaced, reckons Enæs. “Opportunities arrive both in large-caps and mega-caps if you have patience.”

The due managing Pareto Total invests in high-quality businesses globally across different market-cap categories. “We see ourselves as long-term investors in high-quality companies,” says Enæs. “We try to buy them at reasonable prices and hold them for a long time.” At any given point in time, Pareto Total maintains “anything from 15 to 25 long positions and between zero and eight short positions,” running at an average net market exposure between 110 and 115 percent. The long portfolio includes “a bunch of carefully-selected quality companies” such as Roche, Novo Nordisk, Nestlé, Alphabet, to name just a few.

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“Our definition of high-quality is nothing revolutionary,” says Enæs. “We are always looking for companies with very strong competitive advantages, with a strong moat that should be expanding and protecting the future earnings potential of a company,” he elaborates. “These are companies with high profitability, high returns on capital employed and good long-term prospects with a high likelihood of generating higher earnings three or five years out.” The fund managers of Pareto Total often find such “opportunities in sectors that do not enjoy huge secular growth,” according to Enæs. “We find that these sectors are not attractive for new entrants and competitors and can be a good place to look for high-quality names.”

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Long Horizon, Short Positions and Bonds

As a long-term investor, Pareto Total can hold its long positions for many years, but “we do not just buy and forget the companies,” Enæs points out. “We are very sensitive to valuations and we can hold a company in our portfolio for a few months only if the market is offering us the price that we believe is close to our estimate of its worth.”

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In addition to holding a somewhat concentrated basket of high-quality names, Bård Johannessen and Oddmund Nicolaisen Enæs “also use short positions, mainly as a funding source for maintaining a net market exposure of more than 100 percent.” When searching for short candidates, “we are looking for companies operating in structurally-declining sectors,” says Enæs. “We often find very good opportunities in sectors that are being disrupted and business models that are being challenged.”

Pareto Total's investment mandate also allows the portfolio team to invest in bonds. "We have the opportunity to invest in bonds if we find attractive opportunities in the bond market," points out Enæs. However, "we are very stock-centric and very long-biased, so the bond portfolio today is almost nothing." Bonds currently account for about one percent of Pareto Total's entire portfolio.

2020, Fruitful Environment for Pareto Total

The market turmoil triggered by the COVID-19 pandemic in the first quarter of this year offered Pareto Total the opportunity to add to existing positions and add new companies to the portfolio. "We were in a fortunate situation of being below 100 percent in net exposure when the volatility hit in February and March," Enæs tells HedgeNordic. This meant the duo running the fund had some dry powder on hand to improve the risk-reward profile of the portfolio. "During late February and especially March, we went from a net exposure just below 100 percent to 118 percent," says Enæs. "We bought mainly in our existing holdings, but we also found some new opportunities in a couple of companies we had been following for some time."

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Short-term uncertainty and high volatility create a fertile environment for finding attractive risk-reward opportunities, according to Enæs. "Because we have a long-term horizon of several years, we have a very good competitive advantage to buy high-quality names during volatile times, when fear is high and short-term uncertainty is extreme," says the fund manager. Given Pareto Total's portfolio of large- and mega-cap high-quality stocks, "we do not have to worry about liquidity constantly and we do not have to worry about the survival of these companies" even during the coronavirus crisis. "We find the periods of high uncertainty and volatility to be very advantageous for our investment strategy."

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Investments in sound businesses bought at reasonable prices can bring the investor not only comfort but also strong returns in the long term. Pareto Total gained about 11 percent during the months of April and May, bringing the year-to-date performance through the end of May to over one percent. Since launching in early 2016, the fund with €366 million in assets under management has delivered an annualized return of 9.1 percent. "We believe that having a high exposure in high-quality names at reasonable prices is a very safe way to make good returns over time," says Enæs. The price to pay for these returns is navigating short-term volatility. "Our team and our investors need to be robust enough to tackle short-term volatility."

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