



Rookie Fund. Senior Team.

Stockholm (HedgeNordic) - In May of last year, Sweden's oldest hedge fund - Nektar - closed its doors after 21 years. Some of Nektar's team led by Martin Larsén, Anders Augusén and Johanna Ahlgren got back together to launch a new fund - [Frost](#) - that would run one of Nektar's successful sub-strategies.

"The fixed-income trading at Nektar performed well over the years, and Anders and I did not see any reasons not to continue that going forward," Larsén tells HedgeNordic. Three tech-savvy quants and a tech-savvy person on the operations side joined the trio right from Frost's launch at the beginning of 2020.

"Investors want to put a label on you, we would be fixed-income relative value, but we can also do a little bit of macro trading."

Attempting to match Frost to a strategy bucket, Larsén says "investors want to put a label on you, we would be fixed-income relative value, but we can also do a little bit of macro trading." The macro-based trading is set to account for a small part of Frost's investment activities. Frost's universe mainly includes government, covered and municipal bonds, and excludes the riskier corporate debt. "We do not take single-name credit risk in the fund," emphasizes Larsén. Frost also maintains a clear geographic focus, concentrating on Scandinavian fixed-income markets, primarily in Sweden.

Market Anomalies

The Frost team usually seeks to identify between five to eight different market anomalies, each of which is exploited with a set of different positions. “When looking at fixed-income relative value, it is simply the relative pricing of two or more instruments or rate products,” explains Augustín. “What we construct is a portfolio consisting of many different combinations that we like” to exploit a given market anomaly, continues Augustín, who served as a portfolio manager at the now-closed Nektar for over ten years.

“What we construct is a portfolio consisting of many different combinations that we like to exploit a given market anomaly.”

“We express each anomaly in three to four different ways,” further explains Larsén, “which means we have 30 different positions on average.” According to Larsén, “our smallest building block is a position, which can be in turn composed of multiple instruments. Every way you express a set of positions to exploit an anomaly has different features, and you can move risk across different expressions and add value that way.”

“When we implement a theme, we use quite a lot of quant input on how to do that in the best way. On the qualitative side, we spend a lot of time understanding what the macro landscape is looking like and the drivers that we think are important and will be in the future.”

The investment team at Frost led by Larsén and Augustín combines quantitative and qualitative approaches to identify and capitalize on these anomalies. “We are discretionary when we trade,” explains Larsén, “but we have this strong quant support in everything we do.” The quantitative part helps construct the portfolio in an optimal way from a portfolio construction and risk perspective. “When we implement a theme, we use quite a lot of quant input on how to do that in the best way,” says Larsén. “On the qualitative side, we spend a lot of time understanding what the macro landscape is looking like and the drivers that we think are important and will be in the future.”

“We have focused our risk-taking this year post-COVID-19 on our belief that central banks can change and control pricing.”

The duo successfully identified and exploited three anomalies or themes since

launching at the beginning of the year. “We have focused our risk-taking this year post-COVID-19 on our belief that central banks can change and control pricing,” Augusén tells HedgeNordic. Three major themes emerged from the key measures taken by governments and central banks in response to the COVID-19 pandemic. “One theme is on the back of all the money printing and bond buying,” explains Augusén. “The excess liquidity in the system will increase so much that the price of short-term money will decrease or short-term rates will become lower,” Augusén recalls the team’s arguments behind one of its successful bets this year. “That has been one big theme.”

On the back of that excess liquidity, “we have also argued that spread products like covered bonds and municipal bonds will become stable and probably become more expensive and perform well versus other instruments like government bonds,” Augusén continues.

The third theme stemmed from the extensive fiscal stimulus implemented in response to the COVID-19-induced economic crisis. “Because of the extensive fiscal programs by governments, especially the Swedish government, we bet on government bonds becoming less expensive,” says Augusén. “Swedish government bonds started off the year very expensive, but on the back of this supply, they have now become okay-priced from our point of view.”

Inception-to-Date Journey

Frost advanced over ten percent since launching on January 1 through the end of August. “Given the unexpected environment that we ended up in, we are, of course, happy with the outcome,” says Augusén. “Ten percent is a very good number for us, but it is within Nektar’s historical averages that we can look back to.” According to Larsén, “the three themes mentioned by Anders accounted for roughly 80 percent of the return so far.” Attempting to attribute Frost’s year-to-date performance to a single factor, Larsén says that “we were quick to adapt to a new reality” created by the COVID-19 pandemic and the ensuing central bank and government actions.

“Given the unexpected environment that we ended up in, we are, of course, happy with the outcome. Ten percent is a very good number for us, but it is within Nektar’s historical averages that we can look back to.”

“We decided to get rid of the complex exposure that we typically maintain to

operate with every simple exposure,” explains Larsén. “Relative value can be dangerous” in such an environment. “One more thing that is important to stress is that we have not made any big mistakes so far this year,” emphasizes Larsén. “Being in a low rate, low volatility environment, mistakes are quite costly,” he continues. “We focused a lot of energy on not making those mistakes.” The extensive experience accumulated at Nektar also enabled the team to take risks when opportunities emerge. “You learn from experience when to take risk.”

Ideal Market Conditions

Describing the ideal market conditions for Frost’s relative value strategy, Larsén tells HedgeNordic that “we like mild stress” in financial markets. “Not the stress that we had in March,” he emphasizes, “because that could potentially be very dangerous for relative value strategies.” Frost’s strategy also “likes uncertainty” among market participants and “we also like when the economic outlook and risks are reflected in asset prices, but unfortunately, that has not been the case in this environment,” says Larsén.

For that reason, the Frost team has scaled down the amount of capital in the fund in order to focus on strategies that will perform well even in an environment that is not optimal. Frost, therefore, was closed down to new investors at the end of January after reaching SEK 2.5 billion under management, which they believed was the optimal size to start with. After evaluating the fund’s capacity, Frost Asset Management assessed that the market conditions for the fund have improved since the start and, at the end of August, decided to reopen the fund for additional subscriptions with the purpose to raise an additional SEK 1.5 billion. The re-opening is directed to existing unit-holders who want to increase their investments. The asset manager will close the fund again after reaching the additional SEK 1.5 billion.

“I would say we are a little bit different in that we can operate with a higher level of sophistication if we need to. Along those lines, we have a bigger pool of strategies and bigger universe of instruments to trade than our peers.”

Larsén reckons that Frost is “a little bit of a rare species” in the Nordic fixed-income space. “I would say we are a little bit different in that we can operate with a higher level of sophistication if we need to. Along those lines, we have a bigger pool of strategies and bigger universe of instruments to trade than our peers.”