

# Thematic and Unconstrained

Stockholm (HedgeNordic) – There have always been megatrends, powerful seismic shifts affecting businesses, industries and societies. Some decades-long structural changes present opportunities to investors who maintain a long-term view and have the ability to identify the beneficiaries – and losers – of these shifts ahead of time. Michal Danielewicz (*pictured right*) and Jens Larsson (*pictured left*), thematic investors for over 25 years, launched a Europe-focused fundamental equity long/short fund – **St. Petri L/S** – to do just that.

“Structural change is the main driver of future stock performance,” Danielewicz tells HedgeNordic. “Structural change is a dynamic that is very long in nature,” he continues. When taking a top-down view of the world, Danielewicz and Larsson seek “to understand which way the wind is going to blow, not only over the next 12 to 18 months, but throughout this decade and possibility through the next decades to come.” Change, however, is just one of the three main pillars of the duo’s thematic investment process.

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“Whenever we analyze a stock, we focus on three main building blocks: change, expectations and timing,” explains Danielewicz. St. Petri Capital’s thematic investing process starts off by identifying structural changes and working out the implications these changes on various industries and businesses. The second part of the process, the assessment of expectations, aims to identify a discrepancy between market participants’ expectations about the impact of structural changes on a given business and the team’s own views.

“Every stock or every price has its implicit expectations by the investment community,” says Danielewicz. “Based on current implicit expectations priced into a share price, we seek to understand the markets’ expectations and the possible reasons for a mispricing of the implications from structural changes,” he elaborates. “If the potential impact from certain structural changes on a business is not reflected in current expectations, we will step in and initiate a position.”

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As a final step, Danielewicz and Larsson attempt to time their investments and predict when market expectations will converge with their own expected implications of structural changes on a company’s business and its earnings- and cash-flow-generating potential. “It is always difficult with timing,” acknowledges Danielewicz. But because some structural changes are decades-long processes, timing is an essential part of St. Petri Capital’s thematic investment process.

Discussing the importance of timing, Larsson says “we have some themes we know are going to be very big and powerful in the future, but the timing is wrong because there is not enough evidence that the structural change is at full speed.” The area of virtual reality and augmented reality is one such example. “This area has the potential to revolutionize a lot of aspects of our societies, but the structural change is not yet happening,” argues Larsson.

## Portfolio Construction and Current Themes

Danielewicz and Larsson typically identify between 10 to 15 investable themes, which are reflected

in both the long and short portfolios. The duo builds a portfolio of 50 carefully-selected positions – 25 positions on the long side and 25 positions on the short side – to capture these investable themes. “We currently have ten themes reflected in the portfolio,” Danielewicz tells HedgeNordic. “We have more mature, more widely-recognized themes, where the weight and number of positions is higher,” he continues. “But we also have younger themes such as offline romantics where we can have only one position.”

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“The allocation to each theme is a function of our conviction in the strength of the structural change and the discrepancy between market expectations and our expectations about a given theme reflected in share prices,” according to Larsson. “Some themes have high potential and others have low potential. Some of the structural changes that are very much happening right now are tech and the trade war between China and the United States,” he continues. “And, of course, everything related to the coronavirus pandemic.”

One of the themes tied to the technological revolution or evolution and the coronavirus pandemic is the transition to e-commerce. “One of the themes that worked well for us is the whole transition to e-commerce, the change in the retail landscape that has been going for a while,” says Larsson. “One could say that Europe has been lagging behind the U.K and the U.S. and other places like South Korea in the transition to e-commerce,” he continues. “The coronavirus pandemic has really speeded that transition up.”

Changing buying habits towards e-commerce has long been affecting commercial real estate such as malls and shopping centers, and the coronavirus pandemic has only aggravated the situation. “We were pretty negative on the commercial real estate sector before COVID,” Danielewicz tells HedgeNordic.

The duo running St. Petri L/S has been shorting and is still shorting the space. “One area that we still believe is attractive to short is real estate,” points out Larsson. “There is so much wealth, so much money in commercial real estate that is fundamentally being hit very hard by the coronavirus pandemic, particularly retail and office assets,” he continues. With people working from home because of the coronavirus, many companies have been weighting the benefits of paying for actual office space. This leads to a net reduction in demand for office space. “That is going to stay like that,” reckons Larsson.

## **Topping the Charts**

St. Petri L/S advanced over 47 percent year-to-date through the end of August, recording only positive months this year. “The reason the fund did so relatively well this year is twofold,” Danielewicz tells HedgeNordic. “First, we had been shorting real estate companies before stay-at-home mandates accelerated the negative dynamics within commercial real estate,” says Danielewicz. “Second, we had been holding some key positions focusing on the online retail transition theme, which did extremely well in this stay-home environment,” he adds. “We did not buy these companies because of COVID, we had been holding them for almost three years now.”

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Another key reason for St. Petri L/S’s eight-month run of positive returns is that “we were not

positive going into 2020,” emphasizes Danielewicz. “Jens and I did not foresee COVID, but we saw a lot of risk on the macro and political front building and we also did not find valuations that attractive,” he continues. “Once we saw the COVID wave coming, it was not difficult for us to start adjusting for that environment.” St. Petri L/S has maintained a net market exposure of 25 percent since its inception in early 2018, “but the net exposure has been much less than that in the first quarter of 2020.”

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Larsson believes that “the thematic investment process is very well suited, almost ideal, for long/short managers, because structural changes are affecting societies, economies and businesses to their core, thereby creating both long and short opportunities.” According to Larsson, “there is a lot of value being created and destroyed with structural changes, which makes a thematic investment process ideal for hedge funds. The fact that we have been doing this for 25 years is our key competitive advantage.”