Meet the Ray Dalio of Sweden

Stockholm (HedgeNordic) – Talk of paradigms and paradigm shifts has become more commonplace on the investment arena thanks to Ray Dalio. But what exactly is a paradigm shift? Alexander Hyll *(pictured)*, the founder of a Linköping-based paradigm-focused long/short equity fund, defines a paradigm as a cause-effect relationship affecting market behavior and asset prices. "We believe that the economy works like a machine, in so far that a certain stimulus or contraction has a given foreseeable effect," explains Hyll.

"The market is mostly operated by rational people, and that means that a certain stimulus has a certain foreseeable effect long-term," expounds Hyll, who runs long/short equity fund **Adaptive Paradigm Alpha**. "With our understanding of the economy, we look for and identify these cause-effect relationships, which we call paradigms, and then try to position to capture relative outperformance stemming from these paradigms," Hyll describes his investment philosophy.

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Paradigm Shifts

One major paradigm shift recently articulated by Ray Dalio makes gold a good investment and diversifier. According to Dalio, this paradigm shift stems from the devaluation of fiat currencies as a result of unprecedented actions by central banks over the past decade or so. "I believe that it would be both risk-reducing and return-enhancing to consider adding gold to one's portfolio," Ray Dalio wrote last year. Instead of looking for broad paradigm shifts characterized by a wide array of variables and unknowns, Alexander Hyll focuses "on smaller paradigms where we can better understand and capture the entire system."

The reason for focusing on smaller paradigm shifts is twofold. First, "the global macro space of managers relying on a top-down approach is a very crowded field," points out Hyll. Second, "larger paradigm shifts are substantially harder to quantify in a good way," he continues. "The system is so complex that in order to capture everything relevant for the larger paradigm, you need to consider so many factors and build very large models that you lose all the understanding," acknowledges Hyll.

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One paradigm shift Adaptive Paradigm Alpha identified and captured this year involves a change in the way cryptocurrencies are mined. Crypto mining, once an obscure hobby for tech nerds, has transformed into a fully-fledged industry that requires massive investments in energy-intensive computing power. When looking at Bitcoin mining and specifically how miners use higher-end graphics processing units (GPUs) to increase Bitcoin mining power, Hyll realized that "Bitcoin mining uses an unsustainable amount of energy." He also noticed "the trend shifting away from using these GPUs to just using brute force decryption for alternative technologies."

To capture this paradigm shift, "we pitched Advanced Micro Devices (AMD) against Nvidia."

According to Hyll, “almost all of the GPUs for mining were bought from Nvidia on a very large scale, because Nvidia has always famously been better at QDA coding for pure computation.” Hyll “made the case that this was a temporary market” for Nvidia and AMD “would close up the technological disadvantage in this space relative to Nvidia.” Because the two companies are direct competitors active in similar with very similar products, Hyll was able to capture and isolate the paradigm shift associated with the transition to other alternative technologies for mining at the disadvantage of Nvidia.

The Power of Technology and Insight of Man

Adaptive Paradigm Alpha seeks to capture between six to eight paradigms on average, with each paradigm usually consisting of one to three positions. “Typically, we have around 20 to 25 positions, and each position reflects an option spread strategy that often consists of two stocks along with hedges,” explains Hyll. “But a paradigm could also be captured with an option spread strategy involving five or six stocks, it is dependent on how hard we find the paradigm or trend shift to capture,” he continues. “Sometimes, we do a lot of hustling to isolate what is relevant to a given paradigm.”

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Whereas many investors focused on identifying broader macro trends or paradigm shifts may use a fundamentals-based top-down approach, Adaptive Paradigm Alpha relies on a quantamental approach to find paradigms. “We aim to use the power of technology together with the insight of man to find paradigms,” Hyll tells HedgeNordic. This quantamental approach involves identifying a wide range of factors that relate to a given paradigm and then using a quantitative approach to identify which factors are most relevant. “After identifying the causal relationships that define a paradigm, we put up man-made rules into a system to find better clarity on the factors that are most relevant for a paradigm.”

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“When we find a paradigm, we screen companies using a stock analytics approach to drill down to a couple of companies that are best and worst situated to handle a certain paradigm shift,” further explains Hyll. Adaptive Paradigm Alpha tends to build an option spread strategy resembling a pairs trade that involves matching long positions with short positions in two or more stocks that are expected to experience contrasting repercussions from a given paradigm. “We then try to isolate only the factors and risks associated with the paradigm and hedge out as much of anything else as we can.”

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Adaptive Paradigm Alpha always beta-hedges its positions and hedges against adverse currency effects to better capture the identified paradigms. “We have a basket of over a hundred assets, which we correlation test our portfolio against,” says Hyll. The Linköping-based fund manager also builds positions in sector indices to make the portfolio as market-neutral as possible. “Long story short, we look at a lot of risks when we try to isolate the paradigms, so we get rid of the market exposure and any risks that are not associated with a paradigm as well as we can.” If the fund “cannot capture a paradigm properly enough, no matter how good the idea is, we just will not go into that paradigm.”

Only Positive Months in 2020

Adaptive Paradigm Alpha enjoyed only positive months this year, including the turbulent month of March, delivering a cumulative return of 9.2 percent through the end of September. Hyll tells HedgeNordic that "we are obviously very happy with our results, having only positive months this year is something that not a lot of funds have been able to do so far." The strong performance "is largely due to how completely hedged we are, proving that the types of positions we take are very market-neutral in general." The month of March had "the biggest impact on our portfolio in terms of management," points out Hyll.

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"As we saw markets just trading off and saw some big asymmetrical downturns, we made a risk management play and scaled in strangles on the portfolio." A strangle is an options strategy used by investors anticipating the price of the underlying asset to move dramatically in either direction. "When the train is going off the tracks and is speeding towards the city, it is better to move out of its way," says Hyll. "We basically scaled out most of the portfolio for March and started scaling back through April and May as we saw a normalization." According to Hyll, "Adaptive Paradigm Alpha has not captured much of the recovery period either, which is obviously a positive if you are truly market-neutral. We do not want to ride the market either way."