Investing in Tech-tonic Shifts

Stockholm (HedgeNordic) – Thematic investing is often well-suited for industries with emerging business models, fast-evolving environments and technologies. As such, the technology sector fits very well with a long-term, thematic investment approach. The interaction of human ingenuity, innovation and the society's increasing dependence on technology creates sustainable, long-term investment themes that can be exploited by fund managers such as tech-focused investor Inge Heydorn *(pictured)*.

"In technology, what often happens is that a big innovation enters the market and then it takes many years for it to be implemented," Inge Heydorn, the portfolio manager of the long/short equity fund **Thyra Hedge**, tells HedgeNordic. "If you take the cloud transition where people are moving everything up in the cloud, that is really a long-term process happening and still accelerating very, very fast," he continues. Thyra Hedge, which was launched in late 2006, already invested in a cloud company about 12 years ago in 2008. "The companies that are rightly positioned are going to win," says Heydorn. "But it is always going to take time."

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At any given point in time, Thyra Hedge's portfolio tends to reflect five themes, all focused on the technology sector. "We normally run five themes, because that is what we can handle," says Heydorn. "We want to be best informed on every stock and every theme in our portfolio," he emphasizes. "If you call me to go on Bloomberg TV or anywhere in the world to meet analysts for instance, we should know the stocks better than anybody." He goes on to say that "the key thing for us is to have a full understanding of the growth drivers, the demand, the balance sheets and everything else."

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One of the fives themes currently reflected in Thyra Hedge's portfolio revolves around the gaming sector. "I have been investing heavily into gaming, and that was before the coronavirus pandemic," Heydorn tells HedgeNordic. "I saw the industry heading in the right direction with how the games are sold and the commissions inside the games and so on." Instead of sending physical CDs to GameStop and releasing just one version of a game each year, game manufacturers run a game production process that "is now ongoing with upgrades all the time," according to Heydorn. "This is an industry which is really evolving."

Stock Selection Process

Heydorn combines top-down and bottom-up approaches into a single, integrated process to find the winners and losers from a carefully-selected set of themes. "We start off by looking for a theme by talking to industry people all the time," explains Heydorn, who is also a partner at tech-focused boutique investment firm GP Bullhound. This gives him direct access to the knowledge and research-driven insights of a team of over a hundred industry analysts focused on the tech sector. "When we find something that is interesting, we start digging into the industry itself to find out what is really going on."

Heydorn relies on a pragmatic research approach, using a variety of information and data sources to find ongoing themes in the technology industry. Monitoring job search websites such as Monster, for instance, occasionally enables Heydorn to spot emerging themes in the technology sector quite early. “When you put the programming code in the job search tool and see that there are thousands of programming jobs focused on a particular area, you ask yourself the question of why is everyone looking for this type of guys with this specific skill set,” says Heydorn.

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When Heydorn manages to build a picture of an emerging theme that is taking shape in the industry, “then you look at all the companies and start looking for the winners and losers in the future.” This is where the smooth transition from the top-down approach to the bottom-up stock selection process occurs. “The bottom-up process involves looking at how the profit and loss statement is looking today, how the balance sheet is looking today, how the business model is going to look ahead and where the company is headed,” explains Heydorn.

Thyra Hedge’s portfolio houses 30 names on average, usually equally divided between long and short positions. The number of long and short positions across each theme “varies a little bit depending on the theme and how you want to play it,” points out Heydorn. “You can reduce the risk by increasing the number of stocks on both sides, but then you dilute the impact of each holding because you have more things to cover.”

For the basket of long positions, Heydorn mostly looks for companies with a “really strong market position or going into a really strong market position.” The founder and fund manager of Thyra Hedge also looks for companies enjoying high gross margins and solid cash flow streams. “In technology, if you don’t have the gross margin and cash flow, you cannot move,” says Heydorn. “In technology, however, you need to move all the time, because more things are happening all the time,” he continues. “In the best of all worlds, the growth should be going together with cash flows and expansion of gross margins,” characteristic for capital-light businesses generated high returns on capital employed.

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Explaining his approach to selecting short positions, Heydorn tells HedgeNordic that “in technology, it is not that difficult to see who is struggling and who is not.” For Heydorn, a sky-high valuation is not enough to turn a stock into a compelling short-selling candidate. “The market maybe doesn’t care about valuations for a long time, so it cannot be just the valuation.” Short-selling candidates also have “to experience structural issues,” points out Heydorn.

Beta-Neutral Market Exposure

Thyra Hedge aims to maintain a beta-adjusted market-neutral position. “We work very much with beta and try to get as market-neutral as possible given the circumstances in the marketplace,” explains Heydorn. “This means that sometimes we need to be net long and other times, we need to be net short to cope with different market scenarios.” The beta-adjusted net market position helped Thyra Hedge navigate the March turmoil quite successfully, for instance. The fund is up 4.9 percent year-to-date through the end of September after gaining 1.3 percent in March alone.

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Heydorn, however, is not necessarily happy with the 2020 performance. “I am really unhappy to be honest because I think the performance should be better given how well my holdings are doing,” points out Heydorn. “If we ignore share prices for a moment and look at fundamentals, the second quarter was the best quarter my portfolio ever had in terms of EPS growth,” outlines Heydorn. His three largest holdings – Amazon, Activision and Zynga – stood out among all S&P 500 stocks in terms of beating consensus in the second quarter, according to Morgan Stanley’s quant team. “Two of my three biggest holdings, Zynga and Activision, are down since then.”