

Kreditfonden Steps Into Listed Debt



Stockholm (HedgeNordic) - Credit spreads in the Nordic high-yield market widened significantly in March after the onset of the coronavirus crisis. The spread widening stemmed from higher economic uncertainty and default risk among riskier issuers, but also idiosyncratic factors such as massive outflows from credit funds and the resulting temporary suspension of redemptions by some of these funds.

Stockholm-based Kreditfonden has launched a closed-ended alternative investment fund - the **High Yield Opportunity Fund** - to benefit from the indiscriminate selling of lower-rated loans during liquidity crunches in the Nordic bond markets. "The Nordic high-yield market is characterized by thinly traded markets, small issuances, small borrowers, and more complex bond structures," explains Kreditfonden's CIO, Fredrik Sjöstrand (*pictured*). "Almost all high-yield funds with daily liquidity active on the Nordic market had to close for redemptions in March 2020," reminds Sjöstrand. "The same overreaction on the asset class was seen during the financial crisis of 2009-11."

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Sjöstrand goes on to explain that “the secondary market for bonds could not handle the increased transaction volumes and funds were forced to sell their best holdings.” Poor liquidity in high-yield debt makes the market particularly vulnerable to liquidity crunches such as the one experienced in March. “When trading resumed, trades were settled at levels that did not reflect the correct risk-adjusted return target for these positions according to our assessments,” argues Sjöstrand. “Forced sellers realized losses in bonds where the issuers were still creditworthy. Those who managed to take the opposite side of the trade could generate significant risk-adjusted returns.”

On the Opposite Side of Forced Sales

Kreditfonden’s **High Yield Opportunity Fund (HYOP)** aims to take the opposite side of these forced sales. Structured as a closed-ended vehicle, the high-yield fund launched by Kreditfonden in late December of last year “will not need to sell in times of thin liquidity and will not be affected by investor redemptions.” The team at Kreditfonden has created “a high-yield fund that is different,” according to Sjöstrand. “Investing through a closed-end structure, we can capitalize on moves similar to those seen in March 2020.”

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HYOP is the fourth credit strategy run by Kreditfonden, which is known for its successful direct lending fund **Scandinavian Credit Fund I**. In contrast to the other direct lending vehicles, the recently-launched high-yield fund focuses solely on listed debt. “The fund has an investment period of three years and divestment for two years, which implies a three-to-five-year investment horizon,” explains Sjöstrand. “HYOP will produce monthly NAVs, but the fund will not provide redemptions until the divestment period where capital will be distributed pro rata when investments mature.” According to Kreditfonden’s CIO, “the targeted IRR over the fund’s lifetime is 7%, which includes a 2-3% yearly coupon payment.” The fund can also make use of leverage to enhance returns.

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“Because of its closed-ended structure, the fund will be able to exploit periods of low liquidity in the Nordic high-yield market to generate high risk-adjusted returns,” reiterates Sjöstrand. “Investors in HYOP will not be affected by the behavior of other investors. We are able to hold to maturity good credits that for various reasons are illiquid.” Although Kreditfonden does not offer investors the option to redeem their investments on demand, investors can sell their fund units in the secondary market. The fund is listed on the Nordic Growth Market (NGM), with ABG serving as the market maker. This closed-ended structure makes HYOP “better placed to exploit opportunities of mispricing that this market is known for.”

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“Backed by a thorough credit analysis and more than 60 years of experience from investing in the Nordic bond market, we are confident that we can generate a higher risk-adjusted return compared to competing funds,” emphasizes Sjöstrand. The recently-launched fund relies on the same analysis process and the same experienced nine-person team used to run the other direct lending strategies employed by Kreditfonden, with its investment committee consisting of Fredrik Sjöstrand, Jan Lundquist, and Peder Broms. “We employ the same follow-up and close relationship with borrowers as for the direct lending strategies,” says Sjöstrand. “According to us, the high-yield market resembles an illiquid corporate loan market - a market we have successfully traded for many years across several funds and prior in our previous positions in the capital markets.”