Natural Progression

Stockholm (HedgeNordic) – Private market investing requires a level of detail and access to information that is not usually available to public market investors. The level of due diligence required for a successful private market investment often cannot be replicated by public market investors, who may not have the time or resources to undertake such a rigorous due diligence process. Stockholm-based Kreditfonden, up until recently only known for its focus on private debt, has decided to apply its time-tested approach in the listed universe of Nordic high-yield bonds.

In December of last year, Kreditfonden launched a closed-ended alternative investment fund – the **High Yield Opportunity Fund (HYOP)** – to benefit from the indiscriminate selling of lower-rated loans during liquidity crunches in the Nordic bond markets. 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. HYOP relies on the same nine-person team and the same analysis process used to run the other direct lending strategies employed by Kreditfonden.

"We employ the same follow-up and close relationship with borrowers as for the direct lending strategies."

Portfolio manager Peder Broms

"We employ the same follow-up and close relationship with borrowers as for the direct lending strategies," Fredrik Sjöstrand *(pictured)*, Kreditfonden's CIO, tells HedgeNordic. "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 previously in our pre-Kreditfonden days," adds Sjöstrand, who is part of HYOP's three-member investment committee alongside Jan Lundquist and the fund's portfolio manager, Peder Broms.

A Suitable Long-Term Structure

The closed-ended High Yield Opportunity Fund (HYOP) represents a "long term construction for investing in high yield in the Nordic region," explains Sjöstrand. "The Nordic high-yield market is characterized by thinly traded markets, small issuances, small borrowers, and more complex bond structures," he continues. "It is too expensive for banks to hold high-yield bonds on their trading books, so we cannot foresee a liquid high-yield market in the Nordics for a long time." HYOP, therefore, represents a longer-term vehicle designed to benefit from recurring inefficiencies in the Nordic high-yield market.

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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. "Almost all high-yield funds with daily liquidity active on the Nordic market had to close for redemptions in March 2020," reminds Sjöstrand. "The secondary market for bonds could not handle the increased transaction volumes and funds were forced to sell their best holdings."

> *"The same overreaction on the asset class was seen during the financial crisis of 2009-11."*

"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." Poor liquidity in high-yield debt makes the market particularly vulnerable to liquidity crunches such as the one experienced in March. "The same overreaction on the asset class was seen during the financial crisis of 2009-11," emphasizes Sjöstrand.

On the Opposite Side of Forced Sales

Kreditfonden's High Yield Opportunity Fund (HYOP) aims to take the opposite side of 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."

> *"The closed-end structure allows us to invest in attractively-valued high-yield bonds without having to worry about the short-term investor flows associated with open-ended structures."*

"The closed-end structure allows us to invest in attractively-valued high-yield bonds without having to worry about the short-term investor flows associated with open-ended structures," says Sjöstrand. "Investors tend to sell at times when markets are stressed, which is exactly when we find exceptional value for the longer term,"he continues. "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."

"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."

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."

Natural Progression

"The launch of the High Yield Opportunity Fund represents a very natural progression following on our success with the first direct lending fund," says Sjöstrand. "The new fund is designed for investors looking for alternative credit exposure that could complement or replace existing fixed-income holdings that offer little return and insufficient diversification in the current low yielding environment."

"The launch of the High Yield Opportunity Fund represents a very natural progression following on our success with the first direct lending fund."

"HYOP has the possibility and capacity to raise money at five discrete occasions throughout 2021," Sjöstrand tells HedgeNordic. "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 disinvestment period starts, when capital will be distributed pro rata as investments mature."

"Backed by a team focused on 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 in the Nordic high-yield space."

The divesting process will start "after three years when holdings mature and are repaid," he continues. After paying out annual coupons between 2-3 percent each year, "we will then allocate the remaining invested capital pro rata to investors." According to Kreditfonden's CIO, "the targeted IRR over the fund's lifetime is seven percent," which includes the 2-3 percent yearly coupon payment. "Backed by a team focused on 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 in the Nordic high-yield space," emphasizes Sjöstrand.