

Understanding and Capturing Change

Stockholm (HedgeNordic) – European stocks have returned an average of 1.3 percent per annum since the end of 1998 in nominal terms, which amounts to nothing when adjusting for inflation. On the surface, the universe of public companies in Europe has been sleepwalking its way through two “lost decades,” but in reality, there was a breadth of changes afoot on the continent.

“If you invested a hundred euros in a European stock index 20 years ago, you would still have a hundred euros now,” says Michal Danielewicz, who co-founded thematic-focused asset manager St. Petri Capital with Jens Larsson back in 2017. “But if you look beneath the surface, some very powerful seismic shifts have occurred,” he emphasizes. Some sectors, such as the European banking sector, have significantly underperformed, but many other industries have evolved, developed, and created significant value over the years.

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“Given where we are in the long-term debt cycle, the level of interest rates and the disruption that is going on, we could face a similar scenario going forward, where the overall market doesn’t do much, but there is massive disruption beneath,” argues Danielewicz. “If you just focus on the index as a whole, you will not be able to capture the disruption,” warns the fund manager, who launched a thematic-focused long/short equity fund – **St. Petri L/S** – in early 2018. “That is the motivation for us to focus on paradigm shifts.”

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St. Petri L/S, which returned 98 percent during 2020, represents “a thematic, unconstrained and uncorrelated hedge fund,” according to Danielewicz. “We invest in change, we invest in disruption. Our thematic investment process focuses on change, on understanding change, and capturing change,” he continues. “Before we engage with and invest in a company, we try to understand the seismic shifts that are driving and will drive this company and its industry over a longer period of time.” At its core, **St. Petri L/S** is a European-focused long/short fundamental equity fund that utilizes a thematic process for stock picking to capture CHANGE.

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At any moment in time, Danielewicz and Larsson maintain a portfolio consisting of eight to 12 investable themes, which collectively house between 50 to 60 positions – half of which are on the long side and the other half on the short side. “The number of names within each theme depends, first of all, on the maturity of the theme,” explains Danielewicz. “We believe every theme follows an S-curve and has its own maturity life cycle.”

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"For younger, early-stage themes, where we do not have much data to build high conviction, we typically have fewer names," elaborates Danielewicz. "For the more mature, more widely-recognized themes, where we have higher conviction, we put both larger positions and more names into them," he continues. "On average, there are five to six positions across each theme, with the younger themes reflecting one or two positions, and the more mature, higher-conviction themes containing between ten to 15 names," says Danielewicz. "Some of the themes only have short positions, and some of the themes will have a blend of both long and short exposures."

Change, Expectations, and Timing

The idea generation for St. Petri L/S generally starts with company meetings. "Meeting companies is a very good source of new ideas because you can discuss with management teams about their capital allocation priorities, strategic priorities, and company- or industry-specific developments," explains Danielewicz. "That is an excellent source of understanding the background, understanding structural change." The process of understanding change is just one of the three blocks in St. Petri Capital's philosophy: change, expectations, and timing.

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The second block, expectations, involves assessing what market expectations are priced in a company's stock price. "When looking at valuations, you can see what is actually being priced in terms of expectations," says Danielewicz. When analyzing a potential investment opportunity, Danielewicz and Larsson go through "a long list of checkpoints that every fundamental equity analyst considers, which include assessing management quality, scrutinizing the balance sheet and income statements, conducting ESG screening, Porter's Forces and SWAT analysis, all those types of things."

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The duo then adds a thematic overlay to their valuation process, which reflects their own expectations about the impact of structural changes on the analyzed business. "We model our own revenue growth rates, margins, capital allocation, among others," explains Danielewicz. "If this process results in a big discrepancy between our own thematic expectations and what the market is currently pricing in, we will typically initiate a position." The last block, timing, relates to portfolio construction. "From idea generation to stock selection and then portfolio construction, the last part focuses around the maturity of a given theme," explains Danielewicz. "We go back to assess our conviction in a given theme, which decides how much we allocate to the theme and the particular idea related to that theme."

Exceptional Year

St. Petri L/S almost doubled investors' money during the course of 2020, currently enjoying a 14-month string of consecutive positive monthly returns. The fund has now delivered an annualized

return of close to 30 percent since launching in March of 2018. “Last year was a very exceptional year, and one of the key factors was that going into 2020, Jens and I were not particularly positive,” explains Danielewicz. “When you start with a little bit of a negative mindset and something negative like the Covid pandemic occurs, you are already in a pole position to adjust faster to the Covid tsunami than first starting to convince each other that this is negative and you have to go the other direction.”

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“The second point is that many of the themes that Covid had an impact on or accelerated had already been in our portfolio as they were initiated a few years back,” continues Danielewicz. “Themes such as the online retail transition, all the online, stay-at-home or work-from-home themes, had already been part of our portfolio,” he adds. “On the short side, we had already shorted real estate companies before the pandemic,” says Danielewicz. “Again, it was just a question of adjusting the right knobs.”

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Size was also a critical element that enabled Danielewicz and Larsson to deliver a net return of over 98 percent during 2020. “It is quite important to maintain agility and be nimble,” argues Danielewicz. “Things that Jens and I can implement in our portfolio is probably a question of days, sometimes just a day. When you work in a big organization and you have a lot of assets, it is quite difficult to adjust.” The fund’s unconstrained mandate has also enabled the two fund managers out of Copenhagen to achieve an exceptional year. “We are also managing our own money, which means that we are pretty unconstrained to take what we deem necessary positions.”

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“We define change as a transformative force that will persist throughout many economic cycles, it is structural, not cyclical,” says Danielewicz. “These structural changes will transform our lives permanently, so there is no mean reversion and there is no coming back,” he continues. “We at St. Petri have dedicated our careers to trying to understand and capture those paradigm shifts and the ripple effects of those paradigm shifts on company cash flows,” he adds. “Our process is very well-positioned to capture disruption and capitalize on disruption. Thematic thinking is not new to us because we have been thinking in thematic terms for more than 20 years.”