

# Truly Nordic Hidden Gems

Stockholm (HedgeNordic) – Making money in the stock market sometimes involves going places everybody else is neglecting or outright avoiding. Places such as an unloved company getting its house back in order or a small, little-known company with significant upside potential. Staffan Östlin and his co-portfolio manager Johan Eriksson are focused on finding undiscovered and unloved gems among smaller companies in the Nordics for **Adrigo Small & Midcap L/S**. Since launching the stock-picking hedge fund back in late 2017, Östlin has found plenty of such gems.

## The Core

Adrigo Small & Midcap L/S maintains a truly Nordic concentrated, high-conviction portfolio that houses between 25 to 30 long positions allocated across three building blocks: Core Five, Dynamic, and High-Potential. The Core Five block, which “can essentially be called Core Four to Six,” accounts for about half of the fund’s portfolio over time, with each Core position usually accounting between eight and 11 percent of the entire portfolio. These four to six positions represent core, high-conviction investment ideas in companies undergoing some form of long-term change. “That is really where we take a very long-term view,” explains Östlin, adding that “we look for significant change within a company or an industry.”

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“We like to invest in low expectations, and low expectations could involve a share price that has gone South, a company run by mistrusted management, a company experiencing some problems in a division, or a business with a long history of underperformance, but a new management coming in,” Östlin explains the most common traits of the Core holdings. Östlin also emphasizes the importance of aligning his fund’s interests with the ones of management teams and other owners in these long-term investments. “It is very important that we have the right owners and also the right management in the sort of long-term cases, really transformation cases, that tend to have an investment horizon between two to five years,” says the fund manager, who has a little more than 30 years of investing experience.

## Dynamic

The Dynamic block contains about 15 names and accounts for around 35 percent of the entire portfolio, investments with a shorter investment horizon between one and 12 months. “That is a more trading-intensive part of the portfolio,” says Östlin. “We have a good view and understanding of at least 400 stocks from our Nordic universe and quite often we find that, shorter term, the stock market is hammering down some stocks a little bit too much around quarterly earnings releases or other announcements,” explains Östlin. “We might use these shorter-term price drifts as opportunities to generate returns,” says the architect of the strategy powering Adrigo Small & Midcap L/S. “Our dynamic investments allow us to react when market conditions are changing.”

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## **Finding Undiscovered Stocks**

The High-Potential block includes long-term, high-return potential ideas that collectively account for 15 percent of the fund's portfolio on average. "High-potential investment ideas clearly involve much higher risk levels compared to the Core Five," points out Östlin. "We usually make these investments in very small companies that are below the radar screens of many investors and even many traditional small-cap funds," he continues. "Our high-potential ideas have limited sell-side analyst coverage, strong management teams, and commercially viable products on the market." Östlin expects much higher returns from high-potential ideas than the core five holdings, which are expected to double during their holding periods.

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The ability to find high-potential, undiscovered stocks differentiates Adrigo Small & Midcap L/S from other vehicles focusing on the Nordic small- and mid-cap space, considers Östlin. "Investors should expect us to continue to find undiscovered stocks and they should expect us to continue to be very curious," says the fund manager. "We meet around 200 companies per year, and that gives us a very good view of the overall market, of what is happening or changing in the market, and of all new business models coming to the market."

## **Short Book**

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Since launching in late 2017, Adrigo Small & Midcap L/S has maintained a net market exposure between 40 and 50 percent, but "the net exposure varies quite a lot throughout the months," according to Östlin. "The net exposure really depends on the opportunities we find both on the long side and also on the short side," he continues. "The exposure doesn't have too much to do with our view of the overall market." The fund tends to maintain a concentrated portfolio of 25 to 30 long positions, with roughly a similar number of short positions.

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The short candidates usually include market darlings near inflection points, companies hurt by structural shifts in their industries, or companies using aggressive accounting. "Like most hedge funds, we look for aggressive accounting or businesses in structural decline," says Östlin. "We are very pragmatic in managing our short book," he adds. "We trade the short book every day, we are very active, but quite often, we are shorting the same names." Östlin occasionally initiates short positions to hedge out some sector risk stemming from the larger positions and also makes use of index futures to adjust the net exposure over time.

## Performance and Return Drivers

Adrigo Small & Midcap L/S has delivered an annualized return of 26 percent since launching in November 2017, accompanied by an inception-to-date Sharpe ratio of 1.36. “We are very happy with the overall annual return we have managed to deliver,” says Östlin. “We are also pleased to have avoided a down year so far, and we are very happy that we produced a positive return in 2018, which was a difficult year for small caps,” he continues. However, Östlin and his co-portfolio manager, Johan Eriksson, are not satisfied with the drawdowns incurred during a few separate months. “We had two relatively big drawdowns,” acknowledges Östlin. “The focus for us now is bringing down the volatility, particularly on the downside.”

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With a full-year advance of 44.5 percent, 2020 was the fund’s best year yet. “We had very good performance from all of the building blocks in our portfolio,” says Östlin. “We had good returns from high potentials such vertical farming company Kalera, for example, which was added in late March and started off as a very small position,” he points out. “Game-based learning platform Kahoot was more of a dynamic position that started off as a high potential two and a half years ago and performed really well for us,” says Östlin. “But we also had good performance from medical technology company Bonesupport, which is clearly among our core five ideas.”

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Commenting on the fund’s strong rebound following the turbulent market conditions in the first quarter of last year, Östlin says that “in late March we decided to turn around both the short side and the dynamic part of the portfolio.” The team “added more high beta stocks on the long side, which produced very good returns in April and May, so we quickly recovered from the drawdown experienced in February and March,” according to Östlin. “We have also been successful in holding on to the winners,” says the fund manager. “It is very easy to sell a stock when you are up a hundred percent, but we managed to hold on to these winning stocks.” Overall, “It was really stock-picking that has contributed to our performance both last year and throughout our journey since inception.”

*This article featured in HedgeNordic’s 2021 “Nordic Hedge Fund Industry Report.”*