

You Can't Eat a Sharpe Ratio

Stockholm (HedgeNordic) – When launching **Coeli Multi Asset** under Coeli Asset Management's umbrella at the end of 2019, Stefan Åsbrink had a goal to deliver a very attractive Sharpe ratio. Coeli Multi Asset, after all, is intended to serve as a portfolio diversifier or as a fixed-income substitute in a 60/40 portfolio or similar.

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A little more than a year after the launch, Åsbrink can now use the maximum extent of all the instruments and hedging capabilities he initially intended to use. This enables Åsbrink to now focus on increasing the fund's expected return profile by raising the risk level the strategy bears. "It is nice to have a good Sharpe ratio, but as some say, you can't eat a Sharpe ratio," Åsbrink tells HedgeNordic. "Having a decent Sharpe is still the aim; I still aim to avoid very large drawdowns."

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"Going forward, however, I want to increase the expected returns of the strategy, which may result in a slightly lower than previously-targeted Sharpe ratio," continues Åsbrink. "Now I don't have to cry every time the portfolio goes down a little." However, the fund can still be seen as a fixed-income substitute or a portfolio diversifier, albeit with a somewhat higher rate of expected returns than before. To meet the fund's altered objective, Åsbrink still relies on a global long/short equity strategy with an extra feature of global tactical asset allocation and carefully implemented tail risk hedging strategies.

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"The problem with most tail risk hedging is that their cost of carry is very high," explains Åsbrink. The high cost of carry can eat away at the fund's returns despite bringing benefits in the form of downside protection. "There are some strategies that don't have such a high cost of carry, which I can combine with strategies with higher costs of carry – but very efficient – at the opportune time," says Åsbrink. "The combination of active hedging and low-cost passive hedging strategies can help hedge out the portfolio for turbulent market environments and increase the expected return profile of the strategy."

Attractive Combination

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Coeli Multi Asset is based on an "attractive combination" of a dynamic systematic equity long/ short strategy and an overlay of uncorrelated systematic global macro strategies. "The combination of equity long/short with a macro-overlay is fairly uncommon," Åsbrink points out. "Most equity long/short managers are focused entirely on company-specific fundamentals and do not focus too much on the macro environment," he adds. "Adding a top-down macro perspective and introducing a

toolbox to be able to adapt the portfolio based on that perspective enables me to have the possibility to generate positive returns in all market environments, in a market uptrend, downtrend or a sideways market."

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The main strategy powering Coeli Multi Asset is a systematic long/short equity strategy in global equities that seeks to find between 50-60 undervalued quality stocks for the long book and 20-30 low-quality stocks for the short book. "For the quality leg, I am looking for stocks that have an earnings-per-share growth of at least 10 percent," says Åsbrink. "Stable earnings growth is the most important characteristic defining quality for me," he continues. "The growth rate does not have to be extremely high, but rather more consistent over time."

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"The shorting candidates tend to have no EPS growth at all, experience structural or other problems, or rely on industries and business models in structural decline," explains Åsbrink. Coeli Multi Asset's main systematic long/short equity strategy maintains an average net market exposure between 20 to 40 percent over time. "But I have the flexibility to be net short from time to time when markets are turbulent," says the manager. Shorting individual names has proven costly for many hedge funds in recent months, so Åsbrink complements his shorting book with index futures to bring down the net exposure. "I combine the short leg with index futures because it is very risky to engage in short selling of individual stocks because short squeezes can be very painful."

Extra Overlay of Hedging Strategies

According to Åsbrink, the long/short equity strategy is an effective way to build wealth over time, whereas the additional hedging capabilities and uncorrelated, alpha-generating strategies can protect that wealth in turbulent market conditions. One such hedging capability is the extensive use of single stock options to capitalize on the "built-in risk management property of options," explains Åsbrink. "When the market approaches overbought territory, I buy out-of-the-money calls on stocks that I like to gain some extra exposure to," explains the fund manager. "If stock prices come down, I only lose the premium," he adds. "That is an in-built risk control feature, which is perfect when markets are strong and trending because options are usually cheap then due to relatively low implied volatility."

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Åsbrink, who has a Ph.D. in Econometrics from the Stockholm School of Economics focusing on option valuation, portfolio construction and risk control, has also been investing in options on baskets of securities to generate returns. In particular, Coeli Multi Asset has recently started buying over-the-counter call options on market-neutral baskets of securities. "You have a double risk control

in options on market-neutral baskets, with the in-built hedge in the underlier as well as the option protecting against sharp declines in equity markets,” explains Åsbrink. “If you know how to construct them, market-neutral baskets also have higher Sharpe ratios than regular long-only baskets. This makes the option position much more cost-efficient than using a long-only basket as underlier,” he continues. “That’s fairly clever.”

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Coeli Multi Asset also relies on other uncorrelated systematic global macro strategies that “contribute to returns in bad times or at least help the fund avoid losing money.” Some of these strategies include different kinds of hedging strategies as well as carry strategies and value or relative-value strategies across equity, fixed income, credit and foreign exchange markets. “These strategies are sources of extra returns that are not correlated with traditional markets,” says Åsbrink. “With these uncorrelated strategies, the risk-return characteristics of the fund get even better.”

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