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HEDGENORDIC

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NORDIC HEDGE FUND INDUSTRY REPORT 2023

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INTRODUCTION

HedgeNordic is the leading media covering the Nordic alternative investment and hedge fund universe. The website brings daily news, research, analysis and background that is relevant to Nordic hedge fund professionals from the sell and buy side from all tiers.

HedgeNordic publishes monthly, quarterly and annual reports on recent developments in her core market as well as special, indepth reports on "hot topics".

HedgeNordic also calculates and publishes the Nordic Hedge Index (NHX) and is host to the Nordic Hedge Award and organizes round tables and seminars.

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Editor´s Note ...

Nowhere to Hide

There was little space to hide for those active on financial markets. As the dust settles on 2022, it was an all-around brutal year for fund investors. The average U.S. equity fund finished the year down about 17 percent, with large-growth funds down an average of nearly 30 percent, according to Morningstar. For U.S. bond, mutual fund, and exchange-traded fund investors, the story was much worse in many ways. And this pattern was seen all around the world.

Indeed, trillions of dollars were wiped off world stocks and bond markets amid whipsawing currencies and commodities. 2022 has been perhaps one of the most turbulent years investors experienced by a generation of traders.

Hedge funds, too, broadly speaking, found themselves in a tough environment, though pale in comparison with the pure-beta players. The global hedge fund industry was down 2.4 percent in 2022, partially recovering from a torrid first half of the year where the industry was down 4.6 percent.

The hedge fund industry's five-year performance now stands at an annualized rate of 4.2 percent, comfortably outperforming bonds (-2.0 percent). As an industry, hedge funds marginally outperformed equities (+3.0 percent) from a total return perspective over this time frame, but more significantly from a risk-adjusted Sharpe perspective (+0.46 vs. 0.16).

The Nordic hedge fund space also could not evacuate from the global tides. The Nordic Hedge Index Composite (NHX) suffered its second-largest loss on record after retreating by 6 percent. Looking at the NHX sub-indices, diversified strategies were down by 8.6 percent and fixed-income managers, despite an impressive catch-up sprint in the latter part of the year, gave up 7.2 percent on average. Equity-focused managers lost 5 percent and multi-manager vehicles, who are sophisticated investors allocating to other hedge funds, edged down by 0.7 percent. Standing out from the crowd were CTAs, which gained 3.9 percent.

While it may seem there was little area one could escape to, there were many bright spots in the Nordic hedge fund industry last year. It is worth taking a closer look and breaking down the universe into more digestible fractions to get a better picture of how the Nordic hedge fund industry performed in 2022. The heterogeneous language of an index, even a sub-index, does not tell the full story. One-third of the universe, after all, ended 2022 in positive territory.

Eugeniu Guzun, therefore, takes a good look under the stuttering engine in his dissection of the Nordic hedge fund space.

This year's "Nordic Hedge Fund Industry Report" also features allocator views on the role of hedge funds in institutional portfolios, introduces new launches, and highlights many bright spots in the Nordic hedge fund industry. In "The Hedge Fund Cure for Apoteket's Pension Fund," CIO Gustav Karner explains how Apotekets pensionsstiftelse, the pension foundation managing the €1.16 billion pension assets of Swedish pharmaceutical retailer Apoteket, managed to come out of 2022 unscathed and book a positive return of 1 percent.

The team at Antiloop Hedge led by Anna Svahn tell the story of "How a Multi-Strategy Hedge Fund Can be Labeled as Article 8" by relying on data platform for sustainable finance, Datia. Kari Vatanen, who wasn't a big fan of hedge funds when he joined Veritas as chief investment officer in March 2020, says different hedge funds have different roles in a portfolio and you should "Know Your Hedge Fund Investment." The hedge fund portfolio of Veritas returned an impressive 12.3 percent in 2022.

In "Sissener Canopus UCITS Celebrates 11 Years," Jan Petter Sissener and Philippe Sissener describe how 2022 proved to be the best ever year for the single stock shorts, which were up 7.9 percent to account for most of the fund's total return of 8.5 percent in 2022. Thomas Pohjanen's and his team's "Skills Honed and Perfected in and by the Markets" helped Excalibur Fixed Income enjoy some of its best streaks of performance in the past three years and the beginning of 2023.

Developed in a multi-team effort and spearheaded by the seasoned Chief Portfolio Manager Markku Vartiainen, a recently-launched hedge fund by Danske Bank Asset Management is "Answering the Million Dollar Question in Alternative Risk Premia." The fund focused on capturing 'true' alternative risk premia successfully passed the initial proof of concept test in the difficult market conditions of 2022. Pontus Dackmo and Carl Gustafsson have put their "Skin in the Game" to launch Protean Select, a flexible and opportunistic long-biased equity fund "optimized for performance" that successfully navigated markets since its launch in the first half of 2022.

Carsten Bach, CIO of Danish fixed-income boutique CABA Capital, tells "CABA's Journey in Scandinavian Bullet Bonds in a Three-Year Wrapper." CABA Flex seeks to capture an opportunity set with long positions in Scandinavian bullet bonds and short positions in swaps and government bonds to hedge interest rate risk, with these positions designed to be held for three years, after which the fund is liquidated and the money returned to investors.

Activist investor "Accendo Celebrates 15 Years of Active Ownership" and joins the select group – now 33 – of long-running Nordic hedge funds with a lifespan that exceeds 15 years. Founder Henri Österlund hopes "the next 15 years will be a continuation of the first 15 years." Susanna Urdmark and Henrik Rhenman explain their cautious stance on markets and discuss the combination of "Defensive and Opportunistic Growth Attributes" in healthcare.

In "Hedge Funds Find Their Place in Finnish Institutional Portfolios," Kari Vatanen, from Veritas, Mika Jaatinen from Elo and Markus Frosterus from Keva discuss why allocations to hedge funds have increased among Finnish pension funds, if hedge funds still have a role to play in institutional portfolios and why Finnish investors have a preference for international managers.

Kamran Ghalitschi
PUBLISHER, HEDGENORDIC

When the Engine Stutters, Check Under the Hood

By Eugeniu Guzun – HedgeNordic

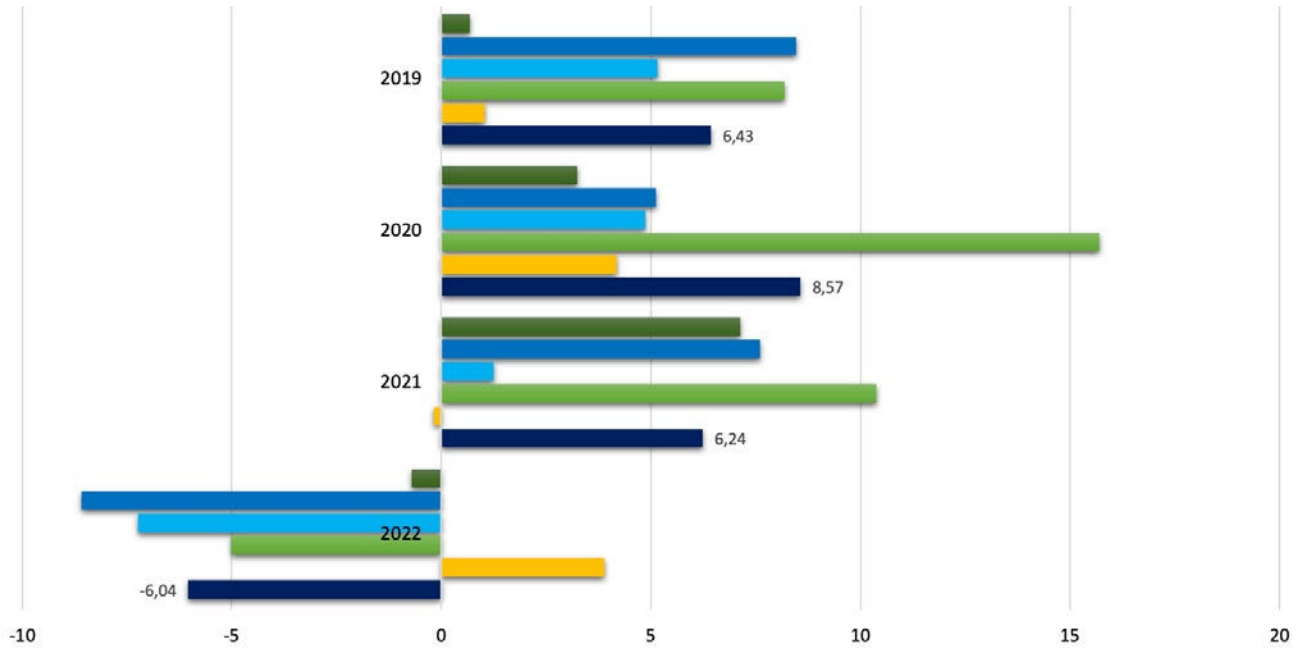
The Nordic hedge fund industry enjoyed a streak of three consecutive years of solid performance. That streak ended in 2022 as the Nordic Hedge Index recorded only its fourth year of negative performance since its inception in 2005. There is little way around the fact 2022 was a bad year for the Nordic hedge fund industry, the second-largest index-level loss on record. A careful look under the hood of HedgeNoridic's equally-weighted index uncovers many bright spots in the Nordic hedge fund industry even in such a difficult environment.

The Nordic Hedge Index has five sub-indices tracking different strategies: CTA, equity, fixed-income, diversified, and multi-manager strategies. Modern hedge funds, including those in the Nordics, have evolved into a heterogeneous group with respect to a range of aspects such as investment strategy, process, and portfolio construction. Each of the five categories in the Nordic Hedge Index can also reflect strategies that are very divergent from each other. To better understand the performance of the Nordic hedge fund industry in 2022, HedgeNordic made a more nuanced segmentation of hedge funds. This segmentation only includes the hedge funds that are still active and were up and running during the entire 2022. As the graph below reveals, averages do hide disparities and there were many bright spots at the fund or strategy level in the Nordic hedge fund industry in 2022.

The CTA sub-index in the Nordic Hedge Index booked a gain of 3.9 percent for 2022, while the ten CTAs or managed futures funds that were up and running during the entire 2022 advanced 6.6 percent on average. More interestingly, the eight trend-following-focused managed futures vehicles in the index (out of the ten) gained 14.4 percent on average in 2022. As the graph below shows, eight of the ten CTA constituents in the Nordic Hedge Index ended 2022 in positive territory. Stockholm-based Lynx was one of the top performers globally and enjoyed its second-best annual performance since its inception in 2000.

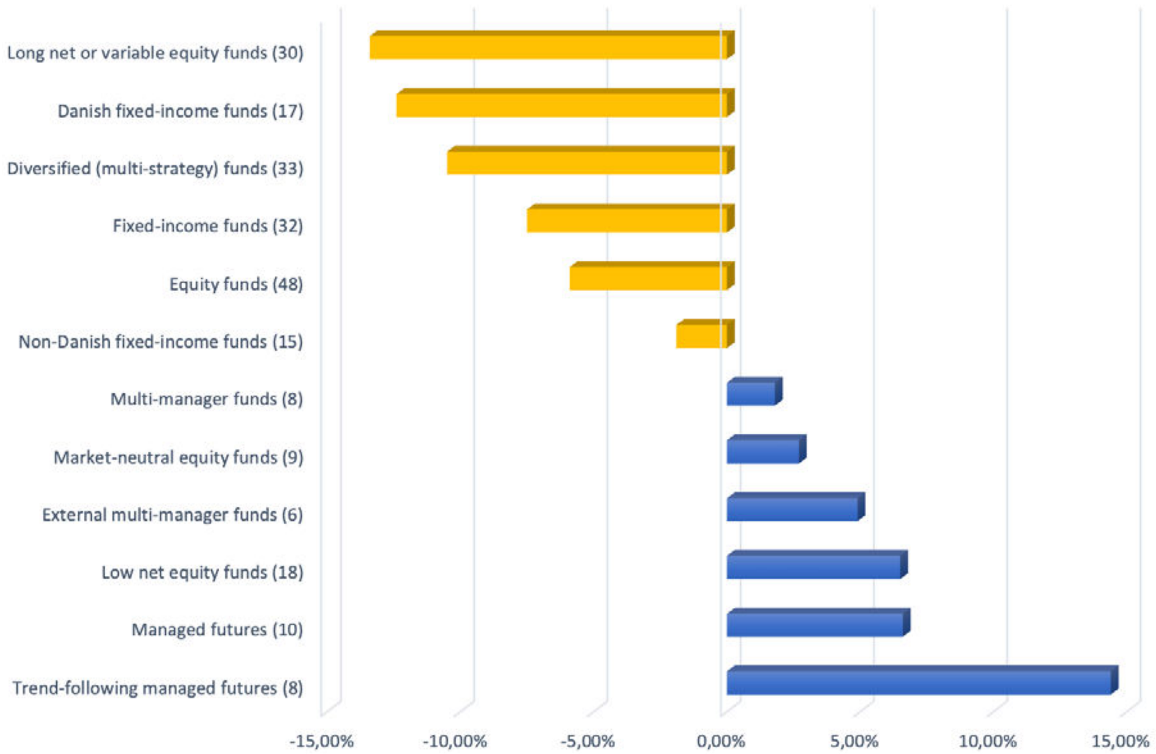
Nordic diversified – formerly referred to as multi-strategy – hedge funds as a whole had their worst year on record as stocks and bonds simultaneously experienced a tricky year in 2022. Within the Nordic Hedge Index, the diversified category represents the most diverse and inclusive category that features both true multi-asset, multi-strategy funds and unique funds that do not fit any other clear classification. The category also includes specialist hedge fund strategies focusing on volatility trading, life settlements, capital structure relative value, financing solutions, or hybrid securities. While some funds such as Svelland Global Trading Fund, Asset Opportunities, and Ress Life Investments enjoyed strong performance in 2022, the group as a whole had its worst year on record. Only long-bias and variable-bias equity hedge funds performed worse than diversified funds in 2022.

Figure 1: Annual performance of the Nordic Hedge Index and its strategy sub-indices from 2019 to 2022.



Source: HedgeNordic

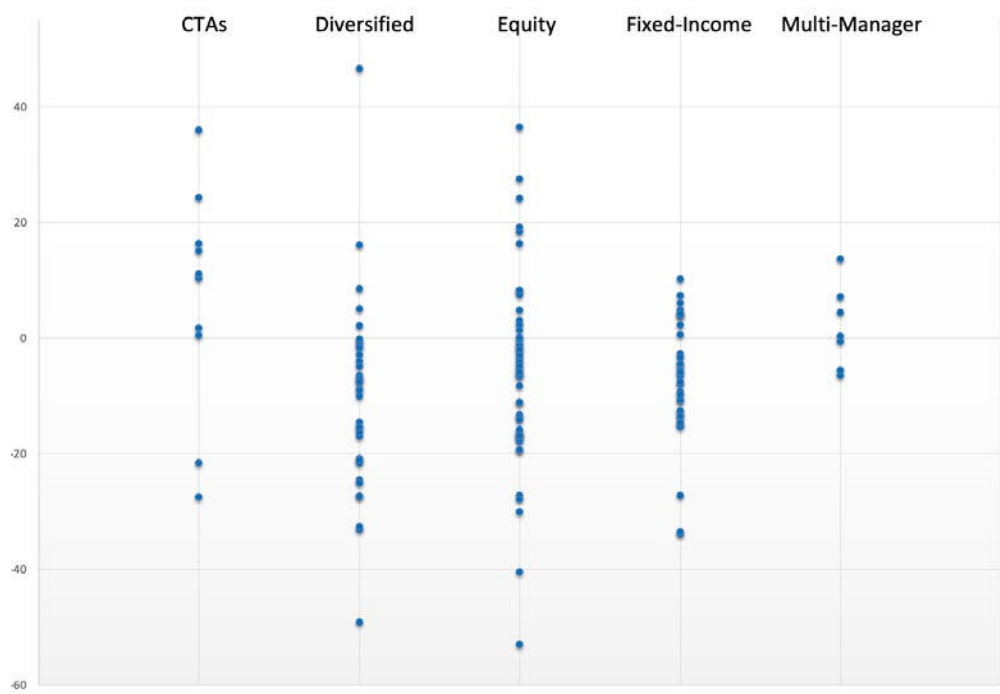
Figure 2: Performance of active Nordic hedge funds across different strategies in 2022. Only funds with a full operational year in 2022.



Source: HedgeNordic

Most Nordic equity hedge funds employ a long-bias strategy, which explains the group's decline of 5.0 percent in 2022 after a return of 10.4 percent in 2021 and 15.7 percent in 2020. The smaller pool of low-net equity funds, which maintain market-neutral exposure or net exposure below 50 percent, in contrast, enjoyed strong performance in 2022. The 18 low-net equity hedge funds in the Nordic Hedge

Figure 3: 2022 Performance of all Nordic hedge funds launched before January 1, 2022.



Source: HedgeNordic

Index returned 6.5 percent on average in 2022. The funds with predominantly net long – or variable – exposure, meanwhile, incurred an average loss of 13.4 percent. The nine market-neutral equity funds ended the year with an average gain of 2.7 percent.

Despite enjoying a gain of 7.9 percent in the final quarter of 2022, Nordic fixed-income managers ended the year in negative territory at 7.2 percent. Only one in every four fixed-income funds within the Nordic Hedge Index ended the year in the green, with Nordea European Rates Opportunity Fund topping the table. Nordic fixed-income managers, particularly those focusing on Danish covered bonds, faced a challenging 2022 as the era of ultra-low interest rates and quantitative easing abruptly came to an end with the arrival of high inflation. The still active Danish fixed-income hedge funds, for instance, incurred an average loss of 12.4 percent in 2022, whereas non-Danish fixed-income funds within the Nordic Hedge Index were down only 1.9 percent on average. Despite facing a challenging environment in 2022, many fixed-income managers managed to end the year in positive territory.

There has long been a discussion if funds of funds warrant their extra layer of fees and yet they continue to deliver solid and consistent risk-adjusted returns. The Nordic funds of hedge funds, renamed multi-manager funds, either represent a "one-stop" solution to a respective asset manager's hedge funds without charging an additional layer of fees or offer exposure to an often-inaccessible set of external hedge fund teams and strategies. Nordic funds investing in external hedge funds gained 4.9 percent on average in 2022, while the broader pool of funds of hedge funds edged down 0.7 percent for the year.

CONCLUSION

Without a doubt, 2022 was not a good year for most Nordic hedge funds. While investors suffered losses from their exposure to different asset classes last year, Nordic hedge fund investors relished a one-in-three chance of booking a profit for the year as one in every three members of the Nordic Hedge Index ended 2022 in the green.

2022 was a challenging year for virtually all asset classes, including hedge funds. However, the environment for alpha generation by hedge funds has been improving and should continue to improve into the new year. The pullback of central banks, for one thing, can facilitate a fruitful environment for trend-followers, stock pickers, and fixed-income managers.

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The Hedge Fund Cure for Apoteket's Pension Fund

By Eugeniu Guzun – HedgeNordic

"We mainly looked at absolute return strategies and hedge funds as a substitute to low-yielding fixed-income instruments, especially investment grade."

Stockholm (HedgeNordic) – 2022 was one of the toughest years in recent memory for institutional investors, as the global economy and financial markets faced high inflation, rising interest rates and volatility. Apotekets pensionsstiftelse, the pension foundation managing the €1.16 billion pension assets of Swedish pharmaceutical retailer Apoteket, was one of the pension funds that managed to come out of 2022 unscathed and book a positive return of 1.0 percent. Hedge funds did their part, both last year and the past five years.

The performance of Apoteket's Pension Fund last year reflects spot-on strategic asset allocation decisions in recent years, as well as – atypical – shorter-term-focused tactical trades. The pension fund managed by CIO Gustav Karner had a higher-than-usual level of protection in the portfolio already at the end of 2021 through well-timed tactical exposure to equity put options and the U.S. dollar. Last year's positive performance comes on the heels of a 12.6 percent return in 2021 and an annualized return of around 6.3 percent over the past five years.

Gustav Karner, CIO

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While the shorter-term tactical asset allocation decisions partly explain the pension fund's positive return in 2022, the solid longer-term return stems from Apotekets pensionsstiftelse's strategic asset allocation approach. The strategic asset allocation decisions led Karner to increase the exposure to absolute return strategies from around ten percent in 2017 to 39 percent at the end of 2021, when the hedge fund allocation stood at about three times the equity exposure adjusted for the put options.

ASSET ALLOCATION APPROACH FAVORED HEDGE FUNDS

Every autumn, CIO Gustav Karner and his colleagues in the investment committee make strategic asset allocation decisions for the Swedish state-owned pharmacy retailer's pension fund. The investment universe spans a wide range of asset classes such as equities, investment and non-investment grade fixed income, private equity, real assets, and absolute return strategies – mostly hedge funds.

"We sit down with our investment committee and analyze expected returns, risks, standard deviations and correlations for all these asset classes over the coming five years," explains Karner, who is in charge of running Apoteket's Pension Fund. "We use all these metrics as input in our proprietary asset and liability management (ALM) model, which helps us decide on the most appropriate strategic asset allocation given our liabilities."

"Interest rates were very low when I joined Apoteket's pension fund as CIO back in 2017, and our ALM model indicated that investments in low-yielding fixed-income investments would not be enough," recalls Gustav Karner. "We had to find other asset classes to meet our objectives, so we mainly looked at absolute return strategies and hedge funds as a substitute to low-yielding fixed-income instruments, especially investment grade," he continues. "The fixed-income space, mainly investment-grade and government bonds, was providing return-free risk, and huge downside risk coupled with very low returns."

Under the helm of Karner, who was already accustomed to hedge fund investing after serving as CIO of Sweden's Nobel Foundation, Apoteket's Pension Fund started building up its portfolio of absolute return strategies and hedge funds. "I have been investing in hedge funds for at least 20 years and know some of the really good hedge funds, especially since my times at the Noble Foundation," says Karner. "The strong investment committee at the Nobel Foundation had very good connections to the world's best hedge funds," recalls Karner.

> "Multi-strategy funds probably suit us better compared to other types of strategies."

Apotekets pensionsstiftelse's allocation to absolute return strategies increased from ten percent at the end of 2016 to 16 percent at the end of 2017 and 39 percent at the end of 2021. "I started as CIO in 2017 and managed to build up a portfolio that suited my convictions by 2019. From 2018, the hedge fund portfolio has returned around 11.7 percent per year and contributed to around half of the broader portfolio's 6.3 percent return," explains Karner. In 2022 alone, the hedge fund portfolio returned 6.3 percent in local currencies. With all investments hedged to the Swedish krona, the hedging trimmed just one percent of the hedge fund portfolio's return.

MANAGER SELECTION

"When I started at Apoteket, I simply tried to invest in the best hedge fund managers and did not pay too much attention to targeting exposure to specific strategies," Karner explains his manager selection approach. "We have been trying to find the best managers and invest in them because they are often closed," he elaborates. With inflation concerns looming in 2021 and expectations about central banks' more aggressive tightening measures to fight inflation, Karner and the investment committee veered toward a more tactical approach to strategy selection in the hedge fund portfolio. "We saw inflation coming in 2021 and saw the need for the Fed and other central banks to aggressively fight inflation, so we moved quite a lot of capital to trend-following CTAs," says Karner. "We hadn't invested in CTAs before, that allocation helped us a lot last year."

Apoteket's Pension Fund allocates capital to a diverse set of hedge fund strategies, including niche strategies run by managers out of Sweden. Karner relies on a quantitative multi-asset portfolio risk and investment decision-making tool to assess the suitability of each hedge fund investment in the broader portfolio. "This tool helps us find and invest in hedge funds that complement our portfolio quite well." Over time, Karner has arrived at the conclusion that "multi-strategy funds probably suit us better compared to other types of strategies." Similarly, he does not see too many added benefits from long/short equity strategies in the broader portfolio due to their beta to equity markets.

OUTLOOK

While the fight against inflation may have started to pay off, central banks will likely continue their efforts as core inflation has yet to peak in many countries. For that reason, Gustav Karner does not yet foresee a very bright outlook for economies and financial markets just yet. "It is more difficult for the Fed and other central banks to fight inflation," says Karner. "Core inflation has come down a little bit in the United States, for instance, but not very much," he continues. "The Fed will need to do more to fight inflation, so the U.S. economy may end up in a recession." As a result, the equity allocation at Apoteket's Pension Fund still remains relatively low at around 12.5 percent following "good results for the last five years."

After a long drought, the higher interest-rate environment is turning bonds into a more attractive allocation. "Since yields are more attractive, we may start reallocating some capital from hedge funds to fixed-income instruments," says Karner. Hedge fund strategies, however, they can also benefit from higher short-term interest rates, according to the CIO. "In this environment, we will continue to keep CTAs in the portfolio as downside protection should conditions turn much worse," says Karner. "But we also expect multi-strategy hedge funds to navigate the environment well because they can move around the exposure to different strategies depending on where they see more value."

How a Multi-Strategy Hedge Fund Can be Labeled as Article 8

Juan Manuel Serruya, CEO and Co-founder – Datia

Manne Larsoon, COO and Co-founder – Datia

"[Integrating sustainability into investment decisions] is actually happening and not realizing this is a big mistake."

Anna Svahn, CEO and Portfolio Manager at Antiloop

KEY TAKEAWAYS:

- Hedge funds can absolutely be classified as Article 8 without changing their investment strategy
- -Sustainability analysis and reporting need to be made for only 3 instruments: corporate & sovereign bonds, and long equities. A platform like Datia can speed up the process
- Hedge funds that do not adjust to become Article 8 might soon be completely disregarded by potential clients

Hedge funds are all about the freedom to invest in a variety of instruments and to partake in complex trading. In this context, taking sustainability into account could sound like a limitation, right? Wrong. As a hedge fund manager, you do not have to change your investment strategy in order to take sustainability into account and even be classified as "Article 8" - a fund that promotes environmental and/or social sustainability, according to the Sustainable Finance Disclosure Regulation (SFDR).

In other words: you can have your cake and eat it too. But is it so simple? Yes. The story of Swedish Antiloop Hedge is a perfect example. Antiloop adopted Datia as their sustainability data platform in November 2022 and told us their path to start an Article 8 multi-asset hedge fund.

THE CHALLENGE: SIGNING UP TO BE AN ARTICLE 8 FUND BEFORE FULLY UNDERSTANDING WHAT THAT WOULD ENTAIL

When Antiloop Hedge was incorporated in 2020, the Swedish financial authorities already demanded that applications for new funds took sustainability into account. As a new player, Antiloop had no choice but to create a process for integrating sustainability into its investment decisions.

"People that have been in the industry for a long time and that have seen greenwashing among funds, are pretty tired of the ESG topic. But now we are talking about standardized formats coming from the European Union. It is actually happening and not realizing this is a big mistake," tells Anna Svahn, CEO and Portfolio Manager, while highlighting how Article 6 funds are already losing opportunities to grow and risk becoming invisible altogether.

It took two and a half years for the fund to be up and running and, in this period, Antiloop's team had the chance to better understand what it would mean to be an Article 8 fund.

"We learned a lot in this process," says Svahn.

The first learning was: as of March 2023, SFDR only applies to three investment instruments: corporate and sovereign bonds, and long position equities. "The vast majority of assets in which hedge funds may invest are not even covered by the recent European regulations," clarifies Svahn.

And the second learning was: the regulation does not force Article 8 funds to change their investment strategy. Instead, it requires funds to define a sustainability policy and communicate how they are taking sustainability into consideration. "There seems to be a general misconception about what SFDR is. When you first read it, it is a lot of information, but it boils down to creating a communication tool," explains Svahn.

In February 2022, Antiloop Hedge was ready to start trading and was armed with knowledge about its responsibilities as an Article 8 fund. The remaining questions were: where would they find the data? And are there expected templates for these reports?

THE SOLUTION: FINDING RELIABLE DATA AND HAVING EVERYTHING COLLECTED IN ONE TOOL

Antiloop Hedge has eight different investment strategies, spanning from the short to the long-time horizons and including assets such as foreign exchange, commodities, and derivatives. Only one of these strategies is long-term equity, composed of a mix of long and short positions. In practical terms, only the fund manager of this last strategy, Karl-Mikael Syding, is required to look at sustainability metrics.

Because this task applies to such a small portion of Antiloop's activities, they needed to find a solution that could dramatically decrease the effort put into it. "We needed to have everything collected in one tool so we could do the ESG analysis before deciding if we wanted to invest in a company or not. But also, to be able to make the reports in a very easy way," says Anna Svahn, CEO and Portfolio Manager.

Antiloop's equity-focused fund manager accesses Datia to screen different companies he is considering investing in, partly relying on the available sustainability information to make a decision on security selection.

MOVING FORWARD: MONTHLY REPORTS? SUSTAINABILITY ANALYSIS OF ALL ASSET CLASSES? NOT A PROBLEM.

In November 2022, Antiloop Hedge became a signatory of the UN's Principals for Responsible Investment. And as the new year started, they published their official sustainability policy on their website.

Antiloop is also expected to report on sustainability quarterly, but since they count on a streamlined structure in place, the plan for 2023 is to report on sustainability aspects monthly. "We are a monthly traded fund, so we figured that publishing the sustainability report together with our standard monthly report will help our investors follow up on how we are doing in all aspects," explains Svahn. "In order to report with that frequency, having a tool like Datia is a necessity."

Looking forward, Antiloop is not worried about the growing demands of an Article 8 fund. "I am hopeful that there will be requirements for sustainability analysis of all asset classes as the regulation evolves," says Svahn. "If you find a reliable data partner like Datia, you will notice that complying with SFDR is not as scary as it sounds," explains Svahn.

SOLUTION FOR A WIDE RANGE OF STRATEGIES AND ASSET CLASSES

Antiloop Hedge is one perfect example of how hedge fund managers can rely on Datia's solution to classify their funds as Article 8 or Article 9 funds. "Antiloop Hedge is a hedge fund that, like many others, invests across various asset classes and holds both long and short positions," says Juan Manuel Serruya, CEO and Co-founder of Datia. "We have built a flexible, yet robust platform that is capable of supporting a diverse range of investment strategies and asset classes," he emphasizes.

Hedge funds and the broader active fund management industry face several challenges when dealing with the SFDR. In addition to the difficulty of gathering indicators for all relevant Principle Adverse Impacts (PAI) and tracking the performance of these indicators over time, fund managers are also required to perform complex reporting periodically both at the product and entity level, according to Serruya. "Acquiring a dataset is just the beginning, as significant effort is needed to integrate the data into the investment and reporting processes," explains Serruya.

Datia offers a comprehensive and transparent dataset, along with intelligent software solutions that facilitate PAI monitoring and automate periodic reporting. This includes generating critical portfolio-level insights and producing key reports such as the PAI statement and European ESG Template (EET) files. "By leveraging automated reporting, Datia empowers its customers to save time while providing modern sustainability reporting that can attract more capital," argues Serruya. "With our solution, customers can focus on defining their PAI considerations, knowing that our platform has all the necessary data, calculations, and reporting ready to go. This means that you can spend less time on administrative tasks and more time making better investment decisions."

With hedge funds increasingly looking to respond to the demands of ESG-conscious investors, Datia will remain committed to helping more hedge funds incorporate sustainability considerations into their investment processes, according to Serruya. "We believe that this will not only help them access more capital but also enable them to make a more significant impact in the world of finance."


Anna Svahn, CEO and Portfolio Manager – Antiloop Hedge

> "By leveraging automated reporting, Datia empowers its customers to save time while providing modern sustainability reporting that can attract more capital."
>
> Juan Manuel Serruya, CEO at Datia

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Know Your Hedge Fund Investment

By Eugeniu Guzun – HedgeNordic


Kari Vatanen, CIO – Veritas

"As a hedge fund investor, you have to understand the behavior of your hedge fund investments in different market environments."

Kari Vatanen wasn't a big fan of hedge funds when he joined Veritas as chief investment officer in March 2020 after more than a decade of underperformance. 2022 was a chance to ease his doubts about the role of hedge funds in institutional portfolios. Hedge funds have indeed proved useful for many institutional investors, including Veritas, in the challenging market environment of 2022. The hedge fund portfolio of Veritas, partly owing to Vatanen's re-organization, returned an impressive 12.3 percent in 2022.

"Hedge funds have performed well in the environment of rising rates and declining equity markets. We have reported double-digit returns for the whole alternatives portfolio and over 12 percent for hedge funds only," says Vatanen. This alternatives bucket only refers to hedge funds and alternative strategies and does not encompass private equity or real estate, which represent separate asset classes. "The diversification effect of hedge funds and other alternatives has been significant, and they have mitigated the negative return impact of equities and fixed-income," he emphasizes. This diversification effect wasn't as visible during the Covid-induced market turmoil in the first quarter of 2020.

"Hedge funds were part of asset allocation at Veritas before my time here and were meant to play a diversifying role," according to Vatanen. The hedge fund portfolio offered many – mostly negative – surprises when Vatanen joined Veritas at the beginning of March 2020, when the Covid crisis started. "We noticed in my first month here that our hedge fund investments did not hedge at all," he recalls. "As a hedge fund investor, you have to understand the behavior of your hedge fund investments in different market environments," according to Vatanen.

DIFFERENT ROLES FOR DIFFERENT HEDGE FUNDS

Soon after taking the helm of investment functions at Veritas as CIO, Vatanen and his team started moving the entire portfolio into three different functional buckets: carry-seeking, diversifying and hedging. As part of the process, Veritas simultaneously started re-organizing the alternatives portfolio based on each strategy's function. The alternatives portfolio, which consists of hedge funds and other hedge fund-like specialist strategies such as insurance-linked strategies, may fit in any of these three buckets. "We have done quite a lot of work to understand the profile of each hedge fund and alternative investment and how it behaves when the market regime changes," explains Vatanen.

"We have different roles for hedge funds and other alternatives depending on their risk characteristics and expected returns," elaborates Vatanen. "Hedge funds can be either alternative sources of carry or they can provide diversification or even hedging effect for risk-on assets." In the pool of alternative investments, which accounted for 13.2 percent of the €4.2 billion investment portfolio at Veritas at year-end, all three functional buckets ended 2022 in positive territory, with tail risk hedging driving the performance. The entire alternatives portfolio returned 10.2 percent in 2022.

The tail risk hedging part of the alternatives portfolio was the best performer in 2022, generating a return in the high-teen percentage range. The diversifying and carry parts delivered positive returns as well. "All parts of the portfolio performed positively, but the best performer was tail risk hedging, which offered protection to decreasing equity markets, rising rates, and rising credit spreads," summarizes Vatanen. By design, the return profile of the hedging component is designed to generate returns when equity markets go down. "We have both alternative risk premium strategies from investment banks and a couple of asset managers that focus on defensive and risk hedging strategies. These are not direct hedges that we are used in other parts of the portfolio."

The alternative carry-seeking bucket mostly includes private and structured credit dislocation and special situations, or credit event-driven type of investments. "There is illiquidity embedded in this type of strategies, which means they are not as interest rate sensitive compared to traditional fixed income," explains Vatanen. Volatility-selling strategies are also part of the alternative carry-seeking bucket. The diversifying alternatives bucket, meanwhile, includes macro and relative value hedge fund strategies, insurance-linked strategies and diversifying risk premia strategies. "This package includes strategies that are not highly tail-correlated compared to other asset classes," according to Vatanen.

MARKET ENVIRONMENT

The new philosophy of portfolio construction based on each investment's function enables Kari Vatanen and his team to adjust allocations as market conditions change. "If our market view is that we need more hedging or more diversification, we tilt the portfolio towards that," says Vatanen. With hedging strategies exhibiting a negative return profile over time, Vatanen relies on a "semi-active approach to the hedge fund allocation to adjust the risk profile depending on the market environment."

The current market environment favors active management, including a wide range of hedge fund strategies, according to Vatanen. "We expect that the current market environment is better for active management and for many diversifying macro hedge funds compared to the environment of negative rates and massive QE," he predicts. The market dominance by central banks has started to decrease, which has caused a rise in macro volatility. "The trends in the macro variables such as rates and FX strengthen, which has been positive for any trend-followers like CTA funds."

According to Vatanen, market fundamentals have begun to play a bigger role in equity markets as well. "The importance of value and expected cash flow measures is increasing when borrowing costs are positive again," he explains. "Diversifying hedge funds that are not relying on credit or equity market beta, might have a better working environment now." Despite fundamentals playing a bigger role in equity markets, Vatanen does not prefer long/short equity managers. "We could have some if they are exceptionally interesting or attractive, but this is not our preference as we have a separate long-only equity portfolio where we can have active funds."

After a strong performance in 2022, Vatanen continues to prefer diversifying macro strategies, relative-value strategies and even tail risk hedging strategies amid a lot of uncertainties in the current environment. "We are a little bit cautious on economic expectations for now, and that's why diversifying and tail risk hedging strategies are still our preference," says Vatanen. "But little by little, opportunities might arise in alternative carry on the opportunistic credit side, for instance," he emphasizes.

The performance of hedge funds had not been attractive in the decade after the financial crisis compared to the risky asset classes such as equities, credit, and private assets, according to Vatanen. "But are we now at a turning point when macro strategies start to perform and risky assets start to suffer?" he asks. One reason for the market environment arriving at this turning point is the end of the quantitative easing by central banks. "The big picture on our side is that after tough times for systematic macro strategies, there will be a renaissance for macro trading," says Vatanen. "We have seen quite similar performance in alternative risk premia, which is coming back in this environment where central banks are not trying to keep the macro volatility low as they have done for over a decade."

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Sissener Canopus UCITS Celebrates 11 Years

By Hamlin Lovell – HedgeNordic


Jan Petter Sissener, CEO and Portfolio Manager

"Exposure depends on our comfort levels around valuations and if markets are cheap, damn cheap, expensive or uncertain. Ideally we get longer as the market falls and shorter as it rises."

Jan Petter Sissener

SWEDISH PROPERTY SHORTS HELP 2022 RETURNS

The award-winning Sissener Canopus global equity long/short strategy has annualized at 12.8 percent and made 268 percent (NOK share class) since inception in April 2012, with less volatility than long only equity indices. The fund is amongst an elite group of Nordic based hedge funds that have delivered a Sharpe ratio near one though this is a fortunate consequence of the investment process, rather than an explicit target.

"We do not manage returns to a Sharpe target but it happened over the past 10 years. Much of that period saw a bull market with declining interest rates but now it is more demanding," says founder, Jan Petter Sissener, who has presided over impressive growth of people and assets. When the firm started in 2009 the board of six people, including the former CEO of Statoil (now called Equinor), was larger than the team of four people. Now there are six investment professionals alone (five Norwegians, and one Brit who is married to a Norwegian). Assets have grown to EUR 600 million in Canopus and a Nordic credit strategy.

If there is no Sharpe target there is certainly an ambition to produce positive alpha. Average annual alpha has been between about 4 percent and 7 percent, depending on which benchmark is chosen. The best benchmark would probably be a blend of Norwegian, European and US equities to reflect the fund's allocation. As of March 2023, long equity exposure was roughly 50 percent Nordics, 35 percent Europe and 15 percent US.

Nordic exposure has sometimes been higher: "we have only limited value add in Europe and the US, more based on a sector approach. If we like oil or banks, we look at European names," says JP Sissener. But the investing mindset includes a global approach, which is natural for some of Norway's more global companies. "When we look at Norway's biggest company, Norsk Hydro, we need to look at the whole value chain including alumina miners, customers such as European car makers, and competitors such as Alcoa. It would then be a shame to be restricted to Norwegian equities when we may find opportunities in Europe or North America, including some sideways pair trades (but not Asia or EM)," says co-portfolio manager, Philippe Sissener. "Since Covid, we do remote meetings globally and interview global companies through teams and zoom meetings," he adds.

Equity beta has made a positive contribution in most years and the fund has averaged 60 percent net long since inception. The net long has ranged from over 100 percent to a brief period of being slightly net short in March 2020, when put options kicked into action and some extra short futures were added to more or less neutralize equity market exposure.

"After the first pandemic and lockdown since 1917 we did not understand anything and stayed neutral for a few months. Ideally, we are 100 percent long and sometimes even more, but we also have to have hedges. Exposure depends on our comfort levels around valuations and if markets are cheap, damn cheap, expensive or uncertain. Ideally we get longer as the market falls and shorter as it rises. We take

Philippe Sissener, Portfolio Manager

a market view on a rolling 3-month basis. We also try to hedge more around reporting season because it has asymmetric risk: companies reporting good figures might rise 2-3 percent but those reporting bad figures could gap down 10 percent and we would have no ability to act," says JP Sissener.

The only losing calendar year was 2018, when the Canopus strategy was wrong footed after lifting its equity hedges in December 2018 in the hope of a Santa Claus Christmas rally. In fact the fund had its deepest drawdown as equities dropped by over 10 percent due to rising interest rates, Quantitative Tightening, and a technology crunch, all on top of an Asian trade war. Late 2015 and early 2016 was also a difficult period, and reaching back to before the fund launch, late 2011 was also tough.

A DIRECT DIALOGUE WITH INVESTORS

Communication with investors becomes especially important in challenging market conditions. Many hedge fund managers in the US and Europe have no retail investor base, and even those that do will often delegate investor relations to distributors and platforms and have no direct contact with retail clients. In contrast, Sissener is distinguished by maintaining a close dialogue with its 6,000 strong investor base.

In March 2020, Sissener began offering weekly video communications every Sunday to calm investors down, and continues to provide a monthly video. There are also 5 or 6 Christmas lunches each year in Oslo hosting 200 or so guests at the Continental Hotel. Sissener is increasingly sought after by distribution platforms but is rather selective in choosing which ones to share fees with; so far the fund has been onboarded onto platforms in Germany and Austria. Of EUR 300 million of assets in Canopus, EUR 280 million comes from the Nordics including a mix of retail, high net worth and family offices in Norway.

VALUE AND GROWTH

The analytical approach has a common sense emphasis on no-nonsense cashflows. The long book usually has a mix of growth and value styles, though the balance does vary and there are also different opinions about how to classify some stocks. "We think Storebrand is a growth stock, growing at 10-15 percent per year as the younger generation need to save for their own pensions, but it is viewed as a value stock," says JP Sissener.

In March 2023 the top holdings include local chip maker Nordic Semiconductor and also the Nordics' largest listed company, Novo Nordisk, both of which are definitely growth stocks. "Novo is a value growth company. Its new weight loss injection is growing like crazy on top of the diabetes treatment. It is not cheap but is a quality growth stock with dominant market share," says JP Sissener.

Some stock picks start with a sector, such as nuclear. "We think nuclear is essential for a solution to the energy crisis and there can be no green transition without it. We started top down and we found two uranium miners listed in Canada," says JP Sissener.

"Equally research can start with the stock, so long as it is not on the ESG exclusion list and passes our good corporate governance screen," points out Philippe Sissener.

The fund has occasionally and opportunistically participated in Nordic IPOs, flipping some of the green issues seen in late 2019, but more often Sissener has been a cautious observer of issuance. "IPOs usually have bad intentions that can be beneficial for exiting shareholders. The perfect time for private equity to exit is when markets are not thinking", says Phillippe Sissener. Some private equity backed IPOs have even become short ideas.

SHORTS IN 2022

In many years Sissener Canopus is really a long equity fund with variable hedges and derivatives while single stock shorts play a smaller role. 2022 however proved to be the best ever year for the single stock shorts, which were up 7.9 percent, accounting for most of the total return of 8.5 percent. "The best theme was Swedish real estate, initiated in January 2022. We used our expertise in credit analysis and worked out that Swedish real estate companies cannot service their debt with higher interest rates and lower yields on buildings," says Philippe Sissener, who also manages the credit fund launched in 2019.

Scandinavian Airline System was also a good short in 2022 while put options on Tesla, which had lost money in 2020 and 2021, paid off in 2022. Tesla founder Elon Musk may share Sissener's liking of Novo's wegovy treatment, but the Tesla stock is too richly valued for Sissener's liking.

Single stock shorts are usually small, starting at around 1 percent position sizes, because if they go wrong the position gets bigger.

A more challenging environment for long stock-picking could sow the seeds for better opportunities. Sissener's best calendar year, up 34.5 percent, was 2013, taking advantage of cheap valuations after the European sovereign debt crisis. If the banking problems of March 2023 do spark off a larger crisis, Sissener could be well positioned to exploit lower valuations.

"It would then be a shame to be restricted to Norwegian equities when we may find opportunities in Europe or North America."

Philippe Sissener

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From left to right: Björn Suurwee, Deputy CEO and Portfolio Manager, Thomas Pohjanen, CEO and Portfolio Manager – Excalibur Asset Management

Skills Honed and Perfected in and by the Markets

By Eugeniu Guzun – HedgeNordic

> "Pure alpha to me is more about trying to understand the market, its implicit expectations, how markets will evolve over time, and how to position the portfolio in anticipation of central banks…"
>
> Thomas Pohjanen

Swedish hedge fund Excalibur Fixed Income has one of the lowest recorded maximum drawdowns in the Nordic hedge fund universe despite being one of its longest-running members. The fixed-income macro fund has experienced only two years of low single-digit losses, while delivering an annualized return of 4.8 percent – the high end of its 4-5 percent target return band – since launching in April of 2001. The ability to generate this return with limited downside risk in fixed-income markets is a "mastery that cannot be taught in even the best business schools," according to founder Thomas Pohjanen.

The past three years and the beginning of 2023 saw Excalibur Fixed Income enjoy some of its best streaks of performance that bring back memories from its first 12-15 lucrative years. The Excalibur team has rejoiced the more volatile and uncertain market conditions characterized by rapid, abrupt changes and reversals. With an annualized return of seven percent in the past three years, Thomas Pohjanen and his team managed to anticipate central bank decisions and capitalize on opportunities arising from diverging expectations within highly liquid and safe money market- and related credit instruments. "Our performance in the past three years reflects more macroeconomic uncertainty and the absolute mainstay of all our investments in very safe credit-worthy instruments," explains Pohjanen.

According to Pohjanen, pure alpha is not about harvesting market risk premia by hoarding up on huge credit risk and magnifying that exposure using leverage. "Pure alpha to me is more about trying to understand the market, its implicit expectations, how markets will evolve over time, and how to position the portfolio in anticipation of central banks moving from neutral to hawkish, or from hawkish to neutral, or neutral to dovish," elaborates the founder and co-portfolio manager of Excalibur Fixed Income. "This is not impossible to do, we have proven that over the years."

One key observation, that has become more pronounced in recent years, Pohjanen has made over his more than 20 years of running Excalibur Fixed Income is that investors and fellow fund managers "tend to stay too long with the messaging of central banks." According to Pohjanen, "it is correct to listen to what the central banks are telling you most of the time. But when markets are heading towards turning points, you have to release yourself from what central banks tell you." Central banks, more often than not, want to be sure with a margin of safety that they are making the correct move before taking action.

A SNAPSHOT OF THE PAST THREE YEARS

The starting point of a more fertile environment for Excalibur Fixed Income was "the unfortunate onslaught of COVID-19 hitting our societies and financial markets in early 2020," recalls Pohjanen. "We were of the opinion that the great health crisis that hit globally would be met at all cost by both fiscal and monetary authorities, to prevent it from also turning into a financial crisis," explains the founder of Excalibur Asset Management. "We expected that the taps would be open and sure enough they were." Pohjanen and his co-portfolio

> "This is a business where it's good to be getting some gray hairs simply because you have seen overreactions, you have seen turbulences, you have seen the psychology of market behavior."
>
> Thomas Pohjanen

manager Björn Suurwee positioned the portfolio for lower interest rates, easier monetary conditions and more quantitative easing, expecting spreads to compress in all sorts of instruments versus risk-free rates. "Sure enough that happened."

At the turn between the years 2020 and 2021, there was still uncertainty and negativity around economic growth prospects. Pohjanen and his team, however, were starting to have a change of heart following the successful development of COVID-19 vaccines. "We felt that the great speed at which medical companies were delivering vaccines would change the picture completely," recalls Pohjanen. As soon as the U.K. started vaccinating people at the turn of the year and early 2021, we thought "this was the seed of a different year." Central banks, however, "were not signaling anything else than continued easy monetary policy."

Soon inflation started picking up in the United States due to different disturbances to the world economy such as supply chain issues and chip shortages. Pohjanen started preparing Excalibur Fixed Income for a different turn of events. When Fed members started sounding the alarm about inflation picking up during the summer of 2021, the Stockholm-based team at Excalibur started adding positions set to benefit from higher inflation and interest rates in the United States. "We started turning from a long duration view in some parts of the portfolio to short duration," says Pohjanen. "We implemented strategies to pick up returns from rising interest rates."

Inflationary pressures soon started showing signs across Europe, and the Nordic region as well. Riksbank's preferred measure of tracking inflation breached the two percent level in August 2022 and rose steadily over the subsequent months. "Markets were still expecting that the Swedish central bank would hold interest rates steady up until the outbreak of Russia's war in Ukraine," recalls Pohjanen. "The Riksbank's chief said the bank was going to hold interest rates steady at zero all the way through 2024 and many participants surely believed them," he continues. "We were building short positions well in advance of February 2022, expecting the central bank to have to turn their message around and this was important in 2022 for the return."

Pohjanen believes one can predict central bank decisions well in advance and build positions to benefit from them. "If you are a student of the same data central bankers look at and they are slaves on the same data wagon as the rest of us, then you are able to predict advance turning points in monetary policy strategy," argues Pohjanen. "This has been a recurring theme over the years. One can discern what will be in the next set of events, when the central bank will turn their message."

With Excalibur Fixed Income focusing on three different markets – the U.S., Eurozone and Swedish fixed-income markets, the team running the fund tends to find attractive opportunities to exploit at any given time. "These three markets tend to move a bit out of sync, so it's possible to construct trading strategies that can benefit from a certain market being ahead of others," says Pohjanen. "You can build, for instance, long-duration strategies in one part of a market and offset some of that risk with an opposite trade in a different market that is not quite as advanced in the business cycle."

DOWNSIDE PROTECTION THROUGH IMMUNIZATION STRATEGIES

Excalibur Fixed Income has recorded one of the lowest drawdowns in the entire Nordic universe, experiencing only two down years of low single-digit losses (1.5 percent in 2018 and 1.7 percent in 2015). "These figures tell you more about how we run our risk book than words can say," once said Pohjanen. "When we are going into a position, we always have pre-determined immunization strategies," explains the portfolio manager.

"If the market moves significantly against you, we have immunization strategies that we do put in place to minimize downside because something is happening that we had not expected and had not foreseen," says Pohjanen. Another observation that has helped Pohjanen minimize losses over the years was to be more careful when a certain market belief or conviction becomes too well entrenched, i.e. many market participants had bought into a certain theme. You want to be more careful if too many investors are on the same train.

To capitalize on a given conviction or theme, Pohjanen also seeks to build a position with a "hockey stick" return profile. "We try to build portions of the portfolio using options. If we are wrong on the direction itself, which is more seldom, timing is devilishly hard," says Pohjanen. "You just don't know if this will happen this quarter or the next quarter. It's a matter of limiting the downside while being exposed to your conviction."

The ability to build a portfolio with a "hockey stick" return profile coupled with limited downside risk "is a mastery that cannot be taught in even the best business schools," reckons Pohjanen. "It has to be honed and perfected by being in the markets," he emphasizes. "This is a business where it's good to be getting some gray hairs simply because you have seen overreactions, you have seen turbulences, you have seen the psychology of market behavior."

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Danske Answering the Million Dollar Question in Alternative Risk Premia

By Eugeniu Guzun – HedgeNordic


Markku Vartiainen, Chief Portfolio Manager

> "The magnitude and attractiveness of certain risk premia are going to change all the time, they are going to change in shape and form as have been for the last years."
>
> Markku Vartiainen

The concept of alternative risk premia is often seen as an extension of factor-based investing, which compensates investors for the exposure to certain risk factors. Both the investment industry and academia have identified many historically rewarded factors over the years, creating a wild 'factor zoo'. After years of research and development, Danske Bank Asset Management launched a hedge fund in last year's turbulent environment to capture 'true' alternative risk premia as compensation for actual risk rather than behavioral-based or data-mined premia. Developed in a multi-team effort and spearheaded by the seasoned Chief Portfolio Manager Markku Vartiainen, the fund is DBAM's strategic wager on the alternative asset classes.

The new fund, Danske Invest Global Alternative Opportunities (GAO), successfully passed the initial proof of concept test in the difficult market conditions of 2022. Launched in August 2022, just ahead of the worst September for equity markets since 2002, the fund has generated a cumulative return of 5.4 percent coupled with a seven-month streak of positive performance, with very low volatility and a Sharpe Ratio of above 2 (based on weekly observations). "One of the early successes is that the strategy has worked exactly as intended," says Søren Funch Adamsen, Chief Portfolio Manager and Head of Portfolio Construction at Danske Bank Asset Management. "That has hopefully answered the million-dollar question."

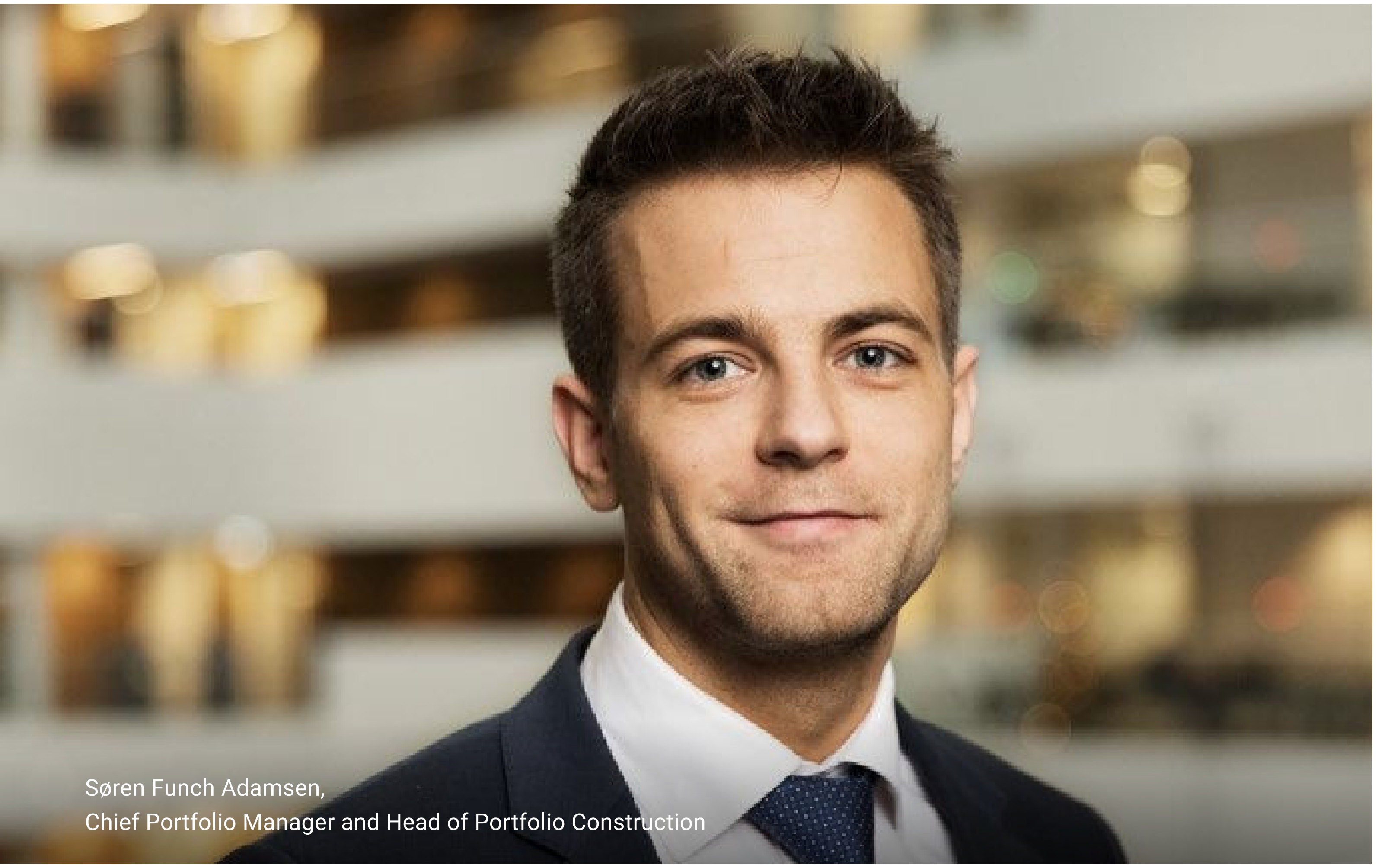
'TRUE' ALTERNATIVE RISK PREMIA

The still-nascent track record may serve as an indication that GAO has indeed found true alternative risk premia. But what is a true alternative risk premium and where does this premium reside in the vision of Danske Bank's Quant & Overlay team? "In recent years, investors and researchers have been building all sorts of models showing behavioral patterns and biases among market participants," explains Chief Portfolio Manager Markku Vartiainen. Some of these behavioral risk premia, such as value, quality or momentum, can be considered by some as alternative risk premia.

"There is another type of alternative risk premia that we think of as true, or structural, risk premia," emphasizes Vartiainen. "There is an excess risk premium in certain asset classes, segments of those asset classes or instruments that reflect true risk," he elaborates. "That excess risk premium is how much market participants are willing to pay for not carrying a specific risk." A case in point is the volatility risk premium, which is based on the premise that implied volatility is persistently priced above realized volatility as market participants are willing to pay a premium for insurance. "Volatility, which manifests itself in different ways in different underlying across different horizons, obviously exhibits true risk premia."

EVOLVING ATTRACTIVENESS OF RISK PREMIA

Danske Bank's GAO seeks to capture these true alternative risk premia across several asset classes such as equities, fixed income, credit, and currencies. Alternative risk premia across most of these asset



Søren Funch Adamsen,
Chief Portfolio Manager and Head of Portfolio Construction

classes became more attractive to harvest in 2022 amid plunging equity prices, rising interest rates, and increasing volatility. "When the market goes into a scenario similar to that one of last year, then these alternative risk premia tend to widen quite a bit," explains Vartiainen. "Alternative risk premia broadened across the board last year after Russia's war in Ukraine started and inflation started getting out of hand."

"It becomes a numerical exercise to find out the size of these risk premia and figure out a way to harvest the premia," continues Vartiainen. "Many investors who did the math, identified the size of excess risk premia, and went on to harvest those premia enjoyed a successful year," he elaborates. And yet, one could still observe significant performance divergence among various players in the alternative risk premia universe. "Whether risk premia investing was successful for you or not in 2022, for instance, mainly depends on what types of risk premia you actually aimed to harvest," explains Vartiainen. "If you were looking at behavioral risk premia, 2022 might have not been so successful, while investors targeting real risk premia had a more successful year."

The excess risk premia have normalized towards the end of the year and going into 2023. "If you take volatility as a proxy for excess risk premia, there is still some room for the volatility to come down and there is still premia to be harvested," according to Vartiainen. "Given that there are no new inflationary shocks or any other massive micro shocks and the world moves on smoothly, investors are still able to capture excess risk premia," explains Vartiainen. "Mind, you do become a bit more vulnerable if something suddenly happens and risk premia widen again," he warns. "One has to be extremely conscious of that fact. Ignoring it is the surest way of having an absolute meltdown in performance."

RISK-ON, RISK-OFF DYNAMICS

Carry strategies harvesting alternative risk premia exhibit risk-on, risk-off dynamics, according to Vartiainen. "Carry or risk premia is a compensation for the risk investors are taking, hence, carry strategies follow a risk-on, risk-off dynamic." For that reason, GAO also employs a set of defensive strategies designed to do most of the heavy lifting in terms of downside risk mitigation. "One has to be very conscious about building protective strategies as well, beefing them up to get insurance for times when you need that insurance most."

"The defensive strategies are particularly designed to have a low cost of carry, implying that they don't ruin the performance in standard market conditions and yet provide a robust hedge in down markets when it is most needed," explains Vartiainen. GAO currently employs 13 independent strategies, a handful of which are defensive. "The fund has so far delivered well in both up and down environments including the most recent risk-off, and the dynamics of our offensive carry strategies and defensive protective strategies have played the way they had been designed to," highlights Søren Funch Adamsen. "This gives confidence that the optimization and analysis that was hypothetical before launching the fund has actually been working as intended."

ALTERNATIVE RISK PREMIA GOING FORWARD

2022 was a good year for alternative – especially true alternative – risk premia, which is expected to represent an alternative to alpha going forward. "The magnitude and attractiveness of certain risk premia are going to change all the time, they are going to change in shape and form as have been for the last years," argues Vartiainen. While the attractiveness of existing risk premia might change depending on the market environment, Vartiainen also expects to see new opportunities in the risk premia space as markets are evolving into areas we have not been to before.

"The market is moving towards the direction that market participants are identifying risks that they want to trade in the market," Vartiainen explains. Market participants have been and will continue to use various instruments to trade and transfer risks. "There are more new risk dimensions that come into the market that are being traded. We just need to be able to understand how to price these risk dimensions and find a way to harvest them," says Vartiainen. "This opens up possibilities not just because of our edge in accurately calculating risk premia in asset classes, but because we are able to look at new types of risk classes that enable diversification of positions."

While equities and bonds often represent reliable sources of long-term returns, many investors are perhaps overly-dependent on them as observed during the market turmoil of 2022. As such, investors can benefit by diversifying their portfolios with other sources of return such as alternative risk premia. "Since the beginning of last year, we have seen that the diversification characteristics of a bond and equity portfolio are much poorer than they had been in the past," highlights Søren Funch Adamsen. "The changed stock-bond correlation makes the role of a product like GAO more important and more attractive within a broader portfolio. This fund can extract yields and provide diversification in an environment where diversification is becoming scarcer."

> "One of the early successes is that the strategy has worked exactly as intended. That has hopefully answered the million-dollar question."
>
> Søren Funch Adamsen

From left to right: Daniel Mackey, Chief Operating Officer; Carl Gustafsson, Investment Manager; Pontus Dackmo, CEO and Investment Manager – Protean Funds

Skin In The Game

By Pontus Dackmo, CEO at Protean Funds

> "Skin In The Game is not a marketing pitch – it's the consequence of us needing to entice other investors to co-invest with us"
>
> Pontus Dackmo

In many aspects of professional life, there is a lack of symmetry between risk and reward. War mongers propagating for a war but are certain never to suffer personally in a battle. Fund managers taking outsized risks (or no risks) but not investing their own money, therefore are not impacted along with investors when returns are negative or insufficient.

Nassim Nicholas Taleb, famous trader-turned-author, a few years ago devoted an entire book to the concept. Reading it was described by the FT as "being trapped in a cab with a cantankerous and over-opinionated driver". I concur. But he still has a point: many players only have incentives, no dis-incentives. If you carry zero downside for your actions, you have no Skin In The Game. In a nutshell: don't put someone else's skin in the game, unless yours is right in there with it.

It's not a new concept, but perhaps forgotten in certain industries today. Already Hammurabi, King of Old Babylon (1800 B.C.), codified, in what is widely considered the first set of laws, that:

"If a builder builds a house for a man and does not make its construction firm, and the house which he has built collapses and causes the death of the owner of the house, that builder shall be put to death."

Harsh, maybe, to translate to asset management in 2023, but you get the point: no skimping on construction standards if your own skin is in the game. No shortcuts allowed. Utilize self-interest – the purest and powerful interest known to man.

This is what shapes Protean's whole being, by explicit design. Avid readers of our monthly partner letter will recognize that we started the fund company to be able to manage our own capital. But the crux is we need institutional access. We need size to be relevant to company managements, liquidity- and research providers. Skin In The Game is not a marketing pitch – it's the consequence of us needing to entice other investors to co-invest with us. Our skin is in the game by necessity and outright design.

Our performance since launch offers an early proof we can and will be adaptive to changing markets. We have participated reasonably in up markets, and protected capital in down markets. Reflecting heightened uncertainty, we continue to run the fund with a diversified portfolio and a net exposure in the lower end of what we expect to be the long-term average.

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There will always be times of sub-standard performance. It's a mathematical certainty. Particularly over shorter periods of time. We manage the portfolio with a multi-year horizon and optimize for long-term performance (at least three years). This is not an excuse for short-term underperformance: we will always choose action ahead of inaction and try our best to minimize friction and mental biases that justify drawdowns, also in the short term.

Since inception in May 2022 we have beaten most indices, but we do not expect this to be the case for long in strong upwards moving markets. The real feature of the strategy is however that the return is generated with significantly lower risk. Our approximate standard deviation since launch is below 8 percent, less than half of what the market has realized in the same period.

A consequence of skin in the game, and an owner-operator mindset, is that we think of the portfolio in dollars and cents (or, rather, kronor och ören). We work for ourselves, and every basis point of absolute performance matters. It reflects on our positioning and work ethic: we hate losing money, but we don't have a business (or a livelihood) if we don't generate returns.

This owner-operator mindset means we are an unusual fund. Funds are often "products", where buzzwords are piled on to incite asset growth. You are buying an exposure (sector, theme, style) and you as an investor, therefore, need to think about changing allocations between products every now and then. We don't think that way. Or work that way. This is our sole vehicle for investing, and we rely on being able to change when the market changes (or preferably right before). We cannot afford, literally and metaphorically, to underperform and blame "our style is out of fashion right now" – we are trying hard to be an all-weather fund.

So far, we've done alright, but the real test will be when a new paradigm emerges. Will we be able and willing to change? The one tenet we keep repeating is this: the real money is made being long. Pessimists don't build skyscrapers. Therefore, we remain stubbornly net long despite heightened uncertainty. We're not overconfident enough to believe we will pick the bottom when it occurs. But, to paraphrase Buffet's 2020 shareholder letter:

"We remain unable to promise results. We can and do pledge to treat you as partners."

With our long-term ambition it is our wish that anyone who invests with us evaluates our performance on a multi-year basis. This is how we evaluate ourselves. If we fail to generate decent risk-adjusted returns on a three-year-rolling basis we promise to close this fund down and return the capital because there is an evolutionary argument to skin in the game we wish to honor: if you don't suffer when making poor decisions, evolution stops working and keeps sub-standard organizations alive. We do not want to fall down that rabbit hole.

> "We cannot afford, literally and metaphorically, to underperform and blame "our style is out of fashion right now" – we are trying hard to be an all-weather fund."
>
> Pontus Dackmo

CABA's Journey in Scandinavian Bullet Bonds in a Three-Year Wrapper

By Eugeniu Guzun – HedgeNordic

Carsten Bach, CIO – CABA Capital.

Danish covered bonds enjoy a reputation as assets of high credit quality and liquidity. Despite being generally characterized as AAA-rated securities, Danish covered bonds still behave like a risky asset class with their spreads to 'govies' widening – sometimes significantly – in risk-off environments. This feature of the Danish and the broader Scandinavian covered bond market occasionally offers rather attractive opportunities.

Spreads in the Scandinavian covered bond market were volatile and generally widened over the course of 2022 as high and rising inflation, hawkish central banks, economic uncertainty, the war in Ukraine and other problems stirred up a toxic cocktail. Danish fixed-income boutique CABA Capital launched a fixed-income hedge fund, CABA Flex, in mid-December 2022 to exploit historically elevated and attractive spreads in the market. "The objective of

“The objective of CABA Flex is to utilize the current very attractive spreads through a transparent investment solution with a high expected return and a relatively low underlying risk.”

CABA Flex is to utilize the current very attractive spreads through a transparent investment solution with a high expected return and a relatively low underlying risk,” says Carsten Bach, CIO of CABA Capital.

Following a few months of “calmness” and spread tightening in late 2022 and early 2023, the distress in the banking system after the forced rescue of Credit Suisse in Europe and the demise of Silicon Valley Bank in the United States has led to another wave of severe volatility and increased uncertainty. “Despite spread widening due to increased tension in the banking system in the middle of March, the fund is still trading with a positive return since inception,” says Bach.

“Importantly, the fund has performed as expected, given the spread developments,” emphasizes Bach. CABA Flex, which offers systematic exposure to structural risk premiums within the Scandinavian covered bond market – wrapped in a three-year maturity fund, is expected to generate an annualized return exceeding ten percent net of fees until its expiration in December of 2025.

WHAT’S THE OPPORTUNITY?

“Following the financial crisis in 2008, global central banks have supported the financial markets by keeping rates low and buying bonds at record scale, a phenomenon that only escalated during the corona crisis in 2020,” explains CIO Carsten Bach. This environment led to very low spreads between Scandinavian covered bonds and government bonds. “This support ended abruptly last year, as central banks turned their focus back to more “traditional” inflation fighting,” says Bach. “Ending these support programs has caused lots of volatility across financial markets, and it has also led Scandinavian covered bonds to regain their attractiveness in hedged terms (i.e. after hedging the interest rate risk).”

The Danish covered bond market generally falls into three major segments: callable bonds, fixed-rate bullets, and floaters. While spreads have become more attractive across all three segments of the market, the team at CABA Capital has focused on capturing the more attractive opportunity set in non-callable bonds. Callable bonds may offer a higher pick-up, yet borrowers in these bonds can call back these bonds in an environment of lower coupons, hence lowering the expected returns for investors.

CABA Flex seeks to capture the opportunity set with long positions in Scandinavian bullet bonds and short positions in swaps and government bonds to hedge interest rate risk. “From the outset, the fund invests in 5-year covered bonds, hedged with swaps and government bonds, on a leveraged basis,” explains Bach. “Within this opportunity set, the fund locks in the higher rates on the long positions relative to the short positions, thereby accruing the spread over time. These positions are held for three years, after which the fund is liquidated, and the money returned to investors.”

“As the fund only invests in covered bonds without optionality, and as it follows a buy-and-hold strategy, the expected return – and the path to get there – can be estimated with a much higher degree of certainty, compared to most other asset classes,” further elaborates the founder of CABA Capital. The nature of the underlying bonds and the three-year maturity wrapping of the fund creates a mean-reverting return profile over time, which means that lower returns, as seen during the market turmoil in March 2023 due to the banking crisis, will be followed by higher returns.

Similar to other hedge funds investing in the Danish covered bond market, CABA Flex relies on extensive leverage to multiply expected returns from spreads. “At inception, CABA Flex had 15 times exposure, meaning that the sum of the long exposures equalled 15 times the fund’s equity,” says Bach. This level of leverage will fluctuate over time depending on the performance of the fund. “When assessing the exposure level, it is important to bear in mind that the fund utilizes risk premiums with very low levels of volatility compared to other asset classes,” says Bach.

As time goes by, the bonds are getting closer and closer to maturity, resulting in a decline in the underlying risk, according to Bach. On average, the fund’s risk, as measured by the standard deviation in returns, is roughly equivalent to half of the risk in equity indices. At the same time, the expected return on CABA Flex equals the historic return on equity indices. “The expected return, until the expiration of the fund in December 2025, exceeds 10 percent per year net of fees.”

MAIN RISK SCENARIOS

Two main risk scenarios can potentially affect CABA Flex, one of which is a significant extra spread widening on five-year covered bonds at the beginning of the fund’s journey. The second risk scenario involves significantly wider spread levels on two-year covered bonds at the end of the fund’s journey. “The likelihood of a major spread widening is difficult to estimate,” acknowledges Bach.

However, if the same strategy had been employed at any point in the past 20 years and held for three years, the worst possible return outcome would have been zero percent after all fees. “Based on extensive back-testing, using 20 years of data in more than 4.000 simulations, the accumulated return (net of fees) on CABA Flex ranged between zero and 65 percent over the fund’s three-year maturity,” concludes Bach.

Accendo Celebrates 15 Years of Active Ownership

By Eugeniu Guzun – HedgeNordic


Henri Österlund, Founder – Accendo Capital

> "The strategy is exactly the same as when we launched, so we must have been doing something right."
>
> Henri Österlund

Hedge funds are not generally known for their longevity. For the funds that do have a lifespan exceeding ten or 15 years, this operational longevity is a sign of something going right. In March of 2023, activist investor Accendo Capital joined the select group – now 33 – of long-running Nordic hedge funds with a lifespan that exceeds 15 years.

"The strategy is exactly the same as when we launched, so we must have been doing something right," says Henri Österlund, the founder of Accendo Capital. "We are independently owned and managed, working for the best interests of our fund shareholders within a single, defined strategy," he emphasizes. That strategy involves an active, entrepreneurial, and predominantly collaborative activist approach to invest in public Northern European companies that are driving or benefiting from technological innovation.

Accendo generally acquires ownership stakes between five and 25 percent in a select group of listed companies in the Nordics, with the investment team relying on their entrepreneurial mindset and cooperation efforts to initiate and run their collaborative campaigns of value creation. "There are enormous opportunities to increase shareholder value in listed companies," considers Österlund. "Far too many companies focus on the formalities of corporate governance." Accendo Capital, on the other hand, uses corporate governance to stimulate the process of shareholder value creation.

"Our activism most closely resembles the engagement and passion with which entrepreneurs would run their own company, while bringing in outside expertise and deep knowledge of capital markets," explains Mark Shay, the Stockholm-based partner and portfolio manager of Accendo Capital. "We work with the investments as entrepreneurs would do and are deeply involved with the companies, much more than most other board members ever would be."

Accendo's private equity approach, derived from Österlund's pre-Accendo background, brings a decisive benefit of private equity to small public companies in the Nordics: a clear, dedicated owner. "One of the intangibles that we bring is the genuine passion for investing and for the entrepreneurial drive in our companies," says founder Henri Österlund. "We do not just sit back and wait for the AGM and vote our shares one way or the other," he continues. "Every day, from morning until night, our job is really about thinking and talking to our companies about how can we make them better.

ACTIVIST'S TRACK RECORD AND SUCCESSFUL CAMPAIGNS

Accendo Capital's approach to investing in a limited number of companies and supporting them to realize their full potential has paid off handsomely in the first 15 years of operation. The Luxembourg-domiciled fund has delivered an annualized net return of over 15 percent since launching in early 2008, exhibiting a correlation of 0.5 with the MSCI World Index or the S&P 500. "We consider all our investments individually and there is no model portfolio nor need for index tracking," emphasizes Kai Tavakka, Accendo's long-serving partner who has recently taken the role of Managing Partner.

From left to right: Elise Auer, Kai Tavakka, Mark H. Shay, LeJean Coetzee, and Nicholas Bianco

"We always monitor and measure if the business is moving faster toward the direction we see best suited for the future," says Tavakka. Accendo does not measure its impact in terms of changes to the board, the number of board meetings, or management changes – although all these abound. "We are proactive and have a clear view of the direction for each company we invest, but we don't go in with hostile agendas," points out Tavakka. Most of Accendo's investments and engagement campaigns have borne fruits, but some have been more successful than others.

Accendo's first bigger investment in silicon wafer manufacturer Okmetic has been one of the most successful investments, generating an internal rate of return of 24 percent over a span of eight years. Under Accendo's watch, Okmetic started investing in more specialized silicon wafer production capacity and started focusing on world-leading customers in the field. "These helped to reduce the dependency on lower margin and more volatile business areas," recalls Österlund. "Overall the topline didn't appear to change that much during our holding period, but the sales mix experienced a dramatic change," he elaborates. "Eventually the strong market position in specialty wafers attracted international interest and we sold the whole company."

Accendo's current investments in Finnish video game developer Remedy Entertainment and Swedish provider of fiber communications solutions Hexatronic have also contributed strongly to returns in recent years. "We helped the listing process since 2016 with an IPO in 2017," Österlund recalls the initial investment in Remedy. "We have actively engaged in the transformation of Remedy from a single-project private company into a public company gaining a greater, more diverse share of game revenues through better project terms and new partnerships."

Accendo has been the largest or among the largest owners of Hexatronic and had board representation since 2016. "Our initial investment thesis was that the company could apply its knowledge and product portfolio from the mature Swedish fiber market to large, growing markets internationally that had lower fiber penetration than Sweden," says Shay. "We recognized that Hexatronic had a strong position among Tier 2/Tier 3 customers, and that there is no viable substitute for fiber." Hexatronic has successfully executed its geographic expansion strategy and has also engaged in M&A-driven growth that extended its geographic reach and product portfolio into new areas such as data centers, wireless communications, and harsh environments.

THE PAST AND THE FUTURE

"The first ten years in the life of an activist investor are the most difficult, thereafter it only is difficult," according to Österlund. He hopes that "the next 15 years will be a continuation of the first 15 years." Accendo Capital will seek to continue delivering similarly strong returns, slowly expand the team if needed, and continue to run a concentrated portfolio. "We plan to continue to be performance-focused, not looking to maximize assets under management or expand with new fund offerings," says Österlund.

"We are still looking to invest in publicly listed companies in the technology space in the Nordics," says Elise Auer, Partner at Accendo. "Turning 15 for such a specialized fund as Accendo is quite an achievement, but it also still feels that there is a lot more that we can do and give," she concludes.

> "We work with the investments as entrepreneurs would do and are deeply involved with the companies, much more than most other board members ever would be."
>
> Mark Shay

Healthcare Combines Defensive and Opportunistic Growth Attributes

By Eugeniu Guzun – HedgeNordic

"Demographic trends support the continued volume growth of the industry and also the need for innovative therapeutics and technologies, which we believe will translate into incremental value creation for this industry."

Susanna Urdmark

The healthcare sector has long been considered a reliable defensive sector in a portfolio. 2022 was a case in point. The sector's defensive qualities stem from the stable and growing demand for its products and services almost regardless of how the broader economy develops. The sector also combines its near-term defensive characteristics with longer-term growth attributes coming from long-term secular tailwinds such as rising standards of living and an aging population.

"People get ill independent of economic environment. Both chronic and acute illnesses have to be addressed no matter the economic outlook," explains Susanna Urdmark, co-chief portfolio manager at Rhenman & Partners. "This creates a floor of stability for the industry that absorbs some volatility throughout economic cycles," she elaborates on the industry's defensive attributes.

Susanna Urdmark, Co-Head and Senior Portfolio Manager,
Henrik Rhenman, Founding Partner and CIO – Rhenman & Partners

www.hedgenordic.com – April 2023
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The industry's growth attributes, meanwhile, come from a range of factors such as innovation, and product development, among others in response to secular trends such as aging populations. "Demographic trends support the continued volume growth of the industry and also the need for innovative therapeutics and technologies, which we believe will translate into incremental value creation," argues Urdmark. "Part of our job is to look for companies and sectors that create additional growth and contribute to that incremental value creation."

DIFFERENT DYNAMICS ACROSS SUB-SECTORS

The broader healthcare industry is made up of multiple sub-sectors that do not move in tandem and form a desynchronized ecosystem. Each sector can be affected differently by rising interest rates, labor costs, supply chain issues, economic slowdowns, or other macroeconomic trends. Flexible and active asset managers with expertise in the industry can incorporate these dynamics into building a portfolio that maximizes the industry's defensive nature, while also positioning for growth as economic conditions improve. "Healthcare as a whole is quite a diversified sector and the different areas can perform differently in various economic environments," explains Urdmark.

"We have the possibility to allocate capital into different sub-sectors to a different degree over time depending on our top-down market assessment," elaborates Urdmark. Individual sub-sectors were impacted in different ways by last year's economic environment. "Most companies have been able to adjust their pricing to compensate for inflation on the cost side," says Urdmark. Although the healthcare sector as a whole is not that highly valued, the higher interest rates as a result of central banks' efforts to combat inflation primarily impacted the valuations of richly valued companies, according to Urdmark.

CAUTIOUS STANCE

While the long-biased healthcare-focused fund under the umbrella of Rhenman & Partners tends to invest in smaller, higher growth-oriented companies over time, "last year we started to have a more 'wait and see' attitude, waiting for better times" by investing in more boring, larger-cap stocks with defensive qualities, according to Henrik Rhenman.

> "Last year we started to have a more 'wait and see' attitude, waiting for better times."
>
> Henrik Rhenman

As Urdmark explains, small-cap biotech companies are the most vulnerable to slowing economic growth and rising rates, as these companies rely on capital markets to sustain future development. Rising rates and risk-off sentiment can put funding at risk. "After the banking crisis in March, the loss-making smaller-cap companies are struggling the most, as there is an increased risk to face difficulties in raising funds going forward."

"Adjusting the allocation between different sub-sectors is just one tool that we have available to us," says Urdmark. The team running Rhenman's healthcare fund can also adjust the gross and net equity exposure as market conditions change. "When the Ukraine war started last February, we decided to lower our gross and net exposure because we were not sure what was going to happen," recalls Henrik Rhenman, the founder of Rhenman & Partners. "It was genuine uncertainty and we have not come out of that somewhat more cautious positioning."

"We reduced our exposure, not because of the implications of the war itself on the broader economy, but because the war broke out in the early stages of a broad-based recovery that was hindered by inflation and interest rates," explains Rhenman. "As long as we are not super convinced that we have a full recovery, we will continue to maintain a more cautious stance with a lower exposure." The team, however, is on the lookout for signs of improving market conditions to re-position the portfolio. "You certainly want inflation down! As inflation comes down, interest rates go down, equity premiums go down, growth prospects go up and financing issues become more predictable."

LEARNINGS FROM COVID-YEARS AND MOST EXITING AREAS

From a top-down perspective, the long-term drivers that have supported the healthcare sector over decades – aging populations, growing spending on healthcare, and technological innovations – remain largely unchanged. The coronavirus pandemic, in particular, proved the ability of the healthcare sector to innovate and create value for society and investors. "We always knew that there was this room for innovation in the healthcare industry," says Susanna Urdmark. "What surprised us was the speed by which that innovation happened with the speedy development of the vaccines, the antivirals, and other therapies that helped patients."

"Perhaps an even greater achievement was the fact that these companies could maintain focus on the other development programs as well," emphasizes Urdmark. "All other development programs did not come to a complete stop when the focus was put on developing treatments needed to deal with the acute situation coming from the pandemic," she elaborates.

One area of the healthcare sector that experienced a huge leap of innovation in recent years has been obesity treatment. Eli Lilly, Amgen, and Pfizer are just some of the companies aiming to compete with Danish insulin producer Novo Nordisk in a new generation of weight-loss drugs. "We have about ten percent of the fund's exposure towards obesity treatment," points out Rhenman.

"Since the beginning of the year, we have told our investors that this is the year we should keep our eyes on what is going on in obesity and Alzheimer's as several new launches are lined up in these areas," says Urdmark. Obesity treatment, for instance, has a huge addressable market "with a great medical need, very few treatment options in existence, and an abundance of new clinical data that will be presented throughout the year," she elaborates. The obesity treatment market is expected to grow from a $2.4 billion category in 2022 to $54 billion by 2030, according to Morgan Stanley Research. "We are very encouraged by the determination of the industry to continue to innovate even in the most difficult situations."

Hedge Funds Find Their Place in Finnish Institutional Portfolios

By Eugeniu Guzun – HedgeNordic

Mika Jaatinen, Portfolio Manager of Hedge Fund Investments – Elo

Kari Vatanen, CIO – Veritas

Markus Frosterus, senior portfolio manager focusing on hedge funds – Keva

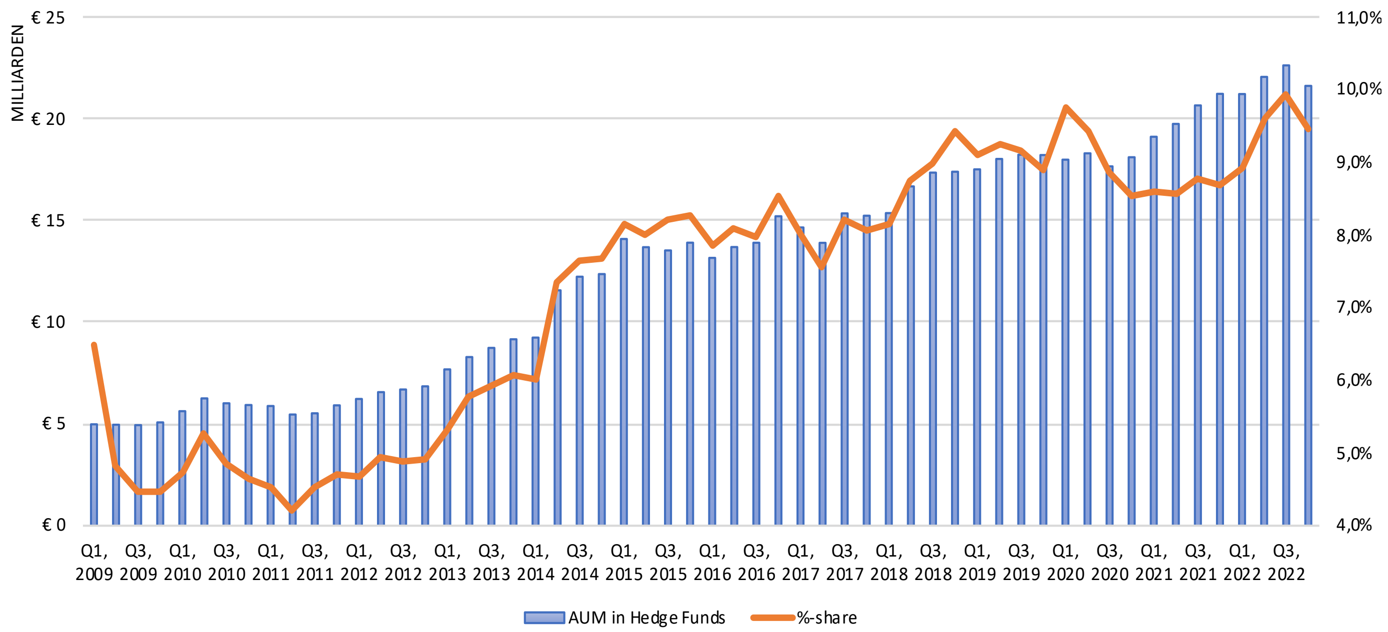
Institutional investors have increasingly shifted their portfolios to alternative asset classes such as hedge funds in the low interest-rate environment after the global financial crisis in the late 2000s. Finnish institutional investors, in particular, have found more space in their portfolios for hedge fund investments.

Data collected by the Finnish Pension Alliance TELA, which gives a good overview of the Finnish pension landscape, shows that hedge fund allocations have steadily increased since 2009 in a group of six of the largest institutional investors in Finland. At the end of 2009, the group – represented by Elo (born in 2014 with the merger of LocalTapiola Pension and Pension Fennia), Ilmarinen, Varma, Veritas, Keva, and the State Pension Fund of Finland – had €5.1 billion or 4.5 percent of their total investments of €113.9 billion allocated to hedge funds. 13 years later, this number nearly doubled. By the end of 2022 the group collectively held €21.6 billion or 9.5 percent out of their total investments of €228.7 billion in hedge funds.

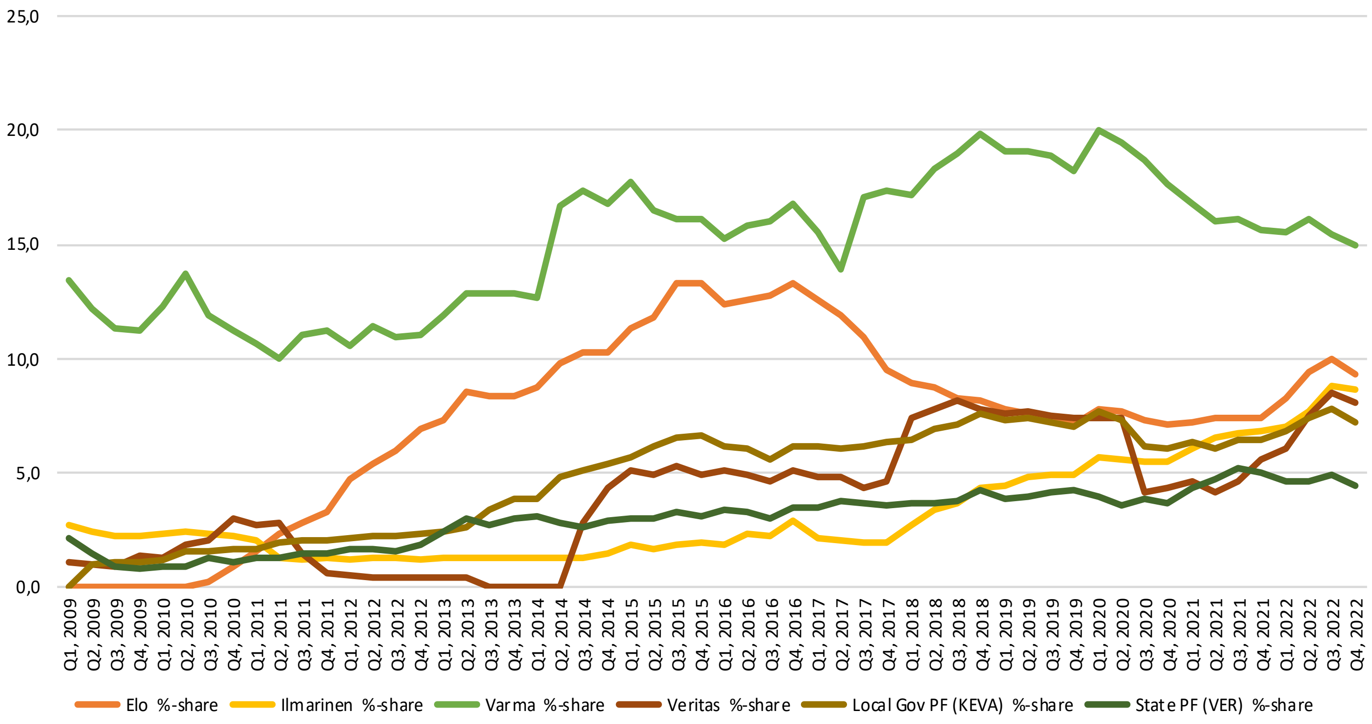
"Hedge funds and other alternative asset classes have been used as diversifiers in the portfolio construction," Veritas CIO Kari Vatanen explains the increasing exposure to hedge funds and alternatives among Finnish institutional investors. "There has been a tendency to move from the traditional equity/bond portfolio towards an endowment model type of asset allocation where alternative assets have a significant role in the portfolio," he elaborates. One reason for this tendency has been a long period of low and even negative interest rates. "High-quality bonds have offered neither yield nor diversification to the equity markets."

Alternative asset classes, including hedge funds, have been seen and used as a good replacement for bonds with positive expected return and some

Hedge Fund Allocations among Finnish Institutional Investors



Hedge Fund Allocations Among Finnish Institutional Investors



diversification benefits, according to Vatanen. "Allocations to hedge funds have increased among Finnish pension funds in recent years, but the same also applies to other alternative asset classes like real estate, private equity, private debt, for example," agrees Mika Jaatinen, Portfolio Manager of Hedge Fund Investments at Elo. "This all is happening as organizations try to achieve more diversification in a market environment where correlations between stocks and bonds are turning from negative to positive."

The appeal of hedge funds reflects the search for additional and diversifying return streams, according to Jaatinen. "Hedge fund portfolios have diversified risks in pension fund portfolios in a negative yield environment," he explains. "Hedge funds are typically seen as ways to diversify overall allocation/return streams and to gain exposure to investment strategies that are difficult to execute in-house."

Markus Frosterus, senior portfolio manager focusing on hedge funds at Keva, corroborates Jaatinen's view. "Overall, one explaining factor for growing allocations to hedge funds is that they cover strategies and areas which are not internally managed by pension funds," says Frosterus. The appeal of hedge funds has increased in recent years due to their substitute role for low-yielding fixed income, so what does the future hold for the industry?

ARE HEDGE FUNDS STILL ATTRACTIVE?

"Hedge funds have worked as an alternative for bonds or fixed income instruments, so their attractiveness in the future is dependent on their expected and even realized return compared to the bonds," argues Kari Vatanen of Veritas. "After the massive increase in market rates, return expectations for fixed income instruments have risen significantly, which means that the relative attractiveness of alternatives and hedge funds as well might be lower than a year ago," he elaborates. "Hedge funds can still provide diversification and even higher expected returns in the changed market environment, which makes them an essential element in the portfolio construction."

Markus Frosterus of Finland's largest pension fund Keva says that "hedge funds are to provide diversification and complement the traditional asset classes, as well as benefit from the occasional volatility spikes and market dislocations." Having a meaningful allocation to hedge funds should still be at the core of most institutional portfolios. "Hedge funds have a place in the portfolios which was shown last year," emphasizes Frosterus. The environment has been fertile for hedge fund managers in recent years and is expected to remain fertile going forward.

The Covid pandemic extended central banks' easing mode post the global financial crisis, which "both dampened certain opportunities and also induced dislocations that were difficult to catch by traditional asset classes," according to Frosterus. "Once the central banks turned around to tightening mode, there were attractive opportunities for credit-related funds, macro funds and CTAs, among others," he continues. Elo's Mika Jaatinen agrees with Frosterus, saying that "hedge funds have managed to perform as expected in the previous three years."

The improved performance stems from several factors such as "heightened level of market volatility, higher dispersion within various asset classes and revaluation of assets due to heightened level of rates and fear of inflation," according to Jaatinen. "All this plays well for most hedge fund strategies," he emphasizes. Jaatinen also expects this process of valuation discovery to continue for years to come, and expects hedge funds to benefit from a higher level of interest rates as well. "It means better opportunity set not just for asset allocators but to hedge funds as well."

Frosterus foresees a similarly bright outlook for hedge fund managers. "Various idiosyncratic opportunities seem to exist on the long and short side in corporate names, for instance, both on the equity and fixed-income side," says Frosterus. He also believes that "volatility will raise its head from time to time to expand the opportunity set." Similar to Jaatinen, Frosterus expects the cost of financing to stay at higher levels than people had been accustomed to, which can create pockets of opportunities for both fundamental and quantitative funds.

> "Hedge fund portfolios have diversified risks in pension fund portfolios in a negative yield environment."
>
> Mika Jaatinen

A PREFERENCE FOR INTERNATIONAL MANAGERS

Finnish institutional investors have significantly increased the amount of capital invested in hedge funds. One might have expected the Nordic hedge fund industry to receive a boost from these flows of capital to the hedge fund space. However, "there has been a tendency to use big established international hedge fund managers in the Finnish institutional portfolios," according to Kari Vatanen. "Local Nordic managers have stayed only as satellites to the core hedge fund portfolio."

Both Markus Frosterus of Keva and Mika Jaatinen of Elo argue that institutional investors compare funds side by side regardless of their country of origin. "We do not have any specific view on regional asset managers. We only have a view on individual funds themselves," says Jaatinen. Elo, for instance, looks for funds with solid risk management and sound operational set-up." Finnish investors have the possibility to invest in the best funds globally, according to Jaatinen, so there is no immediate need to focus on the local industry. "Overall Finnish investors are quite professional in hedge fund investing and they have long experience and good relationships with many hedge funds."

"This is perhaps not fair for start-ups, but due to the fiduciary duties and being a bigger institutional investor, there is typically a need for the potential funds to have a certain level of assets under management and track record with top-notch operational and investment functions, among other things," explains Frosterus. Vatanen agrees, saying that "there is also a lot of potential reputation risk for an institutional investor embedded to the hedge fund portfolio, which makes it important to select fund managers carefully and do the DD with care."

While Sweden can boast about building Europe's second-largest hedge fund industry in terms of assets under management, Finland represents the Nordic region's smallest hedge fund market. "One factor is perhaps the lack of culture and relatively high business hurdles of establishing hedge funds in Finland," explains Frosterus. "Talent pool wise, there are very good Finnish portfolio managers and analysts," emphasizes Keva's portfolio manager. "But they are typically hired by foreign hedge funds and other investment industries." Finnish institutional investors still get exposure to Nordic talent. "We are invested with some international hedge funds that have portfolio managers of Nordic origin in an executive role," says Elo's Jaatinen.

"Hedge funds represent highly actively managed funds, where the selection of the right managers is essential in the portfolio construction process," concludes Kari Vatanen. There is a lot of dispersion between different strategies and funds within each sub-strategy, so successful hedge fund investing is "not just about picking the right strategy but also the right funds within it," according to Frosterus. "Making profitable investments is never easy and markets are more than eager to correct the 'free lunches.'"

> "Hedge funds are to provide diversification and complement the traditional asset classes, as well as benefit from the occasional volatility spikes and market dislocations."
>
> Markus Frosterus

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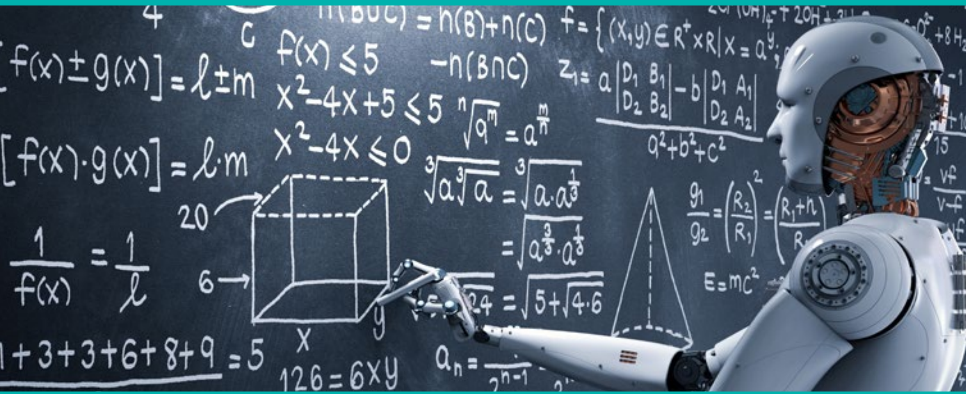

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