JUNE 2018

HEDGENORDIC

Gustav Karner

Hedge funds – The right medicine for Swedish pharmacy pension foundation

Sustainability in Hedge Funds

Approaches and Challenges of ESG implementation

AP1 Breaking with Traditions:

The abolition of alternative buckets

In Focus:

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NORDIC HEDGE FUND INDUSTRY REPORT - Q2/2018

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HEDGENORDIC

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.

NordSIP is a leading news website focused on Sustainable Investment viewed from the Nordics.

The site brings together institutional investors, fund managers and third party service providers concerned with ESG. News, opinions, interviews and analysis are provided are showcased on a daily basis.

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The Editor...

Midsummer gets in the way, you know...

Midsummer is a very natural cut off day when doing business in the Nordics. You can sense the rush and eagerness, of how people try to cramp as much as they possibly can into their agendas Swedes, while at the same time are very reluctant o take on new projects, or even want to consider anything down that line. Swedes, for instance, somewhere around mid-May suggest you get together again "after the summer", which to them is likely mid September. In all this crowededness then, not only does the football world cup get underway, but also HedgeNordic comes along and tries to get a publication out in tight deadlines.

On the first pages of the report, we made an effort to dissect to the Nordic hedge fund space and present data, numbers, some facts and fiction we hoped you´d find relevant. We especially looked at assets under management among the Nordic managers and re-introduce NHX-AGI, the Asset Growth Index to the Nordic Hedge Index family.

Likely the largest single manager fund in the Nordic region now is IPM Systematic Macro, who, to our calculations, took over that distinction from Lynx. We are pleased to therefor be able to have also interviewed the funds portfolio managers Björn Österberg and Mattias Jansson on the success of their fund.

Just a few days ago, the largest independent Norwegian Asset Manager, Sector Asset Management, hosted their annual investor day in Oslo. As always, the event was worth the trip and next to getting insights into the firms funds and strategies, delivered plenty food for thought through their guest speaker line up. In the light of that, we are pleased to have had the possibility to interview one of the founding partners and CEO, Wollert Hvide, on the firms strategy which we are happy to share in this publication.

With Martin Källström at AP1 and Gustav Karner of the pension foundation for the Swedish state-owned pharmacy retailer Apoteket we talk to two of the most recognised individuals in the Swedish institutional allocator space who seemingly are taking very different approaches in their dealings with hedge funds.

When prizes were handed out at the Nordic Hedge Award in April, Rhenman and Partners managed to take home trophies in four categories. We interviewed the two portfolio managers, Henrik Rhenman and Susanna Urdmark for this magazine and want to learn how long this run in pharmaceuticals can last.

In our "in focus" series, we take a deeper look at equity market neutral strategies and different approaches there. Edinburgh based Kames Capital, UBP from Geneva and Amundi from Paris share their views.

And, as we have had in previous publications will also be highlight various aspects and views on sustainable investing with an emphasis on the alternative investment and hedge fund space.

As always though, there is much, much more on the following pages for you to find out. So, hoping you have a great read, best wishes, and looking forward to catch up after the summer!

Kamran Ghalitschi
CEO & Publisher HedgeNordic

by Eugeniu Guzun– HedgeNordic

NHX ASSET GROWTH INDEX - NORDIC HEDGE FUND INDUSTRY ASSETS GROWTH

Though relatively small, of course, in a global context there are a couple of Nordic-based hedge funds with large assets under management (AuM) that can compete with international behemoths (at least in terms of size). The Nordic hedge fund universe currently consists of six hedge funds with capital over the 1 billion-Euro mark, but the vast majority manages up to 200 million Euro in capital. A total of 64 out of the 91 hedge funds that reported AuM data for April 2018 manage less than 200 million Euro in AuM, with 34 of these funds managing less than 50 million Euro.

The just-mentioned figures point out the hurdles we needed to overcome to design an index that accurately measures the development of the assets under management managed by the entire Nordic hedge fund industry. After all, if the assets under management of Brummer Multi-Strategy, the largest hedge fund player in the Nordics with €3.65 billion in capital as of the end of April 2018, would decrease by 5 percent in a given month, the monetary-amount decrease may well offset much of the combined increase in assets enjoyed by smaller players in the industry. For that reason, HedgeNordic has been calculating and publishing an index computed using an equally-weighted indexed-based compounding methodology, namely the NHX Asset Growth Index - NHX AGI.

The NHX AGI Index currently contains 15 hedge funds, which have combined assets under management of

COMBINED AUM OF THE 15 NHX AGI MEMBERS AND NHX AGI PERFORMANCE

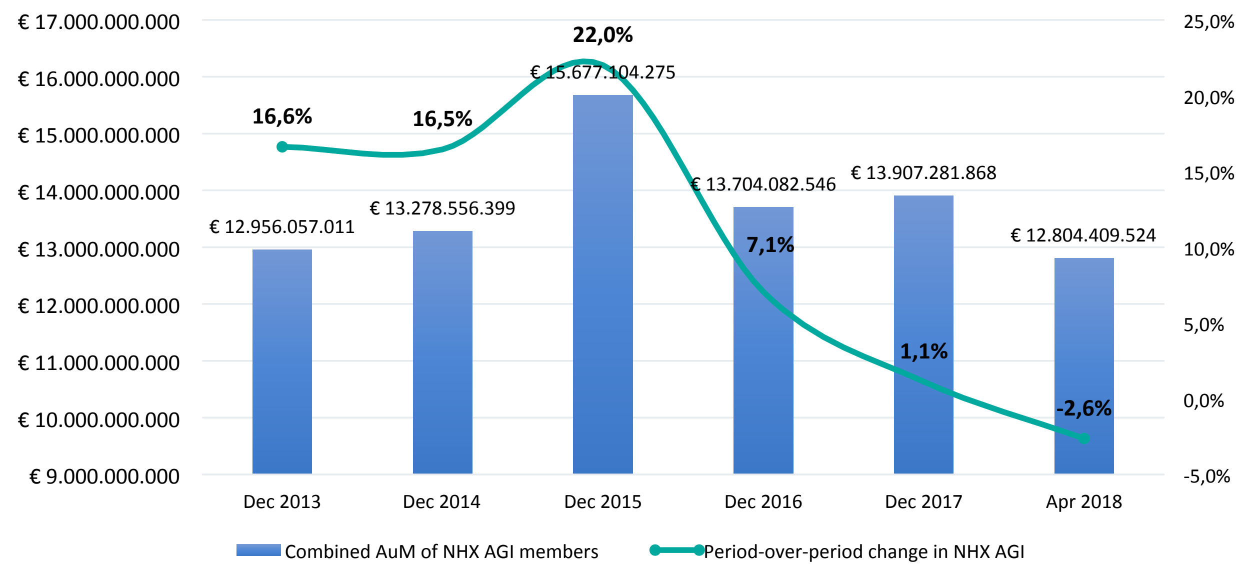

Figure 1. Combined assets under management of the 15 NHX AGI members and NHX AGI performance. Data is based on the 15 members of the NHX AGI Index. Source: HedgeNordic.

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€12.80 billion as of the end of April 2018. This figure constitutes approximately 55.4 percent of the combined assets managed by the 91 hedge funds that reported AuM figures for the month of April. The collective assets of the 15 members of the NHX AGI peaked at €15.68 billion at the end of December 2015 before dropping by €1.97 billion during the following 12 months to €13.70 billion at the end of 2016. The assets managed by these 15 hedge funds dropped by €1.10 billion in the first four months of 2018 from the figure of €13.91 billion recorded at the end of December 2017. Much of the decrease is attributable to declines in the capital managed by Brummer & Partners-backed Nektar, Excalibur, and Brummer Multi-Strategy.

STRUCTURE OF THE NORDIC HEDGE FUND INDUSTRY

The majority of the Nordic hedge fund industry comprises small-sized funds, with a little more than one-third (around 37 percent) of the 91 hedge funds with reported assets under management data for April holding assets of less than €50 million. On average, the 34 small-sized hedge funds manage €19.66 million in capital, with older funds of more than five years old holding assets of €26.96 million on average. From the pool of smaller-sized funds, mid-age hedge funds with an operating life between two and five years manage €14.33 million in assets on average. According to Figure 2, a total of 14 hedge funds of the 91 funds manage between €50 and €100 million in assets as of the end of April 2018, while 14 funds hold between €100 and €150 million in assets. As mentioned above, six Nordic hedge funds manage more than €1 billion in assets and there is a total of eight funds managing between €500 million and €1 billion.

NUMBER OF HEDGE FUNDS BY ASSETS UNDER MANAGEMENT (AS OF 30 APRIL 2018)

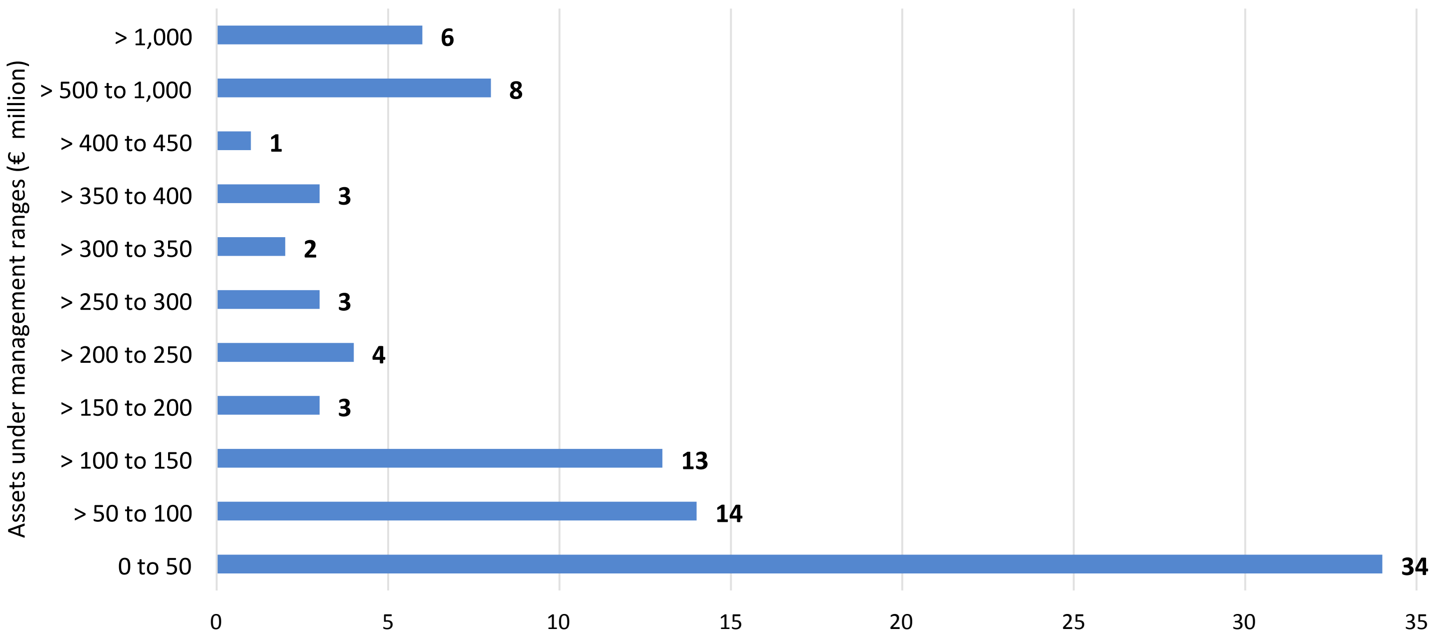


Figure 2. Number of Nordic hedge funds by assets under management. Data is based on 91 of the 162 hedge funds included in the NHX with reported assets under management data as at 30 April 2018. Source: HedgeNordic.

RELATION BETWEEN HEDGE FUND SIZE AND PERFORMANCE

Some past research studies find that small hedge funds tend to underperform larger funds on average due to higher total expense ratios. The performance of Nordic hedge fund players in the past 12 months represents one tiny piece of evidence confirming that finding. For instance, the 27 Nordic hedge funds with assets of more than €200 million as of the end of April 2018 enjoyed an average 12-month return of 4.26 percent. Meanwhile, the 34 hedge funds with less than €50 million in capital had an average return of 1.16 percent for the past 12 months, whereas the 30 funds with assets in the range of €50 and €200 million recorded an average 12-month return of 1.95 percent. The remaining 71 NHX members with no reported AuM data for April had an average 12-month return of -0.05 percent. One should note, however, that these statistics represent a one-year snapshot and a more in-depth analysis may be warranted to reach accurate conclusions.

PERFORMANCE COMPARISON BETWEEN NHX SUB-CATEGORIES, CUMULATIVE RETURNS

Hedge fund age	Number of funds	Average AuM as of April 2018	Average 12-month return	Average 12-month correlation	Average return in 2018
Hedge Funds: Large (>€200 million)					
Under 2 years	na	na	na	na	na
2 – 5 years	13	463,838,281	3.75	0.26	0.03
Over 5 years	14	938,480,756	4.74	0.19	2.25
Total	27	709,949,194	4.26	0.22	1.18
Hedge Funds: Medium (€50 million - €200 million)					
Under 2 years	7	109,544,267	0.14	0.33	0.44
2 – 5 years	13	115,062,431	2.20	0.31	-0.57
Over 5 years	10	99,557,289	1.81	0.24	0.25
Total	30	108,606,479	1.95	0.29	-0.06
Hedge Funds: Small (<€50 million)					
Under 2 years	1	6,149,480	na	0.24	6.32
2 – 5 years	18	14,325,332	2.91	0.25	2.96
Over 5 years	15	26,963,684	-0.94	0.36	-0.32
Total	34	19,660,609	1.16	0.30	1.61
Hedge Funds: No AuM for April 2018					
Under 2 years	8	na	2.04	0.10	-0.68
2 – 5 years	47	na	-0.76	0.24	-0.92
Over 5 years	16	na	1.39	0.24	-0.43
Total	71	na	-0.05	0.23	-0.78

Figure 3. Average assets under management, average 12-month and year-to-date returns by hedge fund size and hedge fund age. Source: HedgeNordic.

Older and larger Nordic hedge funds also performed strongly in the first five months of 2018, with the 14 old and large hedge funds having returned 2.25 percent on average year-to-date. Mid-age small-sized hedge funds performed even better year-to-date, as the group of 18 such funds gained 2.96 percent on average in the first five months of the year. The 71 hedge fund vehicles with no reported AuM data in our database for April were down 0.78 percent on average year-to-date. In addition, medium-sized hedge funds were also down so far in 2018, with the 30 medium-sized funds having returned a negative 0.06 percent in the first five months of the year.

Figure 3 also shows that the older hedge funds among the large vehicles in the Nordic industry manage a lot more assets on average. From the pool of those 27 large hedge funds with reported AuM data, funds operating for five years or longer manage €938.48 million in assets on average, whereas younger funds manage a much lower average figure of €463.84 million. One interesting observation is that older medium-sized hedge funds manage less assets than younger funds. For instance, old medium-sized hedge funds hold €99.56 million in assets on average, while mid-age medium-sized funds manage a larger average figure of €115.06 million.

As shown in Figure 4, the percentage of large and medium-sized Nordic hedge funds with losses greater than 5 percent in the past 12 months was lower than the percentage of small hedge funds with losses of such magnitude. In fact, there was only one large hedge fund with a 12-month loss of more than 10 percent. Meanwhile, the number of small hedge funds with negative 12-month returns of more than 10 percent reached a total of four. In addition, there were no medium-sized hedge funds with a negative 12-month return of more than 10 percent and there was only one medium-sized fund with a 12-month loss of more than 5 percent. Moreover, two large hedge funds have a 12-month return of more than 30 percent, accounting for roughly 7 percent of the number of large funds. Meanwhile, approximately 9 percent of small hedge funds enjoyed returns above 15 percent in the past 12 months.

DISTRIBUTION OF 12-MONTH CUMULATIVE RETURNS BY FUND SIZE

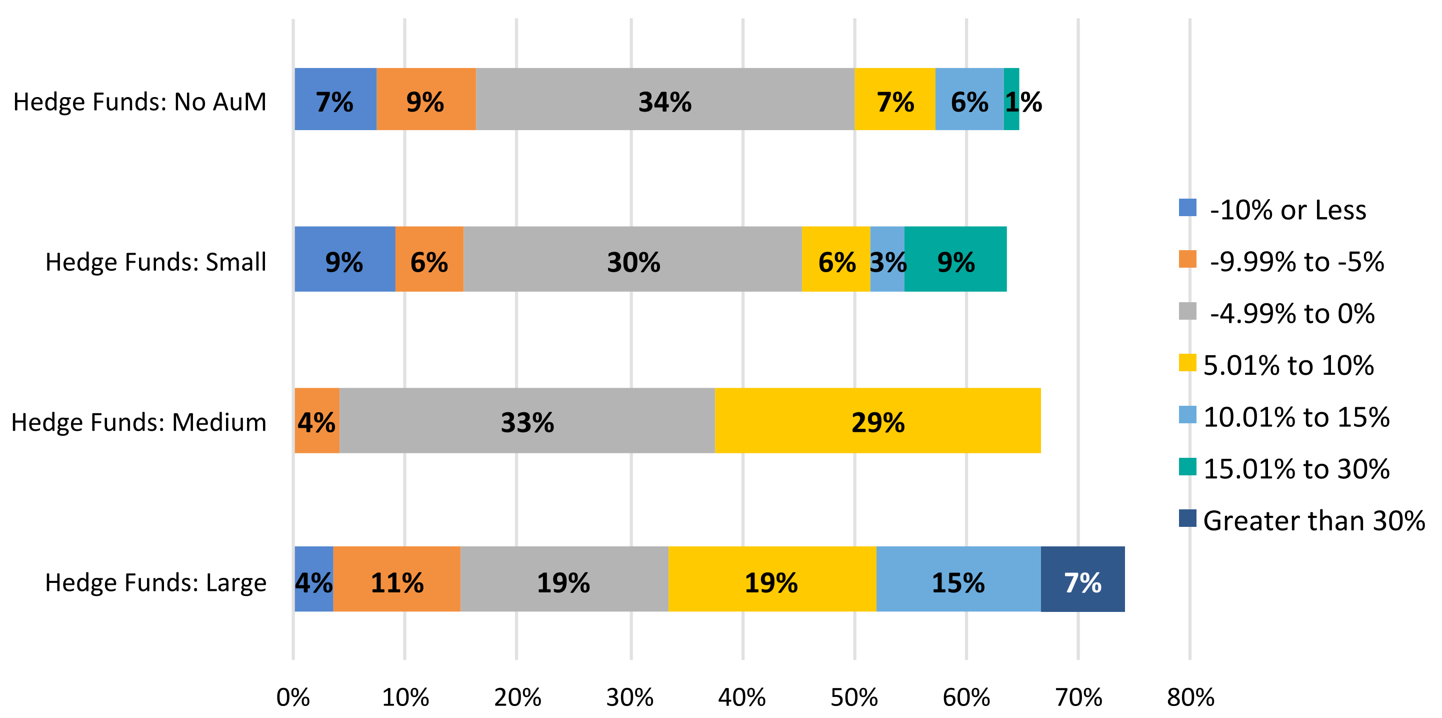


Figure 4: Distribution of 12-month cumulative returns by fund size. Data is based on 91 of the 162 hedge funds included in the NHX with reported assets under management data as at 30 April 2018. Source: HedgeNordic.

Key Facts at a Glance: Assets Under Management Statistics

FIGURES AND DATA BELOW ARE DRAWN FROM THE HEDGENORDIC DATABSE COVERING THE CONSTITUENTS OF THE NORDIC HEDGE INDEX. DATA IS BASED ON 91 OF THE 162 HEDGE FUNDS INCLUDED IN THE NHX WITH REPORTED ASSETS UNDER MANAGEMENT DATA AS OF 30 APRIL 2018.

Hedge Hund Assets by Country

Country	AuM - April 2018	# of funds	Rep. AuM
Sweden	15.3 Bn	98	49%
Norway	927.8 Mn	18	44%
Denmark	6.0 Bn	27	93%
Finland	901.6 Mn	19	53%

Largest "Old" Hedge Fund (> 5 Years)

Brummer Multi-Strategy
SEK 38.62 Billion ~ 3.65 Billion

As of 30 April, 2018

As of December 29, 2017

Hedge Hund Assets by NHX Category

NHX Category	AuM - April 2018	# of funds	Rep. AuM
Equities	4.0 Bn	59	53%
CTA	3.2 Bn	25	88%
Fixed Income	6.0 Bn	23	22%
Multi-Strategy	6.2 Bn	20	50%
Fund of Funds	3.8 Bn	35	66%

Largest "Mid-Age" Hedge Fund (2 - 5 Years)

Nordkinn Fixed Income Macro Fund
SEK 11.24 Billion ~ 1.06 Billion

As of 30 April, 2018

Largest Nordic Hedge Funds by AuM

Fund name	AuM - April 2018
Brummer Multi-Strategy	3.65 Bn
Nektar	2.07 Bn
SEB Asset Selection	1.36 Bn
DI Hedge Fixed Income	1.08 Bn
Nordkinn Fixed Income Macro	1.06 Bn

Largest "Young" Hedge Fund (< 2 Years)

SEB Eureka Fixed Income Relative Value
DKK 1.07 Billion ~ 144.24 Million
As of 30 April, 2018

As of December 29, 2017

1/2 List of NHX AGI Members

1. Adrigo Fund
2. Asgard Fixed Income Fund
3. Brummer Multi-Strategy
4. Catella Hedgefond
5. Danske Invest Hedge Fixed Income
6. Estlander & Partners Alpha Trend
7. Excalibur

Biggest 28-Month AuM Gainers in NHX AGI

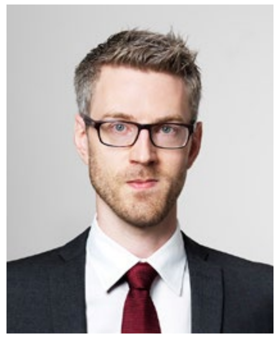
Fund name	28-m Change
IPM Systematic Macro Fund	207%
PriorNilsson Yield	192%
Gladiator Fond	135%
Asgard Fixed Income Fund	38%
Midgard Fixed Income Fund	22%

2/2 List of NHX AGI Members

8. Gladiator Fond
9. IPM Systematic Macro Fund
10. Lynx (Sweden)
11. Midgard Fixed Income Fund
12. Nektar
13. Nordic Alpha plc
14. PriorNilsson Yield
15. SEB Asset Selection

"I have seen a number of calls insisting that the SEK is a screaming buy and that the Riksbank must soon raise rates due to Sweden's strong GDP growth."

BJÖRN ÖSTERBERG



MATTIAS JANSSON

IPM Relishes Return of Volatility

By Hamlin Lovell – HedgeNordic

For the past 10 years, IPM has been outperforming the average global macro or CTA manager, while showing no meaningful correlation to either – nor indeed to hedge funds in general, nor conventional asset classes. IPM has also performed well ahead of most systematic macro managers, as measured by Societe Generale's SG Quantitative Macro index.

As IPM marks its 20th anniversary, absolute performance has also picked up dramatically. In the first four months of 2018, IPM's systematic, fundamental macro strategy is up 7.4% in USD. This is already close to the strategy's average annualised returns of 8.6% since July 2006, while volatility of 10.9% has undershot the 15% strategic target. Some 5% of the 2018 return usefully came in the month of February, when IPM's models were well positioned for the market action around the explosion of volatility.

IPM does not trade volatility as an asset class, but has often done well during risk-off episodes. The strategy's best year was 2008 when it gained 30.9%, though its worst year, down 8.1% in 2011, did coincide with the European crisis.

Markets & Performance Contributors

In 2018, IPM has profited mainly from some big moves in developed market currencies. A contrarian short Swedish Krona position was profitable. "I have seen a number of calls insisting that the SEK is a screaming buy and that the Riksbank must soon raise rates due to Sweden's strong GDP growth." IPM's CIO and Head of Research, Björn Österberg, says "the SEK is very undervalued according to classic measures, and we have the impression that it also is a consensus long, with many fundamental managers expecting mean reversion. But in our models, the negative views based on macroeconomics, risk premia and market dynamics generate signals leading to a short stance versus a basket of currencies". Similarly, IPM's models identify the USD as being overvalued, but once again the risk premia and market dynamics models generate a long position. IPM was also profiting from long of the Japanese Yen. "We were more neutral on valuation

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for the Yen, but macro and flow dynamics were positive" explains Österberg, who leads an investment team of 14. A short Swiss Franc position also did well, despite a temporary setback in February. IPM's models digest the data without preconceived views on how particular assets should perform in particular market regimes. "IPM prefers to use the same models for all currencies, and does not classify them as "commodity currencies" or "safe haven" currencies" explains Deputy CIO, Mattias Jansson.

Some managers maintain steady weights in each asset class, but IPM's multiple model signals dynamically adjust its allocations to its three asset classes: currencies, government bonds, and equity indices. "The weighting in relative value bonds has been below its strategic target for some time, as the model generally has identified fewer opportunities in the space . Signals were weak, or offset one another" says Jansson. Now the RV bond bucket has started showing signs of growing, as outlooks have become increasingly negative in the US (pointing to a short Treasury position) vs. German bunds.

In relative value equities, longs in Italy and Spain are based on low valuations and attractive risk premia, while a short in the US is also partly based on valuation. This spread trade has seen losses as of recent. (IPM's long-only smart beta equities programme, running $3.3 billion, has a significant value sleeve and some similar positioning).

With 85% of the strategic risk budget in the four relative value strategies (developed FX, emerging FX, bonds and equities) IPM's directional sub-strategy only has 15% of the strategic risk budget. Its biggest position is now short equities, having cut and reversed from long stance. "Though the risk premium remains attractive, valuation and sentiment models lead to a short" says Jansson.

In emerging currencies, the long Turkish Lira position has lost money, even after its strong recovery when interest rates were hiked in May, but the EMFX relative value book is only 10% of the risk budget against 30% for the developed FX relative value book. Elsewhere in EMFX, longs in the Mexican Peso, and shorts in the Brazilian Real and Indian Rupee, have been profitable.

Market liquidity

IPM started trading EM FX in 2013, and has not added any markets to its investment universe since then. Whereas some systematic and quantitative managers are adding dozens of exotic and esoteric markets each year, such as commodities on Chinese exchanges and various emerging market interest rates, IPM does not trade commodities and only trades the most liquid asset class – currencies – in emerging markets. IPM's universe remains more plain vanilla and has even been scaled back in recent years. "We stopped trading Swedish Government debt in 2016 after changes in market structure in addition to generally insufficient liquidity (and the Swiss government bond market is even less liquid than Sweden's)" says Österberg. In European fixed income, IPM trades only UK Gilts and German Bunds, because other markets are not judged to be liquid enough for its style of trading and for risk-weighted assets of USD 5.5 billion in the systematic macro strategy. Liquidity is monitored by the Risk Management Committee and the independent Chief Risk Officer, Elisabeth Frayon.

If the investment universe has been pretty constant for five years, what does change, albeit incrementally, are IPM's models. Each year, two or three concepts can be added with others refined or updated. "We are trying to extend models, researching volatility as well as additional dimensions in the fixed income space"" says Österberg. Recently, risk premia and market dynamics have been the greatest thematic contributors to returns. Over time however, a majority of profits have come from the two forward-looking, themes: market dynamics and macro models.

The strategy is typically sitting on cash of 80%, which is now earning a positive return for the USD share class, which is a little higher than the 1.5% management fee. This interest does not generate performance fees for IPM however, because the hurdle rate under performance fees is three-month Treasury bills. The Swedish Krona, Euro and Swiss Franc share classes are still, of course, seeing negative carry on cash balances.

As Morgan Stanley FundLogic is discontinuing its services to external managers, IPM is setting up its own Irish UCITS structure, into which investors should be seamlessly migrated by year end. "We had a great collaboration with Morgan Stanley, but now that assets have reached $1.7 billion, we do not need a platform" says Patrik Blomdahl, Director of Investment Strategy.

> "We are trying to extend models, researching volatility as well as additional dimensions in the fixed income space."

MARTIN KÄLLSTRÖM

HEAD OF ALTERNATIVE INVESTMENTS AT FÖRSTA AP-FONDEN (AP1)

Breaking with tradition:

The abolition of alternative buckets

By Aline Reichenberg Gustafsson, CFA – HedgeNordic

As the Swedish State-led pension fund AP1 is overhauling its approach to alternative investment allocation, HedgeNordic caught up with Martin Källström, who heads the team behind the fund's alternative investments mandate. He explained the idea behind the allocation strategy's evolution and made some critical points about what it means for AP1's alternative manager selection going forward.

"AP1 has been investing in hedge funds since 2012, and the allocation has been proximately five percent of the fund's assets," Källström reminds us. "So far, the purpose of this allocation was to help diversify our risk and to generate protective returns during market drawdowns. While we had a dominant tilt towards systematic strategies, such as CTAs, we have always had an exposure to a wide range of strategies. All the funds we have invested in have a point in common: their lack of correlation with the rest of the portfolio."

Diving into the actual transformation, Källström explains why his fund intends to replace some of the hedge fund exposure by a quantitative overlay on the fund's assets. "Firstly, we have decided to in-source part of what we used to allocate to hedge funds, in particular, to some of the trend following and alternative risk premia strategies. Just to be clear, it doesn't mean that we believe we can generate better returns than CTAs. We apply an in-house quantitative process that should be seen as a pure overlay to our overall portfolio. It is very efficient from a cost of capital perspective, as it requires no actual capital allocation. We will also save on the management fees we pay today. It is a way for us to allocate more risk exposure to diversifying strategies to a lower cost."

> "We have decided to in-source part of what we used to allocate to hedge funds, in particular, to some of the trend following and alternative risk premia strategies."

Given this reallocation, some managers will see the investment in their fund decrease, particularly in the trend following segment, but it doesn't mean

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that Källström and his team were disappointed with the strategies as such. "To the contrary," he says, "we are looking to increase the impact of these types of strategies on our overall portfolio, but in a way that is more efficient for a diversified fund like ours. This will also allow us to refocus our hedge fund portfolio, as we can deploy the capital to gain exposure in new areas."

"A traditional method for asset allocation that several institutions tend to employ is to define well delineated, and sometimes narrow buckets," Källström continues. "With such a system in place, some investment opportunities that don't fit in any given bucket will often be overlooked. We have also experienced this problem in the past. This is why we have now constructed a mandate that is very broad, but with a very specific objective: to generate idiosyncratic returns for the fund."

> "AP1 is taking an entirely new approach to evaluating the cost of capital, not only for the systematic strategies but also for the rest of the hedge fund portfolio."

A few constraints remain of course, due to the legal requirements bestowed upon the AP funds, in particular when it comes to liquidity. "Within the rules, we aim to have as broad a mandate as possible." To make it even more flexible, AP1 is taking an entirely new approach to evaluating the cost of capital, not only for the systematic strategies but also for the rest of the hedge fund portfolio. Källström explains the transition: "Until now, we basically took money from another asset class to allocate to hedge funds, and typically that meant we sold part of our equity portfolio. Our goal is to generate uncorrelated returns, and the cost of that capital is the equity returns that we miss while allocated to hedge funds." To remedy that issue, many institutions set a minimum return, or risk target for hedge fund strategies, which keeps their hedge fund bucket from accessing low-volatility strategies. Risk-adjusted performance may be high and decorrelated, but in absolute terms, the return may still not compensate the internal cost of capital, which is often set to match the expected return on equities.

To increase the flexibility of its hedge fund mandate, AP1 will now be taking an internal loan to finance the hedge fund allocation with a much lower cost of capital. "We can sell equities for example," explains Källström, "while retaining the exposure to the equity market through swaps or futures synthetically. With such a method, the funding cost is not higher than LIBOR. The mandate thus needs to, over time, generate returns that are in excess of LIBOR."

Meanwhile, Källström is not particularly concerned about the idea of taking on a moderate amount of leverage. "We believe that this method will not lead to a materially higher level of risk for the fund. To a certain extent, it may add to our tail risk as correlations can spike in times of crisis. We could suffer increased losses during these times, due to this phenomenon. But given our very long time horizon, we are not exposed to margin calls or even redemptions." The pension fund is unlikely to be in a position to realise losses under challenging times due to external factors and, given the uncorrelated nature of the hedge fund mandate, overall returns are expected to be higher over time.

"We believe this to be a very efficient financing for an exposure such as this one. We create an internal loan construction, so that we are able to choose the asset class where the synthetic exposure presents the most attractive cost." Källström describes the way AP1 views its portfolio construction. The fund is composed of three traditional asset classes: equities (public and private), fixed income and real assets (such as real estate, infrastructure and farmland). And on top come what Källström calls the overlays: tactical asset allocation, currency risk management, alternative risk premia, and idiosyncratic alternative investments. This is where the revolution lies.

Another soft criterion for the new mandate is that the manager should show expertise in an area that cannot easily be replicated in traditional markets, or using alternative risk premia. "The strategy has to exhibit alpha return streams that we can't obtain ourselves, even if we have expertise in the same asset class. It could also be an asset class we can't directly tap into, at least not at the moment. For example, we are looking into insurance-related strategies and parts of the credit market, such as aircraft leasing, or the royalty market."

The transition period has just started and will be completed within the time needed to exit some positions and complete the necessary due diligence process for new ones. "We have already worked extensively on selecting the managers that we will continue working with and those we will not. We have also conducted extensive due diligence processes on a shortlist we have identified.We are now about to start adding new managers to our portfolio," comments Källström.

While Källström does not disclose exactly which strategies his team has set eyes on, he gives a general idea of what these new investments will look like. "Given our constraints, we can't invest in any drawdown funds (private equity-like structures). For implementation purposes, we are setting up managed accounts when it is possible, but we will now invest increasingly in commingled funds. We are focused on getting the most efficient implementation of our investments and that is a multi-dimensional challenge."

> "We are looking into insurance-related strategies and parts of the credit market, such as aircraft leasing, or the royalty market."

"More specifically," Källström continues, "the strategies we are currently looking at are artificial intelligence-focused managers, structured credit and other credit, strategies in the event space and some equity long/short (but it will not become a dominant part). We will keep some of the CTAs we have that are not into trend following, as well as some global macro as a tactical investment, but it won't be as important as it has been to date. Many of them are niche strategies, and they have identified an edge in the market. We also believe that there is often an inverted relationship between size and alpha opportunity, except for quant strategies, which often benefit from size. By definition, some managers have developed an edge in capacity constrained markets, and their advantage will disappear if they grow too large."

The new mandate does not come with a minimum size, and may even be open for seeding new strategies. "Our ability to seed new strategies has increased, but it doesn't mean that we won't require a lot from the manager. It is hard to say exactly what the hurdles will be. We will decide that on a case-by-case basis. But if we partner up at an early stage, we will look for a great opportunity regarding the setup as well. We will bring a lot to the manager and expect a lot in return." In general, of course, the matter of cost is not to be ignored. "We require cost-efficient structures and look at true alignment from all managers, not only through the fees but also concerning transparency and sound governance. We integrate ESG and sustainable investment practices in everything we do, and that is also part of the mandate."

It may seem like a radical shift, but today's strategic move is more an evolution than a revolution, according to Källström. "We have learned a lot over the past five years, and it is only natural that we strive to improve on a continuous basis. While we keep our fundamental investment beliefs firmly anchored, we constantly seek to perfect our approach in every asset class we work with. As such, this upcoming shift in hedge fund allocation can be seen as dramatic from one perspective, but it is also an evolutionary step."

About Första AP-fonden (AP1)

Första AP-fonden (AP1) is one of five buffer funds in the Swedish national income pension system. The capital reserves in the AP funds are used to cover the deficit when disbursements from the pension system exceed contributions to the system.

AP1 has assets under management of SEK 323 billion (at 30 June 2017) in a global portfolio consisting of equities, fixed income securities and alternative investments that include real estate, private equity funds and hedge funds. Första AP-fonden is a long-term investor and an active owner. In its role as owner, the Fund places high demands in the areas of environmental, social and corporate governance.

The Fund's mission is to manage the fund capital in such a way as to generate the greatest possible benefit for the pension system. This means that the Fund strives to deliver high long-term returns while maintaining a low level of risk for current and future pensioners.

The goal for Första AP-fonden's (AP1) asset management is to achieve an annual real return of 4.0 percent after expenses on the total portfolio measured over rolling ten-year periods. Every year, the performance of the AP Funds is evaluated by the Swedish Government and the results are presented in a communication to the Swedish Parliament.

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WOLLERT HVIDE
SECTOR ASSET MANAGEMENT

Diversification is the only free lunch

A Norwegian boutique approach

By Aline Reichenberg Gustafsson, CFA – HedgeNordic

Norway may be better known for its shipping and oil industries than for its hedge funds, but one Oslo-based hedge fund manager has put almost twenty years under its belt so far and is thriving more than ever. Sector Asset Management is now Norway's largest independent hedge fund platform with over US$ 2.25 billion under management. Six independent investment teams compose the offering of this multi-boutique platform, which specialises in high value-added, non-mainstream strategies. HedgeNordic sat down with Sector's CEO, Wollert Hvide to learn about the direction of the firm going forward, and most of all, find out what criteria Sector looks at when selecting new managers.

For Hvide the key to Sector's success relies entirely on its strategies, and therefore manager selection. "To be interesting," Hvide starts, "we need to see an attractive alpha opportunity. We specialise primarily in equity strategies, and in this asset class dispersion within a specific sector or area generates opportunities. We must also believe in a certain degree of predictability in that dispersion or put it differently a potential IC Information Coefficient. Expected return is

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the product of dispersion and Information Coefficient." To illustrate this idea, Hvide talks about the healthcare sector, where Sector Gamma (the investment manager for the Sector Healthcare Fund and Sector Healthcare Value Fund), one of the platform's most successful strategies, focuses on. "Healthcare is one of the sectors with the widest dispersion. If one standard deviation is 30 percent for example, then there is a 60% spread in stock price development between the corresponding stocks for a long/short manager who can identify those stocks, there is an opportunity to generate 60 percent of performance. Now, of course that's where the information coefficient comes into play, and that depends on the skill of the manager."

The art of manager selection goes beyond a simple magic formula. When a strategy seems to satisfy the equation, Hvide's scrutiny goes to the individuals behind the idea and their expertise. "People have to possess the experience and knowledge that fits the strategy," he says. "The specialists that are on Sector's platform today are highly focused and have an extraordinary skillset."

As Harry Markovitz said, "diversification is the only free lunch". Therefore, the universe in which the strategy operates must present a sufficient number of opportunities for the manager to be able to diversify adequately. "If a fund only has two or three bets at the time, if the manager is wrong, which will invariably happen, the risk of being wiped out is just too high," says Hvide. "Beyond that, we are also adamant about the need to follow a robust investment process. It has to run like a well-oiled sausage factory, where the team is able to perform the same type of analysis again and again. It starts with idea generation and follows into portfolio construction. There, we expect pre-trade risk analysis, a careful risk sizing and post-trade risk monitoring. On top, we supply an internal risk control which provides our investors with an assurance that the fund managers are delivering on the commitments they made in their mandates."

For Hvide, strict and sophisticated investment and risk management processes are necessary to meet institutional investors' high standards nowadays. "Sometime at the beginning of the noughties you could still get away with a small-band hedge fund, but today, managers need to be much more professional in every part of the process. In other words, we are unlikely to put people with a mere vision on the platform, those one trick ponies who think they have seen the light and will follow that until eternity."

"One of the reasons Norway does not have such a high penetration of hedge fund strategies into private investors' portfolios as in Sweden for example, is that these funds were only allowed for marketing as recently as 2011."

Given its core belief in dispersion and a high level of expertise, Sector is likely to look at strategies that are somewhat niche. "To deliver alpha, we must look in places where not everyone else is already looking," explains Hvide. "We are more likely to succeed if our universe is not the S&P 500. Large funds, who attract the best talent and have the most resources, are more likely to look at the large caps and markets with high capacity. That is going to be a really competitive environment. Instead, we look for strategies with smaller capacity which provide a higher probability of finding alpha."

Another competitive advantage that Sector possesses is one they can provide to investment teams: asset gathering and marketing. "When we call potential investors, it is not a cold call. We have been talking to hedge fund investors for almost twenty years, they usually pick up the phone to hear what we have to offer," says Hvide. At Sector, the investor base spans across the globe with a high proportion of international investors. Norway's fishing waters may so far not have proven particularly attractive for hedge fund managers. Outside Norges Bank Investment Management (NBIM), one of the worlds largest investors with a large investment capacity, but limited appetite for hedge funds, the Norwegian institutions are typically smaller in AUM, and the rest of the market is composed of family offices and high-net-worth individuals, which are often less familiar with hedge fund investing.

One of the reasons Norway does not have such a high penetration of hedge fund strategies into private investors' portfolios as in Sweden for example, is that these funds were only allowed for marketing as recently as 2011. "Currently, the Norwegian market for hedge funds is about one sixth of the Swedish market in terms of AUM. Even institutions investing in hedge funds are so few that we can count them on both hands," Hvide adds.

Hence three-quarters of the platform's assets come from beyond Norway´s shore, and as much as two thirds originate from outside the Nordics, remaining Europe and the US accounting for about a third, each. Every fund has a slightly different composition given their style. For instance, our market neutral strategies typically appeal to Swedish investors, which like to separate alpha from beta when selecting external managers."

The broad knowledge of investment preferences and Sector's worldwide contact network are essential tools when looking to launch new strategies. Sector does not have an internal fund of fund, and typically new strategies will be seeded with Day 1 capital from Sector's wide ranging network of investors. "We know the active seeders and institutions that are happy to be in early. We also understand their likes and needs".

Sector is evaluating new strategies to take onto the platform and currently two are market neutral strategies. "We are always looking for new talent who would be a value add to Oslo based platform, and which are attractive to our investor base."

Part of our advantage is that the investment community knows who we are, and that we are a solid platform. In 2000, it seemed like "two men and a dog" could raise assets but now solid infrastructure; risk management and compliance is required to attract institutional investors, which is the foundation of Sector's unique business model.

EQUITY MARKET NEUTRAL

Time for Cinderella to Party?

by **Hamlin Lovell** – HedgeNordic

After a nine-year bull market in equities, the perception is that valuations (at least in the US) are high, when looking at cyclically-adjusted measures (such as the Shiller CAPE) and US profits stand at record levels relative to GDP. Consequently, some investors want to de-risk portfolios by reducing equity beta. The return to more normal historical levels of equity market volatility seen in early 2018 also makes equities less appealing on a risk-adjusted basis. Some economists also expect that the US economy could have a recession in 2019 or 2020, and financial markets tend to discount such things before they occur.

And the average long/short equity hedge fund appears to have become highly correlated to equity markets. Some managers may be nimble and flexible in cutting or even reversing their exposure, but those with a hard-wired bias to being long of equities might struggle to deliver positive returns whenever the next bear market comes.

"Increasingly, equity market neutral managers claim that their own, sophisticated and proprietary, measures of factors are very different from more simple and generic measures."

Meanwhile, there has been a wider dispersion of returns between and within geographies, and industrial sectors. For instance, Asian equities have recently been less correlated to US equities; and the tech heavy Nasdaq index has sometimes moved in the opposite direction of other stocks. This increases potential for stock-pickers to generate alpha: which is currently the main source of returns for equity market neutral strategies.

If interest rates ever climb back to more normal levels, then interest on cash could also become a significant return driver for equity market neutral funds. As the long book is substantially funded by the proceeds of the short book, equity market neutral funds can be sitting on big cash balances (how much depends on variables including margin rates and leverage). For investors in US Dollar share classes, interest on cash might now be more than enough to cover fixed costs, such as management fees and other expenses.

DIFFERENT TYPES OF MARKET NEUTRALITY

Equity market neutral strategies have an equity beta that can be near zero or may simply be relatively low (for instance, Morningstar defines equity market neutral as having an

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"The apparently low level of assets in equity market neutral also seems surprising when many allocators indicate a strong intention to invest in the strategy."

equity beta range of +_30%). It is in practice rare to find equity beta of exactly zero - as realised beta can differ from forecast beta - but plenty of managers are pretty close.

Some equity market neutral managers are also country-neutral, and/or sector-neutral, while others can have significant long or short bets on certain countries' equity markets or on particular industries.

What can matter more than country or sector bets however, are exposures to style "factors" such as value, growth, momentum, quality and size. Some alternative risk premia (ARP), style premia or so called "smart beta" strategies will explicitly – and sometimes exclusively - offer exposure to these and other factors. Yet other equity market neutral managers are anxious to avoid factor risk, partly due to memories of the so called "quant meltdown" in August 2007 when some "over-crowded" positions saw heavy liquidation as managers unwound portfolios and dialled down leverage. Increasingly, equity market neutral managers claim that their own, sophisticated and proprietary, measures of factors such as "value" are very different from more simple and generic measures, such as price to book value ratios.

Some managers are now also using new data sources, such as satellite pictures of car parks, shopping centres and ships. Many managers emphasise their computer programming and coding skills and are using machine learning, deep learning and artificial intelligence techniques, such as natural language processing, to analyse data including "Big Data". This can include "unstructured data" such as news that does not fit into a spreadsheet format.

SYSTEMATIC OR DISCRETIONARY?

Equity market neutral can be systematic and quantitative, it may be discretionary, or it can even be a hybrid approach, combining both. Discretionary approaches are more likely to use fundamental data, and systematic approaches are more inclined to use technical data, but as managers broaden out their analytical engines both investment processes use both types of data.

TECHNICAL OR FUNDAMENTAL DATA?

Statistical arbitrage is a subset of equity market neutral that tends to focus on shorter term mean reversion. The earliest statistical arbitrage strategies were based only on mean reversion of historical prices ie technical data but many "stat arb" programmes now incorporate fundamental data.

INSTRUMENTS AND VEHICLES

Liquid alternatives such as UCITS funds (and '40 Act funds in the US) are widely seen in equity market neutral. Because the strategy is often very liquid and diversified, UCITS funds can easily be run pari passu with offshore investment funds. Equally, some managers do run more leveraged versions of their strategies in offshore funds.

Equity market neutral managers will use a mix of cash equities and equity derivatives such as single stock futures, contracts for difference and swaps (UCITS funds cannot borrow stock so must use derivatives on the short side).

They may also use broad equity market index products, or sector baskets, which can sometimes be accessed through Exchange Traded Funds (ETFs). Single stocks are more prevalent on the long side, while sector or index products are more widely used on the short side; (indeed, some managers do not have any single stocks in the short books and are basically only aiming to add alpha from longs). The fact that average market capitalisations are often higher on the short than the long book can introduce some degree of "size bias", though certain managers make a conscious effort to avoid this and do have significant short exposure in small and mid-caps.

A CINDERELLA STRATEGY?

According to the HFR Media Reference Guide, estimated assets in equity market neutral strategies were just USD 63.25 billion, as of the end of 2016. This is open to debate as there is a big grey area in deciding where to draw a line between equity long/short and equity market neutral.

Nonetheless, the HFR figure is only approximately 2% of global hedge fund industry assets of $3 trillion. It is also only about 7% of total equity hedge assets of $849 billion. Yet equity market neutral assets are at their highest ever levels: in 2008 and 2009, assets fell below $30 billion as these liquid managers were used as ATMs. Equity market neutral would appear to be a very unfashionable strategy.

LARGEST MANAGERS

Still, some of the largest hedge fund managers are running equity market neutral strategies. The largest equity market neutral managers include Marshall Wace and Old Mutual in London, (each of which runs over $10 billion); Exane in Paris, and Pictet, Systematica and Reyl, with offices in Geneva. The largest US-headquartered managers include Acadian, AQR and Two Sigma, with mid-sized managers such as Algert and Campbell also present.

ALLOCATOR APPETITE

The apparently low level of assets in equity market neutral also seems surprising when many allocators indicate a strong intention to invest in the strategy. For instance, Credit Suisse's Tenth Annual Global Hedge Fund Investor Survey, released in March 2018, surveyed 345 institutional investors representing $1.1 trillion of assets, and found that a net 19% of them intended to add to equity market neutral (quant), with 15% going for equity market neutral (fundamental).

Perhaps it is time for equity market neutral to enjoy its day in the sun in terms of inflows, and possibly start to party when beta-heavy strategies see setbacks.

THE 'QUANTIMENTAL' APPROACH TO MARKET NEUTRAL

By Pirkko Juntunen – HedgeNordic

Continuously maintaining the beta close to zero in a market neutral fund is possible in theory but can be very difficult in reality. Kames Capital, an Edinburgh-based asset management firm, believes this can be achieved by staying away from the 'man vs machine' argument and instead using the best of both in its investment process.

Neil Goddin, head of equity quantitative analysis, believes that some of the issues with market neutral funds have been that they have in fact not been truly market neutral. "There is nothing wrong with strategies that are long-biased or long/short but they are not market neutral and it is important to distinguish between them," he said.

The Kames Global Equity Market Neutral fund aims to deliver 1 month GBP Libor +5% per annum, net of fees over a rolling three-year period. The fund is managed by Goddin and Craig Bonthron and has returned 3.9% over the past 12 months to the end of April 2018.

"We want this fund to live or die with our ability to pick good stocks on the long side and stocks that are going to underperform on the short side. We do not want it to be about market events or geopolitical events, GDP numbers or Trump tweets - only stock picking and truly independent of any asset class," Goddin emphasised, adding that the recent sell-off did not affect performance. "We are taking the risk of the equity market out by keeping beta close to zero. We have a high level of stock specific risk, whilst few macro events or regional or stylistic bets affect the fund," Goddin said.

Goddin, who joined Kames in 2012 as head of equity quantitative analysis and also has joint responsibility for managing funds within the global equities team, believes in the combined power of fundamental research and quant analysis. He argued that the technological improvements within the industry necessitates the combination of both. "Quant systems are great for analysing large amounts of data quickly. However, they have their limitations when there are specific events or changes such as ongoing M&A, management changes and other factors. Fundamental research can pick up on these issues," he explained.

"We want this fund to live or die with our ability to pick good stocks on the long side and stocks that are going to underperform on the short side."

He jokingly said that 'quantimental' describes his investment approach fairly well, compared to peers who tend to have a more pure quant focus.

Goddin, a risk management expert with 19 years of industry experience, started to implement the Kames equity screening process when he joined the firm in 2012. The screen is designed to aid fundamental research which takes time and resources. "The screen points to the group of stocks that are most likely to outperform which enables a smaller more focused team to make decisions quicker," he said.

In addition to investment management responsibilities, Goddin leads the team responsible for building and maintaining the Kames screen, which is used across the equity team, and advising on optimising risk levels in the funds. His role differs from most typical quant professionals as he sits within the fundamental team, has joint responsibility for managing funds and is an integral part of the equity team; rather than the more traditional model where quant-teams sit separately, away from investors. Goddin is part of a team of 29, headed by Stephen Adams.

The investment process at Kames starts by ranking the investible universe of 5-6000 stocks into a quintile rank of five groups. Specifically, the screen looks at financial strength, cash flow and technicals. Kames will buy stocks in the top quintile, and sell at the bottom quintile. "I would describe the screen in two words – change and improvement. This is where we differ from many other screens that exist. We do not look at value or growth. We start by looking at stocks that are improving, and of course the reverse for shorting stocks. Stocks that show worsening financial strength year-on-year get downgraded and shorted," Goddin said.

Following the screening, fundamental analysis is used to cut the ideas to 75 long and 75 short. Then portfolio

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construction and risk mitigation tools are used to bring the ideas to between 50 and 80 stocks in a high-conviction portfolio. Goddin says the key is to be truly market neutral with net exposure and beta close to zero; combined with high levels of stock specific risk.

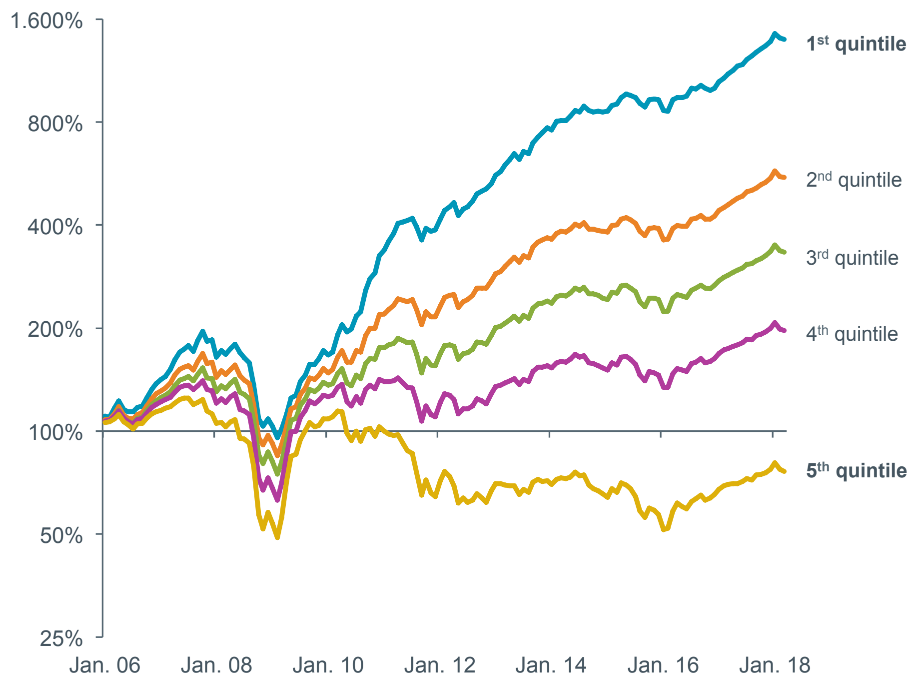
The fundamental research on a company is generally done within a week. "I think we can find out what we need to find out within a week to be 90% confident of our views. The remaining 10% of uncertainty will remain, however long you spend researching," he noted.

The majority of the stocks in the market neutral fund are small and mid-caps as they are less covered by the sell-side analysts. "If we agree with consensus then I don't see much alpha left there," Goddin said.

He explained that over the years he observed fund managers making the same mistakes such as wanting to buy the cheaper P/E stocks vs more expensive P/E stocks. "An example going back 10 years is Unilever which many wanted to buy on a P/E of about 15 over Reckitt Benckiser at a P/E of about 22 in the belief that Unilever would come up to the same level. But that did not happen for many years: with Reckitt Benckiser continuing to hold the valuation gap. The reason was that Reckitt Benckiser was a better run company and a Kames Rank 1 against Unilever at Kames 5. The relationship between the 2 no longer holds true today but it took a long time for the gap to close."

Another example Goddin pointed to is French car-maker Peugeot; again, looking back 10 years ago. "For a long time it looked cheap to a value manager and for many years was trading on a 2 to 4 P/E as nobody was buying their cars. A few years ago they were able to change that and following spending

Improving the stock pickers' batting average



As at 31 March 2018, logarithmic scale.* Includes rolling 3 month periods

"I think we can find out what we need to find out within a week to be 90% confident of our views. The remaining 10% of uncertainty will remain, however long you spend researching."

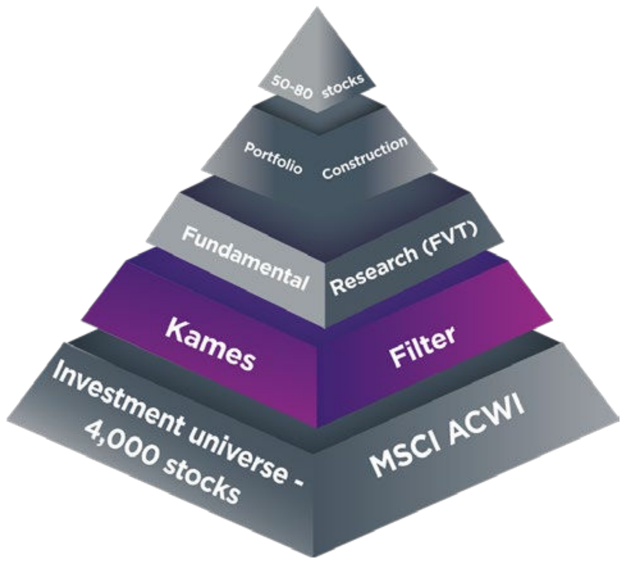
more on R&D they could sell more cars which led to its share price moving up. Subsequently, it also moved up on the Kames screen," he said, adding that value managers would have had to wait eight years for any improvement and lost money in the process. "Kames might have missed the beginning of the turn-around story but we picked it up soon enough after," he said.

According to Goddin the screening tool has been consistent and on a monthly basis Kames Rank 1 stocks outperform Kames Rank 5 stocks on average around 80% of months. "When those at the bottom quintile outperformed, their performance isn't sustained for long periods," he added.

One of the current themes in the short book is 'media goes digital'. "We know we are watching TV in a different way to before i.e. less live TV and instead watch Netflix and Amazon Prime. There are charts showing that when adverts do come on TV, Facebook usage is up. But advertising spending is still high. We have shorts in US and Mexican TV companies. We do not understand why these companies are still valued the way they used to be. They are seen as quite defensive and are thus expensive as the advertising dollars are guaranteed for live TV. We think the market is missing the point to the move to digital media", Goddin said.

A stock example in the Kames long book is Anta Sports, a leading domestic sportswear brand in China. The prices are a 40-50% discount compared to Nike or Adidas, making the goods affordable to the average Chinese. Forecasts show that the sportswear market continues to grow strongly, and Anta's online business is showing accelerating growth. In 2017 the stock price rose over 50% in Hong Kong dollars and earnings growth is expected to rise by 20% per year over next 3 years. Kames therefore expect outperformance to continue and in 2018 the stock is up over 10% already.

"We do not understand why these companies are still valued the way they used to be. We think the market is missing the point to the move to digital media."



Part of Kames and Aegon's history is also its focus on Environmental, Social and Governance (ESG) factors which is an integrated part of the investment process. "The majority of our long positions are positive on the ESG screening whereas our short positions are often negative in that they do not score well on environmental, social, governance or accounting practices," Goddin said.

Using the best of both man and machine in its investment process has so far served Kames' clients well, indicating that Goddin needen't worry about the 'mental' in 'quantimental' after all.

Kames Capital, headquartered in Edinburgh with assets of EUR 50 billion (31 December 2017) rebranded as Kames in 2011. They have capabilities in fixed income, equities, property, cash and multi-asset investing, offering products and services that aim to meet a range of client objectives, including growth, income, total return and absolute return.

Kames Capital is part of Aegon Asset Management, an international group of investment management businesses owned by Aegon NV, one of the world's leading providers of financial services.

In February Kames signed a distribution agreement with Nasdaq's fund platform, Nordic Fund Market (NFM). The platform has 180 asset managers offering over 4000 funds to investors. Kames has been active in Sweden since 2010 but wants to increase its presence in the whole region and the agreement enables Kames to sell its range of 13 Dublin-registered funds in Norway and Finland too.

Neil Goddin - Kames Capital

By Aline Reichenberg Gustafsson, CFA – HedgeNordic

Shifting consumer behaviour: an opportunity for market neutral strategy

At Sector Asset Management, Norway's largest independent hedge fund platform, one key to a successful strategy is the wide dispersion of returns within a particular market. Sector Healthcare Fund, the firm's market neutral healthcare strategy has achieved excellent risk-adjusted results since its inception in 2005. A little less than a year ago, Sector launched a Consumer Market Neutral fund, with a PM previously with the healthcare team. Mads Andreassen, the PM for Sector Consumer Fund started as an analyst within the healthcare team in 2007 and later became responsible for the generic pharmaceutical book. We had the opportunity to talk with him and understand the rationale behind his strategy, and how he expects the consumer market's return dispersion to evolve and potentially generate performance.

"There are areas where the two sectors overlap," Andreassen starts. "Some consumer product manufacturers might have a healthcare division, and some pharma conglomerates have a consumer division. Based on my previous experience I believe it is possible to apply a similar type of analysis to the consumer products companies as we did in the generics book."

The Sector Consumer Fund focuses on large and liquid companies in the developed world, both in the consumer staples and consumer discretionary industries. "We believe there are more than enough opportunities amongst consumer product companies alone to make an exciting investment universe and build a robust portfolio," adds Andreassen.

Andreassen believes that the dispersion in the fund universe makes it an attractive sector to implement a market neutral strategy. "We measure dispersion by calculating the standard deviation of all the returns of the companies within our universe. Historically, this number has been just below the return dispersion of healthcare sector, but it is more than enough to be an attractive market for this type of strategy," he explains. "We also monitor the evolution of this figure over time, and it has been relatively stable in the last couple of years, but we expect that it will increase."

MADS ANDREASSEN
SECTOR ASSET MANAGEMENT

There are a couple of reasons why consumer product manufacturers are likely to see higher dispersion. “Firstly, we are coming out of a period of low interest rates, where some consumer stocks have served as bond proxies. We believe that is coming to an end. Secondly, the ‘global brand titans’ are likely to enter more rough seas, as emerging competition and private labels will challenge their historically healthy top-line growth. We envision that the difference between performance of the winners and the losers will increase and that is a situation where we can find exciting opportunities for our strategy.”

The times for new innovative consumer product companies to capture market share from the larger incumbents have never been as promising as they are today. Barriers to entry are lower than ever, thanks to shifting consumer behaviour, and new distribution channels. “We have always had shifting consumer preferences, but nowadays the changes are happening more rapidly,” says Andreassen.” Brand loyalty is decreasing. This does not mean that we as consumers are less brand conscious, but we are seeing an increasing willingness to try new brands. Over time, this will challenge traditional brand investment strategies and product life cycles will contract.”

Smaller brands access to the marketplace has changed radically. Online distribution channels, such as Amazon provides new brands with an instant global selling platform. Before, a new product was stymied by a few large retailers with limited shelf space. Now with online channels shelf space is no longer a physical barrier. Marketing practices have also changed dramatically. “We are seeing diminishing returns from traditional advertising campaigns, and the purchase process is often much more information driven. Before, a long-earned brand name was what the consumer had to rely on. Now choice often follows a product’s online ratings and feedback. The level of customer engagement is higher both when acquiring a new product, and when providing information to others. “

> “We put much work into breaking down the top line into as much granularity as possible. We then value each product or business segment separately and this sum-of-the-parts model is the most important metric in determining whether a stock is a potential long or short candidate.“

With interesting underlying sector dynamics, the key to a thriving market neutral strategy resides in the manager’s ability to put its chips on the right numbers. “We build our portfolio through bottom up process with focus on valuation,” Andreassen adds. “Our procedure is very similar to that of the healthcare fund. We also try to minimise exposure to unwanted factors and style tilts, to obtain as pure a bet as possible on valuation.”

Nevertheless, isolating the fund from other factors has been a challenge so far this year. “Currently price momentum is being favoured. We are holding back on some shorts due to the strong momentum we are experiencing. In addition, growth is also attracting interest, and, in our eyes, is currently rewarded disproportionately, “Andreassen says. “At the same time, some names we would like to have on the long side have yet to show much valuation support.”

Based on his experience in the healthcare sector, Andreassen explains that underperforming and undervalued stocks at some point reach a support level. It is a price at which enough investors see a good deal. “The finesse is to identify the value traps from the rest. Before we invest in a company, we always build a fundamental valuation model. We put much work into breaking down the top line into as much granularity as possible. We then value each product or business segment separately and this sum-of-the-parts model is the most important metric in determining whether a stock is a potential long or short candidate.“

Based on this experience Andreassen has made some adjustments to the fund’s exposure instead of fighting the tide. “Our long-term target is 200% gross exposure, with very little market beta,” he says. “Now we have decreased our gross to 150% and reduced our strongest momentum positions on the short side, which reduces our negative exposure to the factor overall. It is a challenge to find undervalued consumer names with strong momentum in the current environment, and we target to only use single names on both sides to hedge our overall exposure. Hence, we expect to have a slight negative momentum exposure over time. It is a trade-off, and we need to ensure that it does not become a dominating factor. Growth, on the other hand, is easier to manage, as we can find candidates on both sides.”

GET 'SMART' WITHOUT 'BETA': A SYSTEMATIC MARKET-NEUTRAL STRATEGY

By Aline Reichenberg Gustafsson, CFA - HedgeNordic

FRÉDÉRIC HOOGVELD

HEAD OF INVESTMENT SPECIALISTS, INDEX AND SMART BETA AT AMUNDI

During his recent trip to Stockholm, Frédéric Hoogveld, Head of Investment Specialists, Index and Smart Beta at Amundi, met with HedgeNordic to introduce a new market neutral strategy. We took this opportunity to find out if an index and smart beta manager can really generate the type of alpha a true market neutral strategy offers.

"I think that this ETF can become a serious competitor to other hedge funds, particularly as we propose daily liquidity," starts Hoogveld. "In any case, we have already met with a strong demand for the product. Since we launched last November, we have raised over €500 million for the strategy."

The method behind the product draws on the science behind factor investing, with a "neutralised" market exposure. "The strategy has a long leg and a short leg," explains Hoogveld. "The long leg is basically a multi-factor index, with six of the most commonly used factor premia: value, quality, momentum, low-volatility, carry and dividends. The short leg consists in shorting the Stoxx Europe 600 Futures Roll EUR Excess Return index."

"The long leg is basically a multi-factor index, with six of the most commonly used factor premia: value, quality, momentum, low-volatility, carry and dividends. The short leg consists in shorting the Stoxx Europe 600 Futures Roll EUR Excess Return index."

Technically, on the long side, each of the six factors under consideration is associated with specific screening criteria which depend on a set of ratios or sub-factors calculated for each constituent in the underlying index. For example, 'quality' is linked to ratios like operating income/common equity or cash/current liabilities, 'value' to forward earnings and cash flow yields and 'low-volatility' to standard deviation measured over different periods. The system then ranks the stocks within their respective industry groups. The ranking results into a factor score, which is then aggregated into one multi-factor score for each stock. The final step consists in optimising the weights of the constituents to maximise the exposure to the targeted factors, under constraints such as maximum tracking error or beta exposure to the underlying index.

The devil, as always, is in the details. "We find that this index future is a very efficient way to implement the short leg, as it is the most liquid future available for trading the broad European market," Hoogveld explains. "Some market neutral strategies hedge out their market exposure by shorting single stocks, which makes it is difficult to propose daily liquiditycostly as some stocks may be expensive to short. Another reason we like to work with this particular index provider is that due to the liquidity of the Stoxx Europe 600 Futures Roll EUR Excess Return index we can perform a beta adjustment on a weekly basis. Our clients want our beta exposure to be neutral on a continuous basis, and we can provide that transparently and cost-effectively."

"While hedge funds are sometimes by nature somewhat opaque, by definition an index is transparent," argues Hoogveld. "Every Friday, the index provider resets the short leg exposure to match the beta adjusted long leg exposure to ensure that our beta-adjusted exposure is zero every Friday night. This way, we avoid having a short leg that drifts away and generates an unwanted market exposure."

The argument of cost is indeed one that clients are sensitive to. "If you buy a hedge fund, the TER can be at least 150 bps or even 200," Hoogveld estimates. "With this strategy, the costs are an order of magnitude cheaper. We are effectively commoditising a long/short strategy that some asset managers are charging very high fees for." However, when cost is an argument, index providers also propose similar products which compete with those offered by large asset managers such as Amundi. "As an asset manager, we believe we can add value in general, but especially at the discretionary level. Products index providers offer, can be cheaper, but they are purely systematic, whereas we can tailor make strategies to fit certain needs." In this case, the strategy is currently being offered as a standardised ETF.

This type of systematic market neutral strategy conveniently proposes a return target in between equities and bonds, with a volatility comparable to that of a bond index. According to Amundi, the annualised performance of the iSTOXX Europe Multi-Factor Market Neutral NTR calculated over seven years until end December 2017 is 5.9%. Over the same period the MSCI Europe NTR returned 7.7% per annum and the FTSE MTS IG Broad All Maturities NTR 4.9%. Meanwhile, the volatility over the period was 4.6% for the market neutral index, compared to 4.1% for the bond index, but as much as 16.7% for the MSCI Europe.

What this strategy proposes is as close as it gets to a pure factor performance extraction. It captures the outperformance of a multi-factor strategy over its underlying index, while neutralising the exposure to that market. Beyond replicating what hedge fund managers achieve, it shows that there is a way to get 'smart' without the burden of 'beta'.

Karner´s view of how to best manage a pension fund must be a relief for hedge fund managers, who are constantly under pressure for cost and performance.

by Pirkko Juntunen – HedgeNordic

Hedge funds – the right medicine for Swedish pharmacy pension foundation

Gustav Karner, who took over the leadership of the pension foundation for the Swedish state-owned pharmacy retailer Apoteket in May 2017, has been busy the last 12 months overhauling the entire administration, IT and investments of the foundation initiated by the board before he joined. This has resulted in a new target allocation for alternative allocation to 30% out of which at least 20% will be invested in hedge funds, doubling the previous allocation.

His view of how to best manage a pension fund must be a relief for hedge fund managers, who are constantly under pressure for cost and performance. Karner's aim was to find the best possible, cost effective way of managing the assets while reducing overall risk. This has resulted in the majority being invested in index funds and the rest basically actively managed alternatives.

The board had a clear vision for the SEK12bn fund and Karner started working with the previous management on overhauling the fund when he officially joined in May last year. Not only did he want to review the entire operation of the fund but he also wanted replace the in-house actively managed portfolio with index funds and add a significant portion of alternatives to the mix. As a result the administration and risk control of the fund were outsourced to Wassum and PRI Stiftelsetjänst. Staff was reduced from previously five to two. Karner hired Oscar Arvidsson a quant analyst with a 5 year background in maths to join his streamlined duo.

All of the fund's IT systems were also changed to a cloud-based system. Karner said the changes have halved the costs of the organisation. In addition, Karner swiftly moved to create a five member investment committee with an advisory role, aiding him in his executive decision-making. The committee is an addition to the existing board which has two employer and two employee representatives.

The final part of the puzzle was to review the investment policy. "As a pension fund we have to be able to cover liabilities, even if they are not in our balance sheet, and using an ALM modelling exercise we looked at how to best match assets and liabilities," Karner said. "The main goal in our risk management is to minimize the risk for the buffer e.g. the assets minus the liabilities", Karner adds.

The new investment policy means we will have less risk in the portfolio as well as lower drawdowns than earlier, he explained. The asset allocation was fairly dramatically changed with equities down to 20% from an earlier 30% and in particular Swedish equities were cut to 5% from 25%. Fixed income has been split between 25% in secured debt, 15% in higher return debt such as private debt and senior loans with less liquidity, rather than high-yield, which Karner has divested from recently.

The real estate portfolio remained at 10% but alternatives were boosted to 30%. The alternatives include hedge funds, private equity, convertibles, infrastructure and insurance linked bonds. The majority, or 20% of that allocation will be in hedge funds.

"My thinking is the same as it was in my two previous roles at Länsförsäkringar and more recently at The Nobel Foundations. It is difficult for a small Swedish investor to beat global equity markets so I mainly want to use index managers for cost efficiency reasons. I may look at more active managers in small-caps and emerging markets," he added.

He explained that the foundation has a cautious approach with over a third of the equities being protected considering markets have been rising for nine years.

The foundation's fixed income assets are managed by SEB with investments spread across the Nordic region, Europe and the US. Karner does not like the risk-reward outlook for high-yield and recently sold the holdings. "You do not get paid enough for the risk you take and I think that it is a bubble and I want to get out before it gets hard to get out once everyone else wants out," he added. Karner said he prefers direct lending to high-yield. On the real estate side the foundation invests in three Swedish funds. "I feel pretty happy with this allocation but I have been looking at student housing across Europe and particularly in the UK," Karner said. He also uses SEB for the private equity allocation. The pension foundation has also diversified with small allocations to insurance linked and catastrophe bonds among other assets.

> "My thinking is the same as it was in my two previous roles at Länsförsäkringar and more recently at The Nobel Foundations. It is difficult for a small Swedish investor to beat global equity markets so I mainly want to use index managers for cost efficiency reasons. I may look at more active managers in small-caps and emerging markets."

> "If you are a world-leader in your field, why would you lower your prices? I want to know they can deliver what they promise and I prefer to spend the money where I know I can get good returns after fees."

The most dramatic change in the portfolio has been on the alternatives side where Karner is keen to find 'best in class' managers and is scouring the world. "I have used contacts I build up over the years and have added three hedge funds since I started. I have been fortunate as some of them have been closed for new investors for years," he said. Karner also sources ideas through specialist advisors and peers. He also noted that he likes funds that are closed as they are usually good at what they are doing and he is happy to wait and increase allocation when the opportunity arises.

Karner has invested in Viking Global Investors founded in 1999 by Andreas Halvorsen which now has some US$40Bn in AUM, another investment is with Davidson Kempner which specialises in merger arb and distressed debt and the third is with Two Sigma, a systematic fund managers.

The criteria Karner is interested in when looking for managers are that they have existed since before the financial crises. "If the fund itself has not existed since before the crisis, at least the key people should have managed money since before," Karner said, adding that they need to be able to clearly explain what they are doing and that there is a clear pattern. Secondly, Karner looks at a high Sharpe-ratio, low risk and low correlation to equities. In addition, he wants it to fit well within the overall portfolio. "I also want references. Independent references are key," he added. Other factors include capabilities in the areas of reporting, administration, auditors used, liquidity and governance.

On the issue of fees Karner does not see a problem with paying for the best managers in their field. "If you are a world-leader in your field, why would you lower your prices? I want to know they can deliver what they promise and I prefer to spend the money where I know I can get good returns after fees. Hence the majority is in index funds because I think global markets are difficult to beat investing in long-only funds. Beta should be cheap." he said. Karner mentioned Renaissance's Medallion fund with fees double of the industry standard of 'two and twenty'. Noting that its annualised returns have been equally eye-popping.

Karner plans to continue diversifying and reducing equities and adding hedge funds when the ones he likes open. "Hedge funds suit the SEK12bn sized fund. The Nobel Foundation had 35% allocation to hedge funds but on average Nordic investors have a much lower allocation because of bad experiences in the past.

At Länsförsäkringar we only had 3%. The hedge funds outperformed but they did not really have any impact on the overall performance which is why it is then often deemed too expensive," he explained.

Ethical, social and governance (ESG) are often on top of the agenda particularly for government-owned companies. The Apoteket foundation uses the services of ISS-Ethix for the foundations environmental, social and governance criteria. "We do not exclude companies and prefer having a dialogue instead," Karner said.

A SWEDISH SUCCESS STORY in Health-care and Biotech

by **Hamlin Lovell** – HedgeNordic

Taking home four category wins at the Nordic Hedge Awards on April 25th in Stockholm Henrik Rhenman and Co-Portfolio Manager Susanna Urdmark have all reason to look back at a successful period, and show plenty of optimisim for the future, too. Their fund, Rhenman Healthcare Equity L/S annualised at a net 21% since its inception in June 2009, compounding up to a return of 426%. Founder and portfolio manager, Henrik Rhenman, has a personal track record dating back to the 1990s, when he ran funds for SEB, Cowen and Company, and one for Carnegie, which made 800% over a 10 year period.

In common with the majority of long/short equity funds, Rhenman Healthcare Equity L/S has been net long (on average 122%) and has generated the majority of returns from the long book, rather than its short positions. The short book, of around 25% at the end of March 2018, has been primarily a means of financing additional long exposure. "Shorts have lost money during the long bull market in healthcare stocks" says founder and Chief Investment Officer, Henrik Rhenman. With the benefit of hindsight, there have been idiosyncratic short opportunities in hyped-up biotech names, and sector-wide downtrends in generic drug-makers, including Indian firms and the world's largest, Teva Pharmaceuticals, but Rhenman has not been exposed.

Rhenman can invest across all sub-sectors of healthcare (large pharma, specialty pharma, biotech, medtech, distribution and services), but has had neither longs nor shorts in generics. "The difficulty with these companies is that when valuations are very low, it does not matter if they are not performing, there are always investors willing to take on the risk" explains Portfolio Manager, Susannah Urdmark. "The recent takeover bid for Shire Pharmaceuticals shows how difficult it is to short companies" she adds. Rhenman is

HENRIK RHENMAN, SUSANNA URDMARK,
PORTFOLIO MANAGERS OF RHENMAN HEALTHCARE EQUITY L/S.

> **"I cannot recall Buffet having excelled in any healthcare, and his premise that you must be happy to own a stock for 100 years is impossible for healthcare, given the product turnover."**

completely unfazed by Warren Buffet's recently announced stake in Teva. "I cannot recall Buffet having excelled in any healthcare, and his premise that you must be happy to own a stock for 100 years is impossible for healthcare, given the product turnover". Rhenman's Scientific Advisory Board of medical experts, help to assess the science of new drugs and treatments.

The net exposure has not always been above 100%. It dropped as low as 37% at some points in 2010. Rhenman could at some stage run a market neutral book, or even go net short, though either seems a very remote prospect in 2018. Rhenman is constructive on both growth prospects and valuations for healthcare equities.

A GROWTH SECTOR

Rhenman's big picture view has consistently and accurately been that healthcare growth can continue to outpace the economy, particularly in emerging markets, which are not only growing faster than developed markets – but would also need to double their 5% share of GDP devoted to healthcare, to catch up with the OECD average of 10%. China will soon be second only to the US for healthcare spending.

Rhenman's long-term outlook remains that the healthcare industry is far from mature. For example, "the number of ways to treat cancer has increased from three 20 years ago to 11 today, with combination immunotherapy improving patient survival times and possibly even curing hard tumours" he says. Two core Rhenman holdings are involved. "Nektar is active in this area, with one compound that can be combined with PD1 inhibitors, while Exilixis, having started with small cancer types, such as renal and lymphatic cancers, now has high hopes for other cancers" adds Urdmark.

BIOTECHS STILL DRIVING RETURNS

Biotech continues to generate the bulk of performance. "It has all the features you need to be a stock-picker: growth, volatility, action, targets, and big binary events" says Rhenman.

Some 63% of the 2017 return of 34.5% came from biotechs, in a year when the biotech index did very little. Nearly 50% of last year's attribution was just five biotech stocks. Two produce treatments for high cholesterol: "Nektar Therapeutics, a hitherto neglected firm which I have followed for 20 years, has developed a new drug for high blood cholesterol, and its share price has quadrupled since October 2017" says Rhenman. "Esperion Therapeutics has targeted patients who do not respond to the highest doses of traditional treatments, with a new treatment that can be used in conjunction with statins, or for those who are intolerant of statins- and which is cheaper than injectable drugs" says Urdmark. "Adamas Pharmaceuticals has made it to the market with its first treatment for Parkinsons disease; Oncology specialist Exelixis has gained approvals broadening the potential use of its drug, and raising earnings forecasts" says Rhenman; and "Sage Therapeutics, which is focused on Central Nervous System disorders, has developed new treatments for identifying early stage depression" says Urdmark.

> **"There is no drug price regulation in the US and few think it will ever happen. Even if a future President wanted it, a majority would be needed in the Congress and Senate."**

US REGULATION AND REPUBLICANS

Indeed, FDA approvals for 46 new drugs in 2017 have reached a 21- year, and all-time, high. Notwithstanding Trump's rhetorical tweets and comments, the price regulation outlook for the crucial US market also seems benign ie absent. "There is no drug price regulation in the US and few think it will ever happen. Even if a future President wanted it, a majority would be needed in the Congress and Senate" says Rhenman. Additionally, "so far, most reforms to Obamacare have been incremental and acceptable to the industry" says Rhenman.

Still, he does see some risk of market forces bearing down on prices of drugs (and other healthcare products and services): "For instance, Wal Mart – which has bid for health insurer Humana - would be a very effective buyer of drugs". Rhenman is cognisant that certain segments of the healthcare industry might face price pressures, and is consequently devising a new hedging strategy. Urdmark, is "developing a hedging strategy that will select a basket of short equities to match long book characteristics, based on various criteria and factors. The strategy will be in place before year end, as we do recognise that US elections in November could lead to volatility".

VALUATION DISCOUNTS

Still, at current valuations the expectation is very much for Rhenman to remain net long. Biotech had a raging bull market until 2014, but has been something of a Cinderella sector for the past three years. While FANGMAN (Facebook, Amazon, Netflix, Google, Microsoft, Apple, Nvidia) stocks have accounted for most of the Nasdaq's gains, healthcare now trades on a PE of 16: a discount to both its long-term average of 19 and to the wider US equity market. "Large cap biotechs – Amgen, Biogen, Celgene, and Gilead - are down to PEs of 11 times as investors are not convinced they can re-accelerate growth, and fear for expensive acquisitions" says Rhenman. Yet he reckons the biotech giants could themselves be acquired, and this has happened before: Genentech was bought (twice) by Roche. "Larger pharma companies can cut costs, and better cope with binary risks" he points out. In terms of share prices, even as US equities make new highs, the healthcare sector is 15% below its 2015 peak and biotech is about 25% below its 2015 peak (in Euros). Rhenman expects to see plenty of M&A activity.

The multiple compression seen since 2015 might also reverse. While acknowledging that generalists may be better positioned to make sector timing calls, Rhenman observes that "a maturing business cycle, in the last stages of a strong economy, has historically led to outperformance by the healthcare sector. This has started when investors anticipate weaker economic growth, and continued well into the cyclical downturn until the early cyclicals start to gain attractions again".

ASSETS, INVESTORS AND VEHICLES

Assets in the healthcare strategy are currently EUR 600 million, and Rhenman will hard close at EUR 1 billion. The fund had previously soft closed at EUR 500 million, remaining open to existing investors only. When the performance drawdown in 2015-2016 created more capacity, Rhenman found difficulty filling it from current investors who had often already doubled or tripled their money.

Capacity is really defined by the need to maintain small and mid-cap exposure, which makes up 50% of the healthcare strategy. Rhenman's global long/short strategy has some degree of overlap in large cap healthcare names, but this does not eat into capacity for the healthcare strategy.

Henrik Rhenman has over half of his net worth invested in Rhenman funds, and all staff are also invested. Roughly one third of assets come from people and institutions outside Sweden. Head of Investor Relations, Carl Grevelius, estimates half of assets are retail and half are institutional, based on the sizes of the share classes.

Rhenman do not contemplate a UCITS. "We are a medium sized company and want to keep things simple to focus on core tasks for clients of our two funds. We do not want to spread ourselves too thin, and it is more important to perform than to grow assets" says Rhenman.

FUND DOMICILE IN SWEDEN - FOR ALL THE RIGHT REASONS

By Kamran Ghalitschi – HedgeNordic

> ”Approximately 20 percent of Sweden´s 4,200 billion SEK in fund savings are put into foreign structures, to me that is questionable as it translates into many billions of often unnecessary costs for Swedish fund investors.”

Setting up a fund company has become an increasingly challenging and complex task, not to mention a costly one. In order to meet with regulatory requirements and to make sure that crucial aspects of the day-to-day routines for managing a fund are being met, fund companies are facing a real challenge in setting up fully compliant organizational structures and routines. Since 2014 FCG Fonder, through its Swedish fund hotel solution, offers a way for these companies to outsource critical functions, thereby allowing fund managers to focus on their core competence – managing money. At the same it allows for a more cost-efficient structure, and potentially lower fees to investors.

”It is all about putting the interest of the investor first”, Andreas Julin, head of sales at FCG Fonder tells HedgeNordic when we meet him and founding partner Mikael Olausson in FCG’s premises in Stockholm, overlooking Östermalmstorg.

”The classic way of setting up a fund, where a so-called SICAV-fund is being put in place through a management company in Luxembourg, is being challenged. A solution like that tends to work in the interest of the fund´s owners rather than benefiting the end-investors. It allows for more flexibility when it comes to charging costs to the fund, which in turn increases the fee burden on the investor”, Julin argues.

His argument is supported by recently published data from Morningstar that suggest Luxembourg-domiciled funds are charging a significantly higher fee than Swedish-domiciled ones. For equity funds, the average annual capital-weighted fee load stood at 0.94 percent for Sweden while Luxembourg funds charged 1.43 percent, the corresponding figure for Europe was 1,27 percent.

Of the around 8.800 funds approved for distribution in Sweden, sub-funds and Alternative Investment Funds (AIFs) combined, close to 90 percent were registered abroad in 2017.

"Approximately 20 percent of Sweden´s 4,200 billion SEK in fund savings are put into foreign structures, to me that is questionable as it translates into many billions of often unnecessary costs for Swedish fund investors each year. However, as investors are starting to put more focus on fees, this will ultimately lead them into Swedish domiciled funds as many investors don't want to pay the "Luxembourg premium". This trend is important to have in the back of your mind as fund manager when deciding on your fund domicile, especially if you target Swedish investors", Julin says.

Bringing consultancy competencies to fund solutions

FCG started its fund hotel operations, FCG Fonder, in 2014 when they were approved by the Swedish Financial Supervisory Authority, FI, to manage UCITS as well as Alternative Investment Funds. Today, the fund hotel arm of the business manages more than 10 billion SEK across 25 funds. FCG Fonder is part of the FCG Group, which is the leading consultancy firm in the Nordics focusing on risk, compliance, outsourcing, finance and treasury and customer insight for financial institutions.

The way the fund hotel structure works is that FCG holds the license for the management of the fund and when signing up a new client, outsources the actual portfolio management to the external manager while keeping control of all other activities including risk function, regulatory reporting, NAV and performance calculations. The outsourcing of trading requires for most fund strategies that the fund manager has approval from the FI to conduct discretionary portfolio management services If not so, FCG can even take care of the actual portfolio management.

The entire process from producing the basic fund documentation to when the fund is set up in FCG's system is 3-4 months.

According to Olausson, there are a number of traits that make FCG's offer stand out from the competition.

"First of all, FCG is a full-service partner. We can build on the competencies that we have in our consulting business to offer a wide range of services that are necessary for a fund company to have today in order to meet the demands of the regulator. That includes risk management and reporting, compliance, treasury functions, auditing and performance calculations, not to mention the built in processes we have for communicating with regulators.

"Secondly, we are the only fund hotel to manage all asset classes and all types of instruments, which means that we can deal with all sorts of clients including more complex hedge funds and private equity structures."

"Thirdly, I think the fact that we are based in Sweden and completely independent from banks and other trading counterparties make us more trusted and allow us to quicker adapt to new requirements from clients or regulators.

"What I believe is appealing with the fund hotel set-up is that there is an alignment of interest between the fund managers, ourselves and the investors of the fund. We want the managers to succeed and build their business, that will translate into better profitability for us. At the same time, the managers are checking on us, so that we do our work properly. This to make sure that the fund stays on top of regulations and gives the service required to investors and ultimately gather more assets, hence increasing their profitability."

New markets and services on the roadmap

FCG Fonder are increasingly looking at how to expand onto new markets and how to add new services to its offering. The fact that FCG recently announced a partnership with private equity group Bridgepoint is likely to further accelerate those efforts.

"The partnership with Bridgepoint is all very new, but there is no secret that they want to speed up our international expansion as well as looking into new ways of increasing our footprint in the market, to that end we are open to looking into new type of funds and taking on an even greater responsibility for our clients. We are for instance looking at the alternative investment space with great interest, none the least the real estate and private equity sector. Despite being a game changer for the alternative investment industry, the Swedish "specialfonder" was pretty well prepared when AIFMD was implemented, as opposed to often lightly or unregulated private equity and real estate funds who came to face a completely new reality. For a registered private equity or real estate manager who wants to opt-in to full authorization FCG Fonder can offer turnkey solutions, Olausson says.

MIKAEL OLAUSSON
PARTNER, FCG FONDER

ANDREAS JULIN
HEAD OF SALES, FCG FONDER

> "The Swedish "specialfonder" was pretty well prepared when AIFMD was implemented, as opposed to often lightly or unregulated private equity and real estate funds who came to face a completely new reality."

Offering support when it comes to helping managers with marketing, distribution and communication is another area where we like to be seen as a value partner in the future, Julin continues. If there is one thing that managers have in common regardless of strategy is that they are all looking to raise assets. This needs to be supported by a clear marketing strategy. The marketing field has become very challenging over the last couple of years, not only driven by increased competition in terms of competing funds, but the marketing landscape has changed as well. In a digitized world you need to be visible in new and smart ways.

Another thing that is currently driving change and possibly growth for FCG is the recent decision from the Swedish premium pension system, PPM, to tighten up the requirements for being included on their fund platform.

"There has been a significant increase in the amount of fund companies that come to us asking for advice on regulation and alternative setups to their fund structures, the PPM decision to clean up its fund platform is definitely playing into that."

"Sweden is working at the forefront when it comes to fund regulation which is why we believe that as a fund company, you will benefit from setting up the structure here, it simply makes your investor base better protected. Outsourcing to a fund hotel makes even more sense in that context. We are one of the few winners of the heightened focus on regulation", Julin concludes.

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Q2 2018 Fixed Income Survey

The U.S. growth domino effect

EXECUTIVE SUMMARY

Every quarter we ask leading bond and currency managers to consider valuations, expectations and outlooks for the coming months. Over 2017, we highlighted the dichotomy between interest rate managers' bearish views on U.S. growth relative to credit managers, who have been more bullish. However, over the last two surveys, we have seen a significant change in the direction of travel. It appears as though the impact of U.S. growth is having a domino effect which is seeing market participants come towards a more general consensus. However, as we will see, some areas have suffered.

This quarter, we've put the spotlight on:

- U.S. interest rates and inflation expectations
- Credit markets: cracks starting to appear?
- Casualties from rising U.S. interest rates

By Russell Investments

U.S. GROWTH – INTEREST RATES AND INFLATION

Where are we in the cycle?

Overall, managers are recognising that the U.S. Federal Reserve (Fed) is determined to act. This is particularly clear from the expected increase in the Fed terminal rate, or 'the peak' – i.e. the interest rate that is consistent with full employment and capacity and therefore the interest rate at which the Fed stops hiking.

• Managers are expecting more U.S. rate hikes compared to last quarter. The majority anticipate there will be between three and four 0.25% interest rate hikes over the next year, whereas last quarter the majority expected three hikes. Managers expect the peak in this hiking cycle to reach 3%, up from 2.65% last quarter (figure 1). This level is still low relative to long run nominal growth, but confirms a multi-quarter trend of rising rate expectations.

• However, this has not been mirrored by rising inflation expectations. While we have seen an increasing trend since the Q1 2018 survey, core CPI expectations have only increased from 2.06% to 2.16% this quarter on a 12-month horizon (figure 2). This result somewhat implies that the FED will be successful at controlling inflation.

Is a recession on the cards?

As the U.S. Federal Reserve continues down the path of hiking interest rates, we've also seen a rise in interest rate expectations for 10-year Treasuries – now expected to rise to 3.28%, up from 2.92% last quarter.

Managers also expect to see a flattening of the U.S. Treasury yield curve. As history tells us, if this goes far enough, it usually signals a recession.[1] With this in mind, we can infer that the majority of managers feel that the U.S Federal Reserve is likely to over-tighten interest rates throughout the next 12 months. A flattening of the U.S. Treasury curve could have bad implications for credit; however, we can see below that many credit managers are shrugging this off and remain broadly positive.

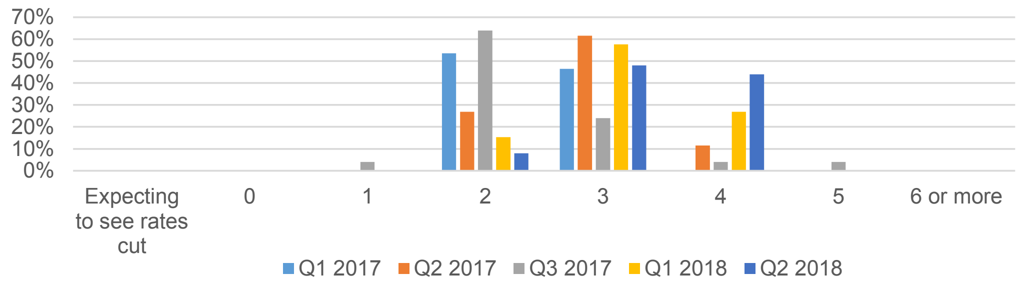
CREDIT MARKETS: CRACKS STARTING TO APPEAR?

Global leveraged credit fundamentals - the bullish view weakens

An aligning of views by market participants is also evident in the bullish view of leveraged credit, which has now come down relative to the previous quarter. When asked to describe the overall corporate fundamental picture for global leveraged credit, we received a mixed bag of results:

- managers expecting an improvement fell from 89% down to 55%
- 35% see corporate fundamentals remaining the same
- 10% see modest deterioration (versus 5% last quarter)

Figure 1: How many more 0.25% interest rate hikes do you expect in the U.S. over the next 12 months?



Source: Russell Investments Q2 2018 Fixed Income Survey

Although we've seen a deterioration of the level of bullishness towards improving fundamentals, the large majority (70%) continue to maintain current portfolio positioning, similar to last quarter's 68%.

Credit spreads

The majority of managers feel that spreads in most credit sectors will remain range bound. However, the remainder had previously generally felt that spreads could see moderate tightening. This quarter, we've seen a flip – the remainder now see some risk of moderate credit spread widening for global investment grade (IG) credit, leveraged credit, and securitised non-agency assets. That being said, more global IG credit managers feel current spreads are high enough to compensate for the risks of deteriorating credit fundamentals over the next 6-18 months. Previously, more than half felt they weren't.

When looking at specific regions, the U.S. finally lost its top spot as the favourite within global IG credit. Europe ex-UK is now number one while the UK is least favourite.

U.S. high yield no longer number one – managers are seeking expertise in multiple sectors

When looking at specific asset classes, U.S. high yield has fallen from consistently being the most favoured leveraged credit sector. The consensus is now much more diversified including U.S. high yield, U.S. leveraged loans, European high yield, European leveraged loans, Emerging Market high yield, and collateralised loan obligations (CLO) mezzanine tranche. On the whole, this implies that the expertise in multiple sectors has become quite valuable.

CASUALTIES FROM RISING INTEREST RATES - CURRENCIES

Emerging market local currencies

Last quarter, the bullish sentiment towards Emerging Market foreign exchange (EM FX) was as strong as we had seen in any of our previous surveys since July 2016. 95% of managers had a positive view overall for expected EM FX contribution to performance over the next 12 months and only 3% anticipated EM detracting from performance (figure 3).[2] However, market performance indicated that manager bullishness proved to be ill timed.[3] Rising U.S. yields and quantitative tightening knocked local currencies and exposed notable weaknesses in currencies such as Argentina and Turkey.

Despite recent hiccups, managers remain positive for the EM FX outlook on the whole, only marginally less so than last quarter. More managers believe that EM local currencies will be a slight performance detractor (13%) while 80% of managers have a positive view overall.

The euro – some upside remains but all eyes are on political developments in Italy

Another casualty of rising U.S. rates has been the euro. A year ago, survey respondents expected the EUR/USD exchange rate to push into the 1.30 to 1.35 range on a 12-month view. However, today's actual exchange rate is instead languishing at 1.17. Indeed, managers this quarter still see an upside for the euro. Although, as the political situation in Italy unfolds over the coming weeks and months, the outlook for the euro may very likely change. Since the closing of our survey, we have seen the coalition of 5-Star and Northern League, who at one point even speculated about getting the Italian central bank to write off its government debt. Perhaps the euro has more tough times ahead, and the playbook for dealing with an Italian populist government is not going to be the same as the one for Greece.

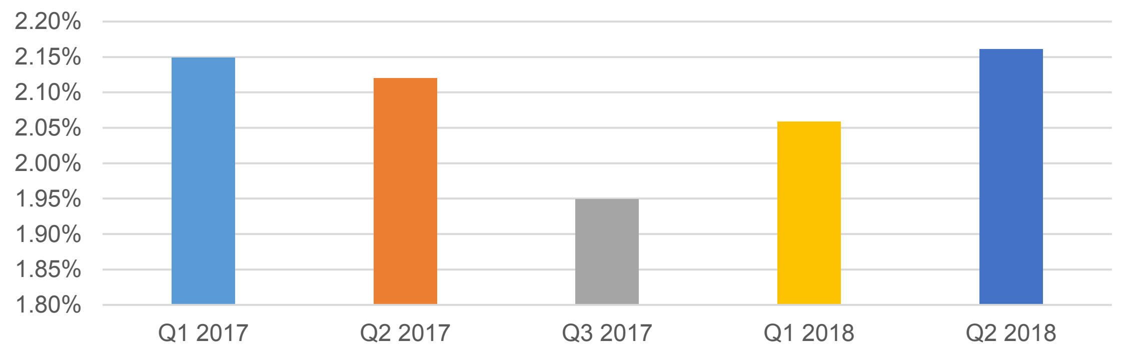
VOLATILITY IS TO BE EXPECTED

Broadly, this survey has indicated that global managers have accepted – and made room for – some market volatility. As interest rates begin to rise in the U.S. and more globally, there does seem to be a consensus that we may begin to see some market dislocation, particularly around valuations and spreads on an absolute and relative basis. One thing that remains clear is that managers across all eight specialities are a lot less bullish overall than they were last quarter. From our perspective, we believe that the survey respondents this quarter may have understated the volatility potential in a variety of places.

As always, we will be keeping a close eye on market developments. Savvy investors should remain vigilant, stay nimble and consider adding some portfolio diversifiers that perform well in rising rate environments.

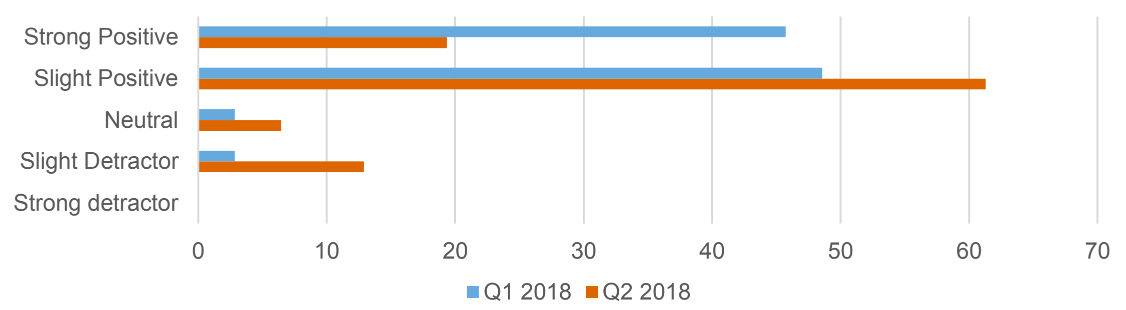
1) A flattening of the curve can eventually lead to an inverted curve, where shorter-dated securities yield more than longer-term bonds. This event has predicted all nine U.S. recessions since 1955.
2) 46% of managers expected strong contributions and 49% expected slightly positive contributions
3) EM FX has sold off by 7% since the February survey, which serves as a major headwind to strong EM FX performance predicted 12 months forward from that survey.

Figure 2: Where do you expect to see U.S. Core CPI 12 months from today? (weighted average)



Source: Russell Investments Q2 2018 Fixed Income Survey

Figure 3: View on EM FX over the next 12 months



Source: Russell Investments Q2 2018 Fixed Income Survey

www.hedgenordic.com - June 2018
HEDGENORDIC

Integrating ESG in quantitative investment processes

By GLENN LEAPER, PhD – HedgeNordic

Offering sustainable investment is first and foremost about ensuring investors that moral values, negative externalities as well as financial aspect will be taken into consideration when investment decisions are made. However, these considerations should not necessarily come at the detriment of return and risk. Early on, Informed Portfolio Management (IPM), the Swedish systematic investment manager, understood achieving strong long term investment results should not be at odds with actively promoting social and environmental issues and improving corporate governance.

While the firm is mostly known for its systematic macro strategy, it has been offering long-only equity products with a sustainable profile since 2006. The firm has integrated ESG factors into the investment process through a number of specifically tailored investment models. For example, IPM's investment process penalises companies that do not meet specific ESG-related requirements, while systematically recovering the lost exposure from exclusions with the help of an optimiser, resulting in a "best in class" approach rather than solely exclusions. When it comes to the risk side of the equation, the longer-term effects of sustainable investing are easier to understand. Avoiding investments in companies with poor governance or that are environmentally damaging is expected to reduce risk in the long run. HedgeNordic sat down with IPM CEO Stefan Nydahl and Anna Frimodig, the Chair of IPM's ESG Committee, for a discussion of IPM's unique approach to sustainable investing.

cutting edge, but continuously improving

When it comes to its ESG policy, IPM focuses not only on investment results. The firm also strives to have a positive bearing in term of ESG on the companies its equity funds invest in, while complementing existing efforts in terms of Corporate Social Responsibility (CSR) through supporting various charities and other activities. Finally, IPM works to concurrently integrate CSR standards among the firm's own staff.

IPM's stated philosophy is to support the principle that companies have a duty to comply with international norms - even if they are not legally obliged to do so -, and as a result, IPM's equity funds categorically do not invest in companies that that do not meet a required standard of business practice based on international norms such as UN Global Impact or weapons-related conventions.

Since 2010, the firm is a signatory to the Principles for Responsible Investment (PRI), which provides the broad ESG assessment benchmarks by which it operates. The company is proud of its rating from PRI, but, as Nydahl emphasises, its norms and requirements change on a yearly basis, as PRI sharpens tools of evaluation and adds new clauses, driven by reported incidents and improved information gathering in the investment space. This means IPM, too, on a continuous basis must adapt its own methodology, where it can prove difficult to adopt everything at once, underscoring the importance of early and continuous engagement with both evolving norms and investors' preferences and needs. "This is a long-term commitment by IPM" says Nydahl. "It's not enough that the CEO or clients are saying [ESG is] a good idea. The ESG effort involves constant work on integration and closely following the evolution of ESG standards, which is part of its appeal."

active ownership & innovative tools

As an active owner, IPM engages in direct dialogue with the companies in its investment universe that violate UN Global Compact or other well-established international guidelines and conventions. It does this through collaborative efforts, engaging through its own initiative, and with the use of an engagement service provider. Its process is based on results from GES's Global Ethical Standard analysis model, which measures compliance with such norms as the UN Global Compact, OECD guidelines for multinationals, and ILO, environmental, human rights and weapons-related conventions. Companies failing to respond to red flags are excluded from the equity funds' investment universe.

The firm's ESG policy in terms of norms-based screening and engagement is implemented in four main steps. First, IPM's ESG Committee is responsible for overseeing all responsible investment efforts and for providing guidance on responsible investment. Second, the equity funds maintain a focus list of screening companies breaching UN Global Compact or other principles, and to verify signs of progress with compliance via its engagements. Third, it maintains an exclude & engage list for companies that do not respond to its engagement, where excluded companies remain so until they qualify for re-inclusion. As a forth step, IPM's Risk Office independently performs daily checks to ensure that the portfolios comply with IPM's ESG policy. Importantly, "to mitigate potential lost exposure due to exclusions," Nydahl explains, "IPM has developed an optimiser that identifies and overweighs companies with similar characteristics as the excluded ones but that comply with the norms, thus applying a 'best-in-class' approach."

IPM also exercises its right – or as the see it, its obligation – to vote according to best corporate governance standards in the companies in which its equity funds are invested. To this end, in 2016 it launched a new website to support its ESG implementation effort, in collaboration with Institutional Shareholder Services Inc. (ISS) to not only disclose its historical voting record, but also to communicate how it intends to vote ahead of general meetings and provide real time updates. "This brings our ESG initiative to another level as it increases the transparency towards our investors and invested companies, but hopefully also encourages others to follow our path leading to collectively promote better standards," says Frimodig.

pros and cons - the earlier, the better

Currently, IPM only applies its ESG methodology to long-only equity products. Naturally, IPM continuously searches for methods to integrate sustainable investing principles into its hedge fund strategies. However, ESG screening makes little sense when it comes to strategies such as global macro that rely on assets that do not directly relate to individual companies, such as currencies and interest rates. The IPM Systematic Macro fund does not invest in commodities, which can be seen as a way to exclude all carbon-related products, but such an exclusion cannot be compared to the active approach used for its equity strategy. "It's certainly a challenge to integrate ESG when it comes to hedge funds, with a wide spectrum of specialised fund categories," says Nydahl. However, he believes that IPM is well positioned to use the experience accumulated since 2006 on the equity product to also be an advocate for an increasing ESG focus within hedge funds. There are signs that hedge funds' interest in ESG is picking up. In a recent initiative the Alternative Investment Management Association (AIMA), in which IPM is a member, worked with PRI to help develop ESG guidance for hedge funds. IPM was an active participant in the working group supporting this effort.

ANNA FRIMODIG
CHAIR OF ESG COMMITEE, IPM

STEFAN NYDAHL
CEO, IPM

Nydahl also thinks there is a possibility to create new alternative products that will benefit from IPM's learning curve. Evidence shows that IPM's ESG implementation has improved investment results: "We have shown that we can provide a portfolio that is just as competitive while simultaneously being ESG compliant – and perhaps, in the future, in the alternative space as well," adds Nydahl.

When it comes to offering new sustainable alternative investment products, IPM might have an advantage over those who have not formally implemented sustainable investing principles for as long as IPM has. As previously mentioned, the PRI has become more demanding over the years, making the slope steeper for a first-time ESG implementation. Another advantage is that "we get a better feeling over time about where the focus is shifting", Frimodig says. "We know what is new and what has always been there." This allows IPM to be more efficient at implementing new requirements.

IPM has also adapted its governance with respect to who in the organisation oversees and is accountable for responsible investment, and who does the actual implementation. "It is hard to come in and adapt to everything ESG related at once", adds Frimodig. Initially, the firm only engaged an ESG specialist to carry the efforts, but it soon became obvious that it was not effective enough. It became a matter of thinking through the entire organisation, where and how ESG implementation affects decision-making across all its levels, including budgeting. ESG needs to be done continuously as a firm-wide project. This, IPM says, translates into an argument for adopting ESG as early as possible: the later companies comply with normative standards that are increasingly enforced at the broader social level, the more difficult it becomes. "There are so many dimensions to take into consideration," Nydahl says. "Should PRI demand less or more from different categories of fund managers? Are the holdings in our hedge funds applicable? Is a new normative idea feasible? ESG integration, yes, but into which of our investment processes, and how? The key is to approach it not from the simplest perspective of how it can apply immediately, but from the intelligent perspective of how and why it makes sense taking all internal and external factors into consideration simultaneously."

At IPM, as is clear, ESG is far from a normative burden or an infringement on investment results. On the contrary, it represents the opportunity to rethink its strategies continuously, thereby maximising potential and enhancing client satisfaction.

ESG opens doors into EM Corporate Debt

By Aline Reichenberg Gustafsson, CFA - HedgeNordic

"...our strongest expertise resides in emerging corporates and in this area, governance and environmental issues can often generate large drawdowns in single names."

While responsible investment has grown fast over the past couple of years, the proportion of assets in fixed income portfolios that follow a sustainable investment strategy is still much lower than in equities. In the arena of emerging market corporate debt, the concept of ESG integration becomes downright niche. Yet several academic studies show a positive relationship between ESG and financial performance. More remarkably, the favourable effect is stronger in fixed income and in emerging markets than in equities and developed markets. This year, the Emerging Market Fixed Income team at Union Bancaire Privée (UBP) launched a product in that exact place. HedgeNordic spoke to Karine Jesiolowski, Senior Investment Specialist - Emerging Fixed Income and Member of UBP ESG Committee to discuss the rationale behind this strategy.

"The idea of launching the Emerging Market Sustainable High-Grade Corporate Bond fund was born last year, in conjunction with the wider re-thinking of our overall responsible investing policy at UBP," starts Jesiolowski. "We decided to embed responsible investment more deeply throughout the organisation, including our asset management and private banking franchises. We set up an exclusion list that would apply to all our clients across platforms, and set up a watch list for companies involved in deep controversy, to ensure that all portfolio managers are aware of potential issues. We also wanted to gain everyone's buy-in to come up with an inclusion list containing ESG champions or companies that have a positive impact in line with the United Nations' 17 Sustainable Development Goals (SDGs). The new UBP policy was implemented as of the beginning of January this year."

For the Emerging Market fixed income team, integrating ESG was a no-brainer. Unlike other organisations where sustainability starts within the equity team and spreads across the capital structure progressively, at UBP, the buy-in was strong on the bond side from the onset. "Here, our strongest expertise resides in emerging corporates and in this area, governance and environmental issues can often generate large drawdowns in single names," Jesiolowski continues. "It made sense to combine ESG with our own credit fundamental and relative value analysis. However, beyond the idea of using ESG to manage risk, we thought that it would be interesting to launch a fund dedicated to sustainable EM credits, as there are simply not many products available in that space."

The first step consisted in defining a wide enough investment universe. "We needed to determine whether the market would be investable and diversified enough to create a portfolio that makes sense," explains Jesiolowski. "It turns out that we do. We teamed up with MSCI ESG Research and integrated our own analysts' input. Combining both, we cover enough companies, even within the investment grade universe, which is our focus, as many investors we identified impose rating constraints on the funds they can invest in. Ex-ante, we can pick from a universe of approximately 200 issuers, which correspond to roughly 60-65 percent of the overall IG EM corporate universe."

Exclusions are not the sole criteria for universe selection. "We didn't think that focusing only on exclusions would make sense," Jesiolowski says, "because want to be able to invest in the best companies and therefore we need to have as broad a universe as possible, within a few obvious constraints." The team chose to exclude controversial weapon manufacturers (including nuclear weapons), tobacco companies, and issuers with substantial involvement in coal extraction or coal-based electricity generation. International sanctions as well as breaching the UN Global compact also trigger an exclusion. In addition to these negative screens, the selection process focuses on the companies that are mindful of ESG and are outperforming their peers in one of several dimensions. UBP uses MSCI ratings to this effect in combination with proprietary research.

"To select among the 200 issuers in our universe we apply our own credit and ESG analysis, and the main driver is bottom-up selection, then we also apply relative value and top-down fundamental tools to help us," adds Jesiolowski. "It is important to be precise in the terminology, however. We are not an impact fund, and we rely primarily on ESG screening. At the same time, we may select some companies that have a positive impact on SDGs, and it is part of our analysts' job to look at SDGs as positive factors for inclusion. This type of analysis helps us chose among two names that have a similar rating for example. We also have the opportunity to invest in green bonds. In fact, the framework green bonds provide is handy to us, as we can invest up to five percent of the portfolio in issuers that are not ESG-rated by MSCI, but we need a strong base to justify our choice."

For Jesiolowski, the end portfolio looks very good indeed. "We end up with a much higher ESG score than the underlying index, as rated by MSCI ESG Research LLC. We reach an average of 5.6 versus only 4 for the index, and we achieve better levels in all three dimensions." In addition to the ESG-oriented selection process, the team also believes in engaging with issuers. "Many people ask if it does make sense to engage even if you are not a shareholder. In reality, you make yourself heard as an investor, whether you own shares of bonds. An increasing number of people speak up, and it has a tangible effect. As a bondholder, the influence may be indirect, but companies increasingly take on board the risk of seeing their cost of financing increase if they don't pay more attention to their bondholders' concerns. This is true in both emerging and developed markets."

"Engagement should always be part of the investment process as well, and not just an afterthought. While opening a dialogue with a company on ESG issues, a credit analyst can observe the company's reaction. Are they listening? Are they prepared? Sometimes, the process will highlight differences of opinion between our analyst and the rating. We don't use external data bluntly, but it helps get the conversation started. We also use GES as engagement manager, especially in the case of more important controversies or when we find it useful to pull together many investors, including those on the equity side."

The fund, which launched at the end of February, currently counts USD 37.5 million of assets under management, which is deployed over 48 different issuers, both corporates and quasi-sovereign. "Fundraising has been a gratifying process. The strategy is truly niche, not only in one dimension but two. First, investors need to come onboard the idea of Emerging Market corporate debt and then consider the ESG aspect, but so far we have received very positive feedback. One of the banks offering our product to its clients has given us a high internal ESG rating. As it turns out, sustainability is what helps us open prospective investors' mind to this very focused fixed income area, and not the opposite," concludes Jesiolowski.

KARINE JESIOLOWSKI
UBP

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THE LONG AND SHORT OF SUSTAINABLE HEDGE FUNDS

PANEL DISCUSSION AT THE NORDIC HEDGE AWARD

Traditionally, the Nordic Hedge Award opens with a panel discussion. While in recent years we regularly had invited allocators and assets owners to talk about their view on the hedge fund space, this year the focus was on sustainable hedge funds.

The panellists were Ann-Sofie Odenberg, Head of Responsible Investment at Brummer & Partners, Simon Reinius, CEO at Optimized Portfolio Management, Ulrika Hasselgren, Head of Sustainability & Impact Investment at Danske Bank and Eric Eidolf, CEO at Nordkinn Asset Management. The discussion was moderated by Aline Reichenberg Gustafsson, Editor-in-Chief of the Nordic´s leading sustainable investment platform, NordSIP.

STATUS OF THE SUSTAINABLE HEDGE FUND INDUSTRY

The discussion started with an overview of the latest trend in sustainability practices adoption among hedge funds. Odenberg reminds us that sustainability is not equal for all the hedge fund strategies. “Equity long/short strategies are often more advanced, as it is easier to integrate ESG criteria in your investment decisions,” she says. “For other strategies, it is not that straightforward. But over the last couple of years, the perception has changed even for those strategies where sustainability is less obvious. Many more people realise that they can find a way to tailor responsible investing to their organisation and their strategy.”

> “Over the last couple of years, the perception has changed even for those strategies where sustainability is less obvious.”

Odenberg mentions that the UN PRI has started working on five work streams for different hedge fund strategies, to propose guidelines to help hedge funds integrated their principles. “I look forward to seeing the launch of these guidelines due in September. I am sure that they will push the agenda even further.”

Reinius, who selects hedge funds for his fund of hedge funds, says he sees an acceleration in the adoption of sustainability in the market. “It is still a challenge for a CTA manager, for example, to integrate sustainability. But five years ago, very few hedge fund managers thought that it was important to look at it. Now all of them know it is a crucial aspect of investing, and at least, they have a good explanation if they are not doing something. The trend is definitely positive.”

Hasselgren agrees that the field of sustainability is continuously developing, also in the hedge fund space. “That said,” she adds, “we have to take a step back and talk about what we mean by sustainability, ESG, or ESG integration which is a term on many policy documents and presentation materials. The way I view it is that true ESG integration is about investing. ESG then becomes a factor along with other investment factors. It should be embedded in a holistic approach to valuing a company. This has been an important part of the dialogue with hedge funds in the past. When you take all the acronyms and the greenwashing away, it is the factors that remain relevant.”

> “True ESG integration is about investing. ESG then becomes a factor along with other investment factors. It should be embedded in a holistic approach to valuing a company.”

EXPECTATIONS OF HEDGE FUND INVESTORS

For Eidolf, sustainability is also relevant with regards to how the actual fund company is run and managed. “If fund managers look at the G,” he says, “whether they care about ESG or not, they can all relate to the necessity of protecting their investors, regarding their product structure, transparency and independence, for instance.”

> “The UN has set a deadline in 2030 to reach those goals. With only 12 years to go, what does that mean for us?”

“When it comes to the implementation,” Eidolf adds, “we are a fixed income macro hedge fund, and it is not straightforward for us to implement ESG factors in our investment strategy. So for inspiration, we look at the Sustainable Development Goals (SDGs) developed by the UN a couple of years ago. The 17 goals are not necessarily equally relevant in the context of hedge funds, but what is key is that the UN has set a deadline in 2030 to reach those goals. With only 12 years to go, what does that mean for us? What can we do to contribute? For us, that's a good way to engage with our investors on the subject.”

“If we look at the number of sustainability reporting frameworks, there are more than 400! That is a staggering number.”

Talking about how investors view hedge funds, Hasselgren believes defining expectations and ambitions is crucial. “The challenge for all of us is to be clear on what we mean and how we view this area,” she says. “If we look at the number of sustainability reporting frameworks, there are more than 400! That is a staggering number. Add to that the number of stewardship codes, investor initiatives, identified sustainability and ESG factors, questionnaires. We need to pause and ask ourselves what this is all about. It is not about investing, but about something else that lands on investors and asset managers. They need to constantly answer questions from society, stakeholders, and of course also from the regulators. As a bank, we view ourselves a. a pillar of society, so we owe these answers to our stakeholders. For our investments, however, and when it comes to our hedge funds in particular, it's crucial that we view sustainability as a factor.”

WHERE TO START

The panellists also gave the audience some practical advice. Both Reinius and Odenberg agree that the minimum you can do as a fund manager is to sign the

“You should show investors that you care and that if you had better processes and measurements available you would implement them.”

PRI. As its name suggests, the PRI proposes a set of principles (6 in total) that guide investors in becoming more responsible in their responsible investing. “Sign the PRI and then read the guidelines thoroughly,” proposes Reinius. “You should show investors that you care and that if you had better processes and measurements available you would implement them.”

“I would talk to my investors and try to figure out what their values and expectations are, and then be transparent.”

“Start by defining what responsible investment mean for your type of investment strategy,” adds Odenberg. “As a minimum, I would talk to my investors and try to figure out what their values and expectations are, and then be transparent.”

“Your approach has to be genuine and close to your business.”

Eidolf continues on the theme of meeting investors' expectations, and he insists on keeping it authentic. “I subscribe to the idea that it is key to understand what responsible investment means to you because it can be subjective,” he says. “If you take all of your investors and line them up, at one end you put the most dedicated ESG investor and at the other end, one that is not so interested. Wherever they stand, all investors must be able to relate to what you are trying to do. Your approach has to be genuine and close to your business.”

“If you don't have your own agenda, your own solid platform to stand on, then you will be like a leaf going here and there.”

Hasselgren picks up on the importance for hedge funds to set up their unique sustainability agenda. “We live in a world where there are stakeholders everywhere. If you don't have your own agenda, your own solid platform to stand on, then you will be like a leaf going here and there. It is crucial to identify for yourself how E, S or G matters for your investment.”

WHERE THE FUTURE LEADS

“The hedge fund community can support the corporate world, by showing companies what is going to happen and suggest how they can position themselves.”

For Reinius hedge funds may have an opportunity to step up. “Hedge fund managers have a clear role to play because they are free to act,” he explains. “Much more so than many investors, especially those governed by large organisations. The world and more specifically the companies that we invest in will be affected by different environmental issues going forward. Carbon-related issues are only a start. I believe that companies will find themselves in situations similar to those the internet has created in many industries. Many companies will be affected by climate change one way or the other, and the hedge fund community can support the corporate world, by showing companies what is going to happen and suggest how they can position themselves.”

Odenberg sees possibilities in technological innovations. “I'm going to use two buzzwords,” she starts, “the analysis of big data and artificial intelligence. As we said, it is often quite difficult for systematic quantitative funds to figure out how to integrate ESG signals in their

“There is an opportunity to analyse vast quantities of information and to build that into our hedge funds.”

algorithms and models. Exploring big data and artificial intelligence may be an answer for them. There is an opportunity to analyse vast quantities of information and to build that into hedge funds. I hope to see those types of solutions emerge.”

“Are short-term hedge funds traders bad for the markets, or do they provide liquidity, and thereby contribute positively to a sustainable financial system?”

Eidolf shares some of the more low-tech solutions his firm has recently implemented. “There are several ways we can move forward, in multiple aspects. For example, a year ago we introduced an investor ombudsman on our board. The idea is simple: add an independent board member that solely focuses on the interests of the investors. We have gained on two fronts: we added a very competent person on the board while ensuring that we keep the investors' point of view in mind in all dimensions of our business.”

Another idea Eidolf contemplates is the role hedge funds can play more widely in the financial system. “At the PRI, for example, there is an active debate about the short-term nature of some investment strategies. Are short-term hedge funds traders bad for the markets, or do they provide liquidity, and thereby contribute positively to a sustainable financial system? There is some work to be done at the PRI level to make sure hedge funds are perceived as less dangerous for the community.”

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