MARCH 2019

HEDGENORDIC

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Where is the Nordic Hedge Fund Industy heading following its worst year in a decade?

NORDIC HEDGE FUND INDUSTRY REPORT 2019

AP funds´ New Approach to Alternatives

Record: Launches & Closures

In Focus: Uncorrelated Strategies

NORDIC HEDGE FUND INDUSTRY REPORT 2019

Contents

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INTRODUCTION

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

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

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

PUBLICATION PLAN 2019:

March:	Nordic HF Industry Report
June:	Private Investors
September:	Equity Strategies
October:	Norway
October:	Systematic Strategies
November:	Alternative Fixed Income

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Editor´s Note...

Ding ding ding…

When the boxing bell´s gong from the last round trading of 2018 faded, Nordic hedge funds started to lick their wounds and look back at the poorest performance in a decade. One must go back to the fall-out of the financial crisis, when terms as sub-prime, Lehman Brothers and Bear Stearns filled the front pages. The Nordic Hedge Index Composite (NHX) gave up 3,6%, closing at an index value of 183,4, the largest annual loss since 2008, when the NHX lost 9,4% in the year, closing at 116,4.

HedgeNordic´s own Eugeniu Guzun in his introduction to this report makes the case that in some aspects, 2018 actually was worse as declines may not have been as steep, but broader and across all sub strategies.

> "Everybody has a plan until they get punched in the mouth."
>
> Mike Tyson

What was also notable, was the dispersion of returns of managers within the same strategy, the most extreme maybe among long/short equity managers – who were all over the place. Returns, on a global scale, could be found returning from -70% to +70%, and beyond.

In all though, especially when comparing hedge funds to traditional, long only assets, under scrutiny, things do not nearly appear as bad as they look and feel on first sight.

Some managers, including smaller, more nimble traders, through exceptional navigation of a highly turbulent market and perhaps a bit of luck, managed to generate impressive returns for the year which was also the worst year for the S&P 500 Index since the financial crisis.

The year was also characterized by an unusual amount of new funds stepping into the ring, and those throwing in the towel.

The hedge fund space as whole has been under rapid fire by investors disappointed by fading returns, often seen as having high beta exposure to equity markets, failing to offer tailhedges, or crisis alpha.

Mike Tyson famously said in a post-fight interview in 1987, that "everybody has a plan, until they get hit in the mouth." 2018 was not a technical knock-out of the industry, but is to be seen if beating hedge funds took can be a catalyst to make to new plans, to revitalize the space.

Hedge funds are not known fo having a glass jaw, but rather in an infight have always been highly competitve and motivated champions of innovation, new technoligies and fringe contenders in finding those pockets of alpha.

One famous boxing quote claims "they never come back!" The hedge fund space, for one, and some of the former champions fallen from grace in particular, are sure to prove the bookies wrong and live to fight another day.

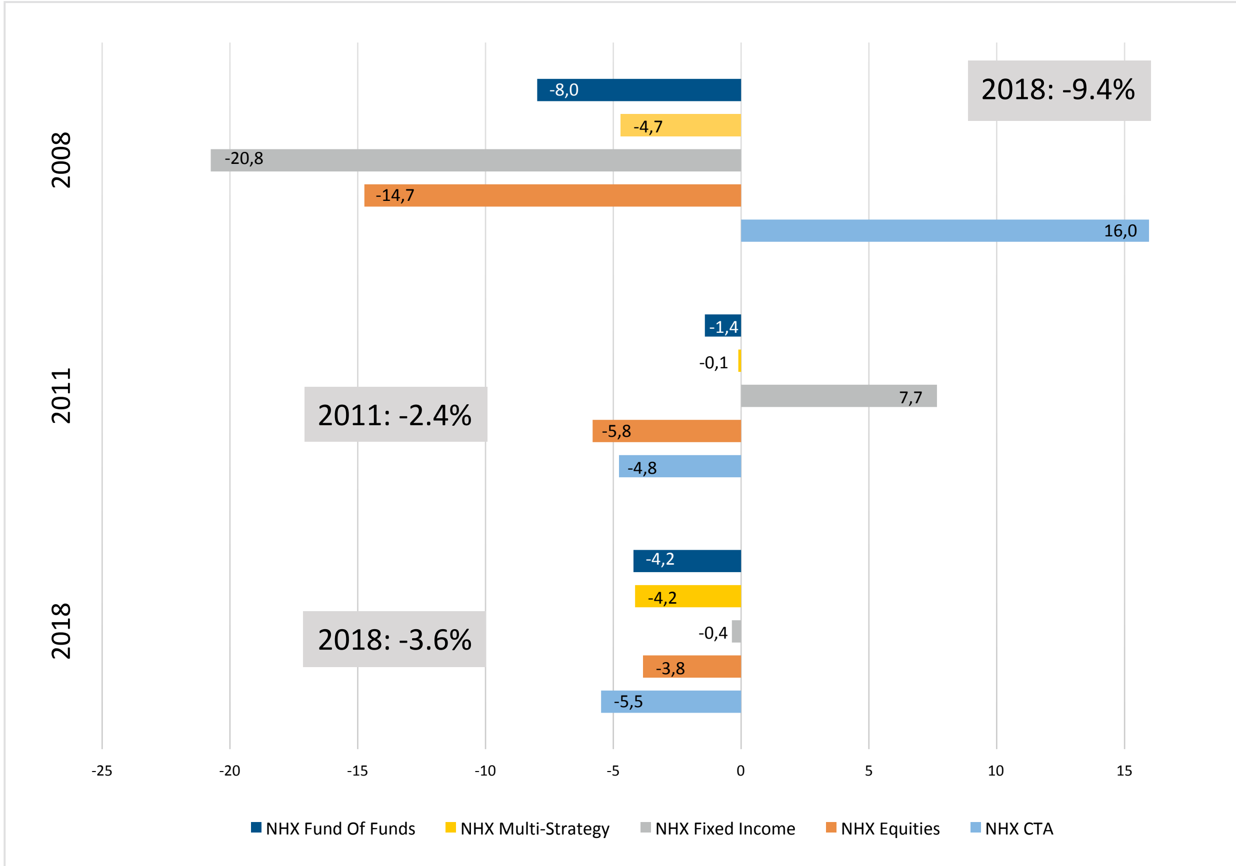
2019 started with some inspiring footwork, but there is still a long way to go to the final bell. Maybe it is time to drop the gloves and throw some bare-knuckled sucker punches.

KAMRAN GHALITSCHI
CEO & PUBLISHER HEDGENORDIC

A GLANCE AT THE NORDIC HEDGE FUND UNIVERSE

In 2018, the Nordic hedge fund industry suffered only its third year of negative performance since the Nordic Hedge Index (NHX) started tracking the industry back in 2005. With three down years during the 14-year history of the NHX, an interesting question to ask (and answer) is whether 2018 was actually the industry's worst ever year. This may be a trivial question, but 2018 was, indeed, worse than 2008 in some respects.

ANNUAL PERFORMANCE OF NHX SUB-INDICES IN 2008, 2011, AND 2018



Source: HedgeNordic

In absolute terms, during 2018 Nordic hedge funds declined by 3.6 per cent on average, recording their poorest year since the financial crisis in 2008, industry's worst year on record. In contrast to both 2008 and 2011, however, none of the five NHX strategy sub-categories managed to navigate last year's financial markets unscathed. 2018, therefore, goes down as the year with the broadest declines across all sub-strategies.

In 2008, trend-following CTAs booked an average gain of 16 percent, whereas funds of hedge funds, equity-oriented, fixed-income, and multi-strategy vehicles all recorded losses. In 2011, another down year for the Nordic hedge fund industry, fixed-income hedge funds stood out and earned an average return of 7.7 percent when all other strategy sub-categories booked losses.

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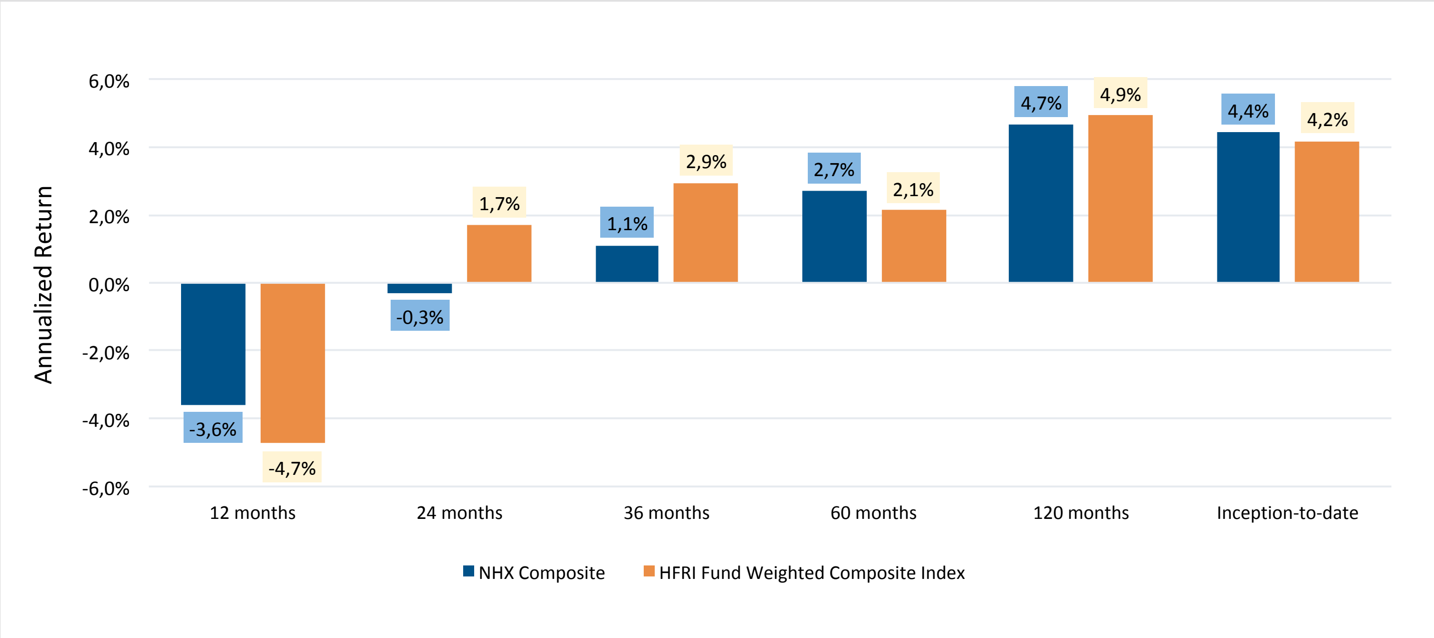
From Bad to Worse (to Good Again)

There is little way around the fact 2018 was a bad year for the Nordic hedge fund industry. In pure numbers, the second largest loss on record. But the industry's performance in recent years has not been exceptionally good in general. The Nordic Hedge Index earned an annualized return of 1.1 percent in the three years starting in 2016 while earning a much stronger 2.7 percent during the five-year period starting in 2014.

ANNUALIZED RETURNS OF THE NHX COMPOSITE VERSUS HFRI FUND WEIGHTED COMPOSITE



Source: HedgeNordic and Hedge Fund Research.

The longer-term performance of the industry appears more encouraging. The NHX Composite delivered an annualized return of 4.7 percent in the past ten years and 4.4 percent since 2005. The average monthly returns generated by all Nordic hedge funds ever included in the NHX Composite exhibited an annualized volatility of 3.8 percent in the past 14 years, which implies the industry has achieved a rather respectable Sharpe ratio above one.

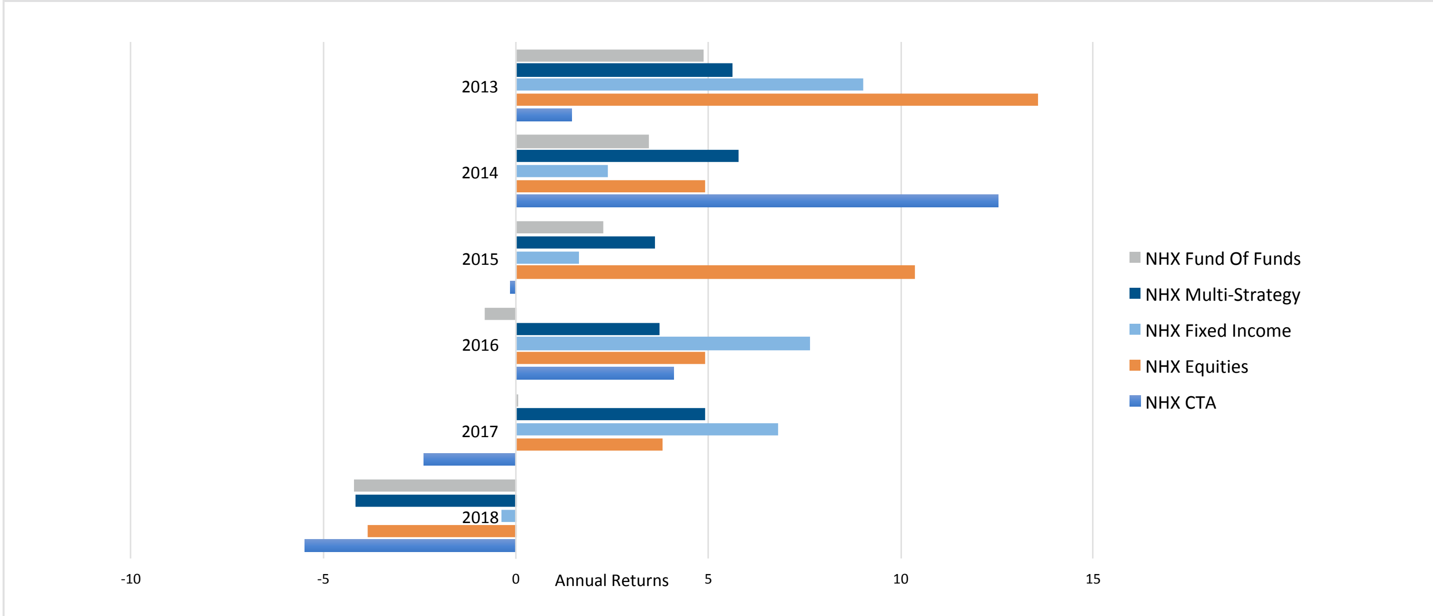
Although there is no simple yardstick to measure the success of the Nordic hedge fund industry, Nordic hedge funds performed broadly in line with their international counterparts in the past 14 years. Global hedge funds in 2018, as measured by HFR's Fund-Weighted Composite Index fell 4.7 percent on average. The HFR index, which includes more than 1,400 single-manager hedge funds that report monthly returns in U.S. dollars (whereas the Nordic Hedge Index reflects the net returns of each fund's main share class irrespective of currency), earned an annualized return of 1.7 percent and 2.9 percent in the past two and three years, correspondingly.

In the five years starting 2014, Nordic hedge funds outperformed their global peers by 0.8 percentage points, but the longer-term performance of global hedge funds is similar to the performance of their Nordic peers. HFR's Fund-Weighted Composite Index earned an annualized return of 4.9 percent and 4.2 percent in the past ten and 14 years, respectively. The HFR's index, however, exhibited higher volatility in returns. Its annualized volatility in returns stands at 5.8 percent and 5.1 percent for the past ten and 14 years, correspondingly. This translates into a Sharpe ratio well below one for the industry. Long story short, Nordic hedge funds have historically beaten their global peers.

Sub-Strategies: Which Strategy Performed Worst?

Nordic fixed-income hedge funds as a group outperformed the other NHX sub-categories for three consecutive years, but equity-oriented vehicles still achieved the highest annualized return in the five years starting in 2014. The 61 Nordic equity hedge funds HedgeNordic currently tracks in the Nordic Hedge Index earned 6.6 percent on average in the past five years, whereas fixed-income hedge funds gained 5.4 percent in the same period. CTAs formed the worst performing group in each of the past two years, yet still managed to outperform funds of hedge funds in the past five years. CTAs earned an annualized return of 1.8 percent in the five-year period starting in 2014, whereas funds of hedge funds earned a mere 1.1 percent in the same period. Multi-strategy funds, meanwhile, delivered an annualized return of 3.8 percent in the five years before this year.

ANNUAL PERFORMANCE OF NHX SUB-INDICES IN EACH OF THE PAST FIVE YEARS.



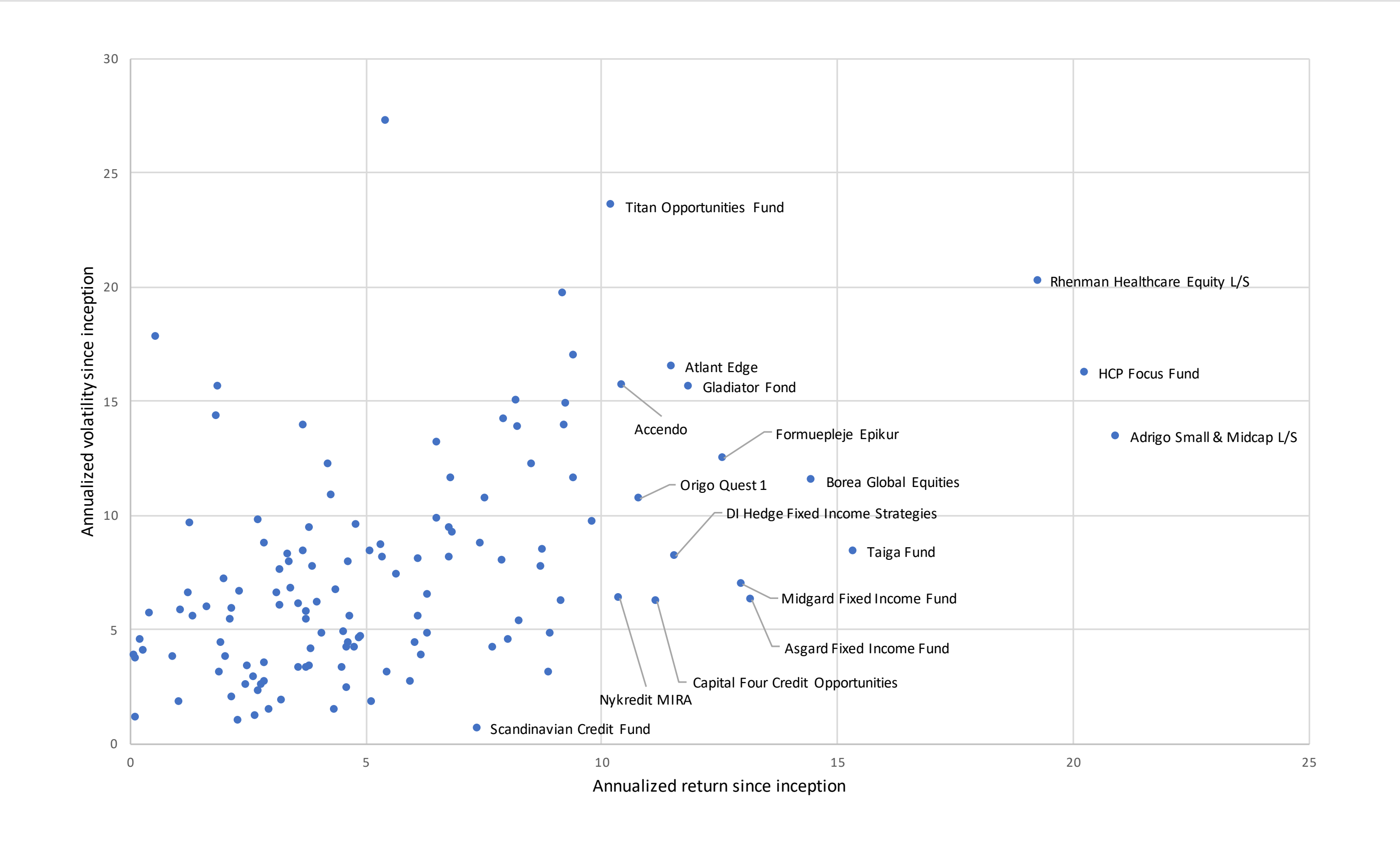
Source: HedgeNordic

Country-by-Country Stats

Swedish hedge funds, by far the largest group within the Nordic Hedge Index (NHX), were down 2.7 percent on average last year. Only around one in three of the 102 Swedish funds included in the index closed the books for 2018 in the green. Danish hedge funds, traditionally heavy on fixed-income strategies, represented the strongest region across the Nordics and over 40 percent of Danish funds delivered returns above zero last year.

FUND NAME	SWEDEN	DENMARK	FINLAND	NORWAY
Number of funds	102	37	17	17
Average 2018 return	-2,68%	-0,94%	-8,07%	-7,29%
Proportion of gainers	35,6%	40,5%	23,5%	29,4%
Proportion of young funds (between 0-3 years)	28,4%	43,2%	11,8%	17,6%
Proportion of mid-aged funds (between 3-7 years)	23,5%	16,2%	41,2%	29,4%
Proportion of old funds (over 7 years)	48,0%	40,5%	47,1%	52,9%
Performance dispersion (difference between top and bottom 30%)	16,5%	10,5%	22,1%	16,5%
Average compounded return since inception	3,65%	6,04%	2,68%	7,12%
Average annualized standard deviation	7,46%	7,63%	10,63%	10,36%

MAP OF NORDIC HEDGE FUNDS BASED ON ANNUALIZED RETURNS AND VOLATILITY.



Source: HedgeNordic

Conclusion

Without a doubt, 2018 was not a good year for most Nordic hedge funds. While investors suffered losses from their exposure to different asset classes last year, Nordic hedge fund investors relished a one-in-three chance of booking a profit for the year, with one in every three members of the Nordic Hedge Index ending 2018 in the green (acknowledging there is a small survivorship bias.)

Based on the strategies employed by most Nordic hedge funds and the net market exposure maintained by these vehicles, one cannot expect the industry to provide constiant returns in the double digits.

Some hedge fund can and will deliver these returns occasionally, but one should not forget the essential benefits of hedge fund strategies: diversification, decorrelation, and solid risk-adjusted returns.

Max Mitteregger, Portfolio Manager - Gladiator Fond

Win the Crowd and Win the Freedom*

*Quoting Proximus, from the year 2000 film "Gladiator" which one five Oscars

By Eugeniu Guzun – HedgeNordic

The long-running market rally we have observed, and some enjoyed since 2009 has translated into impressive returns for long-biased and long-only stock pickers. Max Mitteregger, the founder and portfolio manager of Stockholm-based long/short equity fund Gladiator Fond, managed to beat equity market indices with considerably less market exposure.

Gladiator's Post-Financial Crisis Journey

When loaded up on significant market exposure in a bull market, the laws of chance would permit a few fund managers to turn in strong track records for the past decade. Mitteregger took a different approach to earn market-beating returns. With an annualized return of roughly 16 percent since 2009, Gladiator Fund did turn in a strong record indeed. These impressive results, notably, were achieved with minimal exposure to equity markets.

From a cozy office facing the Berzelii Park in central Stockholm, Max Mitteregger has been keeping Gladiator Fond's average net market exposure at around 15 percent since 2011. After booking a 45 percent return in 2009, which more than recouped the fund's losses in the prior year, and advancing an additional 18 percent in 2010, Mitteregger turned bearish on stocks as a result of the massive central bank money printing. His bearish views helped Gladiator Fond book a ten percent gain in 2011.

"After 2010, I started to become quite bearish on equities. My concerns around the uncertain effects of the printing of money were growing, that's why the fund performed well in 2011 even though markets were down heavily due to the European crisis," says Mitteregger. "Gladiator has been run with a very low net market exposure since then."

"The leverage in the financial system is significantly higher now than in 2008," Mitteregger speaks out his concerns. With the near-zero interest rates and the massive stimulus programs not translating into stronger economic growth, Mitteregger reckons "we are close to the end." The portfolio manager anticipates sluggish economic growth for a long time, "that's why I invest in companies that can grow despite low economic growth."

> "I like to own companies that can grow at a much higher pace than the global economy, companies with good growth prospects regardless of what the economy does..."

Effect of Bearish Views on Investment Style

Gladiator is a long/short equity fund maintaining a highly concentrated portfolio, consisting of only 12 to 15 companies in the long book. Each of the fund's three largest holdings accounts for 10-15 percent of the portfolio, with two additional names accounting for around eight percent each. Mitteregger holds the same positions for a very long period. "I don't change the names in the portfolio very often. I stick with the same holdings for many years," he says on his favorite holding period. "If the valuations of my holdings are stretching, I usually sell a little bit. I build up my positions again when valuations become cheaper."

Since turning bearish on equities and major economies in 2011, Mitteregger decided to invest in companies that can grow regardless of where we are in the business and economic cycles. "I like to own companies that can grow at a much higher pace than the global economy, companies with good growth prospects regardless of what the economy does," says Mitteregger. "Although I prefer investing in growing companies rather than cheap stocks such as Swedish banks, I want to buy these growth companies at reasonable price levels."

Gladiator Fond has maintained a low average exposure to the market since 2011 and Mitteregger discloses he has turned "more net short this year than I have ever been." To reduce the market exposure, the portfolio manager keeps "a few individual short positions but mostly hedge the portfolio with OMX30 futures or put options on that index."

Around 95 percent of the hedging is done using futures and put options. "Since the OMX30 contains a lot of banks and a lot of cyclical companies, I like to be short the index," says Mitteregger. "I expect my holdings to outgrow and outperform the OMX30 over time; that's my view."

In addition to exhibiting good growth prospects, what all companies in Gladiator's portfolio have in common is trustworthy and strong management teams. "If a company suffers a bad quarter, I am not ditching the holding from my portfolio if the management can provide a reasonable explanation for the poor performance," says Mitteregger. Companies run by good managers allow him to put his trust in management to steer the ship in the right direction should things go wrong.

"I need to make some big bets to generate good returns."

2018 Performance, Differentiation, and Cap on Assets

Gladiator Fond earned 19.7 percent in 2018, making it the strongest net performer in the universe of 175 funds making up the Nordic Hedge Index (NHX). In the poorest performing year in a decade for the NHX, many other fund managers struggled to find ways to avoid the market turmoil. "Obviously, the main drivers of last year's performance are the five or six biggest names in the portfolio," says Mitteregger. Calming his success last year, the portfolio manager says "it was just a coincidence that a couple of my big names performed extremely well during the year." Last year's performance was not a one-off event though.

The fund delivered an average compounded return of almost 12 percent per year since launching in early 2005. Its performance in the post-financial-crisis period has been even more impressive. Part of that success stems from Mitteregger's skill at identifying high risk-reward opportunities in the biotech space. "I need to make some big bets to generate good returns," says the portfolio manager. "If everyone is saying a biotech's value can go to zero, but I see a 75 percent chance of making four times the investment, I can afford to allocate six or seven percent of capital to that bet."

More importantly, Mitteregger has skin in the game to make such bets. "Almost all my savings are invested in the fund, so I try to manage all investors' money as if it's my own capital." Currently overseeing SEK 4.6 billion in assets under management, Gladiator Fond was closed to new investors at the end of last year. "You don't have to run for all the money; it is not getting easier to get higher returns as assets under management get bigger," concludes Mitteregger.

Business-Owner Mindset Helps Borea Sit Through Downturns

By Eugeniu Guzun – HedgeNordic

Equity-oriented members of the Nordic Hedge Index dominate the list of the top five all-time performers. With an annualized return of 14.5 percent since kicking off operations in the last quarter of 2011, Norwegian equity fund Borea Global Equities rounds out the top five.

A great deal of that success is down to the team's focus on buying mispriced businesses with long-lasting competitive advantages that function as compounding machines. But equally, it is about having a rooted business-owner and long-term-oriented mindset.

"…we want to own companies that can defy capitalism by delivering returns on invested capital above their cost of capital over an extended period, both proven historically, but more importantly, continuing to do so in the future."

Great Companies at Bargain Prices

As bottom-up investors, the three members of the team running Borea Global Equities have a clear understanding of what companies match the criteria for inclusion in their concentrated portfolio, which usually hosts between 10 and 15 companies. According to portfolio manager Kjetil Nyland, "we want to own companies that can defy capitalism by delivering returns on invested capital above their cost of capital over an extended period, both proven historically, but more importantly, continuing to do so in the future."

The three-member team, which, next to Nyland, includes CIO Willy Helleland and portfolio manager Peer Hastrup Thorsheim, prefers to "fish in industries and among business models that naturally lend themselves to good business economics" reasons Nyland. "By good business economics,

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we mean high returns on both existing and new capital employed, solid market positions, rational capital allocation and a long runway for profitable growth," he adds. High-quality businesses are always up for grabs, but Mr. Market rarely offers them at bargain prices.

Kjetil Nyland, responsible for the day-to-day management of Borea Global Equities, and his colleagues attempt to identify and invest in high-quality businesses only at discounted valuations. As Nyland explains, "we want to familiarize ourselves with the "crème de la crème" of businesses out there, with Europe as our home turf, and do most of the work upfront and then wait for the market to present a favorable price." Company-specific news, general market declines, forced selling on the part of large investors, or many other reasons may, at times, allow long-term-oriented investors to build up positions in high-quality businesses at attractive prices.

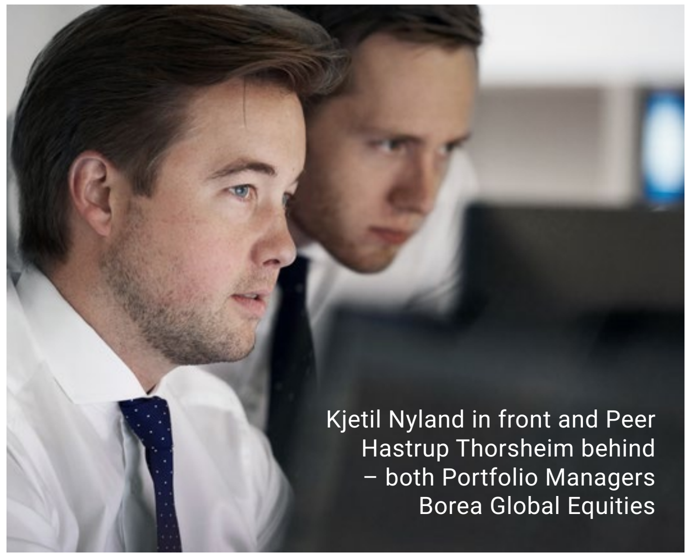
Exploiting Mr. Market's Failures

Explaining why good businesses occasionally trade at bargain prices, Nyland says "what we often see is that people dislike uncertainty, and as a consequence, markets tend to over-discount the uncertainty related to identified risk and under-discount abstract risk." On certain occasions, Mr. Market fails to properly appraise certain businesses, creating buying opportunities for investors such as Borea Global Equities. "We find situations characterized by higher perceived risk compared to actual underlying business risk often provide compelling opportunities."

The team at Borea Global Equities maintains a list of companies they would like to own at the right price, ready to deploy capital whenever Mr. Market offers good bargains. "A good starting point and fertile hunting grounds for good ideas, in general, have been markets, sectors or geographies with a strong negative backdrop of some kind; it could be an index-specific dislocation where great companies are shot by association despite an entirely different set of value drivers," Nyland describes their idea generation process.

"We like to label these type of situations as "perception gaps," where essentially the price mechanism for public companies breaks down and Mr. Market shows its beauty compared to private markets," Nyland adds. Rather than merely focusing on buying stocks on the cheap, the team attempts to find "competitively positioned businesses

> "…we are more rooted in a business-owner mindset and long-term prospects than trading. Due to this approach and having long-term investors, we can afford to sit through downturns…"



Kjetil Nyland in front and Peer Hastrup Thorsheim behind – both Portfolio Managers Borea Global Equities

compounding intrinsic value at high-teens internal rates of return, preferably using a modest amount of debt" Nyland emphasizes. "If cheapness is your primary and only filter for sourcing ideas, you may eventually get multiple expansion, which is fine, but often you end up losing in the long-run because of weakening fundamentals and bad capital allocation."

A Diverse Toolkit Put to Work

Because of the bottom-up focus, Borea Global Equities does not target a specific gross or net exposure. "Our exposure at any given time is the residual of the number of opportunities we can identify both on the long and short side," acknowledges Nyland. In addition to the concentrated portfolio of long positions, the fund typically holds no more than five short positions. "We generally do not short based on valuation alone," he says about their approach to shorting, adding that "we typically only get involved on the short side if we see a stretched balance sheet and a specific catalyst in place, combined with a lofty valuation."

The team led by Willy Helleland also manages Borea Asset Management's fixed-income hedge fund, Borea Høyrente, which enables them to use their experience in bond investing in finding short candidates for the equity vehicle. "Usually the bond market is better at pricing credit risk, and sometimes we find short candidates by comparing how the bond market prices the debt of a company, compared to how the equity is valued," states Nyland. When the team locates discrepancies, they take a more in-depth look at each situation in an attempt to find short candidates.

"A common thread on the short side has been situations where we have been able to utilize synergies from many years as a bond investor and understanding the nuances and dynamics of restructuring processes," Nyland explains how their investing experience in fixed-income markets helps manage the equity fund. The team does not constrain themselves to entering long and short positions only. "We have quite a flexible toolkit in our arsenal, and we use options strategies in certain situations where the overall risk-reward profile looks attractive."

Nyland and his colleagues found long-term equity anticipation securities (LEAPs), or long-dated call options with multi-year duration, quite attractive at least up until the first quarter of last year. "Option-pricing models like Black & Scholes are value-agnostic when it comes to the underlying security, and the implicit normal probability distribution assumption does not often reflect the underlying reality of the business, which again provides opportunities especially when you extend the time horizon," says Nyland. The Borea team look at LEAPs as "one of many tools which periodically provides cheap non-recourse leverage on a business growing intrinsic value." Spin-off opportunities and upcoming index changes also occasionally offer attractive risk-reward investment opportunities.

Industrial Mindset of Owners

Borea Global Equities is "basically sifting the world looking for a handful of extraordinary risk-reward opportunities." The team wants to be part-owners of great companies and want to participate in the long-term compounding of intrinsic value rather than engage in in-and-out trading based on changes in investor sentiment.

Based in the city of Bergen in Norway, Borea Asset Management inherited a strong industrial heritage from its main owners as a result. For that reason, "we tend to have a more industrial approach than traditional fund managers," says Nyland, adding that "we are more rooted in a business-owner mindset and long-term prospects than trading. Due to this approach and having long-term investors, we can afford to sit through downturns," concludes the portfolio manager.

Holding Steady in a Shaky Market

By Aline Reichenberg Gustafsson, CFA - HedgeNordic

> "The alpha from the short book wasn't as high as we would have hoped, but the relative sizing of the book helped us to keep our net exposure closer to neutral."

As HedgeNordic took a closer look at last year's winners, Bodenholm stood out as one of the few fund managers having held a steady keel in last year's rough markets. With a full year performance of 6.5%, Bodenholm One ranks fourth out of 60 funds in the equity category of the Nordic Hedge Index. HedgeNordic asked Per Johansson, fund manager and founder of Bodenholm, how his team generated this positive return while dealing with risk management.

"Some people talk about a crazy year," starts Johansson, "I would say that what we saw was a repricing of risk, rather than a totally unexpected market correction. Markets for both equity and bonds had been going up for a long time, and some segments had reached very high valuations. Many investors ended up concentrating in similar assets, which may have accentuated the correction. It ended up being a wasted year for the hedge fund industry. While we didn't aim to time the market exactly, we did expect an opportunity to see the spreads between winners and losers increase. Given that it happened as we wished, I'm slightly disappointed that we didn't do even better."

PER JOHANSSON
CIO & FOUNDING PARTNER
BODENHOLM CAPITAL

On the one hand, Johansson believes that timing could have been improved on the long book but worked out for the best on the short side. "Some of our longs hurt us, as they had high cyclical exposure," he says. "However, we were protected by a solid short book. The alpha from the short book wasn't as high as we would have hoped, but the relative sizing of the book helped us to keep our net exposure closer to neutral. We have extended resources in strengthening our team dedicated to identifying short candidates as we hired one more analyst early in the year. As a result, we had opportunities to add more positions to the short book promptly."

For Johansson, a successful short relies on the ability of the manager to get three aspects right: fundamental analysis, risk management, and position sizing. "We went back and looked at the positions that generated the most alpha, and we adjusted our tactical sizing in accordance," he explains. "For us, the most effective strategy is to line up a larger number of small positions, rather than sizing to conviction, which involves an element of timing that is even more unpredictable on shorts than on longs."

While some of the long stocks worked against the portfolio in 2018, Johansson is confident that the rationale behind the investment case is still there, and he looks forward to the bounce. One example is a private jet airport operator the fund invested in. "This is a typical case for us, as we focus on spin-offs or de-conglomerations. In this case, we are looking at a monopoly infrastructure asset, benefitting from strong pricing power, and some volume growth over time. The company is selling a third of its non-core activity (aeroplane maintenance and repair) to become a pure play. In 2018, the company announced a growth slowdown from 3 to 2% and the PE multiple contracted violently from 16x to 9x, taking the stock price down 35%. Of course, we were surprised by the magnitude of the reaction, but we are as optimistic as ever that the case is still there, and we expect the stock to bounce back when their divestments are complete, and the industry growth stabilises."

"Could we have picked a better timing?" continues Johansson. "Yes, of course, we can always do better, and perhaps most in terms of sizing, we could have started with a smaller position and waited for a fatter pitch. On the other hand, timing is the hardest thing to get right. We looked at a hotel chain which we believed was attractively valued, and we started buying slowly, given the cyclical nature of the sector. Then the company got bought out by LVMH, and we regretted not having bought more."

"The risky stocks got dumped, yes," says Johansson, "but we are one year further in the cycle, and there is much downside left in the economy."

Going into 2019, Johansson believes in keeping the cyclical exposure low. "We position ourselves to gain from company-specific risk instead of cyclicality," he explains. "Schibsted, for example, is a more volatile stock, and we believe in its long-term value, which will benefit from its monopolistic position."

After all, there may be further downside ahead. "The risky stocks got dumped, yes," says Johansson, "but we are one year further in the cycle, and there is much downside left in the economy. It is hard to say that it is all already priced in." For the team, the path going forward is to continue to focus on the stock picking, with a proven recipe. "We currently have 22 longs and 35 shorts. We don't have any top-down plays, and we continue to look for de-conglomerations, spin-offs as well as those we call 'quality compounders'," describes Johansson.

Johansson will also keep busy during the first quarter, as the fund is launching a UCITS version of its strategy. "Foreign investors are sometimes sceptical about Swedish AIFs, and we want to offer them an alternative that they will be more familiar with while keeping the same strategy that has worked well for us so far," he says. To share the workload, Johansson will be able to count on three new operational recruits including, Erik Orving, who joined in July last year from Stockholm-based Rational Asset Management and recently took over the role of CEO of the firm.

Last but not least, Johansson attributes at least part of its success to the support he has received from the platform the firm is part of. "I am particularly glad about the relationship with have with Brummer & Partners who have believed in us from the start," he adds. "They have been very supportive all along. Many investors commit the mistake of looking a three-month rolling performance, but real winners are made over several years. Brummer & Partners shares this belief with us, and we can count on them when we need it the most. When the markets are rough, who needs a fickle partner?"

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Finding Hidden Value in Neglected Nordic Companies

By Hamlin Lovell – HedgeNordic

Adrigo Small and Midcap Long/Short is up just over 28% from inception in October 2017 to February 2019. This is well ahead of its return target of 8-12% per year, and also higher than the 4-8% return target on Adrigo's flagship hedge fund.

Lead portfolio manager, Staffan Östlin, previously co-managed Origo Quest between January 2013 and June 2017. Adrigo's range of net exposure is expected to be between zero and 50% net long. Though Östlin cannot go net short, he anticipates that, "we might be able to profit during a bear market through stock selection that would make the portfolio behave as if it was negatively positioned". Östlin also believes in, "making use of the balance sheet and maintaining gross exposure of 175% or so, with a decent sized short book".

Staffan Östlin, Portfolio Manager – Adrigo Asset Management

Adrigo's investment universe is made up of 700-800 Nordic companies with market capitalization between SEK 500 million and SEK 55 billion; the sweet spot is expected to be firms between SEK 500 million and SEK 2 billion. Only about 25-30% of these 750 firms have regular sell side research coverage from major banks or brokers, and MiFID II – separating research from trading commissions - has probably reduced coverage. Some listed companies are even paying for research reports.

This extreme neglect opens up a wide field of opportunity for Östlin and co-portfolio manager, Johan Eriksson, who meet at least 200 companies each year and do in-house cashflow modelling. Östlin also leverages his, "extensive network of connections from 30 years in the markets, and picks up ideas from local media. We look at all IPOs but have only actually participated in three or four of them so far".

The key quality sought is change, which can include new management or structural changes at a firm. All current positions are located in Sweden, Norway, Denmark and Finland with some 50% of all positions outside of Sweden.

STOCK PICKS

Östlin runs a concentrated, high conviction book, with 15-25 long positions, of which five are classified as core, long term holdings, which can together make up around 50% of NAV. Dynamic longs (making up around 35% of NAV) can be shorter term, more opportunistic positions while high potential longs (targeted at 15% of NAV) are earlier stage positions.

Of course, some positions can migrate between these categories: Swedish firm, Bonesupport, which makes injectable bioceramic products to promote bone healing, started as a 1% position in the high potential longs bucket and has now grown to a 4-5% size.

Three of the core five longs are currently turnaround situations. For instance, industrial tools and supplies distributor Momentum Group is a firm Östlin has followed for many years. He expects them to increase margins as a consequence of their strategic plan shutting down unprofitable stores. Husqvarna has been hampered by a market fixation on the US consumer products business, but now this has been closed down, Östlin expects investors will shift their attention to its other three, profitable divisions. Holding company Bergman & Beving is another turnaround play. The company will continue to downsize the distribution segment while focusing on its high margin and cashflow generative own proprietary brands offering. A continued distribution network expansion of its own brands on existing and new markets will be the primary growth driver for Bergman & Beving going forward.

Contract drug manufacturer, Recipharm, is perceived to be a turnaround story but Östlin argues that, "the firm should turn out to be a long-term compounder, growing 5-10% per year, from its niche of manufacturing patented drugs for large and small pharmaceutical firms. We have followed the firm since it listed and know the management well. An ambitious acquisition programme contributed to a halving of the share price, which provided a good entry point. We have visited plants in France and Germany and believe that the capex programme is on track despite some delays in 2017 and 2018".

Atlantic Sapphire has an ESG angle: "its business model of farming salmon onshore, arguably avoids the ecosystem disruption and damage to wild salmon that can arise from farming salmon in the sea. The consumer perception of the model allows Atlantic Sapphire to command premium prices for its fish. Though listed in Norway, Atlantic Sapphire has expanded into Denmark and is building a large-scale facility near Miami in the US, which is expected to produce 90,000 tonnes a year by 2026" says Östlin.

In the dynamic bucket, Northern Drilling – which is majority owned by Norwegian billionaire John Fredriksen and has no debt - is an asset play, partly a play on a stronger oil price and could also profit if larger oil companies ramp up their exploration activity.

> "...monthly liquidity is more appropriate for the small and mid-cap fund, which is taking on some liquidity risk at least for the top five positions."

OVERLAP WITH FLAGSHIP FUND

In the long book, there is very little overlap with Adrigo's larger fund, the flagship Adrigo Hedge, which launched in 2006 (Recipharm is one current example) but the short books of the two funds have more common positions, partly because Östlin's short positions tend to be in rather larger companies than the longs. There is potential to use indices for shorts, but so far they have all been single stocks. Östlin is pleased to report he has never experienced a recall of stock borrowed.

The larger Adrigo fund last year moved to daily liquidity, but Östlin feels that, "monthly liquidity is more appropriate for the small and mid-cap fund, which is taking on some liquidity risk at least for the top five positions". This is one reason why the Swedish Special fund would not fit into a UCITS structure, which would require dealing at least twice per month. Östlin is confident that he could manage SEK 2 billion in the strategy, and intends to close the fund at SEK 3 billion.

ALIGNMENT OF INTERESTS

Adrigo owners and staff seeded the fund with SEK 125 million, and as such are substantial investors in the SEK 370 million fund. Additionally, 55% of the Adrigo management company is owned by management, staff and the board.

Adrigo's owners also include some high-profile businessmen in Sweden: Melker Schorling, former Chairman of Hexagon; Mikael Ekdahl, former partner of the Mannheimer Swartling business law firm, and Carl-Henric Svanberg, Chairman of BP and Volvo and former CEO of Ericsson. They have no input into the day to day management of portfolios, but can provide higher level strategic perspectives on industry dynamics.

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"Danish mortgage bonds are viewed as an attractive asset class to leverage because there has never been a default on the bonds since the market was born in 1797"

Michael Nielsen

Partner and Portfolio Manager at HP Fondsmæglerselskab

HP Fonds: Broadening Out Offering

Mainly Mortgages; Opportunistically Other Bonds Too

By Hamlin Lovell – HedgeNordic

Copenhagen-based HP Fonds celebrates its 15th year in 2019. The owner-managed boutique was started by two founders - Henrik Fournais and Peter Nauntofte. Fournais is active in the business to this day, while Nauntofte retired, but is still on the board of directors.

The other two co-owners - Michael Nielsen, who joined in 2008 from Carnegie Bank, and Thomas Kjaer, who joined in 2015 from Alm. Brand Bank – make up most of the five-strong investment team. Staff "eat their own cooking" by investing in their own funds. The firm manages DKK 8 billion (just over EUR 1 billion) in three segments. DKK 7 billion is in unleveraged long-only, split between HP Invest and HP Wholesale, which offers fee discounts for institutional tickets. Here, HedgeNordic will focus on the DKK 1 billion managed by HP Hedge, which is composed of two leveraged strategies and three vehicles.

HP's oldest hedge fund strategy, which has been nominated for two categories for the 2018 Nordic Hedge Award, and received a EuroHedge award for "best fixed income hedge fund" this year, has been hard closed since August 2018 and will only grow assets through performance. Capacity is constrained because the strategy seeks out older mortgage bonds that are an endangered species because a very small percentage of the original loan pools exist. They can be inefficiently priced, partly due to there being little coverage from brokers or the buy side. They can also offer higher yields because they are not eligible under the Basel LCR (Liquidity Coverage Ratio) hence are more costly for banks to hold. Danish mortgage bonds are viewed as an attractive asset class to leverage because there has never been a default on the bonds since the market was born in 1797. Yields are leveraged using repoes or loans, to generate carry of over 1% per turn of leverage, and a return forecast of CIBOR 12 +5% over three years, while hedging interest rate risk.

HP's new hedge fund strategy, HP Hedge Fixed Income, has the same return target, generally hedges rate duration risk, and uses the same investment process that complements quantitative models with qualitative analysis. "But it has only around a 15-20% position overlap with the closed fund" says Nielsen.

While the DKK 3.4 trillion (EUR 450 billion) mortgage market still makes up 75-80% of the fund, it is invested in more liquid mortgage paper, including more recent bond issues. Leverage of 3-6 times, provided by custodian bank Nordea, magnifies the carry.

Most of the Danish mortgage bonds have a AAA credit rating from Standard and Poors, but a small part of the Danish mortgage market is not rated, probably due to the fees required to get a rating. The fund has some flexibility to invest in unrated

Danish mortgage bonds, but is not currently exposed to them. In any case, the bonds are over-collateralised, and lenders have full recourse to other assets or income of the borrower (in contrast to non-recourse mortgages in the USA, where lenders can only foreclose on the mortgaged property)

Most of the holdings are non-callable bonds, with interest rate risk that is hedged, and spread risk that provides the carry: yields of 0.25% to 0.50% are around a whole percentage point above funding costs (which are slightly lower than for the older hedge fund).

"Around 20% of the mortgage bond allocation is in callable bonds, which offer a higher yield in return for their prepayment risk, which cannot be precisely hedged. Around 10-15% of the carry can be spent on options hedging the rate risk, but a sharp increase in prepayments could be costly: we estimate a 1% rise in prepayments could cost the fund about 0.25%. Conversely, a drop in prepayments could produce profits for the fund. Prepayment rates in Denmark vary a lot: they are at all-time lows for high coupon bonds, but can be much higher on low coupon bonds" explains Nielsen.

Carry is a key driver of returns, but roll-down is also important, particularly given steep yield curves. "With five-year senior non-preferred bonds from Nordic SIFI banks paying 160 and three year bonds paying 100, as the five year bond matures it should see some capital appreciation from the tighter spread" says Nielsen.

Beyond mortgages

The new fund can also invest in a range of other areas in the Nordics and elsewhere in Europe: covered bonds issued by Danish central and local government agencies; Swedish Bostad bonds, and sometimes it may make opportunistic excursions into other European government and corporate bonds, including Finnish municipals issued in Denmark, and bank paper.

Some trades are carry trades but others are more based on relative value. For instance, the fund currently has a trade investing in senior, unsecured 'tier 3' bonds recently issued by European banks under the new 'bail in' rules. "These rank above contingent convertibles (CoCos) in the capital structure and pay around CIBOR+160 basis points. As usual, the interest rate risk is hedged, using one or more of: German Schatz/Bobl futures, Danish government bonds or swaps. We expect that the spread could compress as the paper, which as an investment grade BBB credit rating, should attract demand from pension funds and insurers" points out Nielsen.

"The number of banks making markets in Danish mortgage bonds has dropped from 20-25 down to a handful, and the new Basel rules forced the banks to roughly halve their holdings in 2015."

Currently, the fund has no exposure to non-bank corporate debt, but could opportunistically invest in it in stressed conditions. Similarly, European government bonds, normally up to a maximum of five-year maturity for BBB rated countries. Countries rated below BBB can only be invested in to a very limited amount, and only with 2½ year maturity.

Liquidity and Bid-Offer Spreads

Given that interest rate risk is hedged, and credit risk has historically been a spread risk rather than a default risk for Danish mortgage bonds, the returns on HP's strategies can be seen as partly an illiquidity premium.

"The number of banks making markets in Danish mortgage bonds has dropped from 20-25 down to a handful, and the new Basel rules forced the banks to roughly halve their holdings in 2015. As a consequence, bid/offer spreads have widened out to 0.25% or 0.50% in some cases. In a low interest rate climate, this can add up to one or two years' coupon income" reveals Nielsen.

"We try to trade inside the spread and would only expect to pay more in stressed market conditions" he says. Therefore, the strategy is mainly about buying and holding bonds for many years - and usually to maturity.

It also makes sense for the strategy to have entry (1.5% for retail and 0.5% for institutional) and exit (0.375%) fees, so that inflows and outflows reflect the associated transaction costs of buying and selling bonds. These fees are sometimes described as an "anti-dilution levy". The subscription and redemption fees are paid to the funds, to protect investors from these frictional costs, though part of the subscription fee can also be paid to distributors under MiFID II.

Danish mortgages are not alone in having become less liquid over the past decade. Many parts of the corporate credit markets in the US and Europe have also reported liquidity issues, as regulations mean banks hold less inventory. Equally, if some investors cannot accept this liquidity risk, there could be better opportunities for those who can take a longer-term view.

Henrik Fournais and Thomas Kjaer at EuroHedge, receiving an award for "best fixed income hedge fund"

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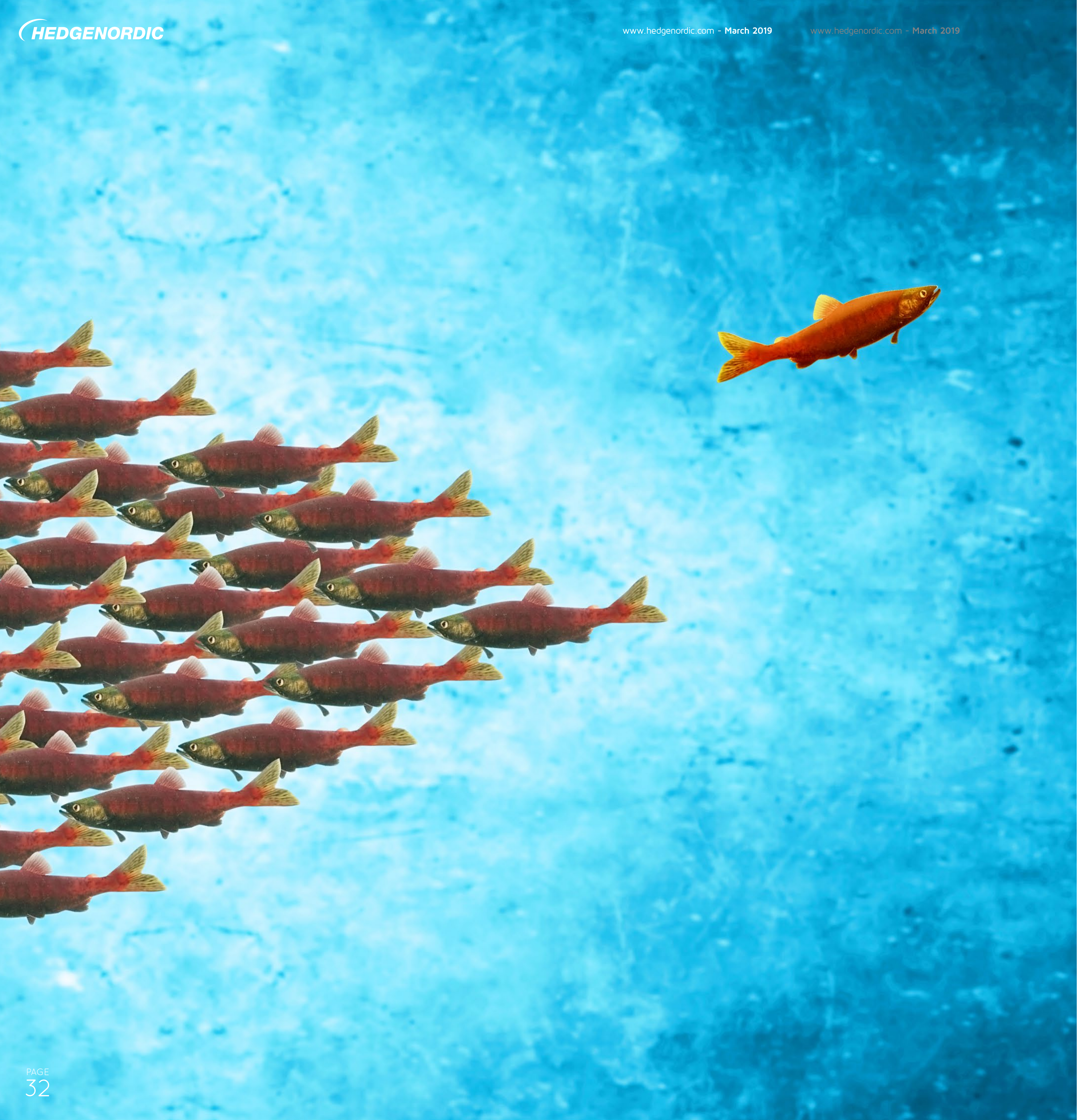

IN FOCUS:

The Search for Diversification

By Hamlin Lovell, HedgeNordic

2018 saw a synchronized downturn nearly all liquid asset classes and markets, with 90% of liquid asset classes losing money – the highest proportion since 1901, according to Deutsche Bank data. There were very few places to hide. The majority of broad hedge fund strategy indices lost money, including some non-directional strategies, such as many equity market neutral funds, partly because factor returns were unstable. There were exceptions however: one market neutral Nordic Hedge Index member, Formue Nord A/S, made 13.59% in 2018.

The search for uncorrelated strategies can be categorized into four areas: illiquid assets; different markets; different factors and different models. The articles following this introcution will introduse some of these strategies with concrete examples.

Illiquid assets

Starting with illiquids, strategies such as direct lending and asset-based lending generally held up well in 2018. This is partly because they are valued using models rather than market prices. Many direct lending funds will not recognize losses until and unless a borrower has been in default for a number of months – even if credit spreads have widened out. That said, asset-based lending strategies lending at a decent discount to collateral values can be in a “heads you win, tails you win” situation: even if the borrower defaults, they can still make a profit by foreclosing on and selling the collateral.

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Still, these strategies may often involve a fund lock up of at least three to five years, which is too long for many investors. Where can diversification be found in the liquid space?

Different markets

The obvious area to look is different markets, including insurance linked securities, catastrophe bonds, life settlements, electricity, or cryptocurrencies. These markets should not be correlated to financial markets - but of course there is no guarantee that they will actually profit during a down year for equities and bonds.

CAT bonds have had a rough two years, partly due to more natural catastrophes occurring, and some say this is partly due to climate change. Payouts for insured losses were $79 billion in 2018, following $150 billion in 2017. The Eurekahedge ILS Advisers index lost 3.92% in 2018, after losing 5.6% in 2017, but there is a wide spread of returns and some managers made money in both years. The Swiss Re CAT bonds index actually made 2.52% in 2018. But as the CAT bond market reached record size of $34.8 billion in 2018, the head of Swiss Re publicly suggested that investors would be disappointed by returns. It is possible that too much capital has flowed into the space, depressing returns.

Life insurance related investments have fared better. The AAP Investable Life Settlement Index made over 10% in 2018, and has been rising steadily since the index was created in December 2012. Life settlements involve buying life insurance policies, paying premiums, and collecting payouts upon mortalities. The distribution of mortalities should not be correlated to financial markets, and discount rates used to value the policies have also been fairly stable in recent years.

As rainfall is a key driver of pricing for Norway's hydro-electric industry, there should not be a financial market correlation. It was an unfortunate coincidence that a Norwegian electricity trader, Einar As, lost USD 114 million in September 2018, as the spread between Norwegian and German electricity prices blew out. A breakdown in historical correlations can of course cause losses in alternative as well as traditional financial markets. But as always, manager selection matters and some electricity traders did well last year: Nordic Hedge Index member, Shepherd Energy Portfolio, who have been trading electricity for over 16 years, were up 13.78%.

> "2018 saw a synchronized downturn in nearly all liquid asset classes and markets, with 90% of liquid asset classes losing money – the highest proportion since 1901, according to Deutsche Bank data. There were very few places to hide."

As bitcoin prices crashed in 2018, it is no surprise to see the Eurekahedge Cryptocurrency index down 71.68% last year. But even in this asset class, there are some relative value traders, essentially making markets in cryptocurrencies without taking a directional view, who profited - mainly from bid/offer spreads, and sometimes from arbitraging pricing discrepancies between different market venues.

CTAs in general had a challenging 2018, but some of those trading less well followed commodities, and trading Chinese commodity markets, which are starting to open up to overseas investors, did much better. For several years, those CTAs trading OTC (Over the Counter) non-exchange traded markets (such as Brummer seed Florin Court) have outperformed, though many of them did not profit in 2018.

Relative value commodity traders, doing trade types such as calendar spreads, often did better than directional traders in 2018, which leads us on to the topic of factors.

Different factors

Hedge funds trading conventional commodity markets could be wagering on the shape of the curve, or looking to pick up positive carry from roll yields, rather than taking a directional view. Curve gradient and carry are clearly different from the momentum factor that lies behind many traditional, trend following CTA approaches.

Within the CTA universe, short term traders – who follow a variety of approaches including mean reversion - outperformed, with the SG Short Term Traders index flat in 2018, while Nordic Hedge Index member, Estlander and Partners Presto, made 7.99%.

Most asset managers have some kind of factor exposures, and Alternative Risk Premia managers are explicitly seeking to capture factor returns. On a risk-adjusted basis, most ARP managers performed poorly in 2018, but the spread of returns was wide. The devil is in the detail of how managers define factors, and apply them.

Merger arbitrage partly profits from deal break risk, and this was a bright spot in 2018, with the strategy index posting low single digit returns as spreads widened but most deals still completed.

Models and data

Last but not least, some hedge fund managers may trade only a handful of the largest and most liquid markets, but do so with very different models, that may not easily fit into any standard factor labels. One example here is Sweden's IPM – Informed Portfolio Management, which has a return profile that does not show correlation to anything we have identified. The manager's flagship systematic macro strategy made 1.86% while its systematic currency strategy was up 3.35% last year.

Some managers are using alternative data, 'big data' and advanced techniques including machine learning, statistical learning, and alternative intelligence, to build new types of models, with different inputs and different mechanics. The skeptics argue that there is a lot of 'hype' around these new approaches, and may point out that the Eurekahedge AI Index lost 5.18% in 2018, very close to the average hedge fund. Nonetheless, that index has shown a Sharpe ratio of 1.63 since 2011, and 2018 was its only losing year. If institutional investors are taking a five or ten year view on hedge fund allocations, it may be better to look at multi-year periods rather than obsess about a one year period.

Calendar years are also somewhat arbitrary, so it may be more useful to look at a range of rolling 12-month periods. Shifting from calendar year 2018, to February 2018 to January 2019, changes the sign from negative to positive for many managers.

Multi-managers

Fund of hedge funds or multi-manager vehicles could be a useful way for some investors to access more unusual and uncorrelated managers, including some of those highlighted above and other approaches.

For example, Sweden's Merrant Alpha Select, which follows a unique and very selective approach to picking uncorrelated managers, made 2.2% in USD in 2018. In the USA, SkyBridge Capital's fund of funds, which manages c.$9 billion, made between 3.6% and 4.5% depending on vehicles, outperforming the broad hedge fund industry by 9-10%. SkyBridge has exposure to a number of specialist credit managers. Global fund of hedge fund assets of around USD 600 billion still represent c.20% of hedge fund industry assets of roughly USD 3 trillion, and the fund of fund industry should not be written off.

Jonas Martenson, Sales Director and Founder – RESS Capital

By Hamlin Lovell – HedgeNordic

RESS LIFE INVESTMENTS

LOWLY CORRELATED, LONG TERM YIELD INVESTING

The secondary market for US life assurance policies is estimated to be worth $3 to $5 billion of face value per year, which is a drop in the ocean of the total market size of trillions of dollars. "This is partly because many policyholders are unaware that they can sell their policies, and instead let them lapse worthless - producing a windfall profit for the insurance company that has collected premiums, but no longer has to pay out" says Resscapital AB founder and director, Jonas Martenson.

More well-informed individuals may instead choose to sell policies. Some 45 US states regulate the secondary market, with rules that include requiring the consent of policy beneficiaries and disclosure of all fees; Ress follows the same guidelines when buying policies in those US states that do not regulate the market. (A secondary market for life insurance policies also exists in Germany and some Canadian provinces, but Ress only buys US policies.)

Forecasting longevity

In fact, Ress is distinguished by its preference for buying policies from individuals who are both physically and mentally healthy, because Martenson argues that, "it is inherently difficult to forecast life expectancy. We do not believe in short life expectancies, it is very difficult even for doctors to assess that a 78-year old has only four years' life expectancy, even if they have a number of ailments".

"We obtain at least two forecasts of longevity and use the longer one in order to be conservative, among other things, as an input for our valuation model. The objective is a gross IRR of 12%, before fees and non-fee expenses" he adds. Other funds using longer or shorter longevity forecasts might project a higher or lower IRR for the same policies.

The return target comes from forecast internal rates of return (IRR) on the life policies, which range from 9-10% on smaller policies and those with shorter longevity projections, to as high as 14-15% on larger policies, and those with longer longevity projections. Ress's average policy size in terms of face value is USD 2 million and the largest is USD 15 million.

Since inception, average annual returns of c.6% in USD have fallen slightly short of the long-term target of 7%, simply because fixed costs were high when the fund first launched in 2011, with around USD 8 million. For instance, the total expense ratio of 5.6% in 2013, has come down to 3.11% in 2018 as assets have grown to over $120 million.

Policy payouts have actually been running ahead of expectations. So far, Ress does seem to have been somewhat conservative in its forecasts of 24 mortalities, as the fund has received 30 payouts from its 250 policies.

Mortality distributions should not be correlated with equity markets, but Ress assumes a 0.2 correlation to bonds, partly because the payouts from life insurance are nominally fixed. Clearly, rising US interest rates mean that nominal returns now offer a smaller spread over cash, but so far have not forced buyers to pay more for the policies. "Sellers are seeking a dollar amount versus surrender value, and we have been buying policies at an average anticipated IRR of around 12% gross for a number of years" says Martenson.

Selective investment criteria

Ress has reviewed 7,000 policies since inception, and bought just under 4% of them. Ress's criteria include credit and counterparty risk guidelines: the insurers must be investment grade companies with a credit rating of A- or above, and the maximum fund exposure is 15% per insurer.

Ress only buys policies that are at least two years old, after which they cannot be contested by the insurance company, nor avoid payouts for suicides. Ress takes advice from a US law firm and believes the prospect of an insurance company successfully contesting a policy, after two years, is remote.

In addition, Ress seeks policies with premiums that are low as a percentage of face value, both initially and in terms of anticipated increases in premium rates. Conceptually, non-guaranteed premium increases could be seen as a type of contingent liability. Premium inflation matters because Ress needs to continue paying the premiums to keep the policies in force, and spends around 2% of the portfolio's face value doing so each year. The rate of premium increases is sometimes guaranteed but not always, in which case Ress has to take a view on the probability of premium increases. Martenson judges that the risk of extreme increases is becoming lower, partly as insurers can only raise premiums on categories or types of policies and cannot jack up premiums on an individual policy.

Ress also keeps a cash buffer of 5-10%, which would probably cover premium costs for at least a couple of years, in the event that insufficient or no payouts occurred. On top of that, Ress has a credit facility of $5 million that could be drawn on.

These safeguards are potentially important as some funds that mis-calculated cashflow forecasts – by underestimating longevity and/or the rate of premium increases – were forced to bring in lenders, who would

"...many policyholders are unaware that they can sell their policies, and instead let them lapse worthless - producing a windfall profit for the insurance company that has collected premiums..."

typically then have the first lien over cashflows from payouts up to certain IRR thresholds. This sometimes resulted in a total loss of value for fund shareholders.

The investment strategy is basically buy and hold, though Ress did sell one policy in 2013 to understand the process involved, and Martenson reckons that the current portfolio of policies could fairly easily be sold to private equity firms (such as Blackstone and Apollo) that have much capital to deploy and tend to buy baskets of policies rather than individual ones. In 2019 the secondary market is reasonably buoyant; Martenson acknowledges that liquidity might dry up if a 2008 Lehman Brothers type scenario was repeated.

Valuation

Ress has a sophisticated valuation methodology, managed by valuation manager Gustaf Hagerud. They update valuations twice per month based on various factors including mark-to-market adjustments. Ress has listed its fund and net asset values are published on Nasdaq GlobeNewswire. It is also marked to a valuation model because the secondary market for life policies is by its nature fragmented and specific to each individual policy. It would not be practical to ask potential buyers incur the labour-intensive costs of providing indicative quotes without a chance to actually bid for the policies.

Deloitte Denmark's actuarial team, which is separate from the audit business, then review Ress valuations twice a year.

Changes in observed discount rates used for the mark-to market adjustments have also led to valuation tweaks, and increases in observed discount rates explain the negative performance periods. For example, Ress may update longevity estimates in various ways, such as when a policyholder seeks to sell a second or subsequent policy, or when US mortality tables are updated by the US Society of Actuaries, which happens roughly every 7-8 years.

In some quarters (such as the book Juvenescence by Jim Mellon and Al Chalabi) there are high hopes that as yet unseen breakthroughs in medical technology could add decades to life spans. Martenson does not view this as being likely to happen very quickly.

Investing and trading

In contrast to some closed end funds in the strategy, Ress has an "evergreen" corporate structure, listed on the Nasdaq Copenhagen exchange. The largest investors are pension funds. Most investors subscribe for new shares at NAV, and can give seven months' notice to redeem without cost, also at NAV, subject to a minimum investment of EUR 100,000.

It is also possible to buy and sell the fund on Nasdaq Copenhagen, with no minimum investment and a typical bid/offer spread of 2-3%. The fund does trade intermittently with some trading most weeks but not necessarily every day. Anyone, anywhere could trade the listed vehicle, but Ress as an AIFM, is only licensed to market to professional investors in most EU countries.

Direct Lending. Recession Proof?

Fredrik Sjöstrand, CIO
Scandinavian Credit Fund I

By Eugeniu Guzun – HedgeNordic

Despite not yet being tested in times of an economic recession, Scandinavian Credit Fund, the first and so far only Nordic alternative fund solely focused on short-term senior secured direct loans, appears to represent a decent all-weather investing alternative. The direct lending hedge fund has delivered 37 consecutive months of positive returns not correlated to other asset classes.

BANK LENDING AND COMPETITION

European businesses rely more heavily on traditional bank lending than their counterparts in the United States. Increased regulation, however, has been weakening the lending activity of European banks to smaller entities. As banks are not lending to small businesses anymore, a gap for players such as Scandinavian Credit Fund opened. And the gap is not likely to go away any time soon. "We have the so-called Basel IV reforms coming up that will make corporate lending even more expensive for banks," reckons Fredrik Sjöstrand, the CIO of Scandinavian Credit Fund.

Commenting on the future role of banks in corporate lending, Sjöstrand predicts "banks will go intermediary-only, where entities like us do the direct lending." Europeans are following in the footsteps of their American counterparts. "Europe and Scandinavia have embarked on the same development that has gone significantly further in the United States," remarks Sjöstrand. "We will have more banks go broker-only here as well."

Whereas bank lending is dwindling, there is now increasing concern of too much money in the hands of direct lenders chasing limited opportunities. The increased demand for direct lenders is allegedly driving down returns and eroding lending standards by offering borrowers more options. Sjöstrand reasons that the dilution or weakening of covenants is prevalent predominantly in the area targeted by bigger sharks, large direct lenders on big tickets between €20 to €50 million.

TARGETING LESS COMPETITIVE WATERS

"Our typical tickets are between SEK 20 and SEK300 million, so we mainly focus on smaller and mid-sized companies in Scandinavia," explains Sjöstrand. "The competition is less aggressive in the segment we operate." Although covenant-light loans have become more prevalent recently, Scandinavian Credit Fund and their team of six debt capital market (DCM) originators have become stricter when giving out loans. "Our lending is always senior secured," emphasizes Sjöstrand.

"We have a standard package of covenants and, on top of that, we seek to identify tangible assets that can be pledged as collateral," tells Sjöstrand. Having tangible assets as collateral is a key element in the direct lending activities performed by Scandinavian Credit Fund, as Sjöstrand and his team have been reluctant to offer loans to platform-based or asset-light businesses. "We said 'no' to everything so far in that area for the simple reason that we do not see any assets we could use as collaterla in these types of companies," says the fund's CIO.

It is not enough for a business to be cash flow positive and revenue-generating to land a loan from Scandinavian Credit Fund. "If we find some collateral around the business, a guarantee from another company, a personal guarantee from ownership or something else that is tangible, then we can consider," elaborates Sjöstrand. "If a borrower goes belly up, there should be something we can hunt."

> "We are of course correlated with bond markets when they go up, but we are basically zero-correlated with all other asset classes."

> "The main risk our investors face is that for some reason we do not do our homework in a proper way when it comes to credit analysis."

CORRELATION AND UNCORRELATION IN RISING (AND DOWNWARD-SPIRALLING) MARKETS

Scandinavian Credit Fund, only three years ago celebrated as the "Rookie of the Year" at the Nordic Hedge Award, aims to offer between six to eight percent return to investors, net-of-fees, every year and the team running the fund has successfully delivered on its promises so far. The direct lending hedge fund earned an average compounded return of 7.4 percent since launching at the beginning of 2016.

More importantly, however, the fund is currently enjoying a 37-month streak of positive monthly gains, with the annualized volatility in returns standing at a mere 0.69 percent. The fund's Sharpe ratio stands at an outrageous 10.2, unmatched by any Nordic hedge fund.

HedgeNordic statistics show that Scandinavian Credit Fund's returns are uncorrelated to traditional asset classes such as equities and fixed income. The correlation coefficient between the fund's monthly returns and those of the Standard and Poor's 500 stands at a mere 0.18, whereas the correlation with the Vanguard Total Bond Market Index equals a negative 0.33. "We are of course correlated with bond markets when they go up, but we are basically zero-correlated with all other asset classes," reckons Sjöstrand. Whether correlations with other asset classes increase in the event of a recession remains to be tested, acknowledges Sjöstrand.

"We may get hit with credit events, especially in times of recession, but we have the collateral if a company goes bust," says the CIO. "If we are delivering negative returns and the rest do the same, of course, correlations will go up," he continues. But as long as the team running Scandinavian Credit Fund does its due diligence on borrowers, the likelihood of returns diminishing and correlations increasing is minimal. "The main risk our investors face is that for some reason we do not do our homework in a proper way when it comes to credit analysis," acknowledges Sjöstrand. "The risk stems from overseeing something when making an investment."

Each transaction performed by Scandinavian Credit Fund relies on an independent analysis, with the fund manifesting no industry focus. Since the Swedish economy is tied to the real estate market because of its sheer size, real estate accounts for one-fourth of the direct lending fund's loan portfolio. "We have decreased our exposure to real estate quite significantly over the past year" in an attempt to improve the correlation or, better say uncorrelation, characteristics of the fund.

Although not yet proven as a recession-proof investment product, Scandinavian Credit Fund most certainly represents a proven market-craze-proof alternative. "We have already proved that we are uncorrelated to all other asset classes," says Sjöstrand. "Adding our vehicle in a traditional portfolio will definitely improve all risk and return metrics if we continue to deliver on our promises as we have done so far," he concludes.

Diversification and Carbon Neutralization, all in One

Kari Kangas
Portfolio Manager
UB Timberland

By Aline Reichenberg Gustafsson, CFA
HedgeNordic

While market uncertainties loom in the bond and equity markets, institutional investors look for alternative investments with low correlation to the stock market. Meanwhile, the pressure to turn to more climate-friendly strategies is increasing, but most opportunities in the 'ESG' space are still in traditional long-only equity funds. Why not kill two birds with one stone and turn to the only asset class today, which offers a stable and low-correlated return, while showing a negative carbon footprint? Kari Kangas, Fund Manager of the UB Timberland Fund, at United Bankers Asset Management, tells us why his fund can procure both.

With a doctorate in forestry economics, Kari Kangas is an expert in forestry, having worked with forests across the world, including with the United Nations in New York and Swedish pulp and paper company Stora Enso in Russia. With the UB Timberland Fund, Kangas can facilitate access to forest ownership for a larger number of people. Even those investors, who could access the asset class independently, benefit from the purchasing expertise and management experience of specialists like Kangas.

The risk-return profile of Timberland is attractive as an alternative to fixed income. Kangas estimates that the revenue from the fund's forestland brings about four percent per year, while the price of the land is in line with inflation, which is currently around two percent.

The trends should remain fairly stable and decorrelated from the markets. Indeed, the volatility of timber prices has fallen in recent years, as the industry no longer depends on construction-driven demand. Instead, prices are supported by positive underlying demand, independently from market-driven trends. "There are several megatrends such as urbanization, demographics, consumer awareness and climate change, which all create huge opportunities and need for wood-based solutions," Kangas explains. "For example, Finnish consulting and engineering firm Pöyry has estimated that the markets for wood-based products will increase by € 200 billion, at a rate of 2.3 % p.a by 2030. We expect this strong trend to keep wood prices in real terms quite stable in the long run and the demand for timberland to exceed supply."

Kangas estimates that the revenue from the fund's forestland brings about four percent per year, while the price of the land is in line with inflation.

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From a sustainability perspective, adding trees to a portfolio is particularly effective in reducing carbon footprint, as despite modern innovation, they remain the most effective tool to capture carbon in the atmosphere and store it. However, as Kangas explain, forests need careful management to ensure longer-term carbon storage, but also a holistic approach to maintain a balanced ecosystem. "In our management, we apply 'rational forestry'," he says. "It means that the Fund uses all management procedures, which are covered in the Finnish Forestry Act, from even-age management to continuous-cover forestry. We select our management method for every site according to applicability and return on investment. Consequently, forest management costs in the fund are lower than on average and large-scale clear cuttings are rare."

"We always prefer continuous-cover forestry when feasible," Kangas continues. "It means that, in conducting our logging process, we select the largest and lower quality trees and remove them from the forests. Good quality, smaller trees have therefore more room to grow. This way, the forest will regenerate itself naturally and remain permanently covered. One positive collateral consequence is that biodiversity is higher than in traditionally managed forests and, for example, game finds more shelter as forests remain covered."

"In the long run rational forestry and sustainable forest management increase carbon stock," Kangas says. "Forest management methods we apply aim at increasing the value growth of the forest which in effect also increase volume growth and carbon sequestration. The same idea is also built into forest certifications systems; standing stock must grow over the years. It is important to consider also lifecycle impacts. Especially wood construction is a long-term carbon sink."

Indeed, unlike products made of pulp and paper, which are likely to be burned and release carbon into the atmosphere within a relatively short timeframe, the wood used for construction will continue to store carbon, possibly over several decades. "The proportion of logs versus pulpwood is roughly 60/40. In 'rational forestry, we aim at maximizing log production. Most of the logs are used in construction industry, nowadays also in multi-storey houses," says Kangas.

"During the past few years there has been rising political will to enhance wooden multi-storey construction for example by modifying building regulations and, more generally, through promotion campaigns and policies favoring use of wood. Technological and product advances such as cross laminated timber CLT and laminated veneer lumber LVL have, together with fire resistant substances, facilitated a renaissance of wood construction and enabled taller and taller buildings. The world's highest wooden building is under construction in Norway. With 18 storeys and 80 meters high it will bypass the 53 meters tall building in Vancouver, which held the record until now."

Kangas also points out that the pulp & paper industry has moved to much more sustainable processes and is now part of an important value chain that contributes to climate-friendly consumption. "New pulp and paper mills are less polluting than ever before," says Kangas. "For example, the new Metsä Group factory in Äänekoski, the largest forest industry investment in Northern hemisphere, is called bio product mill. It reflects a new thinking, where side-products are also processed on site. For example, a sulfuric acid plant has a high environmental impact, as it can significantly reduce sodium and sulphate emissions."

> "We don't compromise our return targets. We aim at providing our investors a good night sleep."

Packaging in particular is an area where pulp & paper products can help the environment. "Keep in mind that wood-based packaging reduces use of plastic. Proper recycling is important, however. Packaging materials can be reused several times before burning if sorted and recycled," says Kangas. "Wood-based innovations are becoming delightfully frequent. Scientists and industry are searching for solutions to substitute non-renewable materials with sustainable ones.

National and international regulations to reduce plastic waste are promoting this development. Innovations replacing plastic will penetrate markets in a larger scale in 2020. For example, plastic-free paper cups are already about to reach industrial scale. Wood-based textiles are expected to be a big trend too in the future."

Wood, of course, also has the potential to answer the need for renewable energy, to some extent. "Wood residues are already used for energy production in combined heat and power plants and roundwood is used commonly in households for heating purposes. However, and according to the cascading use of wood, roundwood should be prioritized on value-adding non-fuel uses, re-used and recycled and finally burned for energy," Kangas adds.

For the manager of the UB Timberland fund, pursuing sustainable targets isn't so much an issue, as it is to find the right properties to add to his portfolio. "Finding suitable deals is the most challenging part of this job," he says. "We don't compromise our return targets. We aim at providing our investors a good night sleep. Decent sleep is definitely one of the benefits of this job."

RECORD NUMBER OF NORDIC HEDGE FUND LAUNCHES (AND CLOSURES)

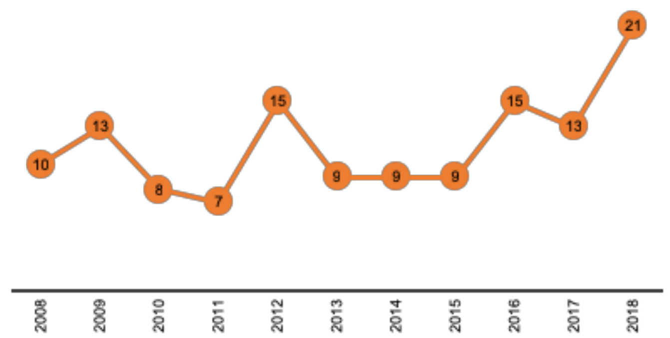
By Eugeniu Guzun – HedgeNordic

Both in the Nordic and global hedge fund industry, closures were a key theme of 2018, especially in the final quarter of the year. In contrast to the global industry, however, new hedge fund launches in the Nordics more than filled up the ranks and empty seats.

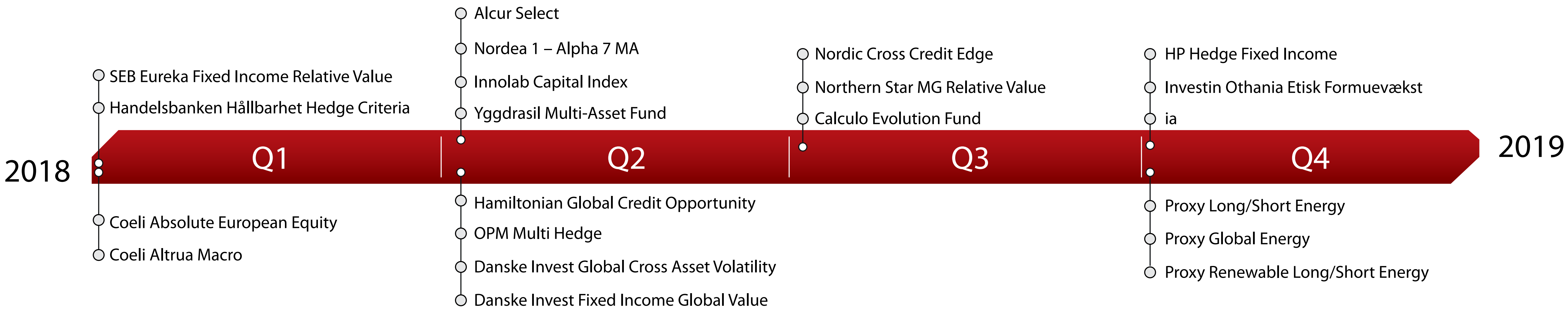
During the course of 2018, 15 constituents of the Nordic Hedge Index closed their doors or merged into other funds, resulting in delisting from the index. Despite the relatively high number of closures, new hedge fund launches outnumbered closures last year. Of the 172 current index constituents, 21 were launched last year alone, the highest number of launches on record. 13 funds currently included in the NHX were launched in 2017 and an additional 15 were started in 2016.

In 2018, the second quarter was the busiest in terms of new hedge fund launches, with eight constituents of the Nordic Hedge Index kicking off operations between April and June. The third quarter of the year, in contrast, was the quietest quarter. Asset manager groups with the highest number of launches in 2018 include Coeli Asset Management, Danske Bank Asset Management, and Proxy P Management. Coeli Asset Management launched two hedge funds during the first quarter, Danske Bank's asset management arm started two vehicles during the second quarter, whereas energy specialist Proxy P Management brought three long/short equity funds on the arena in the final quarter of the year.

NUMBER OF FUNDS (CURRENTLY PART OF THE NORDIC HEDGE INDEX) LAUNCHED IN EACH OF THE PAST TEN YEARS



Source: HedgeNordic



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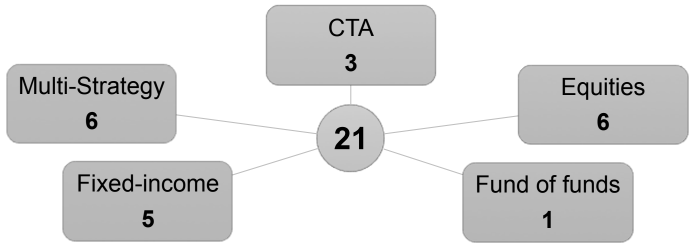
Rookies: Country and Strategy Breakdown

Of the 21 new launches on the Nordic hedge fund arena, six vehicles run equity-oriented strategies, with an additional six funds employing a multi-asset, multi-strategy approach. Five of the new launches focus their investing approach on fixed-income markets. Three new trend-following CTAs and one funds of hedge funds were launched throughout 2018.

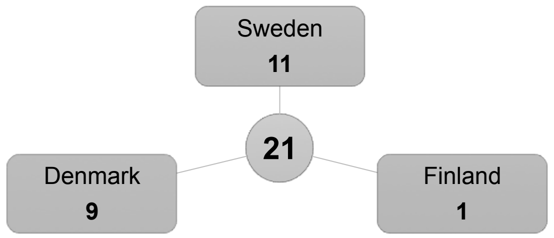
NEW HEDGE FUND LAUNCHES BY STRATEGY



Source: HedgeNordic

Historically, the Nordic Hedge Index has included a large number of Swedish hedge funds, currently accounting for around 60 percent of the index. Last year, 11 new Swedish hedge funds joined the Nordic hedge fund arena. A total of nine new Danish hedge funds kicked off operations last year, a fruitful year for the Danish industry. Only one Finnish hedge fund was started during 2018.

NEW HEDGE FUND LAUNCHES BY COUNTRY



Source: HedgeNordic

How did rookies perform so far?

Despite facing turbulent market conditions in the final quarter, more than half of the 21 hedge funds launched throughout 2018 made money for investors since inception through the end of February. Small-cap-focused long/short equity fund Alcur Select, launched in May of 2018, earned a net-of-fees cumulate return of 21.5 percent through the end of February. Two other equity-focused vehicles, Proxy Renewable Long/Short Energy and Coeli Absolute European Equity, were next in the performance leaderboard.

Systematic trend-following commodity fund Calculo Evolution Fund, one of a handful of trend-followers to perform well last year, earned a cumulative return of 7.6 percent so far. Proxy Global Energy, one of the two long-biased long/short equity energy funds managed by Proxy P Management, completes the top-five leaderboard with a cumulative return of 7.2 percent. SEB Eureka Fixed Income Relative Value and Danske Invest Fixed Income Global Value, two Danish fixed-income vehicles, closely followed suit with cumulative gains of 6 percent and 5.8 percent, respectively.

Looking at Sharpe ratios, a measure of risk-adjusted returns, Investin Othania Etisk Formuevækst fared best among rookies with a Sharpe ratio of 3.8. The fund uses a systematic model to allocate all managed capital either into sustainable equity or bond exchange-traded funds every month. SEB Eureka Fixed Income Relative Value, a diversified relative-value fixed-income hedge fund, exhibits a Sharpe ratio of 2.8 since launching in January of last year. Calculo Evolution Fund and HP Hedge Fixed Income are following suit with Sharpe ratios of 2.2 and 2.1, correspondingly.

If size matters

Some of last year's rookie hedge funds attracted sizeable amounts of capital by the end of February 2019. Yggdrasil Multi-Asset Fund, a multi-asset fund seeking opportunistic risk premia in liquid products and mature financial markets, managed a staggering €774.3 million at the end of February. Danske Invest Fixed Income Global Value oversees €308.2 million in assets under management, whereas SEB Eureka Fixed Income Relative Value manages €272.8 million.

The nine funds of the 21 rookies with reported AuM in HedgeNordic´s database collectively manage €1.57 billion as of the end of February. The record number of hedge fund launches during 2018 and the amounts of assets overseen by rookies may be an indication that the environment for raising capital has been, maybe surprisingly, fruitful for young and promising funds.

INCEPTION-TO-DATE RETURNS OF THE TEN BEST-PERFORMING HEDGE FUNDS LAUNCHED IN 2018

FUND NAME	INCEPTION	INCEPTION-TO-DATE RETURN
Alcur Select	MAY 18	21,48
Proxy Renewable Long/Short Energy	DEC 18	11,51
Coeli Absolute European Equity	FEB 18	10,01
Calculo Evolution Fund	AUG 18	7,61
Proxy Global Energy	DEC 18	7,15
SEB Eureka Fixed Income Relative Value	JAN 18	6
Danske Invest Fixed Income Global Value	JUNE 18	5,76
Investin Othania Etisk Formuevækst	NOV 18	4,58
HP Hedge Fixed Income	OCT 18	3,18
Yggdrasil Multi-Asset Fund	APR 18	2,56

Source: HedgeNordic

TOP TEN BEST-PERFORMING HEDGE FUNDS LAUNCHED DURING 2018 BASED ON SHARPE RATIOS

FUND NAME	INCEPTION	TOTAL RETURN	SHARPE RATIO
Investin Othania Etisk Formuevækst	NOV 18	4,58	3,78
SEB Eureka Fixed Income Relative Value	JAN 18	6	2,78
Calculo Evolution Fund	AUG 18	7,61	2,23
HP Hedge Fixed Income	OCT 18	3,18	2,13
Alcur Select	MAY 18	21,48	2,01
Danske Invest Fixed Income Global Value	JUNE 18	5,76	1,95
Proxy Long/Short Energy	DEC 18	1,3	1,34
Proxy Renewable Long/Short Energy	DEC 18	11,51	1,3
Proxy Global Energy	DEC 18	7,15	0,85
Coeli Absolute European Equity	FEB 18	10,01	0,7

Source: HedgeNordic

LARGEST HEDGE FUNDS LAUNCHED DURING 2018 OF THE FUNDS WITH REPORTED AUM

FUND NAME	INCEPTION	AUM IN EUROS, END OF FEB
Yggdrasil Multi-Asset Fund	APR 18	774.330.000
Danske Invest Fixed Income Global Value	JUNE 18	308.230.000
SEB Eureka Fixed Income Relative Value	JAN 18	272.810.000
Nordea 1 – Alpha 7 MA	MAY18	141.660.000
Danske Invest Global Cross Asset Volatility	JUNE 18	56.490.000

Source: HedgeNordic, Data for February 2019

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A new Danish fund does what it says on the tin…

…and Gold, and Silver, and Copper

By Kamran Ghalitschi – HedgeNordic

The Nordics have a new fund, that does what it says on the tin. Calculo Evolution Fund is a Commodity Trading Advisor, or CTA, that just happens to… trade commodities!

The portfolio manager behind the fund, Philip Engel Carlsson started trading commodities in 2004 at Saxo Bank and even got a chance to trade commodities on the floor of NYBOT in New York, before those went fully electronic. "A super cool experience," Carlsson tells us, "and an important lesson to appreciate how commodity markets really work." Following Saxo Bank, Philip went into Power trading, by joining NEAS Energy - later to form his own software savvy power trading company with physical power trading across Europe. Neas Energy acquired the company in 2012 to integrate the software.

This impressive background procured Carlsson all the ingredients to set up his own fund: a fundamental understanding of commodities, some tech savviness and ability to code combined with a strong interest in machine learning. Add a partnership with two individuals from the Danish VC world and a heavy weight board and the package was sealed.

"No platform trading commodities could do what I wanted it to do, so we built our own." Carlsson says. "I had a very good idea of how to trade commodity markets, and how to put together a portfolio of commodities. All we had to do was to add data over it.

Such a strategy is a rare breed in Denmark, an otherwise equity-, and (even more so) fixed income-heavy market. "A Danish market for a commodity trader is basically non-existent. There is a lot of education to be done along the way," Carlsson says, describing his home market. "We do feel tailwind, though, from investors wanting to diversify away from long-only fixed income and equity markets".

Most CTAs had a tough year in the office during 2018. The CTA sub-index to the Nordic Hedge Index, which Calculo is a constituent of, gave up 5.5% in what was the poorest year since inception of the index. Looking beyond the Nordic shores, the broader, global Barclay CTA index only performed marginally better, loosing 3%. For Calculo though, the story was very different, as the fund recorded a positive return of 7.3% since the fund picked up trading in August 2018. "I can't be entirely sure of course what the other CTAs do, but the larger ones seldom have a pure commodity focus and they certainly got hit when they were wrong-footed on equities . The shorter holding period we have surely also comes into play," Carlsson explains. "When equities fell against the trend in October, for instance, we made very nice profits. And we did so with very low risk, due to the prudent margin usage."

The fund applies a basic, signal driven, fully systematic and strictly rule-based trend-following strategy, and utilises machine learning elements for better understanding, and profiting from trends. "We'd have the machine learning components, for instance, cut trends into smaller trends which helps minimise false signals, and thus mistrades. It is particularly helpful when markets go sideways, or are very choppy."

Carlsson emphasises that the model is not optimised for each signal, market or product class, as that involves the risk of over-optimization. One area he believes Calculo is particularly strong at, and makes good use of machine learning, is taking profits on trending markets. "While we'd typically buy into a position once at a time, and seldom scale in, on exit it may be different. Machine learning helps identify "profit takers" and start to take money off the table even when the trend is still intact, but momentum comes down and the trend weakens, for instance." Many more traditional CTAs would often give up on some of the profits on their books, as stops could be quite far away from market prices in trending markets. A sharp reversal could therefore wipe out much of the gain.

The systematic approach, while strictly monitored by the portfolio managers, does not cater for discretionary overrides in trading. "Risk management however is a hugely important aspect when trading commodities. I cannot specify a concrete scenario, but we have a mandate from the risk management side to liquidate positions and de-risk."

> "Commodities are especially good when it comes to developing trends, or break out signals. And the ability to ride trends up or down just doubles opportunities."

The average holding period of three to four days is short compared to many of the household brands in the trendfollowing CTA space. Calculo currently trades around 17 markets across metals, energies, agriculturals and softs, such as coffee, sugar or cocoa.

Commodities are widely seen as a good diversifier to traditional portfolios. Often though, investors rely on long-only exposure, if allocated to commodities at all. At times, also, equity beta comes through the back door in what investors believe to be a commodity play, when they are invested in sectors such as mining or oil and gas drilling, through stocks. "Commodities are especially good when it comes to developing trends, or break out signals. And the ability to ride trends up or down just doubles opportunities." Carlsson gets excited and is clearly in his element. "A very regional event, like a hurricane in the Gulf of Mexico, could have global consequences on the price of crude. A rainy or particularly dry period in some areas of the world can shift prices on agricultural markets with global impact."

One of the beauties in commodity markets, Carlsson highlights, is "the large ones trade across the globe, and around the clock. That minimises the chance of surprises in the morning."

Many CTAs boast with the number of markets and various contracts they trade and carry the claim to be active on 100, 130 or 160 markets as a quality seal. We find evidence that CTAs are currently re-considering this feature and reducing the numbers as a result. Carlsson sees no value in over-diversifying: "The seventeen markets we currently trade are the largest, and most liquid ones and we do not put too much focus on more exotic, illiquid markets or OTC for the time being.

"There are huge opportunities in the commodity space, many investors don't realise yet," concludes Carlsson, upbeat.

PHILIP ENGEL CARLSSON

CEO AT CALCULO CAPITAL

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Left to right: Mikael Holm Lorsell, Niclas Röken, Wilhelm Gruvberg, and Johan Klevby

Alcur Sends Aggressive Sister Fund to the Races

by Eugeniu Guzun – HedgeNordic

More than a decade after starting their flagship hedge fund Alcur, Stockholm-based asset manager Alcur Fonder sends a new fund to the races. The new fund, Alcur Select, designed to capture superior risk-adjusted returns in Nordic smaller-cap stocks, was one of last year's more prominent hedge fund launches as the rookie fund was nominated in the "New Fund of the Year" category at the Eurohedge Awards 2018.

Portfolio Manager Wilhelm Gruvberg, managed to return nearly 22 percent in less than a year with Alcur Select, since launching in May of last year. Alone in the first months of 2019, the fund gained around 16 percent. Maybe more importantly, the young vehicle came through last year's turbulent fourth quarter without any deep scratches despite its long bias.

10 YEAR CHALLENGE: ALCUR VS ALCUR SELECT

In a nutshell, Alcur Select is a "long-biased small-cap-focused equity hedge fund focusing on the Nordic region, with a tilt towards Sweden" explains Wilhelm Gruvberg, the manager responsible for the day-to-day management of the fund. On average, around 70 percent of exposure comes from small-caps, but the fund can also invest up to 20 percent in larger caps. "We mostly invest in larger-cap names for liquidity reasons, but, on certain occasions, we find very attractive risk-reward opportunities in the space that just cannot be ignored," says Gruvberg.

Commenting on the difference between Alcur Fonder's flagship fund and its younger comrade in terms of segment focus, Niclas Röken says "the two funds have some shared positions, but Alcur Select is tilted towards smaller-sized companies because we want to capture

"For Alcur Select, we search for short candidates that can add to returns rather than reduce market exposure..."

liquidity risk premia as well." Discussing the geographical focus, Gruvberg concedes that "our portfolio tends to be dominated by Swedish companies because our experience and expertise are concentrated in the Swedish market."

Whereas Gruvberg joined Alcur Fonder less than two years ago, Niclas Röken and Johan Klevby, who co-founded Alcur Fonder in 2006 and occasionally contribute to Gruvberg's stock selection and decision-making process, built up their expertise of Swedish equities after co-managing their defensive long/short absolute return fund, Alcur, for more than 12 years. Maintaining an average net market exposure very close to zero, Alcur earned an annualized return of 4.6 percent since launching at the beginning of 2007 at an annualized volatility of only 2.4 percent. This translates into an impressive inception-to-date Sharpe ratio of 1.87.

Downside protection is a quintessential attribute of Alcur, the flagship fund launched shortly before the financial crisis. The fund currently managed by Johan Klevby has weathered market turmoil many times, gaining over five percent in 2008 and nearly four percent last year. The only annual loss so far amounted to a mere 0.2 percent. CEO Niclas Röken handed over the day-to-day management of Alcur to Klevby a year ago. The buy-side experience of Klevby, Röken, and Gruvberg has been recently complemented with the sell-side experience of Mikael Holm Lorsell, a sell-side equity analyst focusing on small-caps who joined Alcur Fonder at the beginning of 2018.

HEDGE FUND ON STEROIDS AND STOCK SELECTION PROCESS

Alcur Select is a long-biased long/short equity fund that "maintains a net market exposure between 50 percent and 100 percent over a full economic cycle" according to Gruvberg. The net market exposure at any given time is largely dependent on the existing pool of attractive risk-reward opportunities. On the back of the flagship fund's success, Alcur Select aims to offer investors superior risk-adjusted returns from the small-cap space by capitalizing on the team's proven stock-picking abilities.

"Our investors are interested in the long-term return of small-sized companies, and our ability to short companies gives investors an additional source of return," says Gruvberg. "Whereas Alcur is shorting companies to bring down the risk and stay in a pre-defined risk spectrum, Alcur Select aims to make money in every short position," Röken outlines the difference between the two funds' approaches to shorting. "Alcur Select seeks an absolute return from all short positions."

Wilhelm Gruvberg
Portfolio Manager
Alcur Select

Regardless of the direction of its investments, either long or short, Alcur Select's underlying strategy lies on its fundamental, bottom-up analysis. Gruvberg applies a flexible, style agnostic approach to investing, but usually prefers to buy dollar bills for 50 cents. As Röken explains, "we look at each position as we always have; each investment opportunity is a risk-reward question than anything else." Gruvberg seeks to build positions in all types of businesses he understands when these are available at prices significantly lower than their estimated intrinsic values.

"We like to invest in high-quality companies earning high returns on capital employed at the right price, but we also invest in low-returning businesses that sell well below intrinsic values," explains Gruvberg. Although the team conducts broader macro analysis, "the bottom-up research process is core to our stock selection process" says the manager. This process involves meeting company management teams, building valuation models, evaluating both upside potential and downside risk, analyzing managerial competence, as well as examining ownership structures. Yet, "the decision to invest or not in a given company comes down to the risk-reward trade-off," reckons Gruvberg.

PREMIER LEAGUE, QUALIFIERS, SHORTING AND FEES

Maintaining a highly-concentrated portfolio of high-conviction ideas is an integral part of Alcur Select's investment philosophy. "Our four highest-conviction cases account for a collective 40 percent of our portfolio," says Gruvberg, adding that they have "another five positions with portfolio weights between five to ten percent." Alcur Select also maintains 15 to 20 very small positions, so-called qualifiers that can eventually end up in the fund's "Premier League" basket of high-conviction ideas. "The position sizes are too small to move a needle in the overall portfolio's returns," acknowledges Gruvberg. "But this approach forces us to learn more about these companies."

The approach to shorting companies, meanwhile, does not differ meaningfully from the approach of selecting long positions. "When analyzing both long and short candidates, we put a lot of effort to identify both the upside and downside of each investment," says Gruvberg. "For Alcur Select, we search for short candidates that can add to returns rather than reduce market exposure," Röken tells HedgeNordic. "In the Alcur fund, the basket of short positions made almost four times the money generated by its long positions during 2018," he adds."To build the portfolio of short positions, we usually look at sectors or companies facing and suffering from structural changes," explains the portfolio manager. Swedish banks comprised one of Alcur Select's main short cases so far. Gruvberg has struggled to see any upside for Swedish banks. "Banks are losing market share in every single important product category: the mortgage business, the card business, the asset management business, you name it," says the manager. "We see no upside, and there is a macro risk on top of that: the Swedish housing and retail market are deteriorating," he continues. "Here is a structural case in a nutshell."

Alcur Select's increased aggressiveness vs. the flagship fund does not make it easier to generate performance-related income for itself, as the younger vehicle needs to achieve a not-so-easy return threshold to charge investors performance fees. Charging an annual management fee of one percent, Alcur Select has to reach a benchmark threshold of five percentage points over the three-month risk-free rate (SSVX90) to charge investors a performance fee of 20 percent with high watermark. "Over time we estimate that this hurdle represents the expected return on equities," says Röken. "We make money for ourselves only when our investors make money," concludes Gruvberg.

Moan and Groan or Fish Lucrative Waters?

Bo Michael Andersen (CIO) and Tore Davidsen (Portfolio Manager)
SEB Eureka Fixed Income Relative Value

By Eugeniu Guzun – HedgeNordic

SEB EUREKA GOES FISHING

Banks are now required to possess more capital and liquidity to operate due to tightening banking regulations, which has affected the cost of holding securities on their books and the cost of acting as market makers. Reduced bank risk-taking, in turn, has led to increased volatility in fixed-income markets and an expanded pool of opportunities for funds such as SEB Eureka Fixed Income Relative Value.

You can either moan and groan about that and do nothing, or you can set up a new Fund to boost liquidity into the markets and offer uncorrelated returns to investors by exploiting opportunities at the same time. Bo Michael Andersen, who had his Eureka moment during his 15-year tenure at SEB Denmark, chose the latter and launched a relative-value fixed-income hedge fund in SEB Investment Management in early 2018 to capitalize on attractive risk-reward opportunities available in Scandinavian fixed-income markets.

"Banks are coming down on risk-taking in both Scandinavian and global fixed-income markets, where historically they have been absorbing risk, holding onto risk and then offloading it at some point," explains CIO Andersen, who co-manages the fund with Portfolio Manager Tore Davidsen. Reduced bank risk appetite and the associated drying liquidity led to increased yield fluctuations in fixed-income markets, thus, creating attractive opportunities for SEB Eureka and other players.

Andersen, who has been building up experience in fixed-income markets since 1996, had tested the strategy behind SEB Eureka before the launch. "We had been observing increasing relative-value opportunities for many years. Starting a broad relative-value fixed-income Hedge Fund made complete sense, as investors could get the opportunity to benefit from those opportunities."

FIRST LEG: RELATIVE-VALUE OPS IN COVERED BONDS

Denmark has the largest mortgage covered bond market in the world, with Sweden and Norway closely following suit. The size of the overall Scandinavian covered bond market is more than three times as large than the region's government bond market. The sheer size of the market and the structure of the Danish mortgage market, in particular, create a fertile hunting ground for vehicles such as SEB Eureka.

Credit risk in Covered bonds is considered low, yet, the average yield spread between covered bonds and risk-free rates is higher than what one would perhaps expect. Partly for that reason, "one-third of our expected return comes from taking advantage of yield pick-up in Scandinavian covered bonds" says Andersen.

More importantly, the so-called pass-through structure of the Danish mortgage market, where borrower activity directly affects bond issuances, creates periodical and exploitable market inefficiencies. The large flows or gross issuance activity driven by borrower activity represent a constant source of relative value opportunities for SEB Eureka and other players.

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Some hedge funds operating in this area employ a significant leverage using repos to magnify returns, while SEB Eureka considers themselves more conservative. “An important pillar of our strategy involves holding leveraged positions in mispriced covered bonds, so, in essence, one-third of our expected return comes from harvesting risk premia,” explains Andersen.

The conservatism reflected in the use of leverage does not necessarily translate into lower expected returns, as the team running SEB Eureka is tapping other sources of return as well. “Although we may hold a little bit less leverage compared to some of our peers, we rely on being more active,” argues Andersen.

“Although we may hold a little bit less leverage compared to some of our peers, we rely on being more active...”

SECOND LEG: ACTIVE MANAGEMENT OF COVERED BOND PORTFOLIO

The passive harvesting of risk premia is one of the three pillars of the strategy employed by SEB Eureka. “The second part of our expected return stems from the active management of the covered bond portfolio, maturity-wise and regional,” he continues. “The active management involves increasing or decreasing exposure depending on how appealing our existing trades are,” adds the CIO, “the geographical mix of existing positions comes into play as well.”

The active approach to managing the covered bond portfolio has proven quite successful since the launch, as the “estimated performance contribution from the average passive exposure accounted for less than one-fifth of the total contribution from the covered bond strategy bucket,” explains Andersen. “If we only had a passive exposure to covered bonds, our return for last year would have been around half a percent or one percent instead of the four percent we earned,” he analyzes.

THIRD LEG: OTHER RELATIVE-VALUE STRATEGIES MAKE FULL HOUSE

“Banks have cut down on warehousing covered bonds on their books quite significantly, but the reduced risk-taking by banks does not only apply to this area of fixed-income markets,” explains Andersen. In addition to capturing yield pick-up in covered bonds, SEB Eureka Relative Value Opportunities allots a significant part of the risk budget in other relative-value strategies, including relative-value trades in Interest Rate Derivatives and XCCY derivatives, carry and relative-value trades in Scandinavian government bonds and relative value trades in Danish callable mortgage bonds, among others.

“We are trying to run a more diversified approach by employing a wide range of strategies that are uncorrelated in nature,” says Andersen. The team running SEB Eureka, set to expand with the upcoming hiring of a third member, strives to avoid “having multiple strategies that are basically pointing in the same direction,” adding that “we want to have as many uncorrelated strategies as possible. We’d strive to maintain four to eight different strategies, but looking at the number of positions, each strategy can be associated with dozens of separate positions.”

INVESTMENT PROCESS: WHAT, WHY, AND HOW?

The process of identifying “What” is mispriced and offers value relies heavily on market screening using proprietary quant models. “We use quantitative tools to screen markets all the time to find price-wise dislocations as a result of commercial flows [borrower activity],” explains the CIO. “Sometimes we hear about a commercial flow creating dislocations in markets, but more often than not, we find opportunities by screening markets using our tools,” he adds.

When dislocations are found, however, the duo running SEB Eureka use their experience to understand “Why” certain securities are mispriced. The use of a quant approach to exploit seeming mispricing can be dangerous at times. “Especially these days, you notice price changes that can be perfectly natural, maybe these changes should have happened a year ago,” clarifies Andersen. “But trying to assess why certain dislocations occur, estimate when these will normalize, and how commercial flows will eventually change are a crucial part of the way we invest.”

The final part of the “What, Why and How” investment process involves “determining the risk-reward characteristics of each trade, finding out how to capitalize on mispriced opportunities, and taking a portfolio perspective by assessing how a new strategy correlates with other strategies or positions we might hold.”

“...if we can truly deliver uncorrelated returns, SEB Eureka does not have to yield six or eight percent to be an appealing investment.”

RETURN TARGET AND MAIN RISK

SEB Eureka has an annual return ambition of four to eight percent with a volatility target in the same range. More importantly, however, the fund seeks to avoid exposure to market directionality in the pursuit of alpha. As Andersen explains, “if we can truly deliver uncorrelated returns, SEB Eureka does not have to yield six or eight percent to be an appealing investment. We focus extensively on being uncorrelated.”

Although the fund’s exposure to credit and interest-rate risks are limited, “the main risk faced by our fund is a drawdown in a distressed scenario,” acknowledges the CIO. “If you enter a Lehman-type scenario, will you have a loss to the degree that you are forced to unwind positions? Much of the risk management, of course, is to evaluate the risk we hold in stress scenarios.

Yet, “a stable low-volatile market would not be good for our strategy,” reckons Andersen. Whereas smooth markets limit drawdown risk in the bucket of leveraged positions in covered bonds, “volatility tends to be lucrative for the other relative-value strategies,” continues the CIO. “Volatility creates opportunities we can exploit.”

The fund SEB Eureka Fixed Income Relative Value which was launched mid January 2018 returned 4.05% in 2018, and has over the first 2 month of 2019 returned 1.90%. Sharp ratio since launch has been 2.98 and AUM in the Fund is DKK 2.1bn in the beginning of March 2019.

STEFAN ROS

CHIEF INVESTMENT OFFICER

SPK - SPARINSTITUTENS PENSIONSKASSA

SPK´s HEDGE FUND STRATEGY AND ALLOCATION

By Pirkko Juntunen – HedgeNordic

> "In general we wanted to increase the active portion and reduce beta risk in the portfolio, and thereby be able to make money in various market scenarios."

SPK, the pension fund for the Swedish savings institutions, has overhauled its hedge fund portfolio quite dramatically over the course of the past few years, having divested from the sector for many years.

Stefan Ros, the chief investment officer of the fund joined the company in 2007 and at the time SPK did have a number of hedge fund investments. "The role of the hedge fund investments was not immediately clear so we decided to divest in 2008, which turned out to be excellent timing," he said.

Over the next few years SPK stayed out of the hedge fund space but once a long-term strategic overhaul was undertaken between 2012 and 2014, hedge funds were again of interest. Up to 2012 SPK had only two main sources of alpha; duration and equity risk premium. "We were keen on finding a larger number of diversified sources of alpha which led us to consider hedge funds again," Ros explained.

The strategy shift resulted in four asset classes; equities, bonds, real estate and alternatives. "Key was to increase the number of return sources and uncorrelated investments. We had concerns about the fees, investment vehicles and

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HEDGENORDIC

hurdle rates within the hedge funds industry. This led to looking at alternative risk premia (ARP) which are long and short and contains little directionality but have a more systematic investment approach. If we could catch 80% of the average multi-strat fund performance in a highly liquid way but at a third of the cost, it wereso much better value for money," Ros said.

"We are willing to pay for skill but not hidden beta and this is not always easy to discern. This picture is clearer with ARPs. We view it as alternative beta," he said.

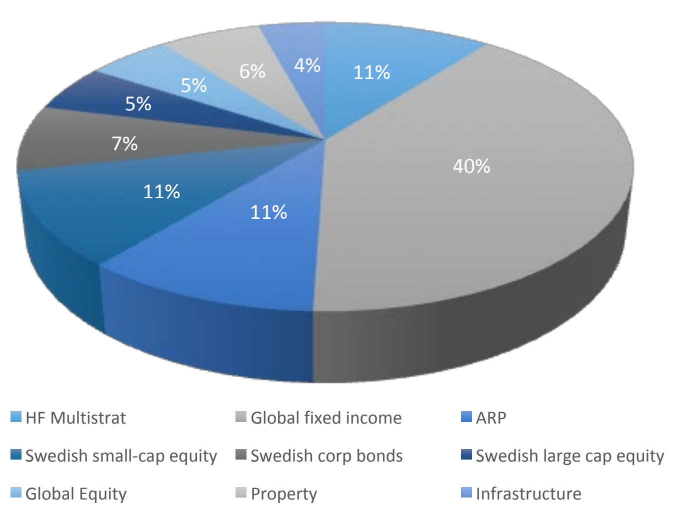
In 2013-2014 ARP were not well established among (Swedish) institutional investors, partly because not many ARP managers could show a reliable and long live track record, and SPK did not go all in. Instead they decided to go 50/50 between ARP and multi-strat hedge funds within their alternative allocation bucket. "In general we wanted to increase the active portion and reduce beta risk in the portfolio, and thereby be able to make money in various market scenarios," he said, noting that SPK has hedge funds in other return buckets than only alternatives. For instance SPK uses Nordkinn for a fixed-income macro hedge fund mandate.

One of the major changes in recent years has been divesting from Brummer & Partner's multi strategy fund in 2017 as a result of poor performance. Instead SPK hired IAM in September 2018. However, Ros wants to emphasise that the main issue with Brummer & Partners was that the strategy no longer fits SPK's needs. "We had a great working relationship with them and they were quick to respond to, for instance, the ESG concerns we had," he added.

Before appointing IAM, SPK looked into the possibility of building its own in-house hedge fund team but realised that the costs and time involved would not make sense. "We view our relationship with IAM as them being SPK's external hedge fund department. This is something that takes time to build and we had known IAM for 10 years. It takes not only track record but also understanding and transparency for a partnership to work well," Ros said.

On the process of finding and hiring external managers Ros said operational due diligence is important and issues such as head-line risks are on top of the agenda. This was one aspect where IAM stood out in a positive way, he said, adding that IAM is big enough to have the resources necessary to be able to have in-depth research and analysis capabilities but still small enough

SPK´S LONG TERM ASSET ALLOCATION STRATEGY



> "The ability and willingness to adapt to the client's needs is vital."

to have a close relationship with clients. "The ability and willingness to adapt to the client's needs is vital," he said. SPK does not use external advisors in general and instead managers can show their interest by contacting SKP via their website.

Another important criteria is liquidity which is why SPK sees a lot of benefits with the UCITs structure. "The regulatory landscape for pension funds and investors is continuously changing. We have to have enough liquidity in the portfolio to be able to adapt to new recommendations as and when they are introduced," he said.

In addition, transparency is important and according to Ros, IAM has high requirements and SPK is able to have the access it needs. SPK also has sustainability requirements such as adhering to UNPRI for instance. "Hedge funds have been slightly behind the curve on ESG issues. However, there is a greater understanding these days for these. We have a few exclusion criteria but our main approach and policy is to push our asset managers. We prefer constructive dialogue as long as there is a willingness to improve," he said.

One of the remaining issues for the hedge fund industry is hurdle rates, according to Ros. "It is not OK that the performance fee should kick in as soon as the return is above zero because that is not skill to me. For the same amount of risk or volatility I could instead allocate to something more traditional where the expected return is clearly higher than zero," he explains.

Ros said ARPs had a poor 2018, which is not so much the fault of the managers, just the current investment climate. SPK is continuously looking into how to improve diversification and is considering creating additional pockets such as trend-following strategies. "We want to discuss any potential additions in-depth and be clear on what we want and what we expect new strategies to do for our overall portfolio before we invest," he concluded.

BREAKDOWN OF SPK ASSET ALLOCATION

STRATEGY	WEIGHT	SELECTED MANAGERS
HF MULTISTRAT	10%	IAM
GLOBAL FIXED INCOME	38%	NORDKINN, BNP PARIBAS AM, JP MORGAN AM, T. ROWE PRICE
ARP	10%	ALLIANCEBERNSTEIN CUSTOM ALTERNATIVE SOLUTIONS (ABCAS), JP MORGAN AM
SWEDISH SMALL-CAP EQUITY	10%	C WORLDWIDE AM, HANDELSBANKEN
SWEDISH CORP BONDS	7%	HANDELSBANKEN
SWEDISH LARGE CAP EQUITY	5%	NORRON AM
GLOBAL EQUITY	5%	T. ROWE PRICE, SWEDBANK ROBUR)
PROPERTY	6%	ABERDEEN AM, GENESTA, PROFI
INFRASTRUCTURE	4%	JP MORGAN AM

Source: SPK

KEY STATS ON PORTFOLIO

PERFORMANCE 2017	3,10%	AVARAGE 10 YEAR RETURN	5,00%
PERFORMANCE 2018*	-1,60%	SHARPE RATIO 2009-2018	1,35

*2018 was SPK´s first negative return since 2007

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Marble Bridge in Nyhavn, Copenhagen

INTELLIGENCE LED ADVISORY TO SELLING IN THE NORDIC REGION

by Kamran Ghalitschi – HedgeNordic

Gaining actionable intelligence on the Nordic buy-side community has over the years become an increasing bottleneck for most types of asset managers. The challenge exist across the range from early stage fund managers to the most seasoned companies in the industry. Whereas many managers have relevant value propositions within or across different types of asset classes, investors' preference for low cost solutions and/or in-house management have curbed opportunities for promoting capabilities to these investors in recent years.

As a consequence, demands from the institutional investor community have changed, and the asset management industry as a whole has had to rethink its approach on how to be relevant for institutional investors. This is true for creating air time to promote core investment capabilities, and even more importantly, in terms of winning new business from institutional investors.

In order to help asset managers overcome these challenges, Copenhagen based Kirstein has since 2003 exclusively focused on tailoring consulting solutions to international asset management firms to whom the Nordic region has been set as a strategic market to grow an institutional client base. "Based on an established Nordic network of more than 150 institutions and more than 500 key decision makers, Kirstein has over the years sought to uncover not only trends and tendencies regarding asset flows, search activities, and addressable assets to external managers, but also to better understand the underlying dynamics of institutional investors' decision making and preferences for external managers," says Jan Willers, Kirstein´s COO. Kirstein´s network not only taps into the largest asset owners in the Nordic Tier I (pension and insurance companies), but also the largest and most sophisticated investors in Tier II (endowments, foundations, companies and family offices).

A key source of information comes in form of quantitative proprietary data, but even more importantly also via on-site interviews with the asset owners. During these meetings Kirsten tests hypotheses regarding the direction of the markets as well as seeks insights to what it takes to become relevant within the Nordic institutional segment. Segmentation of interviews is a crucial act in order to obtain the most relevant information. Therefore, strategic conversations regarding topics such as merger appetite, regulatory challenges, and the evolution of sustainable investment profiles are reserved for C-suite Executives, whereas more operational conversations regarding manager preferences and implementation of new asset classes are linked to portfolio managers, manager selectors, and other types of specialists within the organisations.

Going back to the research, the quantitative foundation of the alternative research revolves around areas such as investors current and target allocations to real estate, private equity, infrastructure, and private debt, typical size of commitments, regional and strategy preferences, indications of upcoming searches across regions, strategies and time frames as well as insights of specific considerations such as preference for fund structures. In order to allow clients to work most efficiently with the data, Kirstein does not offer an open platform to external stakeholders, but rather implements the pool of data as an integrated part of its strategic advisory to clients.

"The key to successfully manoeuvring in the Nordic markets turn on relevant, honest and direct relationship building in the asset management industry. This can neither be done efficiently via database providers nor via third-party placement agents, but rests solely with the business development team within the asset manager's organisation with the support of local eyes and ears on the ground," Casper Hammerich, Kirstein´s client director explains.

JAN WILLERS
COO – KIRSTEIN

CASPER HAMMERICH
CLIENT DIRECTOR - KIRSTEIN

The strategic advisory business at Kirstein is executed by a team of consultants that combines deep industry experience, proprietary investment research, and proven solutions in order to deliver value to clients in a evolving environment for institutional savings. "As an independent and privately-owned specialist advisory company, Kirstein acts as a leading advisor to both regional sales teams and senior executives of global investment management firms with the objective to advise clients on growth and marketing strategies including strategy reviews, strategy positioning, evaluations of market opportunities and new markets to enter, improvement of product appeal and growth prospects, and finally how to enhance the likelihood of winning new business in the Nordic region", Hammerich highlights.

"An overarching message to clients these days can be boiled down to a single sentence. You need access to comprehensive end-to-end intelligence regarding market demand, but equally important also regarding your likelihood of success in the Nordic region.", Hammerich adds.

> "The key to successfully manoeuvring in the Nordic markets turn on relevant, honest and direct relationship building in the asset management industry."

THE AP FUNDS´
APPROACH TO ALTERNATIVES WITH NEW, RELAXED INVESTMENT GUIDELINES

The Swedish national buffer funds, the so-called AP-funds, are subject to much attention worldwide. Recently, the government relaxed investment guidelines for the funds, most notably for illiquid assets where the limit was raised to a maximum of 40% from previous 5%. Some of the funds see this as an opportunity to add hedge fund strategies but also to the other alternative investments. Further changes to the guidelines are expected in 2019-2020.

Before we start looking into AP-funds' hedge fund exposure, if any, it is important to distinguish between the buffer funds, AP-funds 1-4, which have the same purpose and guidelines, from AP7 which is not a buffer fund but the government default fund in the country's premium pension system, PPM. In other words, none are sovereign wealth funds. AP6, which is significantly smaller than the others, is also not part of the buffer-fund structure. It invests in unlisted companies, specialising in private equity through direct, fund and secondary transaction investments and is therefore not part of this article.

Första AP-fonden, AP1

Första AP-fonden, AP1, started investing in hedge funds in 2012 with the ambition of mitigating its largest risk, equity risk. Talking to HedgeNordic, Helen Idenstedt, portfolio manager idiosyncratic alternative investments, said the emphasis was that the hedge funds and strategies selected should fit well to the overall fund, rather than building the optimal, stand-alone hedge fund portfolio.

Until mid-2018 AP1 had large allocations to CTAs and Global Macro strategies in the hope of protecting the fund in falling equity markets. "We were happy with the strategies and performance overall, even though the portfolio did not live through any severe financial stress which it was built for," she said.

During the six-year period between 2012 and 2018 the hedge fund industry underwent many changes. The alpha-beta dichotomy changed, resulting in new investment products. "Things that in the past had been categorized as alpha were all of a sudden seen as replicable factors. Hedge funds were marred by poor performance, and therefore questioned about their high fees. Because of these issues, in 2017 we began to take a closer look at the sector. We liked, and still like, the protective feature of a convex return profile and believe that trend-following strategies can add value. Another step was to investigate if and how we could bring some strategies in-house and whether that would also reduce costs," Idenstedt explained.

Following that process AP1 decided to take the trend-following strategies in-house. "We are not saying that we are more capable than the sophisticated CTAs of the world; our approach is more generic in nature," Idenstedt said.

The decision to take part of the portfolio in-house was a big change, as the role of the hedge fund portfolio changed to the idiosyncratic portfolio it is today, explaining Idenstedt's work title.

The idiosyncratic alternative investment portfolio was implemented in June 2018 with the goal of adding valuable diversification to the fund. "The return target is Libor +4% with a beta below 0.4. We are looking for strategies with an idiosyncratic return stream in the liquid hedge fund space," she said.

HELEN IDENSTEDT - AP1

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> "We liked, and still like, the protective feature of a convex return profile and believe that trend-following strategies can add value."

The change in approach has led to investing in Event-Driven, Long-Short Equity, Statistical Arbitrage, Global Macro, Managed Futures, as well as Credit strategies. Today the portfolio consists of 14 underlying managers both systematic and discretionary strategies with exposures in US, Europe and Asia. "AP1 has a small team of one - me," Idenstedt quipped, adding that she is responsible for the manager selection and portfolio construction while the external partner, Man FRM, is helping with a wide range of services such as operational due diligence, managers searches, and setting up managed accounts, among other things. Managed accounts are preferred but funds are used where managed accounts add less value.

Man FRM was selected through a public tender process but the individual managers do not go through this procurement process. The individual managers are selected through a detailed due diligence process with both quantitative and qualitative elements. "I have a pretty flexible mandate without any set limits on size, location or capacity. However, I do have a fee budget and have to consider internal resources and our investment philosophy, which in a way create implicit limits. The manager-selection process is also dependent on the portfolio that you currently hold and whether the addition of a certain strategy actually improves the characteristics of the portfolio," she said.

Idenstedt looks for uniqueness in terms of expertise in an area, trading in a niche market or specific skills a manager possess. "I am keen on finding a basket of different quality criteria like process-driven approaches, where it is easier to determine the probability of repeatability of expected returns," she said, adding that other criteria, including the robustness of the organisation as a solid company, are likely to have advantages in the long-term.

She admitted that qualitative criteria are harder to pinpoint. "Things such as value and culture are important but harder to rate. Companies that encourage innovation and creativity but also have an environment where mistakes are allowed and where people can speak up and voice ideas is ideal. I try to find out things such as how employees speak to each other, how they are compensated, how they treat the receptionist, how quickly they respond to emails and whether there is one decision-maker or if it is a team effort," Idenstedt explained.

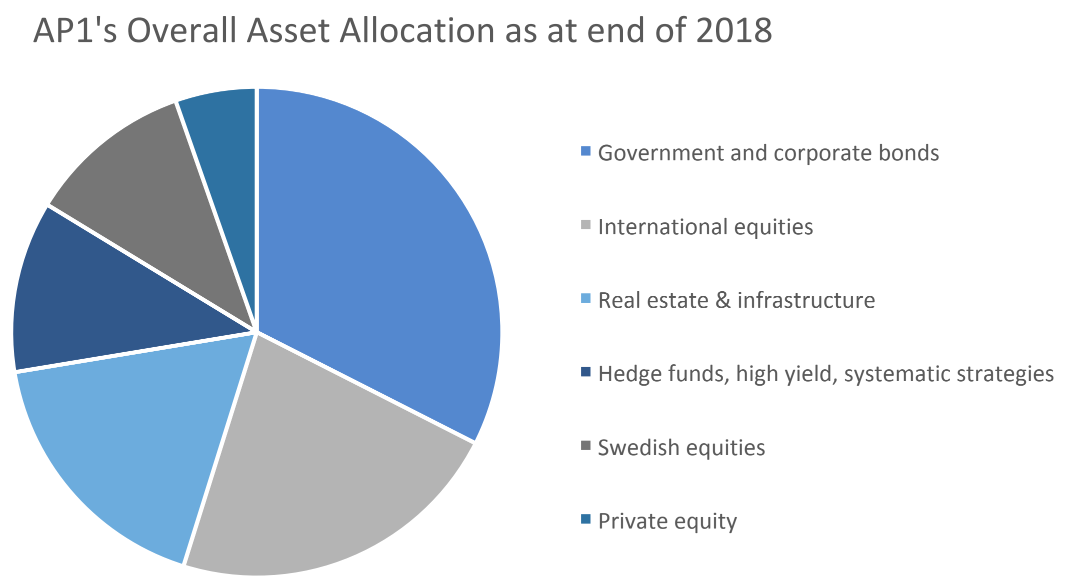
Potential red flags would be lack of transparency on how they do what they do. "It is all about trust and honest dialogue and that we understand each other. The managers have to understand our purpose and limits and they have to be flexible and open to our needs," she said.

AP1's idiosyncratic alternative investment portfolio is up 2.5% for the months of January and February 2019 and up year to date 2.0% at the end of Feb from June 2018. Idenstedt said compared to the benchmark she is satisfied, noting that not many hedge fund strategies were successful in 2018. "The biggest difference compared to the benchmarks is that our approach held up well in Q4 as we have less exposure to beta, testing whether idiosyncrasy works," she added.

As the limitations of liquidity loosen up through the recent changes to the AP fund investment guidelines, AP1 will expand the types of assets it invests in. "We are currently looking at more illiquid strategies in the private and opportunistic credit space. The idea is to capture opportunities that tend to fall between liquid hedge funds and longer lock-up private equity structures. By adding illiquidity we add additional sources of diversification and increases potential to meet our return target," she said.

AP1's target is to invest an additional 1-2% in these strategies over the next two to three years. During the build-up phase of the idiosyncratic portfolio the fund currently invests 4% in hedge funds, down from 5% when it first started in 2012. "We need to have enough allocated to the idiosyncratic portfolio to be able to move the needle in the overall fund while still maintaining the risk level," she said. Going forward AP1 will implement the idiosyncratic portfolio as an overlay in order to get around the difficulties of retaining desired level of risk.

Having a stricter, or perhaps more defined, sustainability ambition may seem difficult in the hedge fund space. Idenstedt admits that it is not always obvious how to implement environmental, social and governance (ESG) criteria for hedge funds so that it has a material effect, rather than just a 'greenwashing' exercise. "We do have an exclusion list that our managers need to adhere to. In addition, we engage to be a responsible investor and work hard to figure out how to, in practice, implement sustainability ambitions in the most efficient way," she said. "An open debate with managers and peers is key to achieve our sustainability goals without compromising return targets. Luckily for me the hedge fund industry is full of smart and intelligent people so I have high hopes that we can figure this out together and in the end make a difference. Magic happens when you engage," she concluded.



CLAUDIA STRANGHELLINI - AP3

“We have retained high-conviction hedge funds which also provide AP3 with top research, macro outlook, portfolio construction capabilities and trading ideas. It is a true partnership relationship we have with our managers.”

Tredje AP-fonden, AP3

Tredje AP-fonden, AP3, started its hedge fund investment in 2007 and it initially focused on global macro and CTAs, which turned out to be excellent timing ahead of the Global Financial Crisis. Claudia Stanghellini, head of external management, said the fund spent the first few years ramping up the portfolio and gradually adding exposure to other areas like long-short equity market neutral, event driven and credit strategies.

Similarly to most, AP3 wanted the hedge fund portfolio to mitigate equity risk. The exposure to hedge funds peaked in 2014 at just under 3% with some 20 funds. “After a few years with modest returns in line with the industry in general, in 2016 we decided to reduce exposure and cut the number of managers,” Stanghellini said. Now AP3 has a conservative allocation to hedge funds and works with hedge funds in partnerships. “We have retained high-conviction hedge funds which also provide AP3 with top research, macro outlook, portfolio construction capabilities and trading ideas. It is a true partnership relationship we have with our managers,” she said.

Today AP3 invests 1.8% in hedge funds within the absolute return bucket. The absolute return allocation consists of internal strategies and external strategies. AP3 manages long-short equity, long-short foreign exchange and long-short fixed income in-house. External managers look after CTA, global macro, long-short credit, emerging markets and volatility strategies. Preferred managers are those with cost-effective approaches that are sensitive to AP3’s particular needs and circumstances. “We have never been invested in fund of hedge funds,” Stanghellini said.

AP3’s allocation to hedge funds is part of the liquid assets and will therefore not be affected by the recent change where the AP funds can invest up to 40% in illiquid assets.

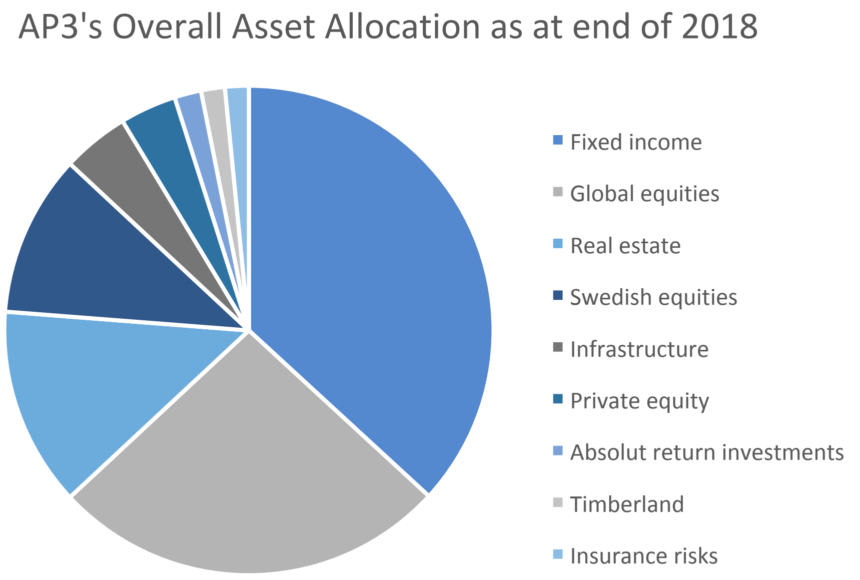
AP3 does all its manager research in-house but uses a variety of external research sources, attends capital introduction meetings, and goes to different industry conferences to be up-to-date with developments and peer-group thinking, Stanghellini explained.

Currently AP3 has a low appetite for hedge funds. “While our portfolio is stable and has a conservative allocation we do keep an eye on new interesting managers. In general the industry has not delivered in the last 10 years and hedge funds have a lot to prove going forward,” she noted. “The market is difficult for hedge funds as rates and volatility continue to remain low. We believe Hedge funds need longer periods of time of higher volatility and higher rates in order to prove their worth,” Stanghellini said.

Fees are something that the AP funds are all concerned with as there is pressure to continuously reduce them. “Fees are crucial, especially when returns have been so modest in the hedge fund space. However, we have started to see fees coming down,” she said, adding that transparency is key, which is why AP3 prefers single strategy hedge funds. “We get better insight into holdings as well as risk and leverage levels,” she noted.

AP3 does not have any formal restrictions on the type of managers or strategies it can look at within the remit of its investment guidelines. According to Stanghellini, AP3 prefers managers with solid organisations and at least a 3-year track-record. “We would require a certain AUM but this depends on the strategy. We also want to see a good client base combined with an institutional process,” she said. AP3 looks for competitive advantages compared to peers and conducts deep due diligence, including numerous site visits in order to see that they understand the needs of AP3 and future challenges considering the prevailing market conditions.

Commenting on the new, more pronounced sustainability ambitions added to investment guidelines, Stanghellini said there are new ESG hedge funds in the long-short equity space mainly and perhaps a few in the credit space. “It is however harder to integrate these aspects into CTA and global macro strategies despite ongoing dialogue,” she concluded.



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Fjärde AP-fonden, AP4

From the publicly available asset allocation numbers it is not clear how much Fjärde AP-fonden, AP4 invests in hedge funds.

In blogs written earlier this year by Andrea Gentilini, CEO of Novus, the portfolio intelligence platform, and based on interviews with Rafet Eriskin, senior portfolio manager who looks after the hedge fund allocation at AP4, the fund does have a sizeable allocation to hedge funds. The blogs are looking at Eriskin's approach to manager selection and how he uses transparency to improve investment decisions and execution of his fiduciary duties, among other things. So far two blogs have been published about Eriskin's experience, and another three are expected.

In the first blog Eriskin emphasises the need for multi-layered diversification and that the partners understand the types of investment risks that AP4 is looking for. As with the other AP-funds that use hedge funds, Eriskin is interested in managers with diversified approaches and specialist skills. Similarly to AP1, idiosyncrasy is a returning feature, i.e. finding unique managers that do not overlap with managers or strategies already used in order to add-value to the overall allocation.

The second blog focuses on transparency and it says that at a point Eriskin required daily transparency from his managers, even moving to intraday updates. However, he realised that this was not necessary in most cases and could even harm the portfolio, as not everyone was willing to provide this detailed level of transparency, resulting in AP4 potentially missing out on good managers. Funds with low turnover, low-trading activity and long-term investment horizon monthly data makes more sense Eriskin told Gentilni. AP4 appointed Novus for portfolio manager analysis in 2016.

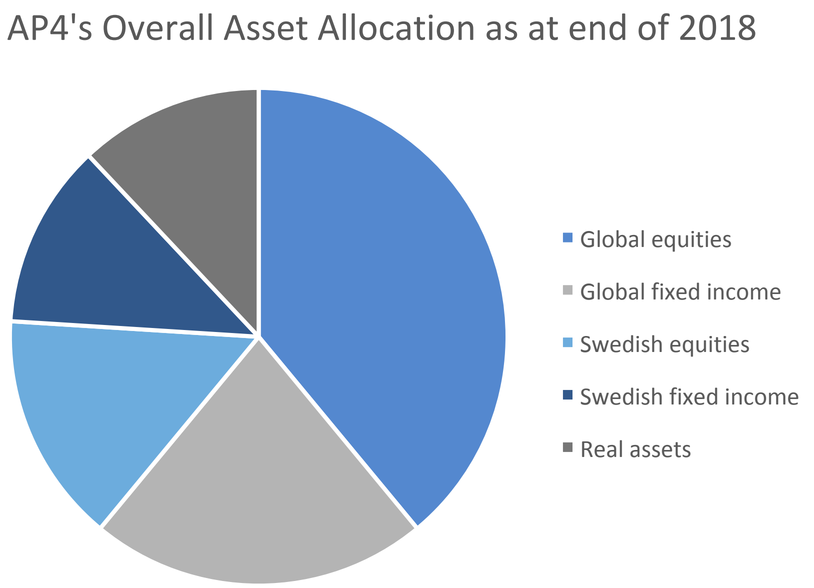
As a result of the relaxed investment guidelines, AP4 hired Jenny Askfelt Ruud in September 2018 to head up its alternative investments team ahead of the changes. She is responsible for the unlisted and illiquid investments within unlisted real estate, private equity and illiquid credit strategies.

In the 2018 annual report, Askfelt Ruud said that in order to really take advantage of the changes and invest in unlisted asserts for the long-term in a cost-efficient manner, AP4 are awaiting the results from an ongoing government investigation into the possibility for the AP-funds to invest in direct unlisted credit and equities. The allocation to unlisted investments depends on the results of the investigation.

> "...in order to really take advantage of the changes and invest in unlisted asserts for the long-term in a cost-efficient manner, AP4 are awaiting the results from an ongoing government investigation."

She mentions direct investments in infrastructure as an option, as well as being able to co-invest directly with other institutions in unlisted equities and credit strategies, as investing via funds is costly.

JENNY ASKFELT RUUD - AP4



FUND NAME	2018 RETURN	MULTI-YEAR AVERAGE RETURN	TOTAL ASSETS (SEK)
AP1	-0,70%	7.4% (10 YEARS)	324 BILLION
AP3	0,60%	7.8% (5 YEARS)	341 BILLION
AP4	-0,20%	7.3% (2008-2017)	349 BILLION
AP2	-1,30%	7.7% (10 YEARS)	335 BILLION
AP7	-2,75%	5.9% (AUTUMN 2000-2018)	460 BILLION

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HANS FAHLIN - AP2

RICHARD GRÖTTHEIM - AP7

Andra AP-fonden, AP2 and Sjunde AP-fonden, AP7

Sjunde AP-fonden, AP7, and Andra AP-fonden, AP2, have taken a different approach compared to the other funds in mitigating equity risk and do not invest in hedge funds.

According to AP2's most recent annual report for the full year 2018, its alternative investments include real estate, timberland and farmland (11%), private equity (5%), alternative credit strategies, (2%), alternative risk-premia, (3%) Chinese A-shares (2%) as well as Chinese government bonds (1%).

In the report AP2 stated its investment management is guided by the principles of diversifying between asset classes and regions and cost efficiency.

Hans Fahlin, CIO, at AP2, stated that he welcomed the new investment rules which will allow an increased use of illiquid assets and the lowering of the limits the funds have to invest in fixed income assets with low liquidity and credit risk from 30% to 20%.

During 2018, AP2 has worked with preparing for the new investment rules and looked at the consequences of the changes. The fund has done research into private equity, which it already invests in, as well as infrastructure. Fahlin said in the report that AP2 will continue looking at whether infrastructure has a place in its private equity portfolio. In addition, the fund is investigating looking at investments which would have a beneficial effect on the climate, such as production of electricity. These types of investments come with good returns, but also contribute to financing the transition to a fossil-fuel free society, according to Fahlin.

A third area the fund has looked into is fixed income strategies with higher credit risk. This is viewed as an investment that falls between equities and bonds. Again, the fund is keen to investigate the viability of such investments in terms of fitting into the overall portfolio. Fahlin said US-dollar denominated emerging markets debt, which the fund already invests in, could be an equally attractive alternative.

AP7 used to invest in fund of hedge funds until 2008, but divested because of high costs and disappointing returns, said Richard Gröttheim, CEO, of the fund.

At the time, it terminated EIM and K2 following a five-year review and moved to a replication strategy with Goldman Sachs instead.

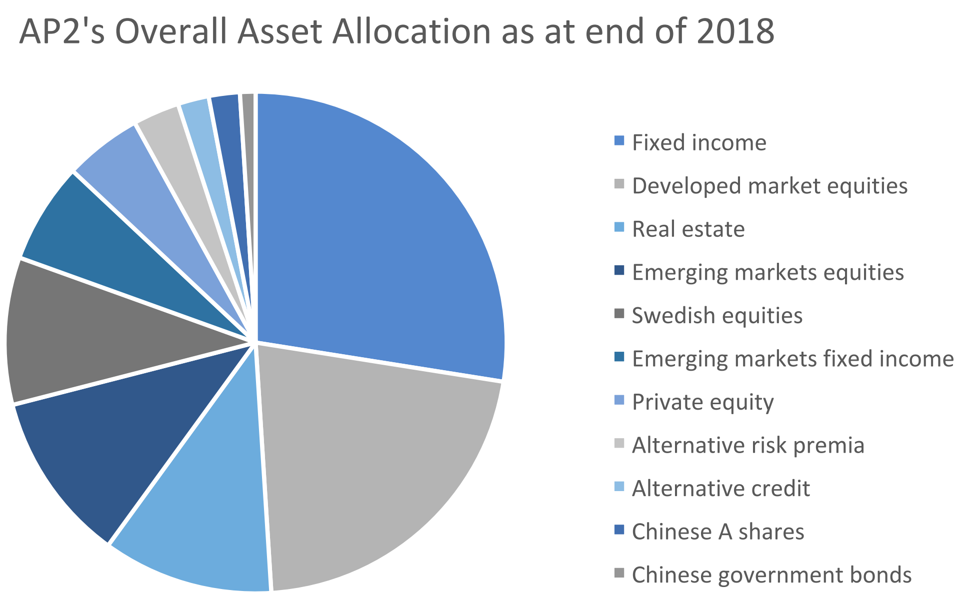
Following a reform of AP7 in 2010 to AP7 Såfa, it adopted 'pure alpha' mandates using a long-short strategy, which is arguably close to how some hedge funds are managed, Gröttheim said, adding that hedge funds would not be added to the mix.

At the time of the reform, leverage was also introduced to further boost return. Ín December 2016, a new strategic portfolio was revealed which is being implemented in stages until 2020.

The first step to introduce more risk profiles to the portfolio began in 2017, with increased exposure to emerging markets and private equity. In 2018 the fund began factor investing with the aim to invest 10% of total capital in these strategies over the coming years. The normal level of leverage was halved to 25% with the actual level lowered to 15%. Other sources of alpha is a decision not to do currency hedging but to allow leverage financing to take place in US dollar because of its comparatively low risk compared to other currencies.

AP7 is also expected to receive a significant boost to its assets as a result of the reform of the premium pension system, which saw it cull the number of funds from 850 to 513. The majority of the assets from the 300+ funds are expected to go to AP7, as two-thirds of Swedes do not actively select funds. Gröttheim does not see any capacity issues arising from this.

Mats Langensjö, the pension expert, has been hired by the Swedish government to look into creating a new framework for AP7. Langensjö is expected to submit his report by the summer, and then a consultation round will ensue. He is expected to look at the future role and objective of AP7. He will also examine the risk level, defining the target group of the default fund, i.e. whether it should be the entire population of Sweden or perhaps prioritising a specific demographic group based on gender, age or earnings. He will also examine whether the investment universe of AP7 needs updating, including its use of leverage, as a result of the objectives and risk profile.



BEST-PERFORMING HEDGE FUNDS IN 2018 BY COUNTRY AND STRATEGY

FIXED-INCOME:
1. Scandinavian Credit Fund 7.3%
2. HP Hedge Danish Bonds 5.3%
3. SEB Eureka Fixed Income Relative Value 4.1%

NORWAY:
1. Mjeltevik Invest 10.2%
2. Sector Healthcare Fund 3.6%
3. Borea Høyrente 3.5%

DENMARK:
1. Formue Nord Markedsneutral 13.6%
2. Calculo Evolution Fund 7.3%
3. HP Hedge Danish Bonds 5.4.%

EQUITIES:
1. Gladiator Fond 19.7%
2. Mjeltevik Invest 10.2%
3. Adrigo Small & Midcap L/S 8.7%

FUNDS OF FUNDS:
1. AIM Diversified Strategies 2.4%
2. Merrant Alpha Select USD 2.2%
3. Atlant Multi-Strategy 1.8%

FINLAND:
1. Estlander & Partners Presto 8.0%
2. AIM Diversified Strategies 2.4%
3. HCP Focus Fund 1.7%

MULTI-STRATEGY:
1. Formue Nord Markedsneutral 13.6%
2. Ress Life Investments 9.9%
3. Atlant Protect 5.3%

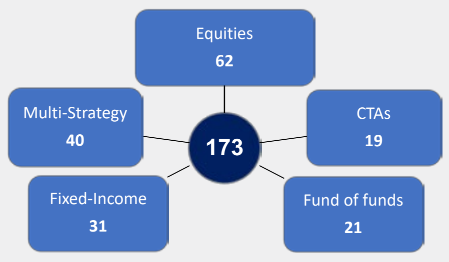
CTA:
1. Shepherd Energy Portfolio 13.8%
2. Estlander & Partners Presto 8.0%
3. Volt Diversified Alpha Fund 7.9%

SWEDEN:
1. Gladiator Fond 19.7%
2. Shepherd Energy Portfolio 13.8%
3. Ress Life Investments 9.9%

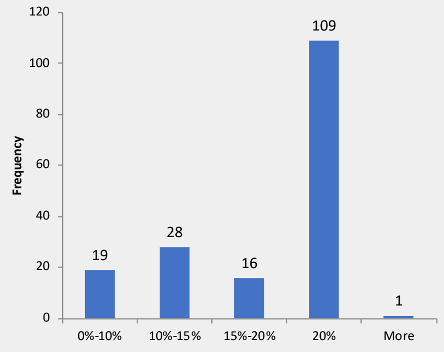
NHX KEY FACTS AT A GLANCE

Figures and data below are drawn from the HedgeNordic databse covering the constituents of the Nordic Hedge Index.

Strategy Breakdown



Performance Fees



Country Breakdown

Dispersion ITD Returns

10.1%

Top 30%
+10.2%

Bottom 30%
-0.9%

Active Hedge Funds

173

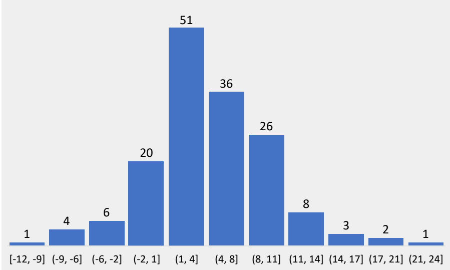
158
in March 2017

Largest Hedge Fund

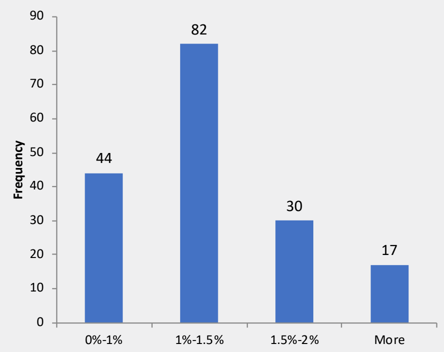
Brummer Multi-Strategy
EUR 3.4 Billion

As of February 2019

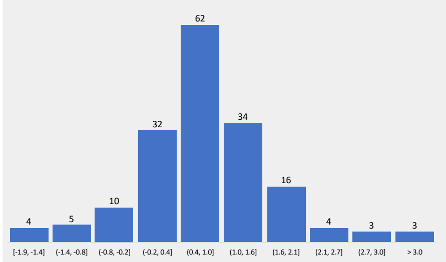
Average Annual ITD Returns



Management Fees



ITD Sharpe Ratios



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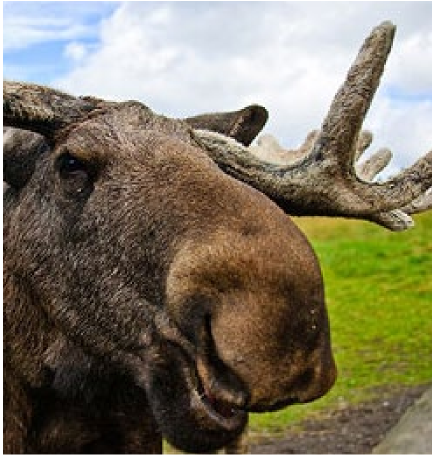

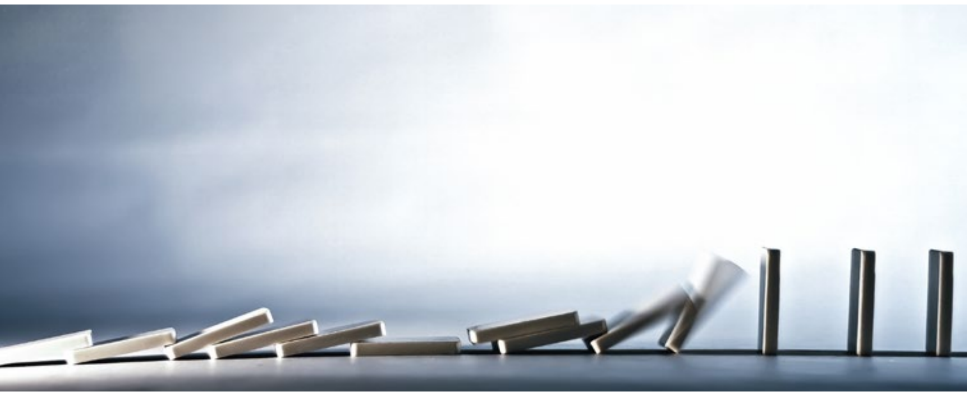

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