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HEDGENORDIC

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SPECIAL REPORT PRIVATE MARKETS

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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 2020:

October: True Portfolio Diversifiers
November: Alternative Fixed Income
November: ESG in Alternative Investments

PUBLICATION PLAN 2021:

February: Quant Driven Strategies
March: Nordic Hedge Fund Industry Report

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Editor´s Note...

A fire-side read.

2020 is turning out to be an incredibly long-stretched year. While it feels like it is never coming to an end, a glance at the calendar gives assurance that we are indeed in the final legs of 2020. No doubt though, we will have a long, tough and challenging winter ahead of us, owed to the pandemic.

Next to planning for the year to come, a year-ending is also a time to reflect on seasons past. One of the treats in my job is that I get to talk to many, many incredibly interesting and inspiring people. I get to meet and interview fund managers, analysts, academics, executives or institutional investors with vast amounts of money to allocate as well as specialists from many other fields. There is the occasional nutjob in our industry, too.

The group of people I really get a good feel from on what is really going on from are marketing and especially sales people (who sometimes have much more fancy job titles). It gets all the more interesting if you have sales people from very large organizations that have everything, literally everything in their offering, spinning from the plain vanilla, long-only products to extremely niched boutique offerings bordering on some very exotic, at times quirky stuff – and everything that lies in between. Simple questions as "so, what are investors buying, or where are you seeing redemptions?" give an immediate insight and feel for trends and shifts in sentiments in allocators' behaviors.

Similarly, discussing – at times drilling deep – with allocators on questions around their "flavors of the month" gives good clues of where assets may be flowing and about the risk appetite in the market.

Already going into This year, the answers from sales teams and asset allocators have, at least subjectively, had an overwhelming overlap. Next to the continued trend towards sustainable investments, anything relating to private markets, typically in private equity or private debt – but also some unexpected niches – seem to be attracting investor interest and hard Dollars.

And the cold numbers too support that subjective impression. Assets under management allocated across private markets hit another all-time high at $6.5 trillion by the end of 2019, as investors continued to shift capital from public asset classes in search of upside. Performance across vintages since the global financial crisis (GFC) has been remarkably strong and consistent.

In 2019 alone, private market AUM grew by 10 percent to reach its all-time high. Significantly, AUM increased for all asset classes, but it was private equity (PE) that drove most of the increase. PE grew 12.2 percent to $3.9 trillion, accounting for about 60 percent of the total. 2019 sealed an impressive decade for private markets, during which AUM grew by 169 percent, or some $4 trillion.

It is high time therefore that HedgeNordic, too dives into this segment. In this publication we will hear "A view from a manager selection specialist," where Gilles Lafleuriel, Head of Real Assets and Alternatives at Nordea Asset Management lets us on his view of "what sectors now." Altamar discussed the interesting era of "Finding Alpha in the Secondaries Market" and the specialists at Kreditfonden highlight the "Ample Opportunities in the Nordic Private debt Market."

Jarkko Lehtonen, portfolio manager at Finnish United Bankers discusses "The magic of real (estate) diversification," while their countrymen at Evli explain how infrastructure investments are "Fulfilling a Necessary Need in the Market." Yet another Finnish team, this time from Manadatum Life, reveal "The Heterogeneity of Private Debt."

Samantha Rosenstock of Man FRM is making the case and explaining why "PC is the new PE" and Ulf Frykhammar from Norron and Coeli's Mikael Petersson tell us how adding some spice can bring "hedge fund alpha in unlisted equites". Daniel Broby from the Centre for Financial Regulation and Innovation at Strathclyde Business School aims to determine "What's It Worth?" in an approach to determine the real-time value of unlisted companies.

Hamlin Lovell is "Exploring More Exotic Asset Classes" and in a specific case of these, saving the best for last, Mats Ohlson managing the Single Malt Fund shows some much needed good spirit as he introduces a strategy investing in rare whiskies.

I do hope this interesting issue of HedgeNordic's special reports makes for some good reading by the fire side.

Enjoy the read, stay safe!

KAMRAN GHALITSCHI

CEO & PUBLISHER HEDGENORDIC

Gilles Lafleuriel
Head of Real Assets and Alternatives
Nordea Asset Management

A View From a Manager Selection Specialist: What Sectors Now?

By Pirkko Juntunen – HedgeNordic

The year 2020 certainly has thrown a giant global curve-ball on any plans that were created in the first quarter, not least in how fund manager selectors are working but also what sectors they see as having a bright future as a result of or in spite of the pandemic.

Gilles Lafleuriel, Head of Real Assets and Alternatives within Nordea Asset Management's manager selection team, said Covid-19 has shifted the discussions with both existing and potential new managers. It has also offered an opportunity for him and his team to examine how various managers have coped with the impact and fall-out of the pandemic, sector by sector.

Not having the ability to arrange site-visits is not ideal, he said. "Being able to experience the work-place atmosphere and interact with the team is invaluable. The spontaneity and elements of surprise are gone in video-conference meetings. Some managers have proposed a tour of their offices with their laptop but the desks are also empty now, we just have to accept the situation," he explained.

It has become important to ask questions in a different way and probe how companies have managed the impact of the pandemic and what specific actions were taken, or how they coped with perhaps shutting down operations in order to stem the blood flow, he said. "We ask more specifics about business continuity plans i.e. which steps they have in place in case of an operationally disruptive event, such as the Covid black swan," Lafleuriel added.

In terms of sectors Lafleuriel explained what he and his team focus on and the rationale behind promoting one over another.

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"The big guys need to start re-inventing themselves and check their smaller competitors, who are coming with great ideas."

"There are basically two types of core infrastructure assets. Some have revenues that rely predominantly on volumes, they do well when the economy – i.e. the GDP – does well. These types of assets, or sectors, were obviously hit hard as was the general public. Airports are the obvious example, with the travel bans and restrictions affecting not only the traffic but also all services around air travel such as restaurants, cafes and shops in airports which account for about 40% of the airport revenues on average," Lafleuriel said, adding that all transports took a hit and are expected to recover slowly as restrictions are being lifted.

In discussions with managers in the affected sectors Lafleuriel is taking a cautious approach and is not only looking at pricing and fundamentals but also scouring for other sectors that have a better outlook. His team monitors a portfolio made up a number of funds which have limited exposure to GDP-sensitive assets. The majority of the underlying assets derive their revenues from long-term contracts or regulatory frameworks that remunerate the assets on their availability, not their output. They are less cyclical and more resilient to the recent types of shocks. One such sector is renewable power, which typically benefits from a power purchase agreement (PPA) that improves the predictability of the future operational cash flows, Lafleuriel said.

He said that of course there are risks in these assets too should the pandemic continue for the foreseeable future. "They continued to be operational and only had minor hiccups in the early days of the lockdown when they were figuring out what was the safest way for the staff to continue operating the power production and distribution facilities", Lafleuriel added.

Lafleuriel is praising the emergence of new infrastructure managers. Even if some of them are too small or too young to stay on his radar, Lafleuriel is always keen to meet with new managers and listen to their ideas. "The big guys need to start re-inventing themselves and check their smaller competitors, who are coming with great ideas," he said, adding that opportunistic strategies are not entirely excluded as long as the strategy is backed by some form of track record.

Lafleuriel is very familiar with the energy sector from his background as an engineer working in the utility sector before switching to finance. "Renewable power is on top of the agenda of most institutional investors, as they are keen to enhance their ESG profile and therefore are replacing traditional assets with more sustainable ones, " he said.

ESG remains at the core of Nordea Asset Management's manager selection. It is the one area where there is no wiggle room whereas other criteria can be more open depending on asset classes and products. Lafleuriel, however, said that building an entire portfolio of renewable power is not ideal. The lack of diversification and concentration on power price risk in particular can be highly detrimental to a portfolio, Lafleuriel explained. "But a sustainable portfolio can be achieved by bundling renewable assets with social and smart infrastructure, and even traditional assets that aim to operate more sustainably," he said.

Going forward Lafleuriel and his team are investigating digital infrastructure as an area which will continue to prosper as the sector grows. "This includes telecommunication towers, fibre networks as well as data centres," he said, adding that the sector is booming on the back of today's megatrends such as digitalisation and urbanisation and consequently homeworking which Covid-19 has strengthened.

Here one of the issues is that supply is having a hard time keeping up with demand leading to relatively high prices, in particular for operational assets. "Covid has been a turning point and we are seeing highly professional and specialised managers in this sector. We see more value in new projects than in operational assets. The owners of brownfield digital assets are enjoying a sellers' market," he said.

"The timberland asset class is offering a unique flexibility as the trees can be cut and sold when the market-demand peaks or stored in down periods. It is also and obviously green by nature."

Another area that his team is exploring is Timberland. "Investing in timberland is owning and managing a property on which forests grow, adding that wood is by nature ever-growing irrespective of what the stock market or the economy does. Furthermore, the timberland asset class is offering a unique flexibility as the trees can be cut and sold when the market-demand peaks or stored in down periods. It is also and obviously green by nature," he said.

Lafleuriel's team is careful in the fund selection process and would therefore only consider funds that invest in properties that are certified by PEFC, FSC or the NGO Leading Harvest. Those certifications pay close attention to the forest management practices and the impact on the entire eco-system where the property is located. Prohibition of harmful pesticides, zero deforestation policy and friendly interactions with local communities are critical among many other sustainability criteria. Of course, from a pure financial perspective, timberland also offers very attractive and stable returns over the longer-term that appeal to institutional investors, he said.

From a general standpoint, Nordea Asset Management's selection process typically includes an assessment of the investment team, their track record of realised and unrealised performance, their ability to retain key staff, the investment philosophy behind the strategy and how repeatable and structured the process is to ensure its implementation.

As Dorothy Parker, the American poet, said creativity is a wild mind and disciplined eye. Creativity within the real asset space certainly is key to getting new managers on Lafleuriel and his team's radar, and staying there, irrespective of size. The current pandemic has shown just how much can be achieved when we use our collective creativity to deal with the unexpected. It would of course be better if the environment for new ideas and solutions, not only in investments, would be such that we would not need a trigger with such tragic consequences as Covid-19 to spur us onwards and upwards.

Finding Alpha in the Secondaries Market

By Pirkko Juntunen – HedgeNordic

In the past few months, investors have been scratching their heads perhaps more than ever trying to answer the question 'where to now?' in terms of investments in order to find that exclusive alpha.

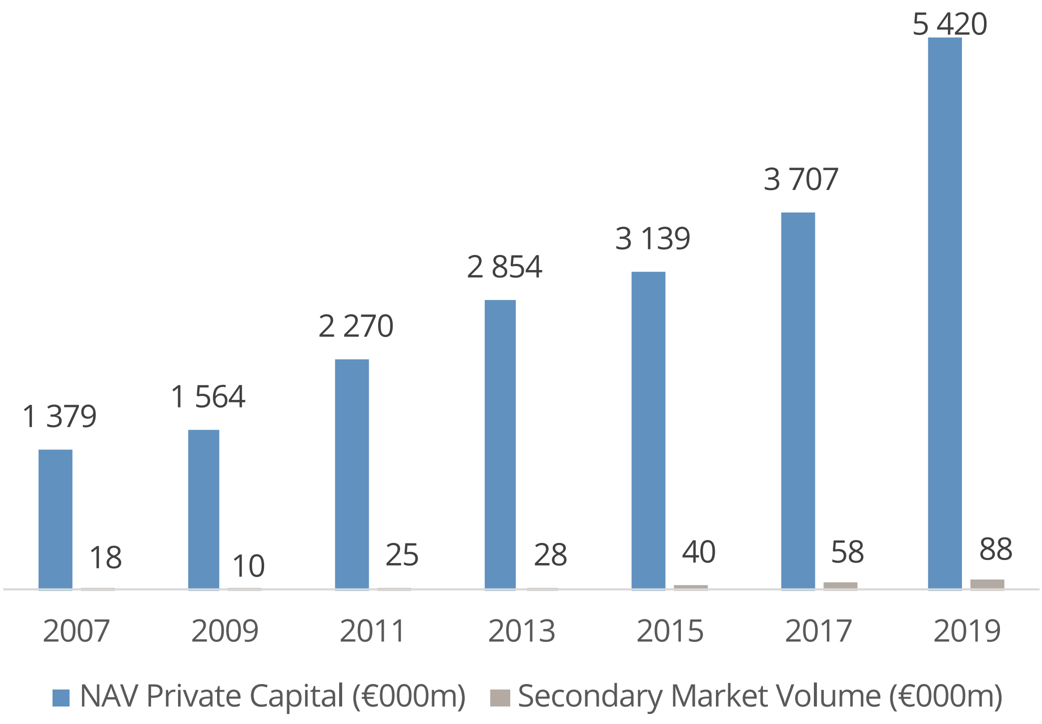
Altamar Capital Partners, the Madrid-based private assets specialist, believe they have at least a part of the answer, namely GP-led deals in the less crowded and less competitive lower-market secondaries space.

These strategies aim to provide a tool for GPs and investors to manage their liquidity and are more transaction-driven investments often involving resetting of terms. As the portfolios tend to be smaller, they lend themselves to a more bottom up approach, more akin to direct private-equity investments, providing that the right incentives and alignment of interests are in place for all parties involved.

Miguel Zurita, Managing Partner, Head & co-CIO of Private Equity at Altamar, said that there is now an ideal opportunity in this segment as there has been a healthy and balanced growth in the market for some time. The overall secondaries market has grown from USD18bn in 2007 to USD88bn in 2019. The GP led segment was pretty much non-existent in 2007 but now represents approximately one third of transactions today. "In addition, there has been a shift from the larger plain vanilla Limited Partner (LP) trade transactions to more complex General Partner


Miguel Zurita
Managing Partner,
Head & co-CIO of Private Equity
Altamar Capital Partners

Growth in market



Source: Preqin (Primary Market) and Greenhill & Co. (Secondary Market Volume). Most up-to-date NAV Private Capital as of December 31st, 2019.

(GP)-led liquidity solutions. You have to keep in mind that increased complexity does not necessarily equal increased risk as long as the complexity is identifiable and terms and incentives can be negotiated."

"Risk mitigation and capital preservation are central facts to this strategy for us, targeting low leverage at the asset level and zero transaction-level leverage", he added.

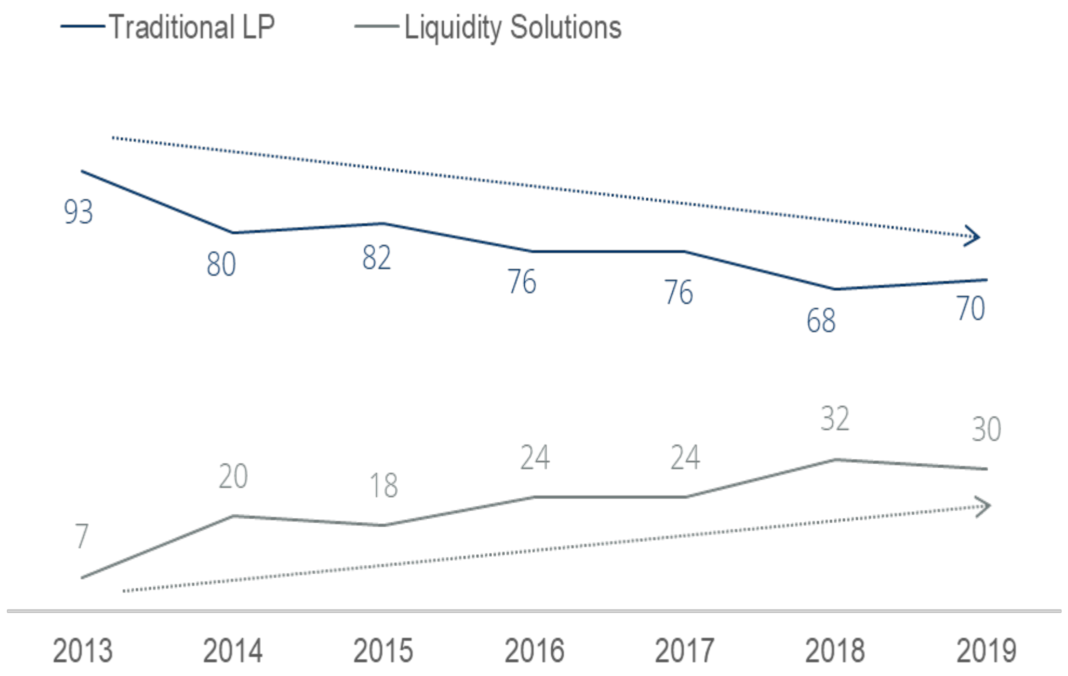
"The growth in private equity in general is set to continue as the asset base grows and as the secondaries market also expands, this smaller niche area has emerged, as most players go for the larger segment. Large funds make up the bulk of the secondaries market but some 20% of transaction volume comes from small/mid-sized funds", he noted.

In the large plain vanilla secondaries market a buyer simply buys the stake from the selling LP at a discount but with the same financial terms as the original LP, with no room to renegotiate. These transactions typically involve larger portfolios with a vast number of underlying companies. If the buyer is a secondaries fund, often leverage is put on the transaction, a good way of getting exposure to the beta of the secondaries market. Historically these types of deals had a 'winner' and a 'loser' and this stigma lives on as often the stake was sold by an LP in distress, making the discount the driver of the return.

Zurita further explained that the smaller, targeted alpha-driven transactions with a focus on proprietary or directly negotiated transactions are also attractive as returns are not dependent on leverage. "The risk-return profile is compelling for GP-led liquidity solutions with no leverage as they typically outperform traditional secondary portfolios with leverage", Zurita said.

"Returns remain attractive throughout the cycle with strong cash-flow dynamics and j-curve mitigation. Other positive attributes include faster visibility on de-risking through liquidity as well as existing GP

Growth in GP leads



Source: Greenhill & Co. 2020 Pricing Paper

> "The growth in private equity in general is set to continue as the asset base grows and as the secondaries market also expands, this smaller niche area has emerged, as most players go for the larger segment."

relationship and information advantage," he said, adding while uncertainties remain, the higher visibility in the small to mid-sized secondaries market, offers advantages.

Zurita also said that of course things can still go wrong as these deals typically involve fewer assets i.e. portfolios are more concentrated and volatile. The volatility and dispersion of returns, however, is also the source for alpha, he added.

Zurita said that the beauty with the liquidity solutions is that global trends and risks such as trade wars, political instability or indeed a global pandemic already priced in and you know what you are buying as it is the secondary market rather than a black pool.

He also said that while there is a slow-down in new commitments, investors are seeing opportunities in existing commitments, Altamar is agnostic as to which regions it looks at and takes an opportunistic approach. Altamar sees specific industries doing particularly well going forward such as telecoms,

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software, gaming as well as selected healthcare assets which have continued to boom during COVID-19.

Furthermore, current market dislocation has created greater opportunities in secondaries and according to a survey by Evercore some 44% of sponsors may consider liquidity solutions transactions to allow more time to create value in their portfolio. “GPs are in a stronger-than-ever position to maximise their assets and buy time as well as get additional capital,” Zurita said.

“In a post-Covid-19 environment there are buyer tailwinds and an enormous potential for revaluation, that should rationalise entry points and allow buyers to catch the upswing”, he said. He explained that there are also opportunities for offensive plays and the environment for executing buy-and-build strategies for quality platforms is also favourable, noting that Altamar is well positioned to take advantage of the growth because of the depth and breath of its platform.

Zurita also said that GP motivations are shifting as the uncertainties of post-Covid 19 continue which is also pushing up transaction volumes. For instance, managers nearing the end of fund terms which were planned for liquidity in 2020/2021 will need to explore and consider other options. In addition, it is expected that fund raising in the traditional primary space will continue to be challenging in the near future.

Zurita also warned that not all liquidity solutions are alike which is why making sure that there is true alignment of interest among the parties is key.

‘You have to examine the motivations of the GPs in order to avoid ‘zombies’ as well as acquire quality assets at a discount to intrinsic value. The complexity of the deals requires sophisticated and knowledgeable buyers therefore relationships are vital for finding the best opportunities,” he said. Altamar only closed less than 10% of the liquidity solutions it evaluated in 2019, proving that being picky is a must.

> “The complexity of the deals requires sophisticated and knowledgeable buyers therefore relationships are vital for finding the best opportunities.”

At Altamar, its executive partners, shareholders and team have committed over €230m in Altamar’s programmes. Zurita believes that another advantage Altamar has over its competitors, in addition to its longstanding primary relationships, access to quality managers and seasoned private equity professionals with a multidisciplinary approach to investment, is the firm’s infrastructure such as the proprietary database tracking 400+ GPs and 5000+ private equity investments.

An area which private equity firms have been criticised for is their tardiness in getting on board the ESG train. Zurita said: “We have a strong team in charge of improving our ESG policies alongside three lines; responsible investment (we are signatories of UNPRI with A+ score in all sections reported), management of our own company (diversity, low carbon impact among other factors) as well as in philanthropy as we set up the Altamar foundation some years ago.”

“In practical terms the review of our ESG policies is part of our due diligence and in the past we have rejected investments for ESG reasons (such as plastics manufacturers or gambling) and in fact one of the recent steps we have taken is to prepare a list of excluded sectors such as pornography, weapons among others. This is a continuous project and will be extended over time. A very positive side effect of this for a firm like ours with a strong culture and where talent is our most important asset, is that having a strong focus on ESG with full engagement from our team members allows us to recruit and retain great professionals,” he concluded.

TABLE WITH KEY FACTS

Altamar Capital Partners

Founded: 2004

AUM: €8bn of which €230mn invested by executive partners, team and shareholders

Staff: 170+ employees (out of which 1/3 are investment professionals)

Independent alternatives specialist firm managed by its 35 partners

Private assets platform with programmes in private equity, secondaries, venture capital, real assets and private credit

Headquartered in Madrid and offices in Barcelona, Santiago de Chile and New York and presence in Taipei

UNPRI Signatory with A+ rating in all sections reported in 2020 (Strategy & Governance, Private Equity, Infrastructure, Fixed Income and Property)

Ample Opportunities in Nordic Private Debt Market

By Jonathan Furelid – Kreditfonden

COVID-19 struck many small and medium-sized companies hard in the earlier part of 2020, leaving loans directed towards these entities at risk. Despite the current challenging conditions, Fredrik Sjöstrand and Peder Broms, who are managing the Scandinavian Credit Fund I – a direct lending fund focusing on the Nordics, see ample opportunities in Nordic private debt market and have managed to show solid performance numbers in what has been unprecedented markets for direct lending in the Nordic region and elsewhere.

"The situation has improved strongly since the COVID-19 outbreak and we are in a very interesting position in terms of deal flow. There is a strong demand for direct loans across the region and the quality of lenders is high. For us as a local player with a solid network and close relationships with the companies in the region, we see continued good opportunities ahead", says Fredrik Sjöstrand head of investments and PM of Scandinavian Credit Fund I - a direct lending fund focusing on the Nordic region with approximately SEK 4 billion in assets under management.

Peder Broms, who is heading the fund's origination activities, underscores that direct lending has become more of a standard alternative in the Nordics, underpinning the strong demand picture.

"Direct lending has become much more mainstream these days and is seen as a real alternative to

Fredrik Sjöstrand
Head of Investments and PM
Kreditfonden

Peder Broms
Head of Origination
Kreditfonden

"Direct lending has become much more mainstream these days and is seen as a real alternative to corporate bonds and bank lending. It is gathering pace in the Nordics"

corporate bonds and bank lending. It is gathering pace in the Nordics following a strong development in Europe and the US. In the US, direct lending has been a massively growing part of the private debt market since the 90's, but it was not until around 10 years ago that this was introduced to Nordic companies, we have some catching up to do.", Broms says.

Deloitte's Alternative Lending tracker report confirms that there is a strong activity in the Nordics with regards to direct lending. According to the report, direct lending was the fastest growing financing form in the Nordics (+233%) with regards to large deals (10 million euro plus) between 2017 and 2019.

Sjöstrand says that the Nordic market is ideal for direct lending activities as it has some of the key traits that makes for a well-functioning market.

"Generally speaking, Swedish companies are well-managed with defined control functions, known legal framework and a high level of transparency. This should not be underestimated as it facilitates lending processes considerably and makes a solid foundation for good relationships with the lenders."

Fredrik and Peder emphasizes that being a local fund in the Nordic direct lending space give them clear advantages and unlocks unique opportunities. The ability to offer more flexible loan terms has also played into the successful management of the fund during the COVID-turbulence.

"We are targeting loans in the EUR 10 million – 30 million range, with a credit quality that is at par or better than high yield. In this niche, very few of the big players are interested in participating and we can negotiate loan terms that are much more flexible in terms of repayment structures compared to traditional bank lending. This served us well during the turbulence, as we could be more solution-oriented than other lenders for those clients that were most pressured by the situation", Fredrik says.

Sjöstrand emphasizes that the fund is not exposed to the most COVID-19 sensitive sectors including transportation, restaurants, and tourism, which is partly why the fund has been resilient throughout the crisis.

As of end September, the Scandinavian Credit Fund I fund recorded a year-to-date gain of 2.8 percent, in-line with the 3-5 percent annual return target (revised from 6-7 percent due to the corona crisis impact). The negative month in March (-0.8%) marked the fund's second down-month since inception in January 2016.

"We are pleased with how the fund has performed during the corona crisis. We have had a very close dialogue with our borrowers in order to fully understand the impact of COVID-19 on their business activities. As for credit losses, confirmed or anticipated, we are reporting in line with the IFRS9 accounting standard, meaning that the negative impact of the corona crisis is already visible in the NAV of the fund" Sjöstrand explains.

Kreditfonden, the management company behind the Scandinavian Credit Fund I, has an 8-person investment team that are closely monitoring the loans outstanding and there is a separate structure to handle "problem credits". Sjöstrand says that the management of unlisted debt is "resource intensive", but that it is crucial to have experienced credit analysts in place in order to set up and closely monitoring all ongoing relationships. These capabilities have been put to the test during the crisis.

"Since we mainly do senior secured debt. It is very important to have structures and resources in place to be able to step in when things do not go as planned and when loans are put to risk. We want to

"We are pleased with how the fund has performed during the corona crisis. We have had a very close dialogue with our borrowers in order to fully understand the impact of COVID-19 on their business activities."

be proactive in finding solutions before this happens, ideally, but in certain cases we need to step in and force action in order to protect the interests of the fund's investors. We have had very few incidents given the severity of the COVID crisis, Broms explains.

During the year, another challenge was imposed on the Scandinavian Credit Fund I as redemption orders of one fifth of the fund was registered as the corona crisis erupted in March. This forced the fund to put up redemption gates in order to orderly meet those requests. Redemptions have now been fully paid out, Sjöstrand says.

"We had a liquidity mismatch as a result of the sudden liquidity preference among investors in March and April. We could not unwind loans to meet the significant redemption request at that point. But investors have now been paid in full, although with some delay. We see this as an exceptional event, but it highlights that there are liquidity risks inherent in this type of investment, and we can only make sure to be transparent with investors about those risks."

Looking ahead, Fredrik and Peder are upbeat about the prospects of the direct lending market in the Nordics, and they see strong investor interest in Scandinavian Credit Fund I as well as in their other fund, Nordic Factoring Fund, targeting the Nordic factoring market. There are also new product launches ahead, Sjöstrand reveals.

"We have a very strong pipeline of new loan deals that makes us comfortable that the Scandinavian Credit Fund I will remain a compelling offer for low risk returns in an environment where traditional fixed income investments have severe difficulties producing any returns whatsoever."

"In the Nordic Factoring Fund, that has yearly liquidity for investors, we also see a very strong deal flow and we are producing consistent returns in line with the stated return target of 6 percent annually."

"Coming up we have the High Yield Opportunity Fund, which is a fund that targets Nordic high yield debt opportunistically, aiming to take advantage of the illiquidity premium inherent in the region. The fund targets a credit quality that is in line or better than high yield senior secured lending and operates below or in the same space as high yield. It has a lock-up of three years and will be able to take advantage of markets that are in stress, such as that experienced during the corona crisis."

"We are currently also pushing the Nordic Direct Lending Fund which is an institutional fund targeting the Nordic direct lending market. It has a closed-end structure and targets larger loan deals. We aim to have seed capital ready to launch early next year and look forward to offer institutions in the Nordics and elsewhere a local direct lending option."

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The Magic of Real (Estate) Diversification

By Eugeniu Guzun – HedgeNordic

Real estate is increasingly becoming a significant element of asset allocation among institutional investors with long-term focus. "Even before the Covid-19 crisis, institutional investors had seen real estate as an integral part of their portfolios," says Jarkko Lehtonen, portfolio manager at Finnish real assets -focused asset manager United Bankers. "I believe that this trend will continue," he adds. "The investment appetite is definitely there."

Relying on an open-ended structure, UB Nordic Property Fund has built a well-diversified portfolio of core plus commercial properties across all Nordic countries to provide investors the opportunity to enjoy real estate returns. "A core plus strategy involves taking a bit more risk than a core strategy and going up the risk curve by investing in secondary locations," explains Jarkko Lehtonen, portfolio manager of the UB Nordic Property Fund. "The additional risk associated with these secondary locations is counterweighted by long-term leases with very good tenants," adds Lehtonen.

DIVERSIFICATION SOURCE ONE: GEOGRAPHIES

UB Nordic Property Fund owns a well-diversified portfolio of 46 different properties that generate steady cash flows for the fund and its investors. "In our core plus strategy, we want to give our investors the stable rental income the properties in our portfolio generate," says Lehtonen. The stable return source has been an important marketing point of this fund, as was diversification. "When UB Nordic Property Fund was launched in 2016, the fund was meant primarily for Finnish non-professional and professional investors, who already had exposure to Finnish real estate," explains Lehtonen. "The idea was to provide these institutions exposure and diversification to the other Nordic real estate markets."

UB Nordic Property Fund's property portfolio, which has a market value of €330 million as of the end of September, has an exposure of 49 percent to Norwegian properties. Danish, Finnish and Swedish properties account for 24 percent, 15 percent and 12 percent of the portfolio, respectively. "The Norwegian property market has been interesting to the fund for many reasons," points out Lehtonen, one of which revolves around the difference between the economic landscapes of Finland and Norway.

Jarkko Lehtonen
Portfolio Manager
United Bankers Plc

> " In our core plus strategy, we want to give our investors the benefit of stable income, without hard assumptions on the future value of the property."

"Looking at the macro picture, the Norwegian economy is very different from the Finnish," argues Lehtonen. "Norway, therefore, provides the best diversification for our Finnish investors and the same logic applies for Swedish and Danish investors. "While Sweden, Norway, Denmark and Finland appear to be fairly similar, the figures of the Norwegian economy are by far the best in the Nordics."

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DIVERSIFICATION SOURCE TWO: PROPERTY TYPES

"We hold different types of commercial properties, that is the whole idea behind a very well-diversified portfolio," says Lehtonen. The fund has roughly 51 percent of its portfolio invested in logistics properties, 37 percent in office properties, nine percent in retail properties and the remainder is invested in one plot. "During these past two years, we have been most active in the industrial segment, consisting of logistics and production facilities, which turned out to be great, especially in light of the ongoing pandemic," asserts Lehtonen. "Investors are focusing on logistics, that's the golden egg." According to Lehtonen, the need for modern logistics facilities is pressing in the Nordics.

The retail segment of the property market, on the other hand, has been under stress for much of the past decade. E-commerce has been steadily growing over the past decades and the Coivid-19 pandemic has accelerated the shift. With an increased share of work being done remotely, property investors are also worried about the impact of the pandemic on office properties. According to Lehtonen, however, "offices have been under change all the time and the work-from-home trend has only added to the headwinds in the short-term."

The future of offices is still under debate, considers Lehtonen, who questions the notion that Covid-19 will "kill" the office. "This pandemic overemphasised the change that would come," points out Lehtonen. "Of course, one may observe a change in how a customer uses office premises, but in the longer term, I do not expect to see a future where companies do not need offices anymore. These trends had been there before, they just gained more speed during the coronavirus pandemic."

> "I would not mind the fund to be twice as big, as it gives added value to both existing and new investors to have a larger, hence more diversified portfolio."

OPEN-ENDED STRUCTURE, LIQUIDITY MISMATCH AND NO SPECULATION

Institutional investors tend to have an extended investment horizon and real estate properties are often suited for such long-term-oriented investors. Occasionally, however, cash is scarce and there is great demand for liquidity. The open-ended structure of UB Nordic Property Fund enables investors to exit investments on a quarterly basis. "These open-ended alternative investment funds in Finland are attractive because they offer liquidity to investors," asserts Lehtonen.

"The higher liquidity is a good thing for investors but represents a bit of a challenge for the fund managers. Because real estate is not a very liquid asset class, there is some degree of liquidity mismatch there," points out Lehtonen. This liquidity mismatch, however, did neither pose a problem for UB Nordic Property Fund during the cash-strapped environment in the first quarter, nor during the uncertain period that followed. "In the Covid-19 crisis, our worst quarter in terms of redemptions was the end-of-June quarter, but we only had a few million euros in redemptions," says Lehtonen. "We managed to communicate to our investors that our vehicle is a long-term investment and there is no point in worrying about short-term fluctuations."

The open-ended structure also enables Lehtonen to build a growing, more diversified portfolio of properties with an attractive risk-return profile. "In a closed-end structure, you are quite exposed to timing [the market]: you have to start buying immediately after raising the capital and then required to sell all the properties at some point," says Lehtonen. With an open-ended fund, both new and existing investors have the opportunity to get exposure to an increasingly more diversified property portfolio. "A bigger fund size definitely helps, in the eyes of the property sellers, the brokers and other actors in the market," acknowledges Lehtonen.

A bigger fund size also helps fundraising, Lehtonen points out. "Attracting investors with this kind of diversification is easier," he continues. "It is less of a leap for the investor to make that investment decision. I would not mind the fund to be twice as big, as it gives added value to both existing and new investors to have a larger, hence more diversified portfolio."

In terms of what investors should expect from an investment in UB Nordic Property Fund, Lehtonen says that "every year we aim at paying bout an annual dividend of up to five percent." The team running the fund has manage to pay out a that successfully for the previous two years. "That is something we want to continue on." Lehtonen and the team have managed to "build a very interesting portfolio," which has a weighted average unexpired lease term of 8.7 years. "Our initial yield is 6.3 percent,, which is remarkably high. Once we leverage up, with our loan-to-property portfolio now leveraged up to 54 percent, we get a nice return on equity percent of 9 percent."

"In our core plus strategy, we want to give our investors the benefit of stable income, without hard assumptions on the future value of the property," asserts Lehtonen. "We want to stress that your returns from this fund come from the real rental income rather than value appreciation," he continues. "Speculation is not how we play the game. We do not buy properties for an expected value uplift; we buy properties for their rental income potential."

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Fulfilling a Necessary Need in the Market

By Craig Houston – Spoon Agencey

Richard Wanamo
Portfolio Manager
Evli Infrastructure Fund I.

Evli's new global infrastructure fund aims to offer clients a defensive investment opportunity with reliable cashflows and good return potential, while diversifying and lowering the overall risk of a portfolio. As global markets have entered a period of uncertainty and volatility, Evli's infrastructure fund is designed to offer strong return potential throughout the economic cycle.

"Infrastructure in previous downturns have proven to be very defensive investments," says Richard Wanamo, Investment Director, Private Assets at Evli Fund Management. "You don't have pricing, which is driven by market sentiment, like you do with equity markets. Although they are capital-intensive, infrastructure investments are very real, tangible assets that have strong downside protection," he explains.

While investors broadly expect lower returns from equities over the next decade, compared with the previous ten-year period, cash flows from infrastructure investments continue to deliver from quarter-to-quarter. "They're often regulated assets on long-term contracts with very creditworthy counterparties, so you get paid reliable cashflows every quarter, no matter the economic cycle or how the stock market behaves," says Wanamo.

Evli's new fund offers investors access to a well-diversified and balanced global infrastructure portfolio, consisting of 7-10 carefully selected top-tier infrastructure funds. "We invest predominantly in Europe, but we want to get the benefits of investing in other developed markets like the US and other OECD countries as well. Infrastructure funds typically raise capital in their first year, and then they gradually invest over an investment period. You then get the time diversification element as well and exposure to different parts of the economic cycle," adds Wanamo.

> "Although they are capital-intensive, infrastructure investments are very real, tangible assets that have strong downside protection."

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BRIDGING THE INVESTMENT GAP WITH PRIVATE CAPITAL

A recent study commissioned by the European Parliament's Committee on Industry, Research and Energy (ITRE) estimates that, in Europe alone, up to 600 GWe (GigaWatt electrical) of net additional power capacity would be needed per decade up to 2050, while investment during the last decade added around 300 GWe. However, governments are struggling to raise the needed capital.

"Many governments and municipalities are over-indebted, and they need more and more private capital to bridge the investment gap in infrastructure. There's been privatizations and divestments of different types of infrastructure assets in Europe as well," Wanamo points out.

However, Wanamo and his team at Evli spotted a problem in bringing private capital to infrastructure. "Infrastructure has become one of the main alternative asset classes for the world's largest investors, like sovereign wealth funds and large pension funds. Finnish investors have woken-up to the benefits of investing in infrastructure, but there haven't been good ways for them to access the asset class. We saw that a lot of our institutional and private banking clients were very interested in investing in infrastructure – so the need was there."

The timing was fortuitous, as Evli was investing in growing its capabilities in alternative investments and gearing up to offer its clients access to infrastructure funds. "So, this new fund is both demand-driven from the market and something that we ourselves concluded needed to be done now. Infrastructure is a strongly growing asset class globally, and institutional investors in Europe and elsewhere intend to further increase their infrastructure allocations according to several institutional investor surveys. We've seen this play out in our own fundraising – our infrastructure fund has already exceeded its minimum target size of €100 million and we have very strong momentum into 2021," Wanamo says.

RETURNS THAT ARE REALISTIC AND ACHIEVABLE

Evli has a clear 'fund-of-funds strategy,' wanting to select the best funds globally within the infrastructure space.

Historically, the unlisted infrastructure funds have offered very competitive returns versus other alternative asset classes. The median annual returns in diversified unlisted infrastructure funds has been on average around 10 percent p.a. However, Wanamo believes that the low-yield environment over the last decade has helped to achieve these figures and a similar upward pricing momentum cannot be presumed for the next decade. "We need to be more conservative in our return targets going forward and we believe that 7 to 9 percent annual returns are something that's realistic and achievable," says Wanamo.

This candid and direct approach can add soft power to the company's hard investment expertise, as it continues to venture across the globe. "Nordic investors and fund managers are seen in the market as being very trustworthy. We typically say what we think, we have very low corruption and there's a lot of long-term capital in our markets. So that attracts funds that are raising money. And having the backing of a trusted and well-established name such as Evli makes us a very reliable counterparty in the market," Wanamo says.

> "By adding asset classes like infrastructure, which don't correlate highly with traditional asset classes, you can have higher returns on your portfolio as a whole, even though you don't increase the overall risk."

NOT VENTURING OUT IS RISKY

Venturing outside the Nordic countries is nothing new for Evli. According to Wanamo, restricting the fund's scope to local markets may, in fact, present a greater risk than having a global approach and wider diversification.

"We're lowering the overall risk of the portfolio by diversifying outside of Europe and the Eurozone countries," he says. He backs his own experience and that of Evli's, to succeed with the new fund internationally. "I have invested globally and within global managers previously, both with private equity and infrastructure. And, of course, Evli's private equity portfolios have global and US exposure," he says.

The need for infrastructure investments is pressing. McKinsey has estimated that to sustain projected economic growth around the world, more than USD 69 trillion of investment in economic infrastructure is needed between 2017-2035, both building new infrastructure and upgrading existing assets. Wanamo and his team are primed to provide the advantages of this massive asset class to their customers.

"By adding asset classes like infrastructure, which don't correlate highly with traditional asset classes, you can have higher returns on your portfolio as a whole, even though you don't increase the overall risk," Wanamo concludes.

The Heterogeneity of Private Debt

By Eugeniu Guzun – HedgeNordic

Born out of the ashes of the global financial crisis, the private debt industry evolved into one of the largest and fastest-growing private market asset classes. Private debt has emerged as a viable asset class for investors before the coronavirus pandemic and even more so during the pandemic. "With private debt becoming a major asset class, it is normal for investors to have a private debt allocation," Jussi Tanninen, Head of Alternatives at Finnish insurer Mandatum Life, tells HedgeNordic. "For an institutional investor, it is actually more active decision not to invest in private debt than to invest," he argues.

Strong demand for yield in today's zero-return environment has made private debt an attractive asset class for many investors. "Obviously one needs to find additional sources of returns in today's low-yielding environment, so investors are turning all the rocks to find those additional sources of income and returns," says Tanninen. "I suppose everybody likes good risk-adjusted returns and private debt can offer just that."

JUST THE TIP OF THE ICEBERG

The good risk-return profile of private debt is just one of the many reasons to invest in the space, according to Matias Hauru, portfolio manager responsible for private debt at Mandatum Life. "Indeed, the illiquidity premium is probably one of the key reasons to invest in this space," Hauru corroborates Tanninen's argument. Whereas the illiquid profile of private debt

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does not suit every investor, according to Hauru, "if one does not have significant limits on the portion of illiquid assets in a portfolio, then investing in private debt is a natural way to achieve better risk-adjusted returns over public debt."

Another advantage of private debt over public debt is the floating-rate nature of most private debt loans, argues Hauru. "This basically means that there is low duration risk in a portfolio of private debt loans." Hauru goes on to argue that private debt transactions also exhibit less information asymmetries than public transactions. "Being on the private side of things, you often get access to better financial information when doing a transaction, which allows you to do more rigorous due diligence," argues Hauru. "In the public space, you need to rely on publicly available information."

Private debt transactions also carry significant downside protection. "When it comes to the downside protection in these privately-negotiated transactions, you can get better terms in loan documentation, covenants and other terms," points out Hauru. Should things get difficult for a borrower, for example because of the coronavirus-induced socio-economic challenges, privately-negotiated loan deals offer a better venue for finding solutions. "One key aspect is that there are less counterparties and stakeholders in these transactions," says Hauru. "You do not have to negotiate with hundreds of bondholders or stockholders to find solutions, which allows you to find better solutions for everyone involved."

MANDATUM'S PRIVATE DEBT PROGRAMME

Mandatum Life has been running a private debt investment programme that is part of the firm's wealth management services. The private debt programme is a good example of successful co-investing, where the insurer pools capital and joins forces with its customers to make larger investments on more favourable terms. "You could call it a fund-of-fund type of program," explains Hauru. "It is not technically a fund of funds, but the approach is very similar."

Almost on a yearly basis, Mandatum Life launches a new investment programme to create a "fund-of-fund type of vintages focused on private debt." According to Hauru, "each of these funds of funds consists of eight to ten private debt funds, covering a wide range of different strategies within the private debt space that range from traditional direct lending to more opportunistic strategies." With the private debt industry representing a very heterogeneous space, Mandatum Life can invest in "anything that in our view represents a good risk-adjusted return strategy across the private debt space." Hauru points out that "our mandate is pretty wide, but especially in private credit, we believe that diversification in terms of risk and return is essential."

Mandatum Life is currently raising capital for its fourth Private Debt investment basket, having invested over €1.5 billion in the private debt space since 2016. "We have been offering this type of product since 2016," Tanninen tells HedgeNordic. "But from balance sheet money we have invested in private debt funds since 2008," he emphasizes. "We have the existing relationships, we have the "information bank" and our 12-year experience to successfully run this private debt investment programme," continues Tanninen. "12 years of experience in this space is quite a long time for a European investor."

"The programme that we have built is basically an allocation tool to private debt for our clients," explains Hauru. "The programme allows our clients to field institutional grade, private debt allocation

Jussi Tanninen
Head of Alternatives
Mandatum Life

"With private debt becoming a major asset class, it is normal for investors to have a private debt allocation. It is an even more active decision not to invest in private debt than to invest."
– Jussi Tanninen

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in their portfolios with smaller tickets." Most of the capital raised for Mandatum Life's private debt programme comes from "so-called programme investors who invest in each of our vintages and use it as an allocation tool for private credit." This co-investing brings increased scale "that allows us to get better terms for our investments, including lower management fees or performance fees, or other terms in the documentation."

Matias Hauru
Portfolio Manager Responsible for Private Debt
Mandatum Life

"The programme that we have built is basically an allocation tool to private debt for our clients. The programme allows our clients to field institutional grade, private debt allocation in their portfolios with smaller tickets."
– Matias Hauru

MANAGER SELECTION PROCESS

"We do not think that there is such a thing as a private debt market as one homogenous group," Tanninen says. "Therefore, we feel that diversification, obviously between external managers, but even more importantly between strategies, is very important." Mandatum Life's private debt team meets over 100 private debt managers a year "to find the ones offering the best risk-return combination in our view."

"Our manager selection process and portfolio construction rely a bottom-up approach," explains Hauru. "When it comes to selecting managers, we first aim to understand very thoroughly the deals that they had done and especially evaluate the risk related to these deals." Whereas Mandatum Life does not have predefined allocations to specific geographies and strategies, "we make sure the portfolios are diversified and balanced."

One common characteristic of all managers selected for Mandatum Life's private debt investment programme is "the presence of a competitive edge that is very difficult to replicate," according to Hauru. One of these competitive edges could involve economies of scale. "Having a €10 billion-fund allows managers to participate in deals that face less competition," says Hauru. "The competitive edges can also relate to the scale of the platform and resources, deal-sourcing capabilities or some country-specific local knowledge."

A manager's ability to protect against a permanent loss of capital is also put under the microscope. "As these are fixed-income investments, it is obviously key not to lose money in these deals as the upside is typically very limited at least in direct lending strategies," says Hauru. "One of the key parts of our due diligence is to analyse the manager's ability to protect the downside in these investments," he continues. "If there are challenging situations, are they able to go through them and for example, go through a restructuring if needed?"

RETURNS AND COVID IMPACT

Hauru says that "there is a lot of variance between strategies." Mandatum Life's private debt investment programme features "opportunistic strategies that can generate private equity-type returns between 12 percent and 15 percent net of fees." The safest, lowest-returning strategies, however, yield about six percent per year. "And then we have everything in between."

The coronavirus pandemic represents the first "real" test for the private debt market and its investors. "While there is still some uncertainty about how the pre-pandemic private debt deals will turn out, part of the asset class has proven itself during the crisis, proving that it is actually able to benefit from crisis situations," argues Tanninen. "We do not know yet whether defaults will pick up, but one thing that we can say is that the asset class was able to deploy capital in stressed market conditions," he continues. "In private equity, even if you had all the dry powder in the world, that did not help much in the second quarter of 2020 because nobody was selling anything."

"The market environment has improved in most of the sub-segments of the private debt market since the COVID crisis hit," points out Hauru. "In opportunistic strategies, which include distressed, stressed, special sits and those kinds of strategies, one could argue that the market opportunity for new investments is probably the best since the global financial crisis," he continues. However, the private debt team at Mandatum Life "do not want to make bets on just selecting some strategies within each vintage," according to Hauru. "Our philosophy is to build a balanced portfolio regardless of the market situation."

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Private Credit – Why PC Is the New PE

By Samantha Rosenstock – Man FRM

In the wake of the 2008 Global Financial Crisis, private equity stepped in to provide financing to firms that had seen their access to the markets disrupted, leading to a period of elevated returns for the asset class. Now it is the time of private credit. With traditional bank financing retrenching from products across the credit universe, private credit is poised to continue its recent period of strong growth. In this article, we look at the increasing sophistication of private credit, the widening range of products available and why we believe investors that have previously participated in private equity should now turn their attention to private credit.

INTRODUCTION

It feels like every crisis is spent comparing and contrasting the present meltdown with previous ones. So it is that we've spent a great deal of time recently looking back to 2008, thinking about how our experience of that period of intense volatility and existential anxiety might inform our actions now. If anything, what's striking is how different the current crisis is from the Global Financial Crisis ('GFC'): we're not (over) worried about the financial system this time; it's developing rather than developed economies that seem most at risk; and liquidity in public markets has remained strong throughout.

Samantha Rosenstock
Head of Investment Research
Man FRM

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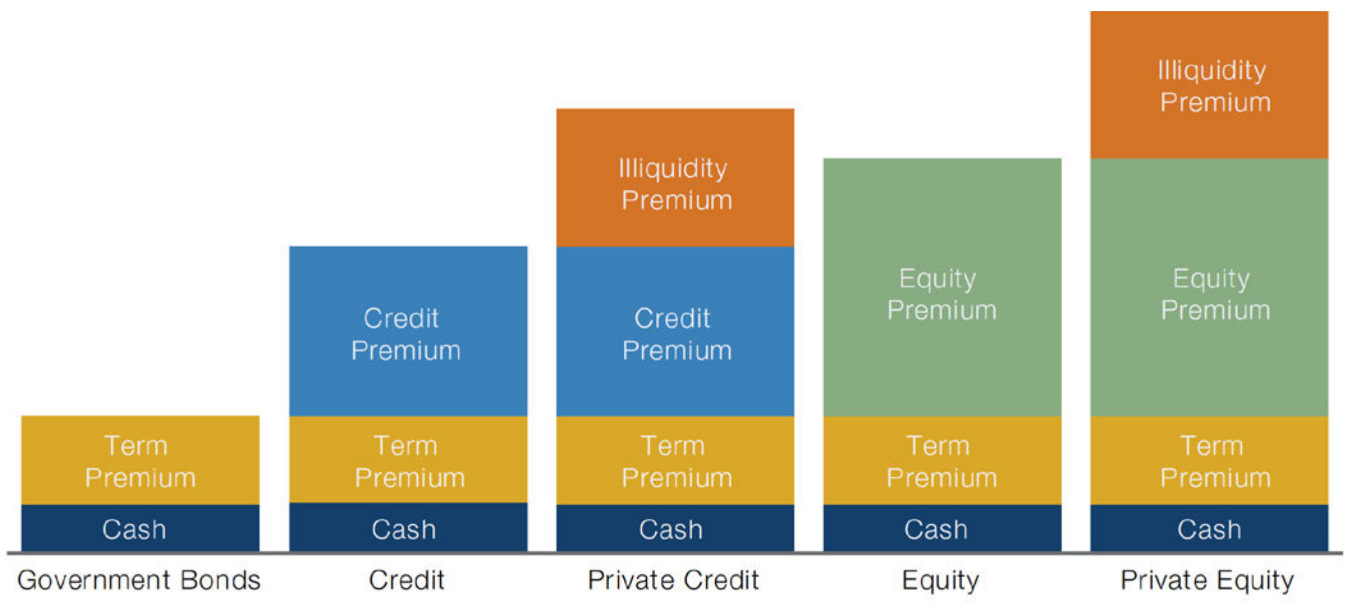
Figure 1. The Relationship Between Public and Private Markets



Source: Man FRM. For illustrative purposes only.

Crises are about opportunities as well as challenges, though. Private equity ('PE') firms thrived in the wake of 2008, deploying their capital into situations where public equity providers had retrenched. It is a good rule of thumb that private markets tend to perform best in the aftermath of public market volatility. Figure 1 provides a theoretical overview of the relationship between public and private markets, and between equity and credit, with an illustration of the various premia investors should demand for participation in each asset class.

Separately, private credit has undergone transformative evolution over the past decade. From a relatively niche asset class, private credit has increasingly become an integral part of many institutional investors' asset mix. As investors cycle their portfolios out of public equities – cognizant of the historical opportunities presented by private markets in the wake of market pullbacks – we believe there is a strong case for preferring private credit over both public credit and public and private equity at this point in the cycle.

> "Private credit has undergone transformative evolution over the past decade. From a relatively niche asset class, private credit has increasingly become an integral part of many institutional investors' asset mix."

THE ROAD FROM PE TO PC

As indicated in Figure 1, the theoretical difference between private and public markets lies in the illiquidity premium – the extra return received by transacting in the private market space through additional fees and superior terms from bespoke negotiations. The problem is that private equity simply isn't currently delivering investors the returns they require. This is down to a number of factors, from the outperformance of public equities on the one hand, to the massive dry powder waiting to be deployed by PE firms and the relative paucity of genuine growth opportunities in which to deploy it. As a recent study by Bain[1] indicated, PE has largely been delivering performance by applying greater leverage to transactions and through multiple expansion (Figure 2). This is a highly competitive, mature market in which vast sums of capital are chasing increasingly rare opportunities in our view.

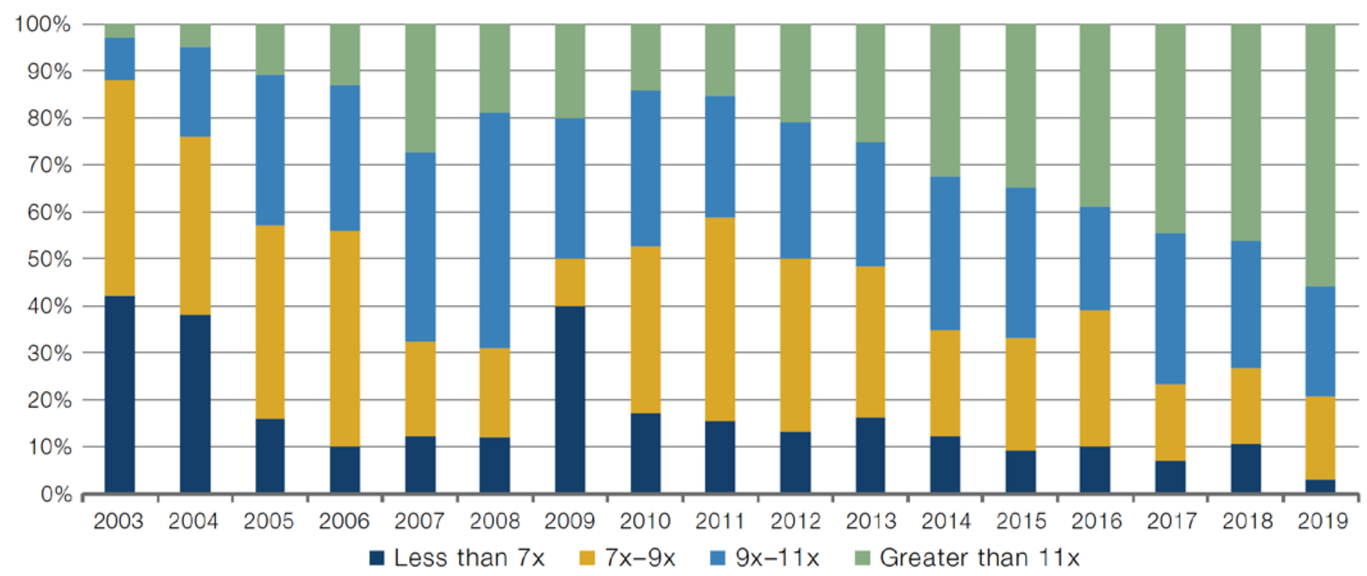
[1]*Source: Bain & Co; Private Equity in 2019: Strong Deal Activity Despite Worsening Macro Conditions; 24 February, 2020.*

The illiquidity premia paid to private equity holders simply isn't adequate, we believe, to compensate them for the meaningful risks involved.

In contrast, the premium paid to investors in private credit relative to public credit appears highly compelling to us. In what was already a low-rate environment, central bank responses to the coronacrisis have driven public credit spreads to historical tights. The premium investors receive for investing in private credit over both public high-yield and leveraged loans is at near-record levels. This increase in the premium commanded by private credit comes at a time when the universe encompassed by the asset class has expanded rapidly.

If we look at the evolution of private credit, we can see that the first real surge in interest in the asset class came in the wake of the GFC, when banks drew back from corporate lending under regulatory

Figure 2. Average EV/EBITDA Purchase Price Multiple for US Buyout Deals



Source: Refinitiv; as of end-2019.

Note: Includes deals with disclosed purchase price and leverage levels only.

> "Essentially, if the years following the GFC were about private credit stepping into the corporate lending market, then the more recent evolution of the market has involved private solutions to a host of specialty lending opportunities that were previously the preserve of the big banks."

pressure and non-traditional financial services firms stepped into their place. Since then, corporate direct lending has grown exponentially, with lenders demonstrating a high degree of sophistication and impressive underwriting standards. This has effectively provided a blueprint for non-traditional lenders to move into a range of other lines of credit provision, as banks not only focused on lower capital charge activities but have also streamlined lending, shedding smaller or specialised lending business lines. This means investors can access a whole host of new exposures in private credit, diversifying their portfolios away from corporates towards specialty finance. Categories available include risk transfer, consumer lending, real assets, real estate, structured finance and orphaned and special assets such as non-performing loans, receivables and equipment leasing.

Essentially, if the years following the GFC were about private credit stepping into the corporate lending market, then the more recent evolution of the market has involved private solutions to a host of specialty lending opportunities that were previously the preserve of the big banks. The lack of traditional financing sources for these categories and the favourable supply/demand dynamics within them mean that returns are often highly attractive. It should also be noted that these lending categories demonstrate a range of attractive characteristics from a risk perspective, generally experiencing stable performance even under stress; being asset heavy with strong underlying fundamentals; often structured to help mitigate downside risk but maintain the upside optionality of capital gains; producing durable cash flows to support self-amortising exits.

CONCLUSION

In summary, private credit has long been considered one of the more compelling asset classes for investors looking for diversification away from traditional public markets. In recent years, the range of exposures offered by the asset class has broadened dramatically and the current opportunity coincides with a period in which private equity is facing significant challenges. Investors should take steps to educate themselves about an asset class which is likely to feature increasingly prominently in portfolio allocations as we move through the latter stages of the crisis and into the next stage of the cycle.

About the author: Samantha Rosenstock is Head of Investment Research responsible for executing Man FRM's research and selection agenda and overseeing manager underwriting across portfolios. She is also responsible for manager due diligence of private credit strategies. Previously, she served as Head of Alternative Investments for the State of New Jersey pension fund and worked at AIG Asset Management.

Man FRM's long history of researching and allocating to alternatives dates back to 1991 with our first commingled credit hedge fund launched in 1995. We currently have over $13bn in assets (July 2020) spanning the entire liquidity spectrum of alternatives supported by Man Group's global and institutional platform. The firm has a dedicated global team focused on alternative credit strategies with experience spanning both liquid and private market investing. Approx. 90% of our clients' assets are in customised solutions. These innovative solutions include managed accounts and expertise in legal fund structuring all supported by Man Group's proprietary technology platform.

Hedge Fund Alpha in Unlisted Equites

By Eugeniu Guzun – HedgeNordic

Ulf Frykhammar
Managing Partner and Portfolio Manager
Norron Asset Management

Mikael Petersson
Portfolio Manager
Coeli Asset Management

Not every company has the urge to rush to be listed on a public market, or may have not yet reached the stage in their business cycle to justify such a move. This segment favors active managers who can invest in these private businesses at a potentially faster stage of growth and perhaps at more attractive valuations.

A handful of Nordic hedge funds have the ability, skill and desire to invest in attractive risk-reward opportunities in this unlisted space. Mikael Petersson, who was the first investment-side employee at London-based Lansdowne Partners and later founded the long/short equity fund Coeli Absolute European Equity, can allocate up to ten percent of his hedge fund's portfolio to unlisted equities. "We have a mandate to invest up to ten percent in unlisted equities, but in reality, we target an allocation of five percent to this space on average," Petersson tells HedgeNordic. "We have maintained an allocation to unlisted stocks between two to four percent since the fund's inception in early 2018."

> "If you have a small but steady flow of attractive investments, it can make a difference over the years."
> – Mikael Petersson

Swedish asset manager Norron Asset Management has also maintained investments in unlisted companies across its three hedge fund vehicles – Norron Select, Norron Target and Norron Alpha. "We have had a sub-strategy in our absolute return funds, in which we have been active in unlisted equities since 2016," Ulf Frykhammar, managing partner and portfolio manager at Norron, tells HedgeNordic. "On average, we have had five percent of our funds' net asset values allocated to such strategies during that time period." According to Frykhammar, "the amount allocated by the Norron funds to unlisted investments depends on a range of criteria," including the risk mandate, UCITS-regulations, potential upcoming funding need in the unlisted portfolio, deal flow, and the maturity of the portfolio.

WHAT ARE THE RISKS?

While "the less crowded space and lower valuations" offer the opportunity for greater returns from investing in private businesses, "this comes with a set of inherent risks such as liquidity risk, market risk, operational risk, among others," according to Petersson. Investing in any type of equity carries significant risk for investors, however, "investing in private businesses is particularly risky due to the lack of liquidity and the usually higher risks associated with the less-mature stage of their growth cycles," argues Petersson.

According to Petersson, another downside of investing in unlisted companies involves the "dependency on exit windows," which, in turn, depend on the broader economic environment and stock market valuations. While there are no market prices for private businesses, the market prices of public

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"In today's capital markets, a growing part of the market is affected by systematic strategies, which means that you have to engage in smaller cap companies, or even unlisted companies, to add distinctive positive value to the owners of your fund."
– Ulf Frykhammar

companies can impact the realization value from selling a stake in a private business.

The investment team at Norron Asset Management corroborates Petersson's views. Their "unlisted equity" sub-strategy "has less liquidity, less transparency and often higher funding needs, and the companies are often obviously at an earlier stage in their development," Frykhammar says. To guard their portfolios against some of these risks, the Norron team is "only active in relatively more mature unlisted companies that a board resolution to list within 12 months after our initial investment," according to Frykhammar. "All the above is transformed into a higher equity risk premium."

"We hope to be able to generate excess returns by managing those risks, and obviously to compress the risk premium, so that we get the return we seek when the company is listed," continues Frykhammar. To mitigate some of the operational risks associated with the early-stage natures of private businesses, the Norron team maintains "a very close dialogue with the companies we invest in, we try to point at certain development criteria's that we think they should consider ahead of listing."

WHY INVEST IN PRIVATE BUSINESSES?

The risks associated with investing in private businesses are wide-ranging and could have a major impact on returns and firm reputation should things go wrong (remember the 'Woodford-gate' episode?). So why would a hedge fund manager, who has the opportunity and possibility to invest across thousands of listed stocks across the globe, choose to invest in private companies? Because the potential rewards may more than justify all the risks involved.

Hedge fund managers are the whiz kids of the finance world who rely heavily on networking to find investment ideas. Their networks can occasionally put very attractive opportunities on the table. "After working in Europe for so many years, I have built a strong network that provides me with opportunities," Mikael Petersson tells HedgeNordic. "We have a strong network from having worked in the some of the world's largest hedge funds and been in the business for more than 25 years," he adds. "The funds I manage offer some characteristics that a typical investor cannot usually get."

Petersson, who runs a Europe-focused long/short equity fund and a long-only by-product, seeks to "produce 2-3x our original investment from unlisted companies within a period of two to three years." This figure translates into targeted annual returns between 26 percent and 73 percent. The investment team at Norron, meanwhile, "are looking for at least 2-3x the internal rates of return that we can generate on average in the listed equity market."

While Mikael Petersson and the Norron team allocate only a small portion of their portfolios to unlisted companies, Petersson argues that "if you have a small but steady flow of attractive investments, it can make a difference over the years." According to Petersson, "so far, we have had two out of three investments with a strong increase in valuation." He goes on to say that "for the investors in our fund, it is a unique investment opportunity which they cannot do or find themselves."

Frykhammar tells HedgeNordic that "in today's capital markets, a growing part of the market is affected by systematic strategies, which means that you have to engage in smaller cap companies, or even unlisted companies, to add distinctive positive value to the owners of your fund." According to Frykhammar, "if we decide to invest in unlisted companies, we do that because we think that we can be able to circulate the higher risk premium attached to such companies to our shareholders." He concludes by saying that "to shareholders in our funds, it has proven to be very profitable to act as a funding bridge the year ahead of a full market listing."

Daniel Broby
Director, Centre for Financial Regulation and Innovation
Strathclyde Business School

What's It Worth?

By Eugeniu Guzun – HedgeNordic

Business valuation is more of an art than a science and is what one might call a "subjective science." However, nobody needs to have complete information and the "perfect" valuation approach in order for financial markets to convey all relevant information and reflect the "correct" market prices. Relying on the premise that "the stock market efficiently prices companies," a Strathclyde's Business School start-up led by a team of former financial sector professionals from Goldman Sachs, JP Morgan, Morgan Stanley and Bloomberg developed a tool that provides real-time valuations for private companies.

"In finance theory, the stock market efficiently prices companies," says Daniel Broby, director of the Centre for Financial Regulation and Innovation at the University of Strathclyde and one of the three co-inventors of the real-time company valuation technology. "Whether or not fund managers agree with that, there is evidence that actually is the case in aggregate," he tells HedgeNordic. According to Broby, "the technology allows real-time pricing, with private estimated valuations fluctuating in accordance with the systemic movements of the stock exchange."

HOW DOES THE TOOL WORK?

The machine learning-assisted tool essentially combines publicly available data from Companies House in the United Kingdom with financial information from stock markets to estimate the value of private businesses. The process of estimating these market values encompasses multiple steps. "We scrape publicly available financial data and

"The technology allows real-time pricing, with private estimated valuations fluctuating in accordance with the systemic movements of the stock exchange."

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industry classification and then apply a valuation algorithm to establish a rough valuation," explains Broby. He further points out that the technology is equally applicable in the Nordics and elsewhere.

Having obtained a sample of firm-specific financial ratios and the valuation coefficient for a given private company, the technology "then uses the public stock markets as a learning data set to refine the valuation." At the core, the machine learning algorithms seek to find public companies with similar characteristics as the private company, with these characteristics including the growth rate, capital structure, number of employees, cash flow, liquidity data, among others.

"Taking our sample of ratios from private markets that we have processed using programming techniques, we then use machine learning to assign a more accurate valuation based on current market prices," explains Broby. "The valuations of private companies are not dynamic and are not priced in real-time. Obviously, the valuations we are creating are," he continues. "This is done in real-time and reflects any adjustments, such as discounts for private ownership."

THE BENEFITS?

"We need valuations of private companies frequently," points out Broby. Instant valuations of private businesses are needed "when tax events occur, probate happens, or when new investors come on board a company." Publicly traded companies have observable stock prices and thereby, their respective market values. Private companies do not. The valuation of private companies can often be a difficult, time-consuming and highly-subjective procedure, considers Broby. "Typically, these valuations take three or four weeks to produce and are costly," Broby tells HedgeNordic.

"In real-time, the technology can do it for millions of companies simultaneously," says Broby. "Imagine being able to look up the value of your friend's restaurant or the shares in that private company your grandfather gifted you," he points out. "The market movements are reflected in real-time. As such, the price of private equity instantaneously reflects events such as the Covid-lockdown." The market value of a publicly listed company, theoretically, takes into account all publicly available information, and so do the valuations spilled out by technology developed by Broby and his team.

"We want to give private firms and the entrepreneurs behind them the benefits and freedom that publicly traded companies enjoy, creating a new market and ecosystem that can allow companies develop more rapidly through more easily available financing, thereby benefitting the entire economy," says Broby. The benefits of this real-time company valuation technology can go beyond helping entrepreneurs and private businesses in raising capital. The buy-side, particularly the private equity industry, can also benefit from the use of Unlisted Limited's technology.

"The private equity industry typically only prices their investments once a year," Broby points out. He considers that "the use of real-time valuations will allow portfolios to be more dynamic and better managed." Additionally, "the equity incentivization will become more refined and transparent to both parties." The technology developed by Broby and the Unlisted Limited team "avoids costly annual valuations of private equity. It will, we hope, democratize private equity investment giving shareholders a tangible instant valuation."

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CURRENT DEVELOPMENT STAGE

Developed by academics at Strathclyde Business School, the technology is awaiting patent approval in the United States and is currently undergoing a beta testing phase. The "first to discover" patent in the US "is the culmination of a great deal of academic research into this developing and ground-breaking technology," Broby said last year. "It's merely a milestone in our ambitions."

The technology was assigned by Strathclyde University to Unlisted Limited, a start-up which is effectively a University of Strathclyde spin-out. "They have developed the technology into a minimum viable product and are commercializing into a revenue making business," says Broby. Elaborating on the technology's current stage of development, Broby tells HedgeNordic that "we have got testing currently going on with one of the top accounting firms, two private equity funds and Her Majesty's tax office in the UK." So far, "the valuations that are coming out are within the bounds of reported commercial transactions in private companies."

Academic research is often perceived to be laborious, narrow and detached from the real world. But the technology developed out of the research conducted by Broby and Unlisted Limited provides a vivid illustration of how academic research can be used to solve some of today's real-world problems. "Research such as this shows the practical applications of academic techniques and real-world applications," says Broby.

Salvator Mundi is a painting by Italian Renaissance artist Leonardo da Vinci dated to c. 1500. Long thought to be a copy of a lost original veiled with overpainting, it was rediscovered, restored, and included in a major Leonardo exhibition at the National Gallery, London, in 2011–12. It is one of fewer than 20 known works by Leonardo, and was the only one to remain in a private collection. It was sold at auction for $450.3 million on 15 November 2017 by Christie's in New York to Prince Badr bin Abdullah, setting a new record for most expensive painting ever sold at public auction.

Exploring more Exotic Asset Classes

By Hamlin Lovell – HedgeNordic

Most investors are familiar with private equity, venture capital and private debt, but more exotic asset classes might offer additional diversification, and potentially higher and less volatile returns. Investors need to choose carefully because these exotic areas have provided a wide range of returns, and some of them have performed poorly for many years.

ROYALTIES – CREATIVE INDUSTRIES

At a time when investors are starved of yield, royalties could be a good place to start. Worldwide royalty collections for creators of music, audiovisual, visual arts, drama and literature reached a record €9.65 billion in 2018, according to the 2019 Global Collections Report published by CISAC. This was up 25.4% since 2018 thanks partly to growing digital revenues. Growth could even be accelerated by new laws, such as the April 2019 EU Copyright Directive.

To focus on one category, music royalties, there are private funds and some publicly listed investment companies. For instance, the London Stock Exchange already has one closed end fund, Hipgnosis Songs [ticker: SONG] which floated in July 2018 and has grown to a market capitalisation of over GBP 1 billion. Round Hill Music, which has acquired Elvis Presley catalogue owner Carlin Music Publishing, will float its investment trust in November 2020.

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ROYALTIES – OTHER INDUSTRIES

Buying shares in a pharmaceutical company clearly provides indirect exposure to drug and other royalties, but also potentially a lot of volatility around politics, regulation, new drug approvals and so on. A drug royalties fund – which may also source royalty deals from inventors and universities - can provide regular income with less volatility. Medical devices and diagnostics can also generate royalties and Greenfield Advisors estimate the worldwide market for healthcare royalties is worth at least $100 billion a year.

Beyond healthcare, patents or other intellectual property in any industry could be securitised into a fund or special purpose vehicle structure to generate income.

The income from some deals can be as high as 20% a year, partly because patents provide a temporary monopoly. Income from IP is also high for a more controversial reason: these assets are often structured to be domiciled in low tax jurisidictions, such as Ireland or parts of Switzerland.

ART

High net worth individuals are already keen buyers of art, with 35% of them investing in it according to a UBS survey. Foundations related to museums buy art to exhibit, but institutional investors in general are less active, although the UK's British Rail pension fund did invest in fine art as long ago as the inflationary 1970s. The headlines are dominated by stories of record-breaking prices, such as US$450.3 million for a Leonardo da Vinci Salvatore Mundi in 2017, but average returns from art have been fairly unexciting. Art has returned an average annual 5.3% and contemporary art an average 7.5% between 1985 and 2018, according to a report from Citigroup, using data from Masterworks.io. This was pretty close to corporate debt over the period. Annual sales of $67.4 billion in 2018 make art a sizeable market, but investors need to consider that transaction costs for art, including storage, transport, insurance, and possibly auction house commissions of 5-25% when it is sold, can be higher than for most conventional assets.

CLASSIC CARS

Individual classic cars do not come close to the prices paid for fine art: the highest sale price in 2020 was US$7.1m for a 1932 Bugatti Type 55 Super Sport Roadster (sold by auctioneer Bonhams). But overall returns have been strong over the long term: the most diversified index – Historic Automobile Group International (HAGI) Top Index for rare classic cars - has appreciated by about 600% since inception in April 2005, though it has also been roughly flat for the past three years or so. For European classic cars, HAGI also publishes more narrowly focused purely on Ferraris; Lamborghinis; Porsches and classic Mercedes Benz cars made between 1920 and 1980.

WINE AND WHISKY

Fine wines have generated strong returns over the past five years, ranging from 26.62% for the Liv-Ex Rhone 100 index to 80.02% for the Liv-Ex Burgundy 150 index, which includes the legendary Romanee Conti. The largest investment category for fine wines, Bordeaux in France, has made 34.47% for the Bordeaux Legends 40 index over the same period. Liv-Ex publishes an index of the most investable wines, called Liv-Ex Fine Wine Investables, but perhaps confusingly, the index itself is not actually investable. Various funds do exist for wine, but some investors would rather maintain their own cellar as an unusual type of "hedge": if the investment does not perform, it can be consumed.

One approach is to buy wine "en primeur", while it is ageing in barrels, before it is bottled, and the same applies to whisky. Swedish whisky has been a treat in the pre-Covid days of the HedgeNordic awards, though whisky from Scotland is the most popular for investment. Historical returns have been as high as 12-20% per year, which can compound up to a very high level. One fund claims to have made 582% over the past decade. Certain rare Japanese whiskies might have done even better.

COINS AND STAMPS

Coins, such as Krugerrands, can be a way to get exposure to physical gold and silver, which is sought after by "goldbugs" who fear that the Government might nationalise gold, as the US Government did in the 1930s. Another type of coin investment seeks coins that have a rarity or scarcity value rather than an intrinsic value from the metals used to make them. This asset class overall has not performed particularly well. The PCGS3000 Rare Coin Index is nearly 70% below the peak it reached in 1989, and has also lost value over the past 10 years. Rarity and scarcity is not sufficient for an investment to perform, and coins have clearly been less fashionable that art, classic cars or wine.

Postage stamps are also very much about scarcity value and can sometimes command extraordinary prices: an 1865 British Guiana One-Cent Magenta stamp holds the world record, selling for USD 9.48 million in 2015. However, the asset class has had a bad experience due to an unusual fund structure. The Stanley Gibbons rare stamps fund had offered investors a guarantee to buy back stamps for either 75% of their present value or 100% of the price paid for them. This resulted in a contingent liability that was many times greater than the value of the fund, which ultimately went into administration. This suggests that if innovative asset classes are combined with an innovative fund structure, the situation can become too complicated. Exotic asset classes should offer enough excitement already, without trying to be too clever on fund structures.

40% Guaranteed in this Liquid Alternative

By Kamran Ghalitschi – HedgeNordic

Private, investable markets stretch a wide range spanning from private equity, private debt and many other things that are rare, of value and collectible. Fine art, exotic cars or rare coins and currency are just some examples where investors and collectors alike can participate through fund structures. Another market that barrels up for such an investment strategy is whisky, and it took a group of specialists from Sweden to get it on track.

"The Single Malt Fund is the world's first regulated whisky fund, under supervision of the Swedish FSA, and listed on a regulated market, NGM in Stockholm", Mats Ohlson, the portfolio manager for the Single Malt Fund claims.

The Single Malt Fund invests in rare and limited edition whisky, both casks and bottles – a product with a remarkable historical yield.

The whisky-investment industry even has its own index to which it can refer, and could benchmark too. Rarewhisky101 APEX1000 tracks the best performing 1000 bottles of rare whisky. Since 2010, and as of December 2019, a total of 49,572 bottles have been included in the APEX 1000, out of a total of 509,873 data entries. Since its inception 9 years ago, the APEX 1000 has grown by over 551%. 2019 saw a" pause for breath" in the first half (due mainly to profit taking of The Macallan), while the second half marked a return to healthy grow that a level of 15% on a per annum basis. And the whisky investment market has shown resilience even through the Covid-crisis.

According to Rarewhisky101, the prices of rare whisky have increased by 7% YTD by the end of September.In April and May, key lockdown months, the RW101 Apex 1000 index increased by 0.32% and 0.59% respectively. Astonishingly, the average price per bottle has increased month on month, every month, since Jan 2019. In fact, the whisky investment market is thriving. In late August 2020, a 55-year-old bottle of Yamazaki whisky sold for a world record price, for a bottle of Japanese whisky, of $795,000 at Bonhams Hong Kong.

STRUCTURAL, EXPONENTIAL CONTANGO

"Strong growth of demand, slow production, limited supply and diminishing supply creates structural, contango for the rare and limited whisky market", explains Ohlson. This is arguably, where much of the value and appreciation stems from. After all, the liquor must remain in the cask for no less than three years by law, and normally twelve years by choice, before it is ready for bottling. This lag from the start of production to when the whisky comes to market makes it hard to react to trends, fashions and shifts in demands – the only way this captured is through the price mechanism.

> "The Single Malt Fund is the world's first regulated whisky fund, under supervision of the Swedish FSA, and listed on a regulated market."

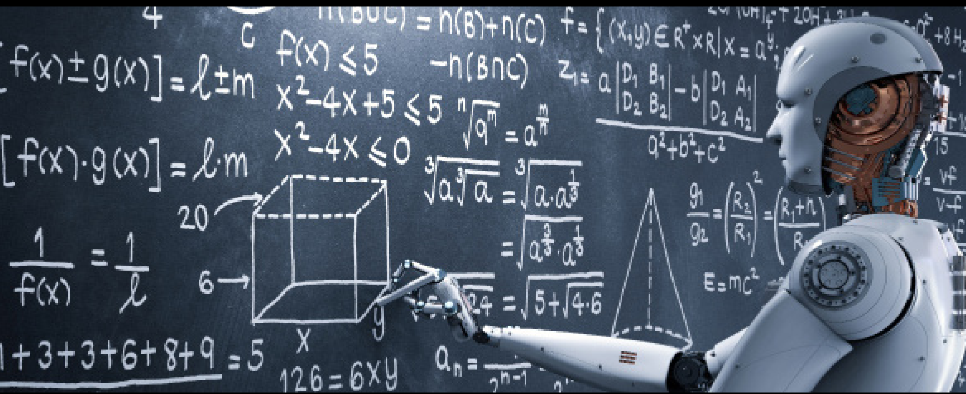
"Strong growth of demand, slow production, limited supply and diminishing supply creates structural, contango for the rare and limited whisky market."

The purchasing strategy for new stock at The Single Malt Fund focuses largely on Scotland (70%) and Ireland (20%) with the US and Japan making up the bulk of the remainder. Just over two thirds of the stock is purchased in bottles of single malt and other collectible whiskies and a third in casks.

Purchasing and pricing strategy indeed is an important factor to the funds' overall success. The aggregated mark up for assets purchased thus far by The Single Malt Fund is 32% - this after less than 1 year from investment date. "On average, TSMF has received substantially higher trade discounts on their purchases than anticipated and budgeted. With a larger AuM (capital), we believe we can further strengthen margins." Ohlson is convinced. Part of being able to maintain or extend the impact of favorable margins, especially also when selling stock will be the funds' own e-commerce platform, that will allow trading inventory while cutting out expensive channels, such as auction houses or wholesalers. It is expected that around 45% of inventory will be the annual turn-over ratio, while 55% will follow a buy-and-hold strategy, to fall into hedge fund lingo.

Limited supply though, one of the key drivers of price, is of little concern to Ohlson: "In Oct 2020, we will take delivery of our first exclusive bottling; Irish Distillers, owned by Pernod Ricard, have sold us a cask of Redbreast 22YO, the only cask they have sold to private clients this year. They will bottle this cask for us, in full Redbreast livery. In 2019, Redbreast 12YO won the coveted IWSC award for the best whisky in the world. We have accounts open with about 70% of the Scotch whisky producers / distributors and 95% of Irish producers."

The fund has a six year lock up (the first of which is already ticking down), aims to return above 10% per annum. It has a 2.5% management fee and the fund manager will retain 20% of the net profits at the end of the fund´s lifecycle.



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