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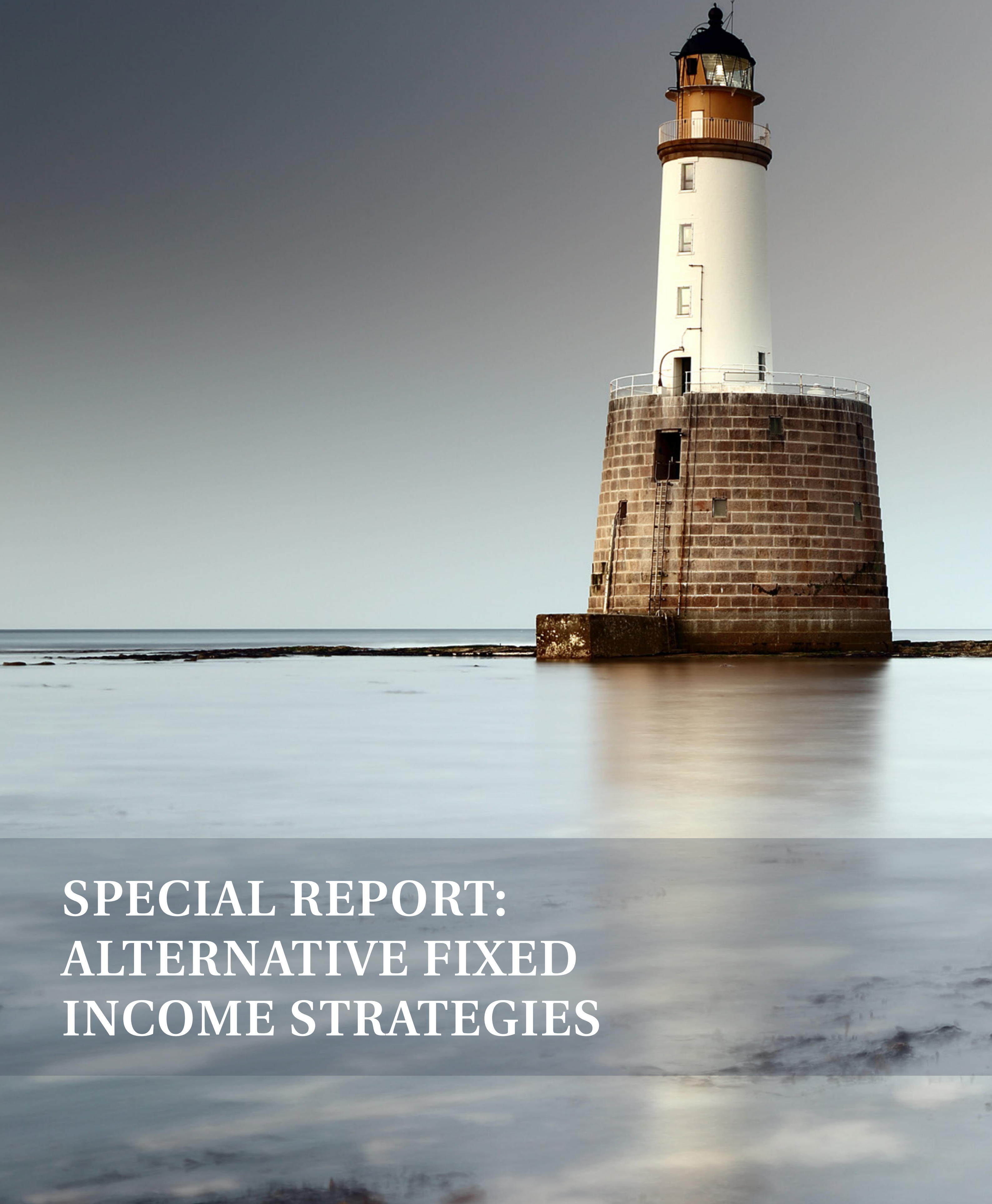

SPECIAL REPORT: ALTERNATIVE FIXED INCOME STRATEGIES

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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 2021:

February:	Quant Strategies
March:	Nordic Hedge Fund Industry Report
April:	Finding Alpha in Equities
May:	Illiquid Strategies
June:	Multi Asset
September:	Value Investing / Quality Investing
October:	Private Markets
November:	Alternative Fixed Income
December:	ESG and Alternatives

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Editor´s Note...

The Death of the Business Suit

When was the last time you had on a full business outfit? I mean, the whole shebang with the shiny shoes, tie, jacket...cufflinks – or the ladies' equivalent. For me, I believe it was in late February, when I had my last business trip. The Covid-business-casual became so accustomed.

I had not even noticed, maybe not even thought about how formal business attire crept out of my routines until I was asked to put together my Christmas wish-list. Asking around in the family what they'd like under the tree, the absence of shirts, ties, and fancy accessories on those lists struck me.

Covid-19 quite obviously is a major disruption to many, many aspects of our lives. The tremendous impact on various industries, the tens of thousands of companies going out of business, the many, many millions of jobs lost around the globe, the people and families behind those – and, of course, the impact on people's health and wellbeing.

Covid-19, more precisely, the measures taken by governments to combat and contain the disease, have become a massive disruptor to our economies and societies. Some industries got hit as if it were snowfall in July, for others Covid just accelerated a trend that existed long before or acted as a catalyst. One aspect the pandemic postponed at least for now, it seems, is the prospect of rising interest rates.

Federal Reserve Chairman Jerome Powell highlighted the importance of the lending programs aimed at battling the economic fallout from the coronavirus pandemic. In prepared remarks for the Senate Finance Committee, he noted that even as recent positive vaccine news raised the prospect of a swifter economic recovery next year, it is not time to shut down emergency programs yet. In addition to the lending and liquidity programs, the Federal Reserve is expected to pump more money into the economy, expanding both its bond-buying program and ultra-cheap loans to banks to support economic recovery. The Central Bank left the target range for its federal fund's rate unchanged at 0-0.25% during its November 2020 meeting. Not much reason to believe other leading central banks will be acting much differently.

With trillions of dollars of debt - and many bank deposit accounts - now offering negative yields, investors need to think outside the box just to stay above zero, and they may need to think harder to keep pace with inflation. To find government bonds yielding more than the local inflation rate, investors probably need to venture into emerging markets, which sometimes entails taking on foreign currency risk.

In corporate debt markets closer to home, private debt or structured credit might offer a higher yield than more liquid debt for those with a longer time horizon. Yet predictions of much higher corporate default rates will mean some cautious investors would rather avoid any credit risk, whether it is in public or private markets.

In this special report then, we want to highlight some strategies and market niches trading with fixed income instruments to do give yield-starved investors opportunities for returns. We will also see if there are instruments and strategies that have similar, or even better, risk/return profiles we traditionally would expect to be covered by the fixed income pot of the portfolio.

Thomas Pohjanen of Excalibur Asset Management explains "The Upside of Downside Protection", René Rømer from Danish Formuepleje talks about how "The Covid-crisis created volatility, but also opportunities for nimble managers," while their countrymen from CABA Capital are "Adapting to Low Risk Premiums."

In other Nordic views, Kreditfonden explain how they aim to "Cater Institutional Investor Demand for Illiquid Private Debt" and Philippe Sissener, Portfolio Manager for the Sissener Corporate Bond Fund, is convinced "Public Issuers are More Bulletproof." Nordic Cross Asset Management are "Thriving Amid Liquidity Crunches," while Moma Advisors and Asgard expect "A Stellar Year for Fixed Income – Volatile for Credit".

Sebastian Schroff explains how yield pickup, diversification and risk control is AllianzGI's Private Debt Multi-Manager Strategy. Tabula Investment Management highlights the "Dual Threat: Illiquidity and Inflation," while Emerging Markets specialist EMSO makes "The Case for Emerging Market Fixed Income Allocations in Global Portfolios."

Plenty to dig into here, enjoy the read!

KAMRAN GHALITSCHI

CEO & PUBLISHER HEDGENORDIC

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Adapting to Low Risk Premiums

By Eugeniu Guzun – HedgeNordic

From left to right:
Chris Nygaard Sørensen, Fund Manager
Mette Østerbye Vejen, CEO
Christian Lindstrøm Andersen, Project Manager
Carsten Bach, CIO.– Fondsmæglerselskabet CABA Capital A/S

The hunger for yield is growing, as yields and risk premiums are going down across the board. We are reaching what were once conceived as unthinkable levels while dealing with a pandemic from which the dire economic consequences are still to be fully seen. "This is also evident within our investment universe, in the mortgage bond market, where risk premiums – observable in the form of the yield pick-up compared to government bonds – are either close to or below their historic lows," says Carsten Bach, CIO at Copenhagen-based CABA Capital.

During the summer of 2017, Carsten Bach, Niels-Ulrik Mousten, and Mette Østerbye Vejen launched the fixed-income hedge fund CABA Hedge to harvest structural risk premiums from AAA-rated Scandinavian mortgage bonds. As the intensifying hunger for yield and the resulting increase in demand for positive-yielding AAA-rated mortgage bonds have made the passive harvesting of risk premia in this space less rewarding, the team opted for narrowing their long-term return objective and becoming more active to spot and capitalize on more alpha-generating opportunities.

"Since the great financial crisis, most asset classes have performed extraordinary well, both due to the positive development in the global economy and the extremely easy monetary policies, including interest rates around the lower bound and years of quantitative easing," says Bach. "With the current starting point of high asset valuations in combination with low interest rates, it is hard to see a repeat of this outstanding performance during the coming decade,"

"While the bond risk premiums correlate with other asset classes, the dynamic risk-taking in the fund, including short positions, has demonstrated our team's ability to generate low correlations to other asset classes."

he continues. "Therefore, in our view, investors must adapt their investment strategies to take this into account, either by choosing between lowering their return expectations, scaling up their risk levels, or adapting into more active investment strategies."

"We have chosen a combination for CABA Hedge, as we have both reduced our return target from 8 percent to 5-6 percent per annum over a five-year horizon and adapted into a more active investment strategy," points out Bach. The lowering of the return target band enables the CABA team to continue to run the fund with the same level of risk, limit the magnitude and frequency of drawdowns and keep delivering similarly-low correlations to other asset classes.

The active investment approach, on the other hand, enables CABA to "mitigate the return impact from the low risk premiums," according to Bach "We believe this adaptation to the low risk premiums will allow us to continue delivering attractive returns, both risk-adjusted and in absolute terms, to our investors," he emphasizes. Despite lowering the long-term return objective, the investment team comprised of Carsten Bach and Chris Nygaard Sørensen has been able to deliver 12 percent year-to-date through the end of October.

BEING MORE ACTIVE HAS BECOME LESS COSTLY

Chief Product Manager Kristian Myrup Pedersen describes CABA Hedge as "a fixed-income hedge fund specializing in AAA-rated Scandinavian mortgage bonds with a dual strategy of harvesting structural risk premiums and utilizing alpha-opportunities from deep local knowledge about the Scandinavian bond markets." The more flexible and active approach to investing has allowed the CABA team to "add significant value to investors by scaling the risk level up and down over time, depending on the market opportunity set," points out Pedersen. "While the bond risk premiums correlate with other asset classes, the dynamic risk-taking in the fund, including short positions, has demonstrated our team's ability to generate low correlations to other asset classes."

> "While we would have preferred to have high risk premiums, the low risk premiums are actually allowing us to be more active in our dynamic risk taking, and by doing so, we have been able to mitigate the negative effect on the beta strategy."

According to Pedersen, the lower risk premiums represent a challenge for both long-only investors seeking beta within the Scandinavian mortgage bond market and hedge fund managers alike. "As risk premiums have declined, the expected return from our beta strategy, which involves being long mortgage bonds and short government bonds, has declined too," asserts Pedersen. CABA Hedge, after all, is designed to capture risk premiums in the mortgage bond market, primarily stemming from spread risk and prepayment risk, on a duration-neutral basis.

Whereas bond risk premiums appear low on an absolute basis and in comparison with other asset classes, they are attractive on a risk-adjusted basis, according to Pedersen. The Danish mortgage market, at the end of the day, is considered one of the safest in the world, which enables investors to employ some leverage to enhance returns without adding too much risk. "By applying leverage, the bond risk premiums across Nordic mortgage markets become attractive on an absolute basis as well," points out Pedersen. Nonetheless, the lower risk premiums driven by the understandable hunt for yield in recent years represents "a challenge for us, as the performance tailwind consequently has been reduced."

"As risk premiums have come down, other opportunities arise," says Pedersen. More importantly, "it has become somewhat easier to benefit from dynamic risk-taking through both long and short positions," he emphasizes. "The reason is that the price in terms of lost carry from being out of the market and the price in terms of negative carry from being short mortgage bonds have come down too," he continues. Therefore, it has become less costly for CABA Hedge to employ the dynamic and active approach to investing. "While we would have preferred to have high risk premiums, the low risk premiums are actually allowing us to be more active in our dynamic risk taking, and by doing so, we have been able to mitigate the negative effect on the beta strategy."

The active approach has enabled CABA Hedge to perform well and limit drawdowns. Pedersen provides an example of an active move by the CABA team. "In the summer of 2019, just before interest rates collapsed and prepayments skyrocketed, we reduced our callable mortgage bond exposure to zero, by doing so, we avoided getting hit by prepayments, and we had dry powder to benefit from the subsequent market opportunities." A more recent move was undertaken during the coronavirus-triggered market volatility and turmoil. "During the Corona crisis in the spring of 2020, we went short callable mortgage bonds, profiting from the broad-based market sell-off. In this case, too, we subsequently benefitted from our dry powder," concludes Pedersen.

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AllianzGI's Private Debt Multi-Manager Strategy

YIELD PICKUP, DIVERSIFICATION AND RISK CONTROL

By Hamlin Lovell – HedgeNordic

Allianz Group has been building out its alternatives capabilities for over 10 years. More than 20% of AUM of the Allianz Group insurance portfolio of EUR 795 billion is in alternatives strategies. Allianz Global Investors (AllianzGI) manages EUR 77 billion of alternatives strategies, which cater for both proprietary capital and third party investors. Strategies such as infrastructure equity and private debt, where Allianz partners with external GPs, have been opened to external partners to invest alongside Allianz with all the benefits that come from investing with one of the largest global investors in alternative asset classes. In private debt funds alone, Allianz is committing around $5 billion per year, which is approximately 2.5% of the global asset raising of $200 billion per year.

"The feedback from external clients has been very positive. Our co-investment programs are cost-effective ways for clients to gain access to best in class managers and direct co-investments, while benefitting from diversification and strong alignment of interest with one of the largest global investors in alternative asset classes. Our two Infrastructure Equity strategies, a direct core European strategy and a global diversified strategy, have been oversubscribed, which is strong and positive signal from our clients." -Erik Rosenvärd, Head of Nordics at Allianz Global Investors

"Yield pick-up and creditor protection are the two main reasons to invest in private debt. In addition, our scale and capabilities as a long-term investor puts us at a unique position to invest in the asset class", says Sebastian Schroff, Global Head of Private Debt at Allianz & Lead Portfolio Manager for the AllianzGI Multi-Manager Private Debt program, who is based in Munich, Germany.

Sebastian Schroff
Global Head of Private Debt
AllianzGI

YIELD PICKUP

Allianz is focused on financing mid-market companies, defined as those with EBITDA between EUR 10 and EUR 100 million. Comparing private debt yields with a headline leveraged loan index might overstate the yield premium, since the indices are dominated by large cap loans that yield less than mid-market debt in public markets. "Within the mid-market space, senior private lending offers a yield pickup of 200-300 basis points versus the leveraged loan market", says Schroff. Of course, this varies according to factors including how leveraged companies are. "Adjusting for leverage, the yield pickup is 50-100 basis points per turn of leverage", he adds.

ILLIQUIDITY AND COMPLEXITY PREMIA

The reasons for the extra yield include an illiquidity premium for locking up capital for multi-year periods and a complexity premium for the

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variety of documentation and situations. It is not straightforward to split the yield pickup between illiquidity and complexity, but Schroff believes that complexity is certainly relevant: "complex and tailored financing solutions, typically agreed with one party in a short period of time, are an important part of the strategy".

YIELD COMPRESSION

Private debt is not immune from the general yield compression trend seen throughout credit markets. As more capital flows into the space and more asset managers launch funds there is more competition for some deals. Equally, "banks are still retrenching, so the growth of private debt fills the gaps in bank finance. And private credit has plenty of room to grow. Private credit is still only one third of the size of private equity, and is often financing private equity backed transactions", says Schroff.

SPONSORED VERSUS NON-SPONSORED DEALS

Given that many parts of sponsored lending segments have become crowded, Allianz has focused on diversifying into niches such as non-sponsored transactions. The weighting between sponsored and non-sponsored does however vary between the US and Europe. "The European market is still dominated by sponsored transactions, but the US also has a stronger non-sponsored market, which can offer more attractive pricing combined with strong downside protection if underwritten properly. Although leverage multiples have increased, we are still able to get comfort from equity cushions to provide protection in a downside scenario alongside strong workout capabilities of the GPs we work with", says Schroff.

A separate phenomenon is the growing number of private equity managers launching private debt funds. "We are monitoring these funds, but our portfolio is strongly tilted to managers who have always had private credit as their core business. Downside protection is our core objective and hence historical track record and proven workout capabilities across business cycles are major selection criteria", he explains.

"Our co-investment programs are cost-effective ways for clients to gain access to best in class managers and direct co-investments, while benefitting from diversification and strong alignment of interest with one of the largest global investors in alternative asset classes."

Erik Rosenvärd
Head of Nordics
AllianzGI

VINTAGE VARIATIONS

Workouts become critical when defaults emerge. In common with private equity, returns on private debt vary a great deal by vintage, and have historically been highest after crises. Allianz has invested in private debt funds since before the GFC. Realized fund IRRs have been in a range of 6% to 16% since inception in 2007. "The best vintages benefitted from a dislocation in financing markets after the GFC, and then delivered the highest IRRs and multiples. But even the most challenging pre-GFC vintages that went into the crisis largely invested still had positive returns and strong multiples", he recalls.

DOWNSIDE PROTECTION

"Most important in private debt is to structure transactions well and be able to drive recoveries in challenging situations. The ability to recover money is strongly linked to being able to step in early. We insist on strong downside protection and do not like lenders to compromise on covenants. As a result, we have generated annualized loss rates significantly below traded comparables such as high yield or leveraged loan markets", he points out.

Allianz prefers countries that offer strong creditor rights: "for example, the US market benefits from strong creditor protection. In Europe, the Nordics tend to have strong creditor rights and in Asia, Australia is a positive example", says Schroff. In addition, less cyclical sectors such as healthcare and IT are preferred. Moreover, particularly in more challenging market environments, smart structuring is essential to preserve capital.

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“Our general approach to private debt is to build scalable long-term relationships with GPs, which often date back 10 years or more.“

Downside protection is not purely obtained through investing in senior direct lending strategies. For example, more opportunistic and countercyclical special situations strategies can help to create a resilient private debt portfolio because they particularly benefit during credit market setbacks. Alongside the Allianz insurance portfolios, two strategies are available for partners: The “diversified” strategy, which invests the majority in senior loans, and a more “opportunistic” strategy which is more evenly weighted between senior, subordinated and special situations. In each segment, the focus is on allocating to managers who are very much specialized in their respective segments.

OPPORTUNISTIC AND DIVERSIFIED STRATEGY

The 2020 vintage is targeting returns in the middle of the historical range, of 8-11% for the opportunistic strategy and 5-8% for the diversified strategy. “We have historically outperformed these targets, but the past ten years included the post-crisis period that was characterized by a benign global economy and low default rates. In our underwriting, we are always conservative and price in a full-blown economic cycle to ensure that our return expectations also hold throughout a downturn”.

COVID-19 CRISIS IMPACT

The Covid-19 shock is arguably such a test for private debt, though the impact on yields has ultimately been much smaller than the GFC. “Immediately after the pandemic shock, we saw much less deal-flow and a significant repricing as well. Shortly after, liquidity – strongly supported by central bank measures – returned and pricing is now largely back to pre-Covid levels. Leverage levels are however somewhat more conservative, so the spread per turn of leverage is higher than pre-Covid, which is a positive development. In terms of defaults and recoveries it is still too early for quantifications. The ability to drive workouts and restructurings will be essential and make the difference between good and bad results. For disciplined market players and solid portfolios, the next years will likely offer attractive opportunities in private markets”.

RELATIONSHIP AND SCALE BENEFITS

“Our general approach to private debt is to build scalable long-term relationships with GPs, which often date back 10 years or more. We manage a portfolio of private debt funds of total commitments of $20 billion and write tickets of typically $300 million to $1 billion to individual funds, which makes us a very large investor. Our partners appreciate our stability to invest consistently and the ability to scale up investments together is always mutually beneficial. This almost always results in recurring investments with our partners, as long as our performance expectations are met”, says Schroff. “The fact that we are one of the largest investors globally in private debt brings many advantages, such as improved economics and the ability to actively steer our investments via fund advisory boards”, he adds.

CO-INVESTMENTS

“Access to co-investments is another benefit from being a large and experienced investor. Around 10-20% of the Allianz private debt program investments are done via co-investments. These allocations are usually free of management and performance fees. When doing co-investments, we again focus very much on downside protection by avoiding concentration risk: For example, we currently have a very diversified portfolio of more than 50 co-investments. As a result of this broad diversification our co-investments are very stable and resilient. We only co-invest alongside funds we are also invested in, to ensure alignment of interest. We do co-investments across the various segments of our private debt portfolio, but they are strongly tilted towards more conservative performing credit strategies”, explains Schroff.

ESG

Allianz actively drives sustainable investments across asset classes. For example, Allianz is a founding member and chairs the UN-convened Net Zero Assets owners’ alliance that represents more than $5 trillion of assets and works towards transitioning portfolios to net-zero greenhouse gas emission. This active approach is also applied to private debt investments. “There is an active dialogue and active engagement with GPs on their ESG approach, policy and objectives. Whenever we see shortcomings with one of our GPs, we engage in detail to drive improvements. Given that we are always a very sizeable investor, we do have the ability to really make a difference and we actively use it”, says Schroff.

Please contact the Nordic sales representatives at Allianz Global Investors for more information: Erik.Rosensvard@allianzgi.com or Henrik.Zeffer@allianzgi.com

A Stellar Year for Fixed Income – Volatile for Credit

By Hamlin Lovell – HedgeNordic

Morten Mathiesen
CIO for Moma Advisors
Investment Manager for Asgard Fixed Income Fund
Regular Prize Winner at the Nordic Hedge Award

PERFORMANCE 2020

Since launch in 2003 the Asgard Fixed income strategy has amassed returns of more than 725% corresponding to an impressive compound annual growth rate (CAGR) or return of 13%. For the Investment Manager, Moma Advisors, which targets high risk adjusted returns, the realized Sharpe Ratio close to of 2 is equally satisfying. 2020 has been a volatile year with the draw-down during the COVID crisis in March followed by an environment, which was very profitable for the strategy. "Although 2020 on many levels was frustrating and challenging, the year also provided a good balance between volatility and stability. That has enabled us to reach a return of more than 15%, which is close to potential given the risk restrictions", says CIO Morten Mathiesen.

"At the offset we had expectations of approximately 8% for the year, but the spike in volatility in March due to the covid-19 outbreak provided some welcome opportunities to re-adjust the portfolio for higher returns" according to Morten Mathiesen. Portfolio turnover in March and April was higher than normal as the manager took advantage of the dislocation in relative pricing.

Although the main contributor to the return has been positions in Nordic covered bonds, other sources of return, such as cross-currency and other forms of basis, have also contributed well in 2020. These are relative value positions that do not depend on the absolute level of interest rates.

EXPECTATIONS FOR 2021

After the stellar performance in 2020 the outlook for 2021 is more modest. "We have seen spread

> "Even though the funding situation is still favorable, we expect a lower return in the coming year."

contractions in the Nordic covered bond markets throughout the year, and even though the funding situation is still favorable, we expect lower return and allocation coming from Nordic covered bonds", Mathiesen explains. However, this may of course change according to market volatility over the year. Changes in the shape and slope of the yield curve could also increase or reduce the potential return target due to the contribution of roll. Either a general market setback or a curve gradient change could widen out spreads and allow Moma to build trades that generate higher income.

A lower-than-historical realized return expectation for the year to come should of course also be viewed in the context of lower expected returns in fixed income markets more generally, where $17 trillion of bonds now have negative yields in November 2020. Relative to conventional fixed income strategies, the advantage of the Asgard strategy is still intact. The ability to obtain leverage for the safest assets at competitive sub-LIBOR rates, and the flexibility to trade across multiple sub-sectors of the fixed income markets, provide more potential return drivers.

SUBSCRIPTIONS AND REDEMPTIONS

Assets under management have only increased slightly in 2020 from EUR 809m to EUR 832m. A closer look at the number reveals a somewhat more turbulent picture, as the manager has been hit with redemptions of close to EUR 100m in 2020. "A few of our international investors have faced new regulatory hurdles in 2020 making it difficult for them to justify the investments in our funds. Fortunately, we have also seen inflows from various quarters, which in combination with higher NAV has resulted in a net increase in AUM in the year", says Birger Durhuus, CEO at Moma Advisors.

SWEDISH SHARE CLASS

As expected, low and negative interest rates on deposits have forced investors in Scandinavia to look for alternatives. Moma Advisors has noticed an increased interest from Family offices and High Net Worth individuals in both Denmark in Sweden. "Due to popular demand we decided to launch a SEK share class in Asgard Fixed Income Risk Premia a few months ago and have already seen significant interest from Swedish investors to invest in the share class" the CEO continues. Performance for the SEK class should be very close to the EUR class, given the minimal interest rate difference between the two currencies; the USD class has outperformed the EUR class thanks to the USD having higher interest rates than the EUR.

ESG INTEGRATION AND GREEN BONDS

Moma Advisors has spent considerable time this year exploring the best way to meet the growing demand amongst investors in relation to sustainability. Although the relevance of ESG considerations to investment decisions varies across asset classes and strategies, the investment manager is committed to integrate ESG factors. In this context, Moma Advisors has been active in purchasing green bonds for the fund. As of today, approximately 50% of NAV in the Asgard Fixed Income funds is invested in green bonds. This is likely to be a growing trend. "We have seen more issuance of green bonds in Denmark and Sweden, and we expect to see further growth of issues of mortgage and government bonds in the future", says Durhuus.

TERMINATION OF THE ASGARD CREDIT FUND

The Asgard Credit Fund was launched in 2016 and has been managed by a separate team of credit specialists within Moma Advisors. The fund was based on some of the same investment ideas and strategies as the fixed income funds, but applied to the asset class of global credit. Although the fund has delivered positive returns since launch, its volatility has been significantly higher and has resulted in a meager Sharpe Ratio. This, in combination with dwindling investor interest, led Moma Advisors to take the tough decision to wind-up the fund and return the cash to investors by the end of this year.

"It is never a positive experience to close a fund prematurely, but we are pleased that the unwinding of all positions has been done in a orderly manner, and that the fund actually increased more than 6% in value in the month where the positions were liquidated", says Durhuus.

Birger Durhuus
CEO
Moma Advisors A/S

> "We have seen more issuance of green bonds in Denmark and Sweden, and we expect to see further growth of issues of mortgage and government bonds in future."

NEW FUND LAUNCH IN 2021

Asked about future product offerings, CEO Birger Durhuus replies, that "Moma Advisors has been working intensively during the past year on the construction of a new fund, that will offer investors exposure to global fixed income, global credit and various other related instruments". The investment manager aims to launch the fund in Q1 next year. "We are really excited about this project which is a collaboration with another investment manager who brings a very different set of skills into the investment processes", says Durhuus. At this stage Moma Advisors is not ready to disclose the identity of the investment partner.

Thriving Amid Liquidity Crunches

By Eugeniu Guzun – HedgeNordic

From left to right: Emil Nordström, Fredrik Tauson and Magnus Nilsson – all Founding Partners and Portfolio Managers at Nordic Cross Asset Management

In today's unique environment of ultra-low bond yields, fixed income is mostly used by institutional investors in a defensive capacity, for the diversification of risk, for the protection of capital and as a source of liquidity. Sweden's immature, illiquid and occasionally dysfunctional corporate bond market may have proven that fixed income does not always exhibit these defensive properties. During the month of March alone, 35 funds related to the corporate bond market in Sweden closed doors for redemptions amid a liquidity crunch in the country's fixed-income market.

"The corporate bond market is characterized by extensive periods of low volatility throughout which investors can harvest the underlying carry premium in corporate bonds," says Fredrik Tauson, a founding partner and portfolio manager at Swedish asset manager Nordic Cross Asset Management. "But then you have these periods of interruption with harsh liquidity challenges, as we experienced during the spring and as we saw from time to time a couple of times before," emphasizes Tauson. Aware and wary of these short – but painful – patches of illiquidity, Nordic Cross Asset Management designed an investment strategy that not only limits the impact of liquidity squeezes but also uses them as a source of extra returns.

OPERATING IN A DYSFUNCTIONAL MARKET

"From time to time, the corporate bond market is dysfunctional with large liquidity challenges," Fredrik Tauson tells HedgeNordic. This structural dysfunctionality was obvious during March when intensifying investor worries about the coronavirus pandemic triggered a broad sell-off in corporate bonds. "The most obvious way to go around this liquidity problem is for traditional corporate bond funds to take on less liquidity risk by holding more cash and liquid assets, which may hamper their future returns," asserts Tauson.

Nordic Cross Total Return Bond Fund rests on three main pillars to provide investors exposure to BB

"To compensate for the low- or non-yielding part of the portfolio, we use derivatives to boost our credit exposure during periods of low volatility."

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and BBB corporate credit while maintaining ample cash on hand for turbulent periods. "Instead of investing every last penny in holdings hampered by scarce liquidity, we invest only about 60 percent of the fund in direct corporate bond holdings during normal markets," says Tauson. "The rest is cash and liquid holdings," he continues. "To compensate for the low- or non-yielding part of the portfolio, we use derivatives to boost our credit exposure during periods of low volatility."

"When we enter environments characterized by harsh illiquidity, we activate our opportunistic strategy and use our big cash position to buy attractively-valued bonds," highlights Tauson. "We combine our portfolio of long-term core holdings that generate the carry with an opportunistic strategy of investing during turbulent periods when we see obvious liquidity premiums in the market," explains Tauson, who manages Nordic Cross Total Return Bond Fund alongside Emil Nordström and Magnus Nilsson.

THE CORE

"In the bottom of the fund, we have the core portfolio with solid names, with satisfactory credit quality corresponding to BB to BBB credit ratings," Tauson tells HedgeNordic. "These are normally cross-over bonds between the high-yield and investment-grade bond segments," he continues. Cross-over bonds tend to be more liquid than bonds with ratings below the bottom rung of investment grade, Tauson also points out. About half of the core holdings in Nordic Cross Total Return Bond Fund's portfolio represent investment-grade bonds and the other half consists of high-yield bonds.

The portfolio of core holdings is designed to serve as the main contributor to the fund's return over time due to the carry of corporate bonds and the pull-to-par tendency of bond prices to approach par values as the maturity dates approach. This "core" pillar of the fund's portfolio generates the "hold and earn" carry, the additional yield of corporate bonds on top of the risk-free treasury bond yield. "A portfolio of BB and BBB bonds approximately generates a carry of STIBOR plus 300 basis points," highlights Tauson. "Looking back at the fund's history since inception, about three-fourths of the performance comes from the core holdings."

> "We combine a fundamental bottom-up approach with a quantitative approach to maximize risk-adjusted returns and mitigate the most obvious risks in fixed income."

THE DERIVATIVES AND OPPORTUNISTIC LEG

Nordic Cross Total Bond Return Fund also allocates a pre-determined risk budget to call options that provide additional exposure to the BB to BBB credit risk spectrum during calm market environments. In this sub-strategy, the fund's credit exposure automatically accelerates or slows down depending on underlying volatility. "We get more boost during low volatility, with the exposure being automatically reduced as volatility rises," says Tauson. "This is totally, fully quantitative and automatically risk budgeted, so it is no decision of ours when to reduce or increase exposure."

The automatically-adjusting credit exposure through derivatives has low capital utilization, which leaves the team with ample cash to deploy opportunistically in times of turmoil and liquidity crunches. "This toolbox enables us to hold more cash and liquid positions that we can use for opportunistic investment decisions," explains Tauson. Nordic fixed-income markets occasionally encounter periods of interruption with limited liquidity, similar to the environment experienced in March earlier this year. "We activate our opportunistic strategy in turbulent markets like the one we just had," says Tauson.

In times of distress, the team running Nordic Cross Total Bond Return Fund opportunistically buys high-quality corporate bonds trading significantly below par. "We go for corporate bonds with large liquidity premiums," says Tauson. "The perfect targets are names with strong credit quality, but for liquidity reasons, trade well below par," he elaborates. "Relying on three different strategy pillars, we combine a fundamental bottom-up approach with a quantitative approach to maximize risk-adjusted returns and mitigate the most obvious risks in fixed income such as liquidity risk, duration risk and credit risk."

LEVERAGE FOR CALM MARKETS

Nordic Cross Total Bond Return Fund also relies on a limited use of leverage to run its investment strategy, which is quite uncharacteristic for most fixed-income funds. "This is a traditional UCITS IV fund, so we are restricted to those restrictions and regulations just as everybody else in the UCITS territory," says Tauson. "The strategy helps us to create some additional exposure during periods characterized by low volatility, periods that normally result in rising net asset values thanks to the underlying carry."

"But since the exposure automatically decreases as volatility rises, we are actually less exposed to the market compared with traditional corporate bond funds during turbulent periods," Tauson emphasizes. This became evident during the spring, when Nordic Cross Total Bond Return Fund fell less than its peers. "The purpose of the strategy is to create market exposure during benign periods and to enable a prudent liquidity which we can use opportunistically during market stress."

ESG INTEGRATION

Environmental, social and governance (ESG) has long been a hot topic for equity investors, with the fixed-income arena also observing a rapid expansion in ESG integration practice among fixed-income money managers. "We integrated ESG from the start of the fund more than three years ago," says Tauson. "We were actually one of the first credit funds that integrated ESG factors in the investment process," he asserts.

The Nordic Cross team's approach to ESG integration involves excluding bonds issued by entities generating revenues from fossil fuels, controversial products such as tobacco, alcohol, military equipment, among others. "We also aim for promoting bonds that are issued by companies that are at the forefront of ESG integration," says Tauson. "ESG is an evolving theme, so we are constantly looking over our ESG process to find ways we can enhance it."

From left to right: Jens Nystedt, Senior Portfolio Manager and Oliver Faltin-Trager, Portfolio Manager - Emso Asset Management

The Case for Emerging Market Fixed Income Allocations in Global Portfolios

By Jens Nystedt and Oliver Faltin-Trager – Emso Asset Management

Prior to the Covid-19 pandemic, it was increasingly difficult to find fixed income assets with attractive nominal or real yields. This trend is expected to continue as G7 government yields are likely to hover near zero for the foreseeable future, and it is difficult for us to envision a world where economic output meaningfully accelerates as deflation remains a bigger risk than inflation. This environment is likely to compel G7 central banks to continue providing monetary stimulus and capping real yields. As a result, we think that the performance of typical 60/40 portfolio allocation between DM equities and DM fixed income will likely lag the historical returns that this mix has achieved over the last two decades. With real and nominal government bond yields already low, we believe that the 40% fixed income portion of the 60/40 portfolio will no longer be able to act as a shock absorber during equity sell-offs. In addition, while there is limited upside to government bond positions that are already at zero or negative yields, we also believe that investors may be underestimating the asymmetric risk of these longer duration assets selling off materially during a period in which a stagflation scenario could develop in the G7.

We believe that allocators will have to look increasingly towards non-traditional asset classes to deliver the yield and diversification that government fixed income has traditionally delivered. It is clear that allocations to “hybrid” fixed income asset classes, which offer equity-like returns but with traditional fixed income volatility levels, will likely increase. We think that EM fixed income should play a more significant role in these allocations due to their generally favorable risk/reward characteristics and the availability of higher nominal and real yields. EM fixed income is now a USD 23 trillion asset class that offers ample diversification, opportunity, and liquidity (see Figure

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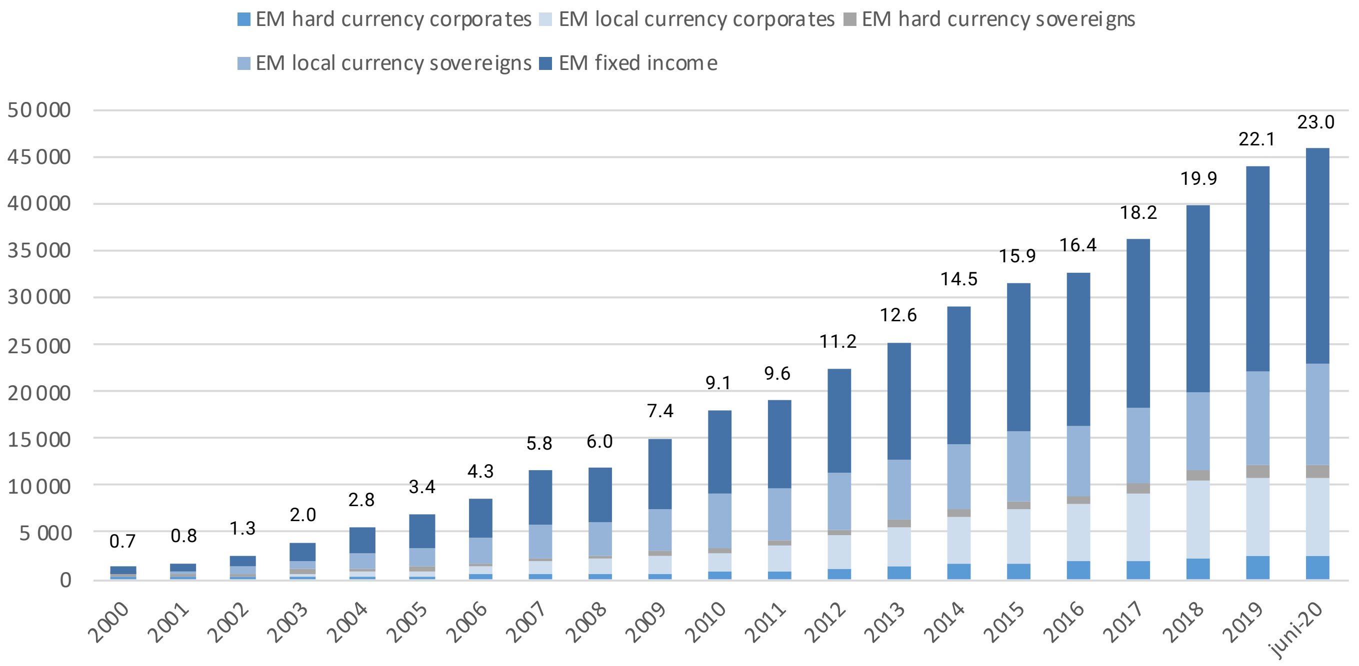
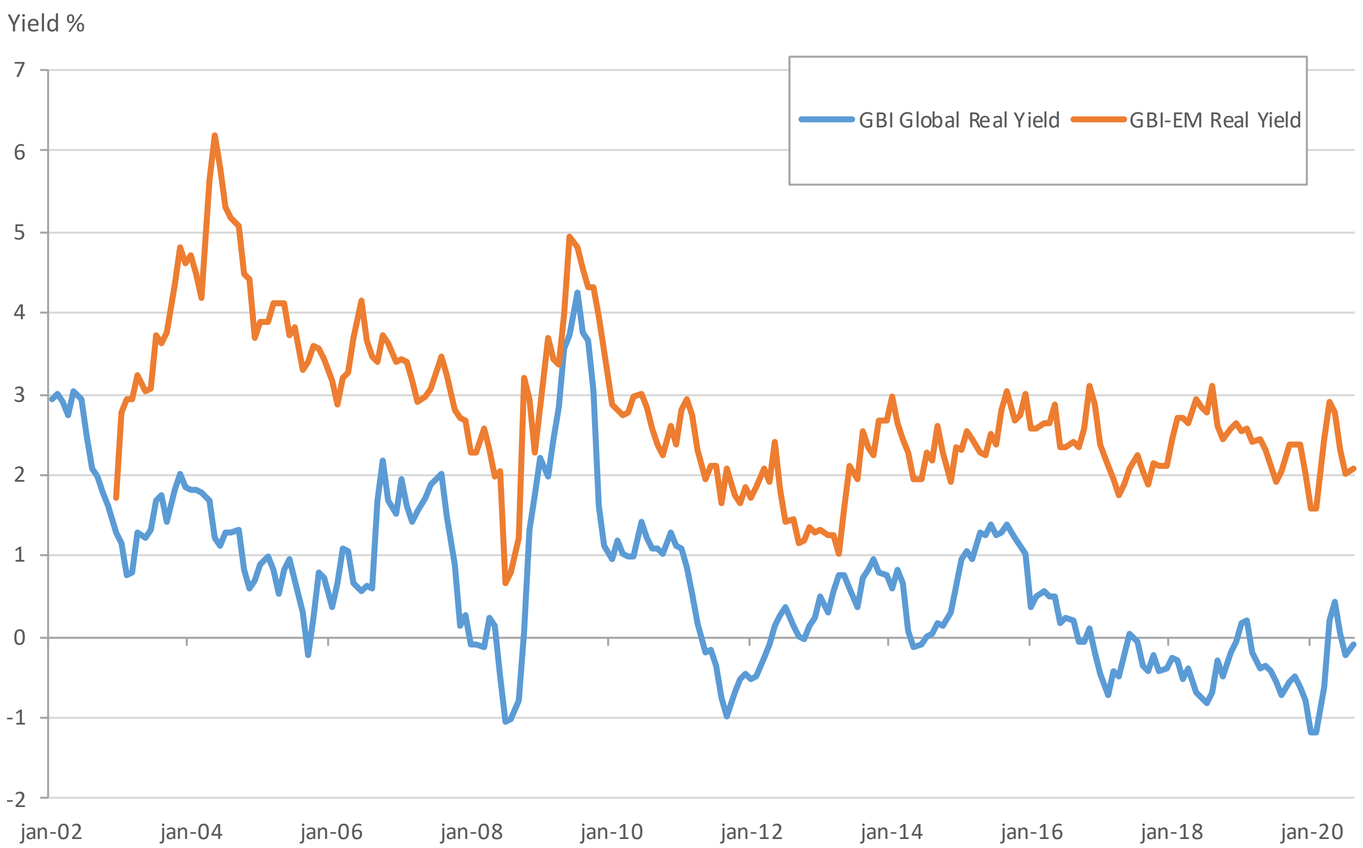
Figure 1.
The EM debt stock has increased to USD 23 trillion, a near 400% increase since the Global Financial Crisis.



Source: JP. Morgan

Figure 2.
Local currency EM fixed income offers a significant real yield pick up over developed markets



"We believe that allocators will have to look increasingly towards non-traditional asset classes to deliver the yield and diversification that government fixed income has traditionally delivered."

1). Historically, institutional investors in the US and Europe have strategically underinvested in EM due to home bias considerations or general risk concerns. However, given that the zero-yield world is likely to remain in place for the foreseeable future, we believe allocations to "hybrid" asset classes, including EM fixed income, should be significantly larger going forward. Jan Loeys and Shiny Kurdu, strategists at JP Morgan, for example, recently examined the optimal top-down macro asset allocation with forward looking return expectations and arrived at a 20/40/40 split of bonds/hybrid/equities[1].

Investors' risk concerns about EM credit quality were more justified in the late 1990s and early 2000s when EM crises were quite frequent. Volatility in Russia, which led to the Long-Term Capital Management crisis, and general conditions in Argentina and Brazil in the 2000s left their mark on investors. In recent years, however, EM sovereigns have generally only experienced extreme volatility due to global shocks, including the Global Financial Crisis in 2008-09 and, currently, the Covid-19 pandemic. However, even these shocks have had a less significant impact on EM, due to the absence of fixed exchange rates and the development of local fixed income markets.

We believe that the secular improvements in emerging market fundamentals are not yet fully appreciated by developed market investors nor favorably priced into emerging market fixed income assets. It is important to fully examine the EM fixed income opportunity set and discuss the key characteristics of some of the major EM fixed income asset classes, the importance of EMFX hedging in mitigating drawdowns, and what role EM fixed income should play in an optimal global fixed income portfolio.

When we breakdown EM fixed income into its key components, we find specific opportunities in each of them. We believe that EM sovereign hard currency fixed income, which consists of issuers with a broad range of credit quality and risk exposures, offers ample opportunity for diversification and bottom-up research. After the recovery in EM, year-to-date EM sovereign IG returns have recovered all their losses and are now positive year-to-date, and, in our view, the EM non-IG segment still has value, particularly in

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frontier names where EM specialist experience can help to identify value and avoid credits with poor fundamentals

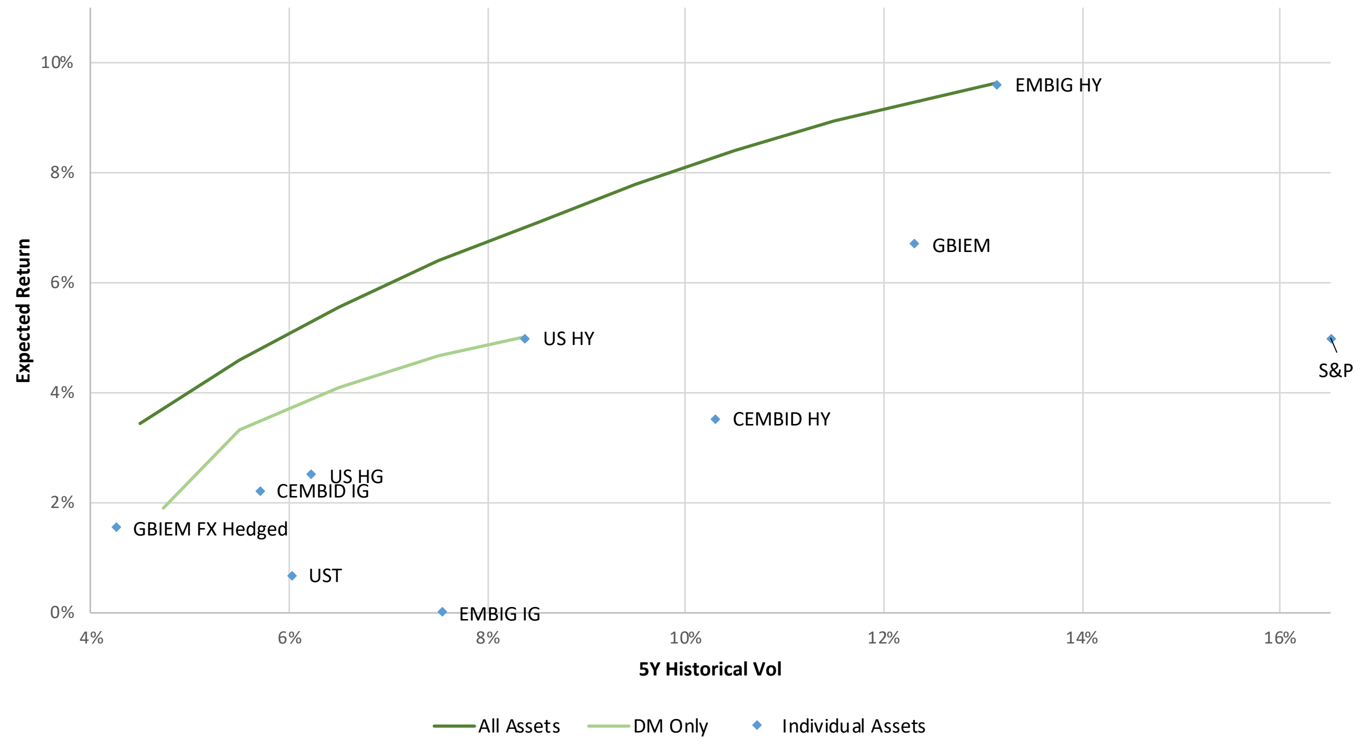
EM corporate bonds, whether hard or local currency, account for most of the outstanding EM debt stock. Asian issuers account for nearly 40% of the debt outstanding and have seen some of the most rapid growth during recent years. With over 700 issuers in the JP Morgan CEMBI BD Index, we believe that EM corporates can also offer many attractive idiosyncratic opportunities across regions and sectors at an attractive yield in current market conditions.

There are also many opportunities in local currency denominated fixed income assets for selective investors. Ongoing EM quantitative easing efforts, while supportive of a flattening curve trend, remain a headwind to EMFX outperformance. Yields for the key benchmark, the JP Morgan GBI-EM Global Diversified Index (GBI-EM), have declined significantly since mid-2018. However, on a spread to developed markets, many IG-rated EM local currency fixed income markets still offer attractive pick-ups, especially in real rates. Due to its volatility, EMFX has been a significant driver of local fixed income returns for developed market investors, and its annual performance has ranged from -17.6% to +5.8% since 2011.

For our analysis, (Figure 3 below) we performed a mean-variance portfolio optimization exercise to bring these asset classes together to determine how they could provide value for a developed market investor by adding EM fixed income assets to a typical US fixed income portfolio. When considering the optimal portfolio allocation to emerging market fixed income, key inputs are return and correlation assumptions between asset classes. At Emso, we prefer to use forward looking returns. We typically generate a 12-month forward return expectation per asset class for the first year, and use 10-year historical returns thereafter.[2] We break down EM fixed income into hard currency sovereigns, corporates, local currency sovereigns, and FX exposure, using the main JP Morgan EM benchmarks[3]. We then implement a mean-variance portfolio optimization

> “In conclusion, as the traditional asset allocation model is likely to be challenged over the next decade, we believe that investors are going to seek out more attractive risk/return opportunities outside of the 60/40 model including hybrid fixed income.”

Figure 3.
Efficient Frontier Analysis



Source: Bloomberg and Emso as at September 2020.

using our 12-month forward return expectations and empirical volatilities and correlations.

Emso has found that including EM fixed income assets expands the efficient frontier. Figure 3 includes the liquid USD fixed income efficient frontier with and without EM assets. This illustrates the degree to which EM assets expand the efficient frontier outwards due to lower correlations, higher yields, and acceptable expected returns. Raising the efficient frontier by more than 1 percentage point for a given level of volatility implies a roughly 20% increase in its Sharpe ratio. High yield hard currency sovereign bonds are particularly useful for expanding the efficient frontier given a higher yield than US HY, but with a lower correlation of below one.

US HY credit essentially defines the efficient frontier for US fixed income, and its correlation with EM fixed income can vary significantly over time. Unsurprisingly, EM corporates tend to have the highest correlation with US HY, while local sovereign bonds have the lowest. Correlations have increased recently as a result of the Covid-19 sell-off and subsequent coordinated monetary policy support. However, rolling correlations remain below 1, indicating that even EM corporates offer some diversification benefit to US HY investors. EM sovereign HY, as well as local fixed income exposures (FX hedged), offer attractively low correlations, particularly during less volatile periods.

There are several ways to optimize a portfolio that includes EM fixed income assets.[4] Clearly the optimal portfolio depends on what the investor is targeting: high Sharpe, high return, or low volatility. Using our most recent estimates, the maximum Sharpe portfolio in this framework is a combination of US HY and EMBI HY driven by the currently attractive valuations in EM sovereign HY as well as longer-term

Figure 4.
Optimized Portfolio

	Max Sharpe	Min Vol	Target Return	Target Vol
EMBI IG	0	0	0	0
EMGI HY	53%	0	93%	33%
CEMBI IG	0	0	0	0
CEMBI HY	0	0	0	0
GBI-EM: FX				
Unhedged	0	0	0	7
GBI-EM: FX				
Hedged	0	87%	0	0
UST	0	13%	0	0%
US IG	0	0	0	0
US HY	47%	0	7%	60%

Source: Emso as at September 2020.

return potential and its diversification value (see Figure 4).

Given the future challenges to returns, Loeys and Kurdu recommend a 20/40/40 allocation to bonds/hybrids/equities for investors who do not want to cut equities too aggressively. Although we do not include a range of hybrids in this exercise, this portfolio optimization exercise suggests that within the hybrid component, a higher allocation to EM fixed income can work across a range of optimization targets. This seems both intuitive and consistent with our empirical portfolio optimization results given current valuations and empirical correlations. For example, in a maximum Sharpe portfolio, as Figure 4 below suggests, nearly 50% of the hybrid bucket could be filled by making an allocation to EM sovereign HY.

In conclusion, as the traditional asset allocation model is likely to be challenged over the next decade, we believe that investors are going to seek out more attractive risk/return opportunities outside of the 60/40 model including hybrid fixed income. At Emso, we believe that EM fixed income should be a significant part of that new mix given the depth and breadth of the asset class, its relatively high yield, the diversification opportunities it provides, and the exposure that it provides to the faster growing parts of the global economy. Active management could add incremental returns, if paired with a successful EMFX hedging overlay. Moreover, we currently find EM HY exposure particularly attractive, but bottom-up research capabilities remain a critical component of the security selection process to avoid exposure to assets with genuinely fragile fundamentals given the shock to global growth that Covid-19 has generated.

[1] "The Long-term Strategist: 60/40 in a zero-yield world," by Jan Loeys and Shiny Kurdu, JP Morgan, 30 June 2020. Loeys and Kurdu, list HY bonds and loans, CLOs, CMBS, convertibles, equity and mortgage REITs, preferreds, and utilities as examples of hybrid securities.

[2] The only exception is for EMFX (spot return), where we assume 0 return after 12-months rather than its historic depreciation rate, given its current cheapness on a REER basis. Note that we add another asset, i.e. local currency FX-hedged, as that is the actual investable asset. The returns from the pure local rates component is not replicable for a foreign investor.

[3] EMBI Global refers to hard currency sovereigns, CEMBID to hard currency corporates and the GBIEM to local currency sovereign fixed income. IG (or HG) and HY refers to the investment-grade and high-yield versions of the benchmark.

[4] We also include the S&P 500 Index in our portfolio optimization exercise, but we use the 5% annualized forward looking return forecast of Loeys and Kurdu which makes the S&P 500 Index relatively unattractive in this portfolio optimization.

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Public Issuers More Bulletproof

By Eugeniu Guzun – HedgeNordic

Philippe Sissener
Portfolio Manager
Sissener Corporate Bond Fund

In the search for yield, many investors have been tempted towards high-yield bonds. For these investors, there is some reassuring evidence showing that, over the long term, high-yield debt delivers what it says on the tin: high yields. Sissener Corporate Bond Fund, which took home the top honours in the "high-yield" category at this year's Alt Credit European Performance Awards, pursues a strategy of collecting coupons from Nordic high-yield bonds and, more importantly, avoiding defaults.

"Our local knowledge of the Nordic market, its companies and sectors, makes us better positioned to avoid defaults over time," says Philippe Sissener, the portfolio manager responsible for Sissener Corporate Bond Fund. "The big differentiator between us and more traditional high-yield funds is that we are very biased towards publicly-listed issuers," emphasizes Sissener. "This focus is associated with higher transparency, better reporting, availability of management, among others."

Discussing the advantages of investing in the bonds issued by publicly listed entities, Sissener says that "first of all, members of our investment team, portfolio managers and analysts, have most likely followed the publicly listed companies in our universe for a number of years already." Founded in 2009 by Jan Petter Sissener, Philippe's father, Norwegian asset manager Sissener AS is also managing long/short equity fund Sissener Canopus. "Secondly, just by looking at the share price, you get an indication of how the market is viewing the future of the company," Philippe Sissener tells HedgeNordic.

> "The recovery rates in default scenarios are much higher among publicly listed entities than in the private ones."

"Thirdly, and most importantly, there are fewer defaults in the Nordic market among publicly listed companies," says Sissener. "History has shown that there is a much lower default rate among bonds issued by publicly listed entities compared to those of private companies." If defaults do occur, "the recovery rates in default scenarios are much higher among publicly listed entities than in the private ones," according to Sissener. "The last though not least important part is from a liquidity standpoint, "One of the key things that led us to this great performance this year was how we had positioned ourselves ahead of the downturn in March."

it is a lot easier to trade and sell the bonds issued by publicly listed entities." Overall, Sissener's focus on this segment of the market "makes things more bulletproof."

PORTFOLIO COMPOSITION

"We will outperform by keeping a relatively concentrated portfolio of bonds that are handpicked and closely monitored by our analysts and portfolio managers with extensive experience," says Philippe Sissener. Sissener Corporate Bond Fund runs a concentrated portfolio containing between 30 to 40 names that are well worked through. "A concentrated portfolio is the key and only way to avoid defaults," he continues. "Our approach is a handcraft of investing in the right companies. That is where the whole secret is."

The security selection approach involves "quite a big and complicated process, not for each name specifically, but for the portfolio as a whole," Sissener points out. "The portfolio needs to have balanced diversification between sectors and companies, while keeping in mind that some companies are interrelated," he continues. "The Aker group here in Norway, for instance, has a big holding company on top and lots of subsidiaries under its umbrella that also issue bonds," Sissener elaborates. "You need to make sure that the total exposure to the group company does not exceed your internal limits."

Around 30 percent of Sissener Corporate Bond Fund's portfolio is currently exposed to the energy sector. "We have a fair amount of our portfolio in the energy space as defined by the Global Industry Classification Standard (GICS) methodology, but that does not mean oil and gas specifically," says Sissener. "Some of that exposure goes to solar parks, wind parks, and some sub-suppliers to both solar and wind industries," he adds. "Under the GICS methodology, some parts of the shipping sector are also defined as energy."

The GICS industry classification does not accurately reflect the actual composition of Sissener Corporate Bond Fund's portfolio, Sissener suggests. "In addition, we have some bias towards some of the niche banks, as their perpetual bonds are trading quite favourably at the moment," highlights Sissener. "Apart from that, we maintain a fairly balanced and well-diversified portfolio."

ON TRACK TO DELIVER

The fund overseen by Philippe Sissener advanced 6.5 percent year-to-date through mid-November. "We are very proud of what we have done so far," says Sissener. "We tend to guide our investors between five and eight percent per year and we have shown that the portfolio is resilient and our aim achievable even through a global pandemic," he continues. "We are up over six and a half percent year-to-date through mid-November, on track to deliver what we think is achievable in the long-term scenario."

"One of the key things that led us to this great performance this year was how we had positioned ourselves ahead of the downturn in March," highlights Sissener. "We could not predict the coronavirus pandemic at all, but we had a cautious stance going into 2020," he continues. "The wave of new bonds that came to the market was not paying very well compared to the risk they were bearing, in our opinion." According to Sissener, "we tend to say that the Nordic high-yield market is supposed to trade between 300 and 700 basis points, but some companies were issuing new five-year bonds even below the 300 basis points-band."

For that reason, the team running Sissener Corporate Bond Fund "preferred shorter-dated bonds available in the secondary market," according to Sissener. "When the market collapsed in March, we had an average tenor of approximately 2.5 years, and this was one of the contributors as to why we managed to fall less than the market in general." Sissener Corporate Bond Fund also had between five to ten percent of its portfolio exposed to hospitality-related issuers such as hotels and airlines. "We just sold those out with a loss, we bumped them out as soon as we could in early March, which ended up being a good idea."

The team also reshuffled the portfolio from shorter-dated to longer-dated bonds throughout the March tumult. "Sissener Corporate Bond Fund used all the cash on hand to buy longer-dated bonds that had fallen much more and thus our investors got to ride the recovery and bull market since then," says Sissener.

Formuepleje's 2020 Performance Turnaround

THE COVID CRISIS CREATED VOLATILITY – BUT ALSO OPPORTUNITY FOR NIMBLE MANAGERS

By Hamlin Lovell – HedgeNordic


René Rømer, CFA
Portfolio Manager
Formuepleje A/S

Formuepleje's Fokus fund is up by 7.11% for the year to November 11th, after a drawdown in the first quarter. In contrast, its benchmark had a larger drawdown and a shallower recovery - it is only up 0.23% for the year to the same date.

The benchmark is the Nordea mortgages index applying the leverage of around four times. The Formuepleje Fokus strategy has not varied its leverage over 2020. Active management explains the outperformance.

DYNAMIC DURATION MANAGEMENT

"In early 2020, spreads on Danish mortgages had tightened, partly due to foreign inflows, which now make up 30% of the market. We therefore decided to go underweight of duration and we underperformed the benchmark in January and February. The benchmark has duration of around 2.5 years, and we went to 2 years. After applying leverage, the figures are 10 years for the benchmark and 10 years for Formuepleje Fokus", says portfolio manager, René Rømer. This substantially explains why Formuepleje Fokus had a smaller performance drawdown than the index in March.

"When the Corona crisis hit, it was a liquidity event that blew out all kinds of bond spreads. There were fears about liquidity, but in fact liquidity did not drop as much as in 2008. We wrote to investors that we expected a mortgage market normalization based on market liquidity normalizing. We then decided to increase our duration to 3.5 years, which works out at 17.5 years including the leverage. Central banks took decisive action on liquidity, which helped the market to recover", he adds.

"When the Corona crisis hit, it was a liquidity event that blew out all kinds of bond spreads."

CALLABLES AND CARRY

The other important shift was in the mix between bullet bonds, which have a predetermined maturity, and callable bonds, which could be repaid before maturity at the option of the borrower. The callables offer a higher cash yield, because the lender has effectively sold a prepayment option to the borrower. But even after factoring in the option value, Rømer judged that, "in March, the option-adjusted spread on callables was attractive and callables seemed cheap on a relative basis".

The Danish market is split roughly 50/50 between the two types, and Formuepleje shifted from slightly underweight to significantly overweight of callables. "In March we went from 40% to 70% callable bonds to pick up more carry, which has been the main driver of our outperformance since May. Performance has been nearly linear".

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Søren Astrup
Managing Director
Formuepleje A/S

The arithmetic of the carry is based on subtracting borrowing costs from the income on the bonds. "Income of around 50 basis points less a borrowing cost of minus 30 generates net income of 80 basis points per turn of leverage. The leverage of four times multiples this up to annualized income of around 4%", explains Rømer.

Borrowing costs have somewhat increased for two reasons: "In March, the Danish central bank unusually increased its interest rates, from minus 75 to minus 60, while the ECB stayed on hold. This initially increased our repo rate from around minus 55 to around minus 30 basis points. It has since slipped back to somewhere near minus 35". The repo rate increased a little bit more than the 15 basis point increase in the Danish central bank rate, because liquidity has tightened in the Danish money markets. "Excess reserves on the government account at the Danish central bank have gone from 200 billion to about 166 billion. This reduction raises rates at the short end of the curve. In contrast the ECB has 3,000 billion Euros of excess liquidity", points out Rømer.

> "In March, the Danish central bank unusually increased its interest rates, from minus 75 to minus 60, while the ECB stayed on hold."

The Fokus strategy is almost entirely in Danish mortgage bonds. It can invest up to 50% in Swedish covered bonds, but has never gone over 5%. It had a little bit of exposure earlier in 2020, but now has none. "Sveriges Riksbank (Sweden's central bank) buying has tightened spreads to the extent that the market is not attractive for our level of leverage", says Rømer.

OUTLOOK FOR RATES

It is worth noting that although Formuepleje has quite substantial exposure to callables relative to its own history, other managers using more leverage have more exposure to prepayment risk, whereas Formuepleje has more exposure to interest rate risk and forms a macro view on it.

Formuepleje is confident in emphasizing carry partly because they expect interest rates to remain rangebound. "Our major wager is that rates will stay in a range, as central banks want to keep funding costs down and Europe cannot afford much higher interest rates. Equally, much lower rates could create problems for the banking sector so we cannot see the German Bunds going much below minus 60", says Rømer. Formuepleje's stress tests suggest that the strategy performance would still be positive after a 50 basis point rise or fall in interest rates, but that a 100 basis point move in either direction could cause losses. Rømer reckons that moves of such a size are very unlikely. "Given the output gap we do not expect an inflation pickup that could require the ECB to raise rates", he points out.

CHOICE OF BANKS' MORTGAGE POOLS

A marginal driver of returns this year has been Formuepleje's long standing preference for mortgages from certain banks where there is a pattern of lower prepayments. "Prepayments have been higher on Danske Bank and Jyske Bank bonds, because it is easier to make digital payments, amongst other things. They have been lower on Nykredit, which is a consortium of smaller banks", says Rømer.

While it is worth researching differences between banks, Formuepleje does not carry out 'postal code' analysis of individual mortgages (in the way that some US mortgage managers do) because the bonds are pooled from multiple borrowers. Individual loan to value ratios are not a worry but aggregate loan to value ratios, across a whole pool of mortgages, are monitored, and these have gone down in 2020. "There had been fears that the Covid crisis might reduce real estate prices, but in fact they have increased, partly due to the generous fiscal support Denmark's government has been providing. Though it may be some while before Denmark's GDP recovers to pre-Covid levels, we are quite comfortable about credit risk in Danish mortgages after 230 years without a default", says Managing Director, Søren Astrup.

Kreditfonden Caters Institutional Investor Demand for Illiquid Private Debt

By Jonathan Furelid – Kreditfonden

Jan Lundquist
Portfolio Manager
Kreditfonden

Since 2016, Swedish direct lender Kreditfonden, through its management company Finserve Nordic AB, has offered its Scandinavian Credit Fund I to retail investors and small institutions in the Nordic region. To build on its track record and to meet an increased institutional demand for private debt in the Nordics, Kreditfonden now pushes ahead with a new fund – the Nordic Direct Lending Fund.

"It is a very natural progression following on our success with the first fund. The new fund is designed for institutions that are looking for an alternative credit exposure that could complement or replace existing fixed income holdings that have a difficult time in the current low yielding environment", Fredrik Sjöstrand, CIO of Kreditfonden, explains.

The structure of the Nordic Direct Lending Fund (NDLF), is a closed-end AIF with an 8-year lock-up period. It targets investors that can stay with the investment for a number of years, and who look to become compensated for the illiquidity risk inherent in the underlying investments. The fund aims for an annualized return, net of fees, of 5-7 precent with no leverage applied. It will invest in private high yield corporate loans.

"The closed-end structure allows us to lend long-term to Nordic companies without having to worry about the short-term investor flows that tend to work to a more liquid fund's disadvantage. Investors tend to sell at times when market are stressed which is when we find exceptional value for the longer term", Sjöstrand says.

Like its predecessor, NDLF will focus its lending activities to the Nordic region and primarily invest in senior secured loans in SEK, but the size of the loans will be in the range of SEK 150-500 million, which is larger than the EUR 5-35 million range traded in the Scandinavian Credit Fund I. According to Sjöstrand this provides for a great opportunity-set.

"It allows us to compete in larger bond issuances, which give us access to a broader range of quality companies to lend to. Although the competition is also admittedly higher in this space, we will have good use of the network we have built in the Nordics over the years to harness the most interesting credit opportunities.

The NDLF will make use of the vast experience of the Kreditfonden Investment team, credit analysts and loan originators and has also added senior capacity in Jan Lundquist as portfolio manager. Lundquist prior was the global head of risk and head of rates trading at Swedbank's trading unit within FX and

> "Many sound Nordic businesses have had serious setbacks during the pandemic and will need funding to get back on track."

Fredrik Sjöstrand
CIO
Kreditfonden

"Investors tend to sell at times when market are stressed which is when we find exceptional value for the longer term."

Fixed income and was most recently with global macro hedge fund AVM.

"Jan has a long experience from managing risk in fixed income and credit markets and has successfully done so both in a large bank set-up and in a hedge fund environment, he is uniquely positioned to manage this fund in the best possible way", Sjöstrand says.

The board of the fund also includes some very senior names including Göran Tidström (a long-term partner of PWC and chairman of the European Financial Reporting Group) and Ante Nilsson (founder of Tanglin and Ambrosia hedge funds). In the fund's credit committee Anders Hjort (former head of credit trading at SEB) is among the names.

EXTENSIVE DUE DILIGENCE PROCESS

The NDLF will seek to invest in sound and cash flow generating businesses across a number of different sectors. The due diligence process for finding loans will be extensive and involve a multi-stage review process where everything from the potential lender's market position, debt ratios, margins and quality of management will be thoroughly assessed. The process is well proven within the investments teams since years of track record in other direct lending funds.

Post investment, the fund has a pre-defined monitoring process and will engage closely with the borrower to secure orderly payment of agreed interest and to make sure that the business is in line with expected development paths. There will also be strict covenants and heavily negotiated loan documentation to avoid credit events. At any given point in time, the fund will have between 20-30 investments.

"We will be a very active lender from day one, the Covid-situation means that business conditions can change rapidly and that requires close monitoring of the borrower's situation. In order to have control of the investments, we will also seek sole lender positions where the fund has control or ownership of the debt tranche", Jan Lundquist says.

ESG-RESTRICTIONS APPLIED AND INTERNALIZED

In order to meet the increasingly high standards required from Nordic intuitions when it comes to sustainability and ESG, Kreditfonden has worked hard during the last couple of years to set up and internalize an ESG policy for all of its investments. The fund management company also recently signed the UN PRI.

"The ESG policy excludes investments in unethical activities and also involves positive screening favoring companies working for a more sustainable future. In the SCFI we have included wind farms and sustainable real estate projects for example. We have also appointed a dedicated person overseeing that we adhere to the policy and UN PRI guidelines", Sjöstrand says.

PRIVATE DEBT – AN IMPORTANT FINANCING TOOL TO IGNITE THE COVID-STRUCK ECONOMY

In the light of a Covid struck global economy, private debt and direct lending to SME's have become an increasingly important part for financing the global economy. According to a recent survey from the alternative credit council and Allen & Overy, private credit will have provided SME's and mid-market businesses with over USD 100 billion in fresh financing in 2020. According to Sjöstrand, the Nordic Direct Lending Fund will be an important source of capital for Nordic businesses given more flexible terms than traditional bank lending.

"Many sound Nordic businesses have had serious setbacks during the pandemic and will need funding to get back on track, in that context NDLF will serve as an interesting financing option and equally create good investment opportunities for the fund and its investors."

The Nordic Direct Lending Fund is currently raising assets with a target launch date mid-2021 and an anticipated AuM of SEK 5 billion, with a hard cap of SEK 7 billion. According to Sjöstrand, demand is high, particularly among tier two and tier three institutions who have started to look into the asset class more recently.

"The tier one institutions already have allocations to private debt and are currently looking after existing holdings rather than entering new ones, the smaller institutions however show great interest and appetite. We are optimistic to reach our target AuM and to get the fund up and running by June 2021 at latest."

Nimbleness in the Credit Space

By Eugeniu Guzun – HedgeNordic

As the market environment remains uncertain and interest rates are hovering around zero, traditional bond holdings provide little protection to portfolios in times of market turmoil and virtually guarantee no returns in the immediate future. Unsurprisingly, many investors are looking for fixed-income replacements for their portfolios, with alternatives becoming increasingly important. "Alternatives have become a big focus at UBP because of where we are in the cycle, and hedge funds can provide differentiated sources of return," John Argi, Co-Head of Alternative Investment Solutions at UBP, tells HedgeNordic.

"Investors are seeking to complement or replace the traditional fixed-income bucket, what used to be an allocation to corporate investment grade," he points out. "If you want a less risky allocation to fixed income, it is almost impossible to get even positive yield," Argi shares a common concern on many investors' minds. To escape this return-free risk morass, investors are increasingly looking at alternatives such as the US-high-yield-focused long/short credit strategy run by New York-based Global Credit Advisers (GCA). "GCA brings very deep expertise in the credit long/short space. Its strategy is one of the most interesting we've come across, successfully generating good and stable performance throughout its long track record, it explains why we have chosen to partner with GCA," says Argi.

Founded and steered by Chief Investment Officer Steven Hornstein, GCA employs a long/short corporate credit strategy engaged in sector-based

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Steven Hornstein
Chief Investment Officer
Global Credit Advisers (GCA)

"The strategy combines a bottom-up approach to sector and single-name selection with a macro overlay."

investing primarily in the high-yield segment in US markets. GCA's investment process relies on a collaborative environment involving sector specialists, a credit committee, and one primary decision maker, the Chief Investment Officer, who has more than 35 years of experience in high-yield investing. "Our long/short corporate credit strategy is about credit selection, predominantly in high yield," Hornstein tells HedgeNordic. "This is something I have been doing for close to four decades."

"We predominantly invest in US high yield, but we can invest in European high yield as well," says Hornstein. "We don't do emerging markets, we don't do structured products. We only do what we know," he continues. "We stick to our core competency and our pedigree, which, in our world, represents a rather

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large sandbox." Despite focusing on US high yields, GCA's portfolios have the flexibility to invest across the entire credit spectrum, from investment grade all the way down to deeply distressed securities.

"The strategy is opportunistic, very sector dynamic and marries fundamental research and a lot of trading expertise on valuations, price points, dispersion, default rates, global economic environment, interest rates, and so on," Hornstein goes on to say. "The strategy combines a bottom-up approach to sector and single-name selection with a macro overlay." GCA's strategy, therefore, relies on the team's vast experience in credit markets to find and capitalise on investment themes across different sectors.

THEMATIC INVESTING ACROSS SECTORS

Hornstein and his team of eight investment professionals typically build the portfolio allocation around three or more themes. Still, fast-changing environments can broaden the range of themes reflected in the portfolio. "The portfolio usually reflects three to four reasonably large themes that have short-term, medium-term and long-term implications," says Hornstein. "Given the number of sectors that we cover, we can have as many as eight themes reflected in the portfolio, especially in an environment that is undergoing a lot of significant structural changes with fast-changing outlooks either on the positive or negative side."

Whereas Hornstein has the final say on what goes into the portfolio, his team of analysts provide the input for the decision-making process. "The portfolio reflects what the analysts are seeing on the field in their sectors," explains Hornstein. "We don't have a team of analysts just roaming around the world, looking for hotspots or looking for the next trade," he continues, "everything really comes through the research team, as analysts have their core coverage focusing on one, two or three sectors." As soon as various themes start taking shape during team discussions, single-name selection becomes the focus. Each theme can reflect two to three positions in single names to as many as five to ten, "depending on how we think we can extract the best return potential."

"In summary, the six analysts will pitch ideas from their sectors," says Brian Hessel, Co-Founder and COO. The team of analysts presents ideas to the credit committee composed of Hornstein, Hessel and the Head Trader, David daCruz. "Their objective is to convince us that an idea makes sense," explains Hessel. "Then Steve and David do a lot of work on ways to best express the trade, whether it is just going to be a directional long or potentially a long/short in the same capital structure or across different companies."

"The edge is really the decades of experience through credit cycles, market cycles, interest rate cycles, sector cycles. The nimbleness of the team is the real edge, especially in a year like 2020."

SHORTS AND LONGS AS PROFIT CENTRES

GCA portfolios typically maintain between 50–150 single-name long and short positions across 100–150 issuers. "On the long side, we are looking for companies that show increasing cash flows, companies that use their cash flows to pay down their debt and improve their credit quality," says Hessel. "On the short side, we are looking for the opposite."

Short books can play different roles for long/short managers, including alpha centres, profit centres and hedge centres. The team running GCA's strategy aims to, "generate a return on both sides of the portfolio," according to Hessel. "Our short book is not necessarily a hedge for the long book: it is a profit centre on its own." Looking at 2020 in particular, the fund's short exposure contributed more to returns than the long exposure.

The strategy has delivered a positive net return through the end of November, successfully managing to scoop up gains even in the turbulent first quarter. "Early on in the COVID days, we realised the challenges that a lot of these levered companies might be exposed to because of the shutdowns and lockdowns," says Hornstein. "We had to act pretty quick because we had 2019 closing out with very strong consumer demand, low interest rates, reasonably good equity valuations, and a relatively calm market environment," Hornstein points out. "With the trade deal behind us, market participants had some reasons to be pretty optimistic and that changed very quickly due to the pandemic."

On the short side, the team looked at sectors and companies that were going to suffer from the lockdowns. "At the beginning, we put together a rather reasonably sized short book on the lodging, leisure and entertainment space," which strongly contributed to the 2020 performance. "As we got through the worst of the lockdown period, and then things started to open up a little bit, we had to be equally as quick to get back to take those short positions off," Hornstein emphasises. "Then we had to go back to what can benefit from this, where do we see some meaningful benefit," said Hornstein, such as the at-home trade.

Overall, the two themes that contributed most to the performance of the portfolio in 2020 were, "the broader at-home trade, which had a number of components to it, and the shutdown trade that sought to capitalise on what sectors were going to be seriously impacted," says Hornstein. "At the macro level, those were the two big ones, but then we could dissect them across several sectors and sub-sectors."

The nimbleness of the team, facilitated by the many years of experience of the entire team, has enabled the strategy to navigate the difficult market environment in the first quarter of 2020 and other market conditions for over 13 years. "The edge is really the decades of experience through credit cycles, market cycles, interest rate cycles, sector cycles," concludes Hornstein. "The nimbleness of the team is the real edge, especially in a year like 2020."


Thomas Pohjanen
CEO and Partner
Excalibur Asset Management

The Upside of Downside Protection

By Eugeniu Guzun – HedgeNordic

One of the most widely recognized pearls of wisdom of Warren Buffett goes along the lines of "Rule number one: Don't lose money. Rule number two: don't forget rule number one." A three-member team out of Stockholm comprised of Thomas Pohjanen, Björn Suurwee and Marek Ozana too believe that avoiding a loss should be the primary goal of their fixed-income macro hedge fund Excalibur.

"A good risk-adjusted return relies on a proved ability not to lose too much when you are wrong," says Pohjanen, who founded one of Sweden's oldest hedge funds alongside Björn Suurwee in 2001. Excalibur has delivered a net-of-fees annualized return of 4.7 percent since inception, well within its long-term target return band of four to five percent a year. The fixed-income macro fund experienced only two down years in its almost 20-year history, with both of these annual losses running within a range between a low one percent and two percent. "These figures tell you more about how we run our risk book than words can say," points out Pohjanen. "The powerful effect of compounded interest adds up to 147 percent performance since inception."

THE STRATEGY IN FOCUS

"Excalibur is active in the field of fixed income in three main markets: Sweden, the Eurozone and the United States," Pohjanen tells HedgeNordic. However, "the strategies that we employ are not exclusively fixed income, they can also entail positions that are

> "A good risk-adjusted return relies on a proved ability not to lose too much when you are wrong."

more FX-related," he continues. "The majority of the type of themes and plays that you would find in Excalibur's portfolio and could have found over the now almost 20 years have been in those two fields," says Pohjanen. "No equities, no raw materials, metals or anything else."

To achieve Excalibur's long-term return objective, Pohjanen and his team look for major macroeconomic themes shaping up in fixed-income markets. "We tend to be rather conservative in terms of having too many themes on," says Pohjanen. "Over the years I have seen correlations move to one very quickly in stressed periods, so I am not a fan of putting a large number of trades that statistically look okay in calm weather," he continues. For that reason, Excalibur's portfolio usually reflects between five to seven themes at any given point in time, with every theme composed of four to five trades.

"The themes would typically be built around the shape of the yield curve, outright level of yields, and spreads between instruments," explains Pohjanen. These are relative value and absolute value plays "one would normally recognize in any fixed-income portfolio that is absolute return." Pohjanen goes on to emphasize that the team at Excalibur "utilize the full range of fixed-income financial instruments, including futures, cash bonds, swaps, interest rate options or currency options."

The three-member team running Excalibur use "many different venues" to search for these five to seven themes. "First and foremost, all the things and information we take in as managers that form the basis of our discussions," Pohjanen elaborates on the team's information processing approach. "We decide upon what has the potential to become a theme and what we should move forward with and analyze in further depth," he continues. "That type of

> "It seems that one of the advantages of our style is that the experience of the team leads us to be able to quickly process incoming data, propose strategies, and enact them in our portfolios when volatility strikes and the level of stress hits the market."

intake ranges from things that would consider any economically-interested person, all the media around us, all the initiated magazines, newspapers, digital as well as printed," Pohjanen lists some of their information sources. The team also use purchased independent research, research from banks, and other sources of macro-based research.

ALWAYS DELIVERING IN STRESSED PERIODS

The measures that governments and central banks around the world have taken in response to the coronavirus pandemic have created a fertile environment for the fixed-income macro hedge fund run by Pohjanen and his team. Excalibur gained 9.4 percent over the rolling 12-month period through the end of November and 10.6 percent year-to-date. "This particular year, with the stress in the market place and volatility that followed up on the unfortunate outbreak in Wuhan, things, of course, moved very quickly," says Pohjanen. "It seems to me that stressed market situations tend to create market situations where prices are moving out of the realm of economically-motivated," which can provide attractive risk-reward opportunities for funds such as Excalibur.

The themes and plays that contributed most to Excalibur's 2020 performance have revolved around the policy responses to the coronavirus pandemic. The strong performance stems from "the expectations that we would get a significant policy response when we and others in the market came to realize the seriousness of this situation," explains Pohjanen.

One of the themes focused on central bank activity in Europe and Sweden. "In Europe, the Riksbank and the ECB were at a policy level where a change in the level of interest rates, the repo rate, could not really do much," says Pohjanen. "Very early, the conclusion by our team here in Stockholm was that the mainstay of the policy support would come from QE. We expected heavy support by the ECB in different countries involved in the Eurozone," he continues. "As that expectation was given a high level of confidence in our discussion, we proceeded to construct trading strategies or themes." The team at Excalibur, therefore, was more bullish on peripheral eurozone debt than the debt in the core economies.

"Another theme closer to home involved some of the high-quality bonds that we trade and have traded over the years in the Swedish market, non-government bonds but still high quality in terms of credit risk and liquidity, which were trading at attractive levels in our view," says Pohjanen. "We also expected the Riksbank to be very aggressive and that, of course, would lead to them increasing purchases and starting purchases of bonds that they had purchased before, and so they did."

Looking back at Excalibur's track record, one could easily notice that the fund is performing strongly in highly turbulent market environments such as the financial crisis of 2007-2009, the European sovereign debt crisis that followed and this year's coronavirus-induced crisis. "It seems that one of the advantages of our style is that the experience of the team leads us to be able to quickly process incoming data, propose strategies, and enact them in our portfolios when volatility strikes and the level of stress hits the market," highlights Pohjanen. "That seems to be an ingredient that has been with us."

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Michael John Lytle, CEO – Tabula Investment Management Ltd.

"The current slew of negative factors means markets may experience more than just a seasonal liquidity slump this year."

Dual Threat: Illiquidity and Inflation

By Eugeniu Guzun – HedgeNordic

With yields hovering near all-time lows, some investors are understandably concerned about the impact of a potential pickup in inflation on bond prices and yields. With 2020 – a year to forget for most of us – coming to an end, there is one additional worry for bond investors: falling liquidity around year-end. European fixed-income ETF provider Tabula Investment Management is telling investors to hope for the best but prepare for the worst, warning of the potential double threat from lower liquidity in the bond markets at year end, and a change to the decade-long trend of low and stable US inflation.

According to Tabula, bond market liquidity may be drying up towards the end of the year, when investors need it most. Bond markets often see lower liquidity towards year end, with the sell-side preparing to trim balance sheets and the buy-side closing its books. The heightened uncertainty due to the coronavirus

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pandemic and its economic repercussion means that liquidity in the bond markets could prove even worse than in recent history.

"The current slew of negative factors means markets may experience more than just a seasonal liquidity slump this year," says Tabula's CEO, Michael John Lytle. "As European lockdowns ease, there is a risk of a third wave of cases in the middle of winter. In addition, there is increased focus on rising debt levels and expectations of worsening economic data is beginning to grow. All of these have the potential to temper the recent vaccine-led relief rally and lead to further defaults. It seems like we have had all the good news."

The illiquidity associated with the normal over-the-counter (OTC) bond market trading infrastructure is leading bond investors to look for alternatives in the fixed-income exchange-traded fund (ETF) space. Whereas assets held in ETFs are accounting for a small slice of the overall bond market, ETF adoption among bond investors is gradually increasing. "Growth in fixed income ETFs was inevitable, given the huge shift towards passive products and the success of ETFs in equities," Michael John Lytle said at the beginning of November.

Tabula, for instance, runs the Tabula iTraxx IG Bond UCITS ETF (London Stock Exchange: TTRX), which tracks a benchmark index reflecting the performance of a basket of EUR-denominated corporate investment grade bonds and replicates the credit risk profile of the iTraxx Europe Index. iTraxx Europe, as the most liquid European investment-grade corporate credit instrument, covers 125 liquid European investment grade entities and used as a reference for both long and short credit default swap positions.

"It's becoming ever more likely that the era of stable developed market inflation is coming to an end."

THE END OF LOW AND STABLE US INFLATION?

Inflation is also an escalating concern among institutional investors. The US Federal Reserve has committed to a new inflation regime, allowing inflation to run ahead of its historic two percent target, with the incoming Biden administration expected to be more supportive of an accommodative monetary policy and to increase inflationary pressure. Biden's pick for Treasury Secretary of ex-Fed chair Yellen suggests a close tie-up between fiscal and monetary authorities, points out the team at Tabula. According to the European fixed-income ETF provider, "these factors, combined with the demand/supply fallout from COVID-19, mean that, medium term, inflation is once again on the agenda."

"This year, we have witnessed extraordinary monetary stimulus, which when combined with loose monetary policy, introduces impetus for future inflation," says Michael John Lytle. "The Federal Reserve Board balance sheet has doubled in six months, and global narrow and broad money supply are up 22 percent and 14 percent respectively this year – annual growth rates last seen in 1993 and 2008 respectively," he continues. "Changing Central Bank mandates and new fiscal policies are also putting pressure on inflation. The incoming Biden administration is committed to further COVID-19-related stimulus, including more direct payments to households," says Lytle. "This, combined with what the Fed does next, could significantly affect the long-term outlook for US inflation."

"It's becoming ever more likely that the era of stable developed market inflation is coming to an end," said Lytle in early November. The prospect of higher inflation increases the attractiveness of Treasury-inflation-protection securities, or TIPS. Tabula, the London-based asset manager focused on fixed income, recently launched the Tabula US Enhanced Inflation UCITS ETF (London Stock Exchange: TINF; Borsa Italiana: TINE), to provide exposure to both realised and expected inflation in a single index.

"Currently, the ETF market offers a choice between traditional inflation-linked bonds, delivering realised inflation, and more sophisticated products offering exposure to inflation expectations but with no real yield," Lytle explained the rationale behind Tabula's US Enhanced Inflation UCITS ETF. "Our conversations with investors revealed that most want exposure to both realised and expected inflation, ideally in the same product."

The ETF combines a TIPS portfolio with exposure to US inflation expectations, tracking the new Bloomberg Barclays US Enhanced Inflation Index, which Tabula co-developed with Bloomberg. The index delivers realised US inflation via exposure to US Treasury Inflation-Protected Securities (TIPS) across a wide range of maturities. The ETF tracking the index takes exposure to 7-10-year US TIPS, in combination with a short position in 7-10-year US Treasuries, which provides reactive but liquid exposure to medium-term inflation expectations.

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The Healthy Organism of the Nordic Hedge Fund Industry

By Eugeniu Guzun – HedgeNordic

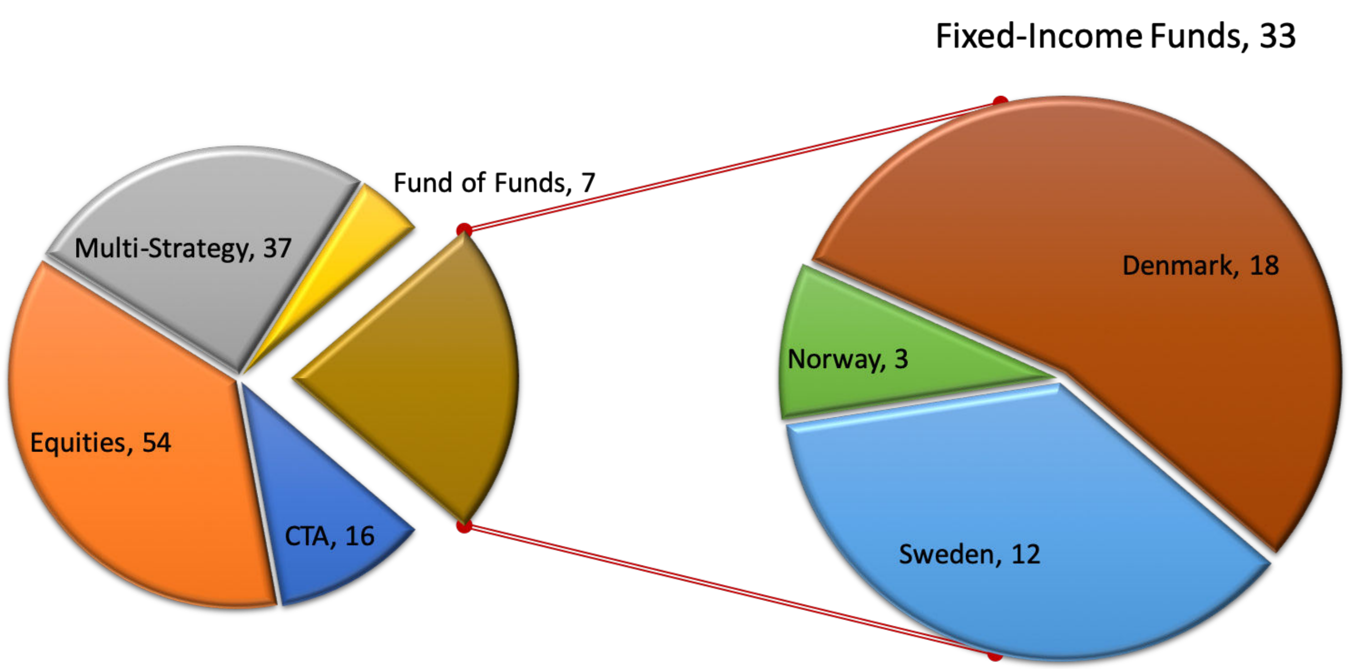
When asked to highlight some unique features of the Nordic hedge fund industry, we most often point out that the industry houses several of world's largest CTA managers and a strong pool of fixed-income hedge funds (mostly Danish but not only). Judging by the statistics provided by the HedgeNordic database, the group of Nordic fixed-income hedge funds is in a very solid and healthy state, especially when comparing to the broader industry. There are a couple of data points backing this statement.

First, eight new fixed-income hedge funds have been launched in the Nordics since the beginning of 2018 and only two funds closed down during the same period. In fact, the "fixed income" category is the only strategy category in the Nordic Hedge Index with new launches outpacing closures since 2018. Second, the collective assets managed by Nordic fixed-income hedge funds increased from around €6.4 billion in December 2017 to €7.3 billion in December of last year, and further increased to €7.8 billion at the end of September this year. Third, fixed-income hedge funds handily outperformed all four remaining strategy categories in the Nordic Hedge Index in the previous 24 months and outperformed all but one strategy category in the past 60 months.

COUNTRY OF ORIGINATION

There are 33 fixed-income hedge funds in the Nordics as of the end of November, compared to 26 at the end of 2017, 31 at the end of 2018 and 32 at the end of last year. During 2020, one new fund joined the industry and one vehicle shut its doors. Fixed-income relative value fund Frost was launched by former employees at the now-closed Nektar at the beginning of 2020. SEB Alternative Fixed Income, one of the largest fixed-income hedge funds in the Nordics in recent years, was put into liquidation towards the end of March. 2019 and 2018 were more fruitful in terms of new hedge fund launches in the Nordic fixed-income space. Five new funds were launched and joined the Nordic Hedge Index during 2018 and an additional two funds were launched during 2019. No fixed-income hedge funds closed down in 2018, and only one fund shut its doors last year.

Country Breakdown of Nordic Fixed-Income Hedge Funds.



Source: HedgeNordic

About one in every five active members of the Nordic Hedge Index are classified as fixed-income hedge funds, and more than half of all fixed-income funds are based in Denmark. The Danish mortgage bond market is one of the largest and most liquid bond markets in the world, which partly explains the high number of Danish fixed-income-focused hedge funds. Of the 39 Danish funds in the Nordic Hedge Index, 18 solely focus on investing in the fixed-income space. The Nordic hedge fund industry also includes 12 Swedish fixed-income funds and three Norwegian funds. There are no Finnish fixed-income hedge funds in the Nordic Hedge Index.

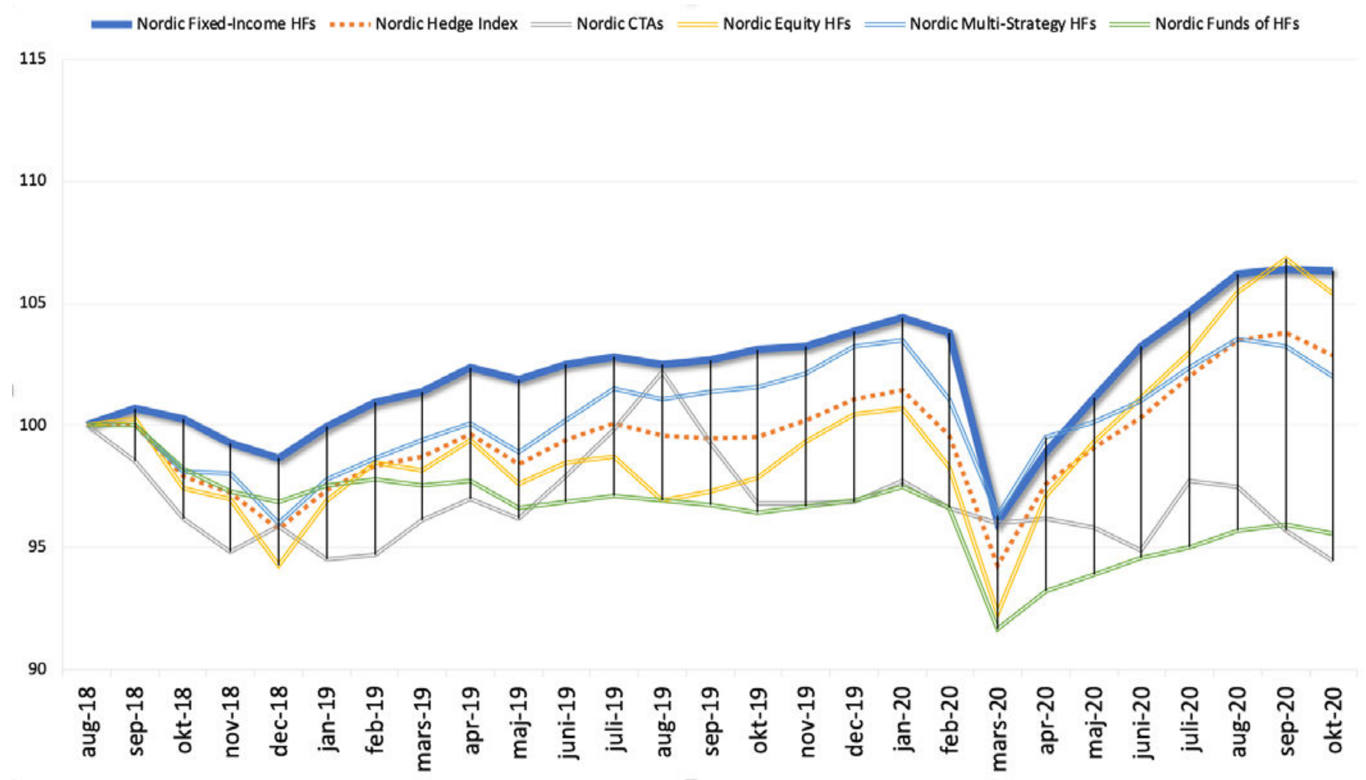
NORDIC FIXED-INCOME HEDGE FUNDS VERSUS THE REST

Nordic fixed-income hedge funds outperformed each of the remaining four strategy categories in the Nordic Hedge Index in the previous 24 months starting from September 2014 and outperformed CTAs, multi-strategy and funds of hedge funds (all but equity hedge funds) over the past 60 months. Furthermore, fixed-income hedge funds are up 2.4 percent on average year-to-date through the end of October, with the group trailing only equity hedge funds this year.

Nordic fixed-income hedge funds, as expressed by the NHX Fixed Income, generated a cumulative return of 6.3 percent in the previous 24 months through the end October, surpassing the 2.9 percent cumulative return delivered by the Nordic Hedge Index. Equity hedge funds, the second best-performing category in the past 24 months, delivered a cumulative return of 5.4 percent during the period.

Over the past 60 months, Nordic fixed-income hedge funds delivered a cumulative return of 23.1 percent on average, whereas equity hedge funds generated a cumulative 30.9 percent. The average Nordic hedge

Performance of Nordic Fixed-Income Hedge Funds Versus Other Strategy Categories



Source: HedgeNordic

fund, meanwhile, delivered an average cumulative return of 18.8 percent over the past five years through the end of October 2020. International fixed-income hedge funds, as measured by the Eurekahedge Fixed Income Hedge Fund Index, generated a cumulative return of 25.0 percent in the previous 60 months and a cumulative return of 7.9 percent over the past 24 months. The Eurekahedge index currently includes almost 300 constituent funds.

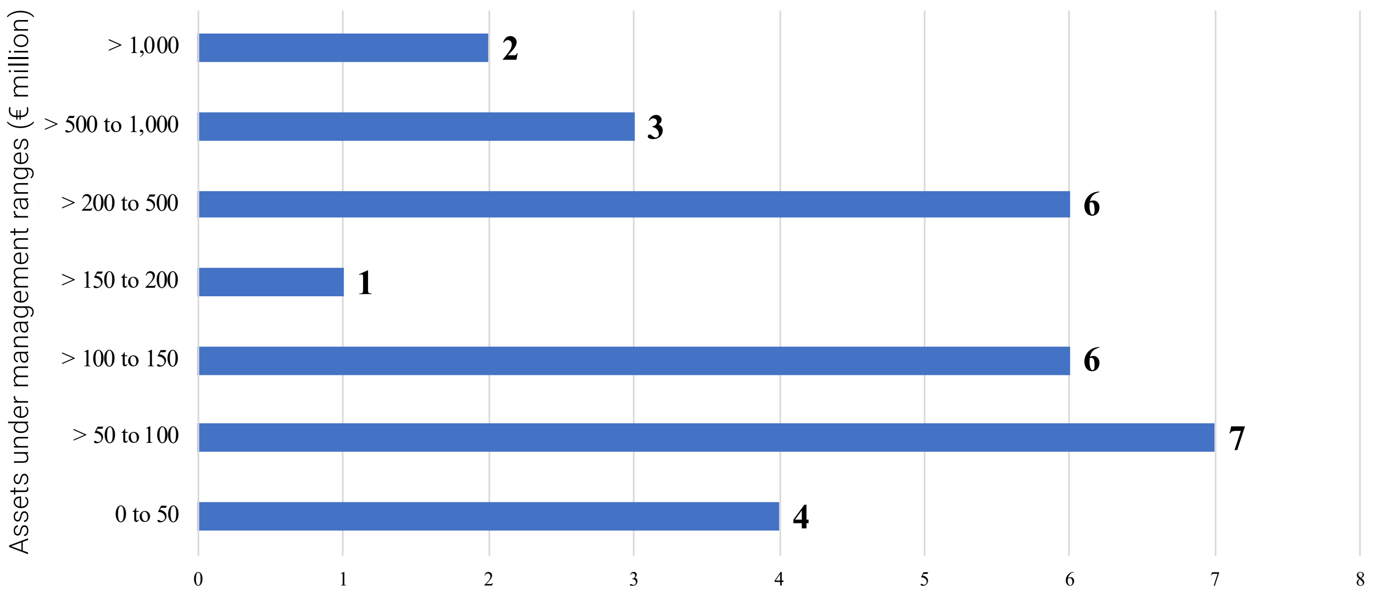
WHO’S THE BIGGEST?

The universe of Nordic fixed-income hedge funds oversees €7.79 billion in assets under management as of the end of October based on data from 30 of the 33 members of the NHX Fixed Income. 28 of the 31 fixed- income-focused members of the Nordic Hedge Index that were up and running in December of last year (including the now-closed Trude and SEB Alternative Fixed Income) had €7.77 billion in asset under management at the end of 2019. The current members of the NHX Fixed Income category, which now manage 7.79 billion, had €7.31 billion in assets under management at the end of last year and €5.87 billion at the end of 2017. The fixed-income segment of the Nordic hedge fund industry had €6.44 billion under management at the end of 2017, based on data from 24 fixed-income hedge funds out of the 26 up and running at the time.

At the end of October, Danish-based fixed-income hedge funds collectively managed €4.08 billion of the €7.79 billion, whereas Swedish funds managed €2.89 billion. The three Norwegian fixed-income, two of which are under the umbrella of Borea Asset Management, funds collectively managed a little over €800 million in assets at the end of October.

Danske Bank Asset Management’s suite of four fixed-income hedge funds oversees about €2.5 billion in assets as of the end of October, accounting for 31

Number of Nordic Fixed-Income Hedge Funds by Size



Source: HedgeNordic

percent of the "fixed-income" category's combined assets. Stockholm-based Nordkinn Fixed Income Macro Fund is the Nordic industry's largest fixed-income hedge fund with assets under management of €1.14 billion at the end of October. Danske Invest Hedge Fixed Income Strategies closely follows suit with assets under management of €1.08 billion. These are the only fixed-income hedge funds in the HedgeNordic database with assets above €1 billion.

The majority of the Nordic fixed-income hedge funds manage over €100 million in assets (18 of the 29 vehicles with reported assets under management figures). Eleven of these 29 funds manage more than €200 million, and 11 vehicles oversee less than €100 million. Three Nordic fixed-income hedge funds manage between €500 million and €1 billion in capital as of the end of October. As mentioned above, two fixed-income funds from the Nordic Hedge Index manage over €1 billion.

It is worth pointing out that younger fixed-income hedge funds in the Nordics have been relatively successful in attracting capital from investors. The ten Nordic fixed- income funds launched during 2017 or later (with an operating life of less than four years) collectively manage €2.2 billion or €184.7 million on average as of the end of October. The eleven hedge funds started before 2012 (with an operating life of more than ten years) oversee a combined €3.1 billion or €256.8 million on average. The remaining eight mid-age hedge funds started from the beginning of 2012 to the end of 2016, meanwhile, manage €2.5 billion or €310.9 million on average.

THE BEST PERFORMERS

Two funds managed by Copenhagen-based fixed-income manager Moma Advisors achieved the highest annualized return in the past 36 months to the end of October among the funds with a track record of more than three years. Asgard Fixed Income Fund delivered an annualized return of 7.7 percent in the past three years, while Asgard Fixed Income Risk Premia delivered an annualized return of 7.3 percent. Danske Bank Asset Management's flagship fixed-income fund, Danske Invest Hedge Fixed Income Strategies, followed suit with an annualized return of 6.1 percent. Stockholm-based direct lending fund

Scandinavian Credit Fund, meanwhile, achieved a net-of-fees annualized return of 6.0 percent in the past three years to the end of October. Copenhagen-based fixed-income hedge fund CABA Hedge generated an annualized return of 5.5 percent over the same time span.

The two Asgard funds also delivered the highest cumulative returns over the past 24 and 12 months. Looking at risk-adjusted returns over the past three years, Scandinavian Credit Fund achieved a Sharpe ratio of 6.46. Over the past 36 months, Asgard Fixed Income Fund and Danske Invest Hedge Fixed Income Strategies achieved Sharpe ratios of 1.41 and 1.39, respectively. Up and running Nordic fixed- income hedge funds have performed relatively well over time. After all, 13 of the current 33 funds achieved inception-to-date Sharpe ratios above one and 27 of the 33 funds delivered inception-to-date Sharpe ratios of more than 0.5.

Ranking		3-Year Annualized Return	Ranking		3-Year Sharpe Ratio
1	Asgard Fixed Income Fund	7,7%	1	Scandinavian Credit Fund I	6,46
2	Asgard Fixed Income Risk Premia	7,3%	2	Asgard Fixed Income Fund	1,41
3	Danske Invest Hedge Fixed Income Strategies	6,1%	3	Danske Invest Hedge Fixed Income Strategies	1,39
4	Scandinavian Credit Fund I	6,0%	4	Asgard Fixed Income Risk Premia	1,34
5	CABA Hedge	5,5%	5	CABA Hedge	1,06
6	Danske Invest Fixed Income Relative Value	5,4%	6	KLP Alfa Global Rente	0,78
7	Nykredit EVIRA Hedge Fund	3,2%	7	Danske Invest Fixed Income Relative Value	0,76
8	Midgard Fixed Income Fund	2,8%	8	Nordkinn Fixed Income Macro Fund	0,67
9	Borea Høyrente	2,7%	9	Excalibur	0,65
10	Excalibur	2,4%	10	Midgard Fixed Income Fund	0,47
Ranking		**24-M Cumulative Return**	**Ranking**		**12-M Cumulative Return**
1	Asgard Fixed Income Risk Premia	22,4%	1	Asgard Fixed Income Risk Premia	12,9%
2	Asgard Fixed Income Fund	22,3%	2	Asgard Fixed Income Fund	12,8%
3	Danske Invest Fixed Income Global Value	20,3%	3	CABA Hedge	12,7%
4	Nykredit EVIRA Hedge Fund	19,5%	4	SEB Eureka Fixed Income Relative Value	11,3%
5	CABA Hedge	16,2%	5	Danske Invest Fixed Income Global Value	10,2%
6	Danske Invest Hedge Fixed Income Strategies	14,9%	6	Danske Invest Fixed Income Relative Value	9,7%
7	SEB Eureka Fixed Income Relative Value	14,2%	7	Excalibur	9,4%
8	Danske Invest Fixed Income Relative Value	13,5%	8	Danske Invest Hedge Fixed Income Strategies	8,3%
9	Scandinavian Credit Fund I	10,5%	9	Borea Obligasjon	8,3%
10	Midgard Fixed Income Fund	9,4%	10	Formuepleje Fokus	4,9%

Source: HedgeNordic

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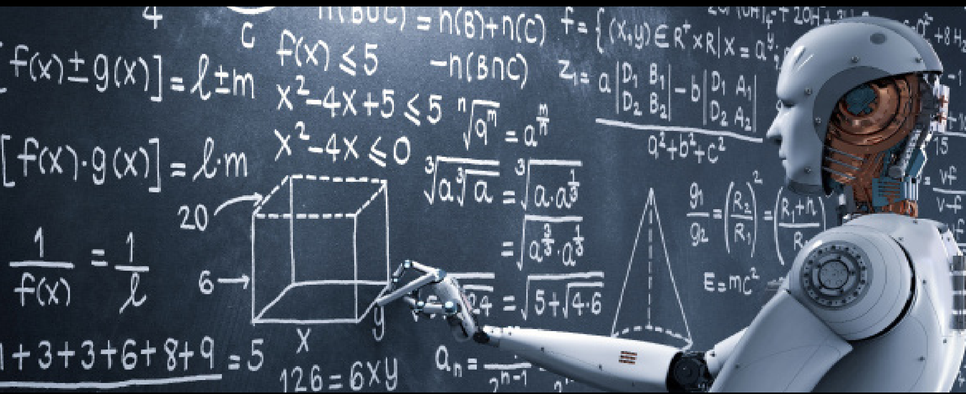
"Your single access point to the Nordic Hedge Fund Industry"



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