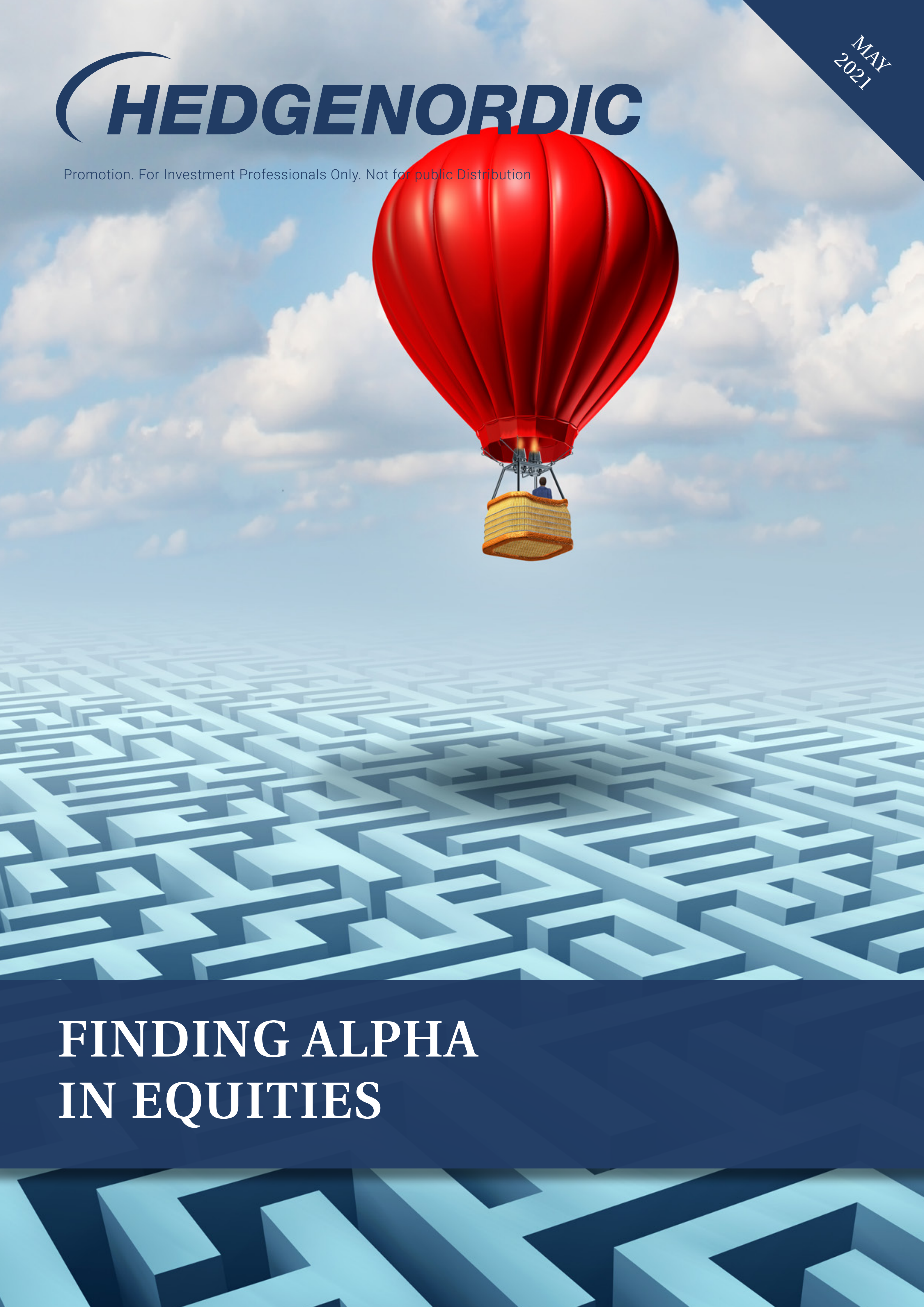
HEDGENORDIC

MAY 2021



FINDING ALPHA IN EQUITIES

Contents

HEDGENORDIC

INTRODUCTION

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

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

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

PUBLICATION PLAN 2021:

June:	Private Markets
September:	Quant Strategies
October:	Value / Quality Investing
November:	Alternative Fixed Income
December:	ESG in Alternatives

CONTACT:

Kamran George Ghalitschi
Nordic Business Media AB
Kungsgatan 8
SE-103 89 Stockholm, Sweden
Corporate Number: 556838-6170
VAT Number: SE-556838617001

Direct: +46 (0) 8 5333 8688
Mobile: +46 (0) 706566688
Email: kamran@hedgenordic.com
www.hedgenordic.com

Picture Index: Lightspring---shutterstock, Tartila---shutterstock

Design & Layout: Sara Ahlström

www.hedgenordic.com – May 2021 HEDGENORDIC

Editor´s Note...

A Maze in Equities

I would like to argue there is no more "real asset" than stocks. You invest in real companies which have employees, talent, know-how, patents, buildings, clients, supply chains, distribution networks, cash flows and so on and so on. At the same time, there can be little said against the reality of stock markets becoming more and more decoupled from "the real economy." The Covid-crisis perhaps made this more evident than ever.

While millions of jobs were lost and we saw massive compression of economic activity with entire industries brought to their knees, stock markets continued their stubborn ascend with only a short interruption, which again, proved to be a buying opportunity. The uncertainties around the US presidential elections and storming of the Capitol left stock markets utterly unimpressed.

Even so, the equity-focused investment management arena as a whole has become a fascinating, heterogenous marketplace. Directional versus non-directional, active versus passive, value versus growth, public versus private markets, micro caps to large caps, different geographic focuses and industries and the list could go on.

In the hedge fund and the alternatives space, one could intuitively assume the possibilities are even greater, with managers being able to go long and short, run concentrated portfolios, work with various tools such as leverage, options, or unlisted OTC instruments. There is a maze of opportunities to trade with equity instruments. And yet, more and more active managers repeatedly and consistently fail to see through the fog of war and fail to leave the battlefield as winners against their passive counterparties, such as ETFs.

While there is some deviation in the numbers of different researchers and publications, Barron's, for instance, claims that 82 percent of fund managers fell short of their S&P 500 benchmark over the past 10 years, with 87 percent failing over 15 years. Similarly, 74 percent did not match up to the S&P Midcap 400, while 75 percent also underperformed the S&P Small Cap 600 during the ten-year period ending June 2020.

Averages, of course, do not tell the full story and there are those strategies and managers that do succeed in finding their way through the maze and succeed in delivering alpha to their investors. Many of these, we are pleased to highlight, we find in the Nordics.

In this issue of HedgeNordic's special report on "Finding Alpha in Equity Markets," we will be looking at "Alecta's Hunger for Private Businesses," where portfolio manager Marcus Lüttgen lets us in on the Swedish pension provider's views on private equity. We will also hear why "Japan is getting into the Zen Zone" from Sector's Trond Hermansen and highflyer Accendo Capital insists that "A Good Reputation is Worth Real Money."

Norwegian Taiga Fund describes how "Ordinary is the New Elixir" in the search for stocks and Nina Hammerstad, CEO of newly set-up REQ Capital describes the interesting approach of "Investing in Culture."

Market timing is something I always considered one of the most challenging parts of investing in equities. Coeli's Mikael Petterson then tells how "Timing it Right" can really play into your hands and Janne Kujala describes how "Unicorns Roam in the North."

Three Nordic equity long/short managers argue the case for "Small Managers, Big Alpha" and Danielius Kolisovas shares some of his research on the Nordic Hedge Index, where he believes to have found "Unusual Crisis Performance In the Face of COVID-19."

In an editorial, Eugeniu Guzun takes Nordic equity managers to the ring for the epic battle of "Fundies vs Quants" and Finnish alternative investment manager AIM Capital explains their approach to allocating to investing to equity hedge funds as "Long/Short Equity Managers Wear Multiple Hats" before we round off the report by "Demystifying Short Selling."

We do hope this publication gives you good insight into the (Nordic) landscape of managers and strategies that can successfully find their way.

KAMRAN GHALITSCHI

CEO & PUBLISHER HEDGENORDIC

Alecta's Hunger for Private Businesses

By Eugeniu Guzun - HedgeNordic

Marcus Lüttgen, Portfolio Manager - Alecta

Many up-and-coming companies with great prospects are no longer racing to list their shares on public markets. Despite the extra challenges coming with private asset investing, institutional investors increasingly recognize the diversification and return benefits of investing in private companies. Swedish pension provider Alecta now has about $1 billion allocated to unlisted equities. Four years ago, this number stood at zero.

"The main benefit of investing in unlisted companies is the shareholder value creation and growth opportunities some companies can provide," Marcus Lüttgen, portfolio manager at Alecta, highlights the benefits of investing in private companies. "By also having the opportunity to invest in unlisted companies, Alecta can gain access to some attractive investment opportunities among unlisted companies and does that as a strong financial partner with a long-term investment horizon."

"Currently, between 1-2 percent of the total equities portfolio or almost $1 billion are allocated to unlisted equities," Lüttgen tells HedgeNordic. "There are a lot of interesting, big companies away from the stock exchange and we have appetite for more," the portfolio manager told Swedish business daily Dagens Industri earlier this year. Many private companies today no longer feel the need to go public to raise money via an initial public offering, with this private-for-longer trend benefiting investors who can invest in these companies at a faster stage of growth.

"Some private companies are strong and mature but at the same time in an earlier or more dynamic stage of their growth cycle or company development," Lüttgen highlights one advantage of investing in private companies over public ones. "The private equity space has grown a lot with larger companies that are developed during an extended period with private ownership," the portfolio manager discusses the private-for-longer trend. "Therefore, the number of relevant investment opportunities in the private space is also rising" for large institutional investors such as Alecta.

CURRENT PORTFOLIO

"We communicate what kind of investment candidates we are looking for, very high-quality businesses that are providing outstanding customer value and a proven, scalable platform for further development and growth," Lüttgen describes Alecta's selection approach in the unlisted space. Alecta has so far made four investments in unlisted companies.

"The main benefit of investing in unlisted companies is the shareholder value creation and growth opportunities some companies can provide."

"The veterinary chain IVC Evidensia, pest control company Anticimex and online pharmacy Apotea are such examples of highly successful privately-held companies that we recently have invested into as a co-investor," Lüttgen tells HedgeNordic. Most recently, Alecta has also invested SEK 300 million in music rights tech company Epidemic Sound.

"We follow a careful process to evaluate the potential for each company we choose to invest in," Lüttgen and his colleague Leif Törnvall, who are both responsible for the investment, commented in connection to Alecta's investment in Epidemic Sound. "Epidemic Sound meets many of the criteria we are looking for – they are a global market leader in their industry, have a strong corporate management, great growth potential and an ability to scale up their business profitably," they added. "Alecta is a long-term investor and we believe that Epidemic Sound and the company's management will create value for our customers at a level above the rest of the stock market for many years to come."

"Through the investment in Epidemic Sound, we continue to build up a portfolio of holdings in unlisted companies with great growth potential," Hans Sterte, the chief investment officer of Alecta, commented on the investment in Epidemic Sound. "In recent years, we have made investments in Anticimex, Apotea and IVC Evidensia and are looking for more attractive investments in this area," asserted the CIO. Elaborating on Alecta's approach to investing in private companies, Sterte says that "for unlisted companies, Alecta acts as an independent financial partner, which has the ability to follow as an investor for a long time."

Although Alecta has primarily invested in unlisted companies based in Sweden, the portfolio management team is looking at a much broader list of predominantly European companies to build its unlisted equity portfolio. And Alecta is looking for more large-sized investments in unlisted equity in Europe. "We want the unlisted investments to have a relevant size for the portfolio," Lüttgen recently told Dagens Industri. "This means that investments in new companies of less than SEK 500 million will become unusual."

ILLIQUIDITY PREMIUM

"The lack of liquidity and the complexities of executing transactions in the unlisted space are examples of disadvantages compared to listed companies," Lüttgen tells HedgeNordic about the downsides of investing in private companies. Even so, investors' increasing allocations to private assets enable them to pick up an illiquid premium or even a premium stemming from the complexity of private investments, which translate into higher expected returns over publicly traded assets of broadly similar quality. "When liquidity is high in many markets, we can get a relative premium for investments in unlisted companies with less liquidity," says Lüttgen.

However, private equity is not the only asset class rewarding investors for illiquidity and complexity. Many other alternative asset classes can offer better returns than publicly traded assets to compensate investors for tying up their capital. For long-term-oriented investors such as Alecta, the illiquidity of its investments in private assets may not matter too much as long as the lack of liquidity is adequately compensated for. "We are looking for that premium in all asset classes in our portfolio, not just equity," concludes Lüttgen.

www.hedgenordic.com – May 2021
HEDGENORDIC

Trond Hermansen, Portfolio Manager – Sector Zen

Japan Getting Into "Zen" Zone

By Eugeniu Guzun - HedgeNordic

Towards the end of last summer, Warren Buffett's Berkshire Hathaway unveiled stakes of more than five percent in five Japanese companies, his largest ever investment outside the United States. Buffet's investment could be a testament to the fact that the Japanese stock market is full of "value plays" – great companies with solid business prospects and cash-rich balance sheets trading at low valuations relative to intrinsic value, operating in a market with improving governance.

Relying on a Benjamin Graham-inspired approach, Oslo-based money manager Trond Hermansen had been eyeing "value plays" in the Japanese market long before Graham's protégée, Warren Buffett, unveiled his investments in Japan. The long/short equity fund – Sector Zen – he co-manages with analyst Lars Solberg under the umbrella of hedge fund house Sector Asset Management has capitalized on many of these value plays. "Although Sector Zen invests in Japan, the fund has more to do with stock picking and finding value in individual situations," explains Hermansen. "That is the focus of the fund, and because of all the changes going on in Japan at the moment, we believe that this is a very good investment opportunity set for the kind of investment strategy that we employ."

> "Because of all the changes going on in Japan at the moment, we believe that this is a very good investment opportunity set for the kind of investment strategy that we employ."

BEN GRAHAM-INSPIRED APPROACH

Benjamin Graham's guideline of investing when you are getting more than you are paying for will never go out of style, but his original approach of focusing on the balance sheet and finding net-nets – stocks selling for prices well below net current asset values – may have gone out of style everywhere but Japan. According to Hermansen, the original Graham approach "goes hand in hand with the situation in Japan, because there are a lot of listed companies in the Japanese market that are overcapitalized." On aggregate, the Japanese market is the most overcapitalized in the world among the major global markets.

"We also look at the earnings- and cash flow-side of things, but there is so much hidden value on the balance sheets of Japanese companies, and that is why we believe this approach is interesting," Hermansen explains the rationale behind his Graham-inspired approach. "If you look at value investing in a general sense, it used to work extremely well in Japan for decades. But since the global financial crisis, value has not worked anywhere on a passive

> "The lack of sell-side coverage leads to undervaluation and what we believe is the huge opportunity in Japan."

basis," acknowledges the fund manager. "On a more selective basis, value investing has still been working, but under a slightly different approach than before and on a more individual basis."

THE CASE FOR JAPAN

After decades of being avoided by investors for reasons dating back to the late 1980s, the Japanese stock market is finally getting attention again as those reasons are dissipating. Despite Japan being the world's third-largest economy, having strong institutions and solid rule of law, it has been difficult for investors to get comfortable with Japan "partly because of the excessive cross-ownership within the market," argues Hermansen. "The cross-ownership, this so-called Keiretsu system, has meant a lack of transparency, accountability and governance."

"In the past, the Keiretsu system used to protect companies and served as an effective takeover defense mechanism," explains the fund manager. "We believe that is also a cultural thing. Japanese companies are often very, very conservative," points out Hermansen. "Because of the lending bubble in the 1980s, companies have been extremely focused on paying down debt and not taking up any new debt. They would rather just sit on a pile of cash and be safe during the next downturn," he elaborates. "But obviously too much idle cash on the balance sheet is not very good for shareholder returns."

Japanese companies have been allowed to maintain and build overcapitalized balance sheets for too long, "but that is changing," argues Hermansen. "Nowadays, companies have to comply more with shareholder demands than they used to." There are top-down and bottom-up forces driving improvements in governance and stewardship in the Japanese stock market in recent years. "From the top-down side, there are a couple of reforms or so-called codes that were introduced," says Hermansen.

The Japanese Financial Service Agency (FSA) launched the Japanese version of "Stewardship Code" in early 2014. "The stewardship code handles how you act as an investor in listed companies, and that is very important in Japan," says Hermansen. "Domestic pension funds, for instance, have not been accountable in the past for how they vote on AGMs. These days, most of them are more transparent and increasingly vote in line with good corporate governance principles." elaborates the fund manager. "Domestic investors signing up to the stewardship code is very important."

"One year later, in 2015, we also had the establishment of the first version of the corporate governance code," continues Hermansen. "That code handles how you are acting as a listed company and that is extremely important because again, most of these 3,600 listed companies in Japan have really not been questioning why they are listed in the proper sense." As a result, companies are increasingly focused on creating returns for shareholders. "This corporate governance code has been revised on several occasions, and there is a new revision coming out shortly," says Hermansen.

"As a part of that push for better governance, the Japanese government has also come up with several initiatives," adds Hermansen. As part of the Japanese government's "Action Plan of the Growth Strategy" released in June 2019, the government also addressed cross-ownership and the parent-subsidiary dual-listing situation in particular. "We believe it is a game-changer that from the top-down you have much more focus on how to improve the governance," considers Hermansen.

SECTOR ZEN'S CORE

Whereas Warren Buffett has found attractive "value plays" among the largest listed businesses in Japan, the opportunity set is even larger and more appealing among the smaller businesses. With the Japanese stock market asymmetrically skewed, with 80 companies taking up about half of the country's stock market capitalization, "a lot of small and midcap stocks, which might have a perfectly viable business, are simply neglected by investors," argues Hermansen. "They are not big enough in terms of daily stock market liquidity, for instance, to be profitable for the sell-side houses to focus much on," he elaborates. "The lack of sell-side coverage leads to undervaluation and what we believe is the huge opportunity in Japan."

Hermansen's Sector Zen seeks to maintain a portfolio of 40 to 50 of such opportunities. "We look for situations where there is scope for change," Hermansen starts to explain the stock selection process. "First of all, the valuation has to be attractive. But we also like companies with strong balance sheets permitting financial improvement or companies with scope for improvement in returns by taking necessary measures," he elaborates. "We also look for hidden value on balance sheets in terms of equity, real estate portfolios, among others."

"In addition to reviewing the combination of balance sheet quality and valuation metrics, we also like companies where the ownership structure is open to change," emphasizes Hermansen. "That is why we have been particularly focusing on listed subsidiaries of large listed companies," he continues. "Because then we believe there is a high likelihood of one or two exit strategies to unlock the value, either the parent company acquires 100 percent of the subsidiary, or they are looking to sell the company to somebody else," says Hermansen. "That is the core of our strategy."

Among the companies with no dominant shareholder in the ownership structure, Sector Zen seeks to invest alongside activist investors. "If you have one or two activist investors invested in a company, it is quite likely that they will make shareholder proposals and the Japanese media will write about those," says Hermansen. The number of activist funds following or focusing on Japan has more than doubled over the last two or three years, according to Hermansen. "This is a complete game-changer in terms of the investor base, which has led to the cross-ownership level coming down to a level that is more attractive for outside investors," he elaborates. "The combination of top-down pressure and bottom-up pressure makes the investment opportunities highly attractive in our opinion."

www.hedgenordic.com – May 2021 HEDGENORDIC

From Left to Right: Henri Österlund, Mark H. Shay, CFA, Elise Auer, CAIA, Kai Tavakka, CFA – Accendo Capital

A Good Reputation is Worth Real Money

By Eugeniu Guzun - HedgeNordic

The number of activists and the abundance of capital to invest have been increasing, with activist investors becoming a force to reckon with. While some management teams may be wary of shareholder activism, some executives in the Nordics are welcoming one particular activist with open arms. Throughout its 13-year journey, Nordic-focused activist investor Accendo Capital has built an intangible but powerful and hard-to-replicate asset: reputation – a reputation as a collaborative, value-enhancing shareholder.

"By now, there is a fairly good and wide understanding in the small-cap space in the Nordics about how we work," explains senior partner Mark H. Shay, CFA, who manages the Accendo Capital portfolio alongside founder Henri Österlund and partner Kai Tavakka. "One thing we have noticed over time is that companies we are approaching today are, generally speaking, more informed about the work that we do and more positive," he continues. "If you turn the clock back about ten years, companies did not really know what we were about. The idea of an activist investor gave rise to some uncertainty among companies."

The reputation as a collaborative, value-enhancing owner has been accelerating and broadening the deal flow for the activist investor. "Our deal flow today is more diverse and more active than it was ten years ago," Shay says, highlighting one positive aspect of Accendo's long track record. "We occasionally get calls from founders or main shareholders who ask us to take a look at a certain company," he points out. "They may feel that what is missing from their overall group of stakeholders is an active, financially-oriented owner. We feel like we are never short of investment opportunities," continues the senior partner. "We really need to be selective and find cases that are a good fit for us and where we are a good fit for the company and its owners on the other side."

> "One thing we have noticed over time is that companies we are approaching today are, generally speaking, more informed about the work that we do and more positive."
>
> – Mark H. Shay

WHAT ACCENDO BRINGS TO THE TABLE

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

As an activist investor that typically seeks board representation, Accendo draws upon an extensive network of experienced and knowledgeable industry experts who are ready to engage with companies and promote the activist investor's interest in an entrepreneurial, active board of directors. "We have a network of really interesting high-energy people that we work with and we are always keen to meet and work with more such people," emphasizes Österlund. "When we can introduce them to our companies to make something happen, we do it."

Accendo collaborates with four senior advisors who assist the value-creation process both across its six portfolio companies and within Accendo Capital. "They have a broad range of skills and experiences that help us partly with our portfolio development, developing each of the holding companies, but also in terms of developing Accendo Capital as an investment management firm over time." The senior advisors are helping Accendo to find answers to questions such as "How can we grow as a firm? How can we strengthen our offering to our investors, avoid risks, increase assets under management and diversity of our investor base in a productive way over time?" adds Österlund.

Accendo relies both on its own and its network's experience and expertise to create value in the portfolio companies. "The real value of involvement is the passion and the energy that we bring into our companies," emphasizes Shay. "That is not just something that we are content to sit back and watch how things unfold," he continues. "It is about being on our toes, looking at what large customer we could possibly bring into this company that they do not already know, or being in touch with a person looking for a job in the market that would be a great fit," says Shay. "It can be all kinds of things over the course of a year or several years."

FOCUSING ON THE "G"

Investors – both institutional and private– are increasingly adapting their investing practices to make them more environmental, social and governance (ESG)-aligned. "Our positioning there is

> "One of the intangibles that we bring is the genuine passion for investing and for the entrepreneurial drive in our companies."
> – Henri Österlund

really aligned with the 'G' part of the ESG, which gets actually very little attention," points out Mark Shay. "A lot of the attention is on clean-tech investing, for example, which is an important part of our future, but the governance part is something that is frequently overlooked," Shay says. "Even from the beginning in 2008 before people really started talking about ESG, we identified an opportunity in governance to help realize value and make improvements to companies." The focus on governance is "about having a shareholder mindset, doing what is right for the shareholders at every step along the way."

"In terms of the other two components, the 'E' and the 'S,' we do not have a distinct formal strategy around ESG investing, partly because it can lead to a strange focus if you let it run the wrong way," comments Shay. As Accendo is a long-term investor with an investment horizon of five, ten or more years, ESG issues are fully embedded in the selection process without a formal approach to ESG.

"We are trying to find the best investment opportunities that are out there for the next five, ten or more years," says Shay. "And when you look at a business commercially, clearly a plant that is dumping wastewater into the river behind the factory is not the kind of company that we would be investing in, or if we were, the first thing on the agenda would be to do a full clean-up and get back on track," he continues. "An ESG dogma or doctrine can lead to some funny ideas and a lack of focus on what is commercially important."

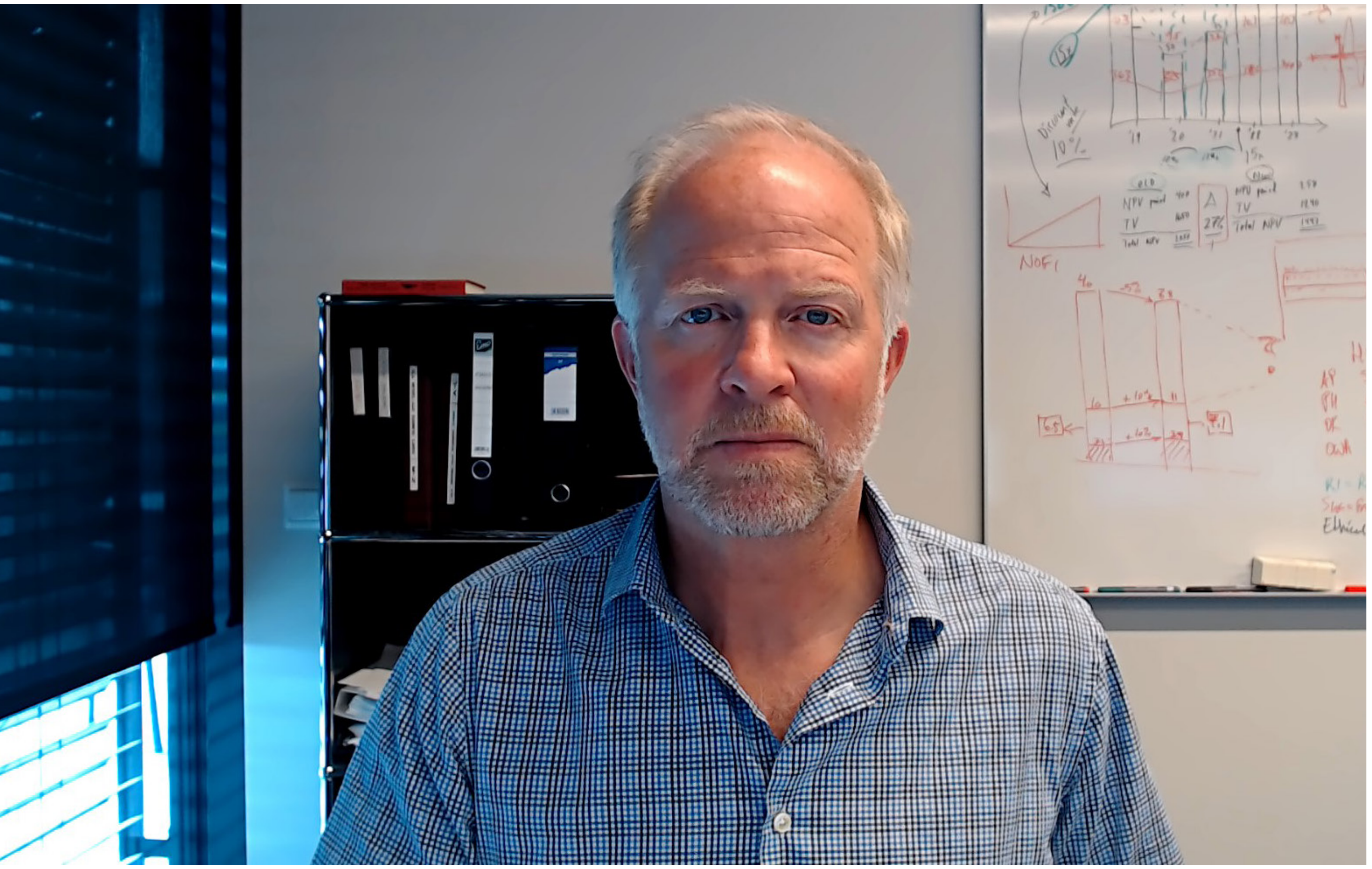
ACCENDO'S PLACE IN AN INSTITUTIONAL PORTFOLIO

Large institutional investors generally hold a wide array of asset classes, securities and investment vehicles in their portfolios, but passive, well-diversified portfolios can hardly capture the excess returns stemming from active ownership. According to Elise Auer, Accendo's Director of Investor Relations, Accendo Capital fits very well in the portfolio of an institutional investor that "believes and sees evidence that active ownership can create excess returns." There are many outstanding activist fund managers out there that are creating significant value by focusing on large companies. "There are, however, only a small handful that are doing similar work with the smaller-cap companies," argues Auer.

"The activist component amounts to us entering the company as an entrepreneurial owner," explains Tavakka. "We do a lot of work in our companies at the board level related to capital allocation, which is maybe the most important thing that we do," he continues. "Often small companies that are successful with good technology see tons of opportunities coming at them every day. The difficult part of the job as an owner is to try to select the best opportunities and say no to other ones."

Ordinary is the New Elixir

By Eugeniu Guzun - HedgeNordic



Ola Wessel-Aas, Founding Partner and Portfolio Manager – Taiga Fund.

> "Over time, the way we invest works in all of the environments that we have ever experienced."

In an environment characterized by low economic growth, where earnings growth becomes scarce, investors have been willing to "pay up" for growth. "With interest rates or risk-free rates coming down continuously in the last two decades because of economies being in a slow-growth environment, clearly growth has been more valuable," says Ola Wessel-Aas, the portfolio manager of long-biased long/short equity fund Taiga Fund. That partly explains the outperformance of growth companies marked by higher-than-average rates of earnings or sales growth against the cheaper-priced slower-growing companies.

Despite Taiga Fund favoring less-expensive "mature businesses with sustainable business models accompanied by strong balance sheets and cash flows," the fund managed by Ola Wessel-Aas and Andreas Petterøe has delivered an annualized return of 15.6 percent since launching in May 2008. "I could be tempted to agree that we have indeed met our return targets despite rather than because of market conditions," Wessel-Aas tells HedgeNordic. "But we don't pay so much attention to what markets generally like or don't like, what type of style works and how one defines value versus growth," he emphasizes. "Over time, the way we invest works in all of the environments that we have ever experienced."

THE COMEBACK OF THE ORDINARY

"Finding companies with the qualities and the prospects that we value will produce returns over time," says Wessel-Aas. "You can find them in every market. It is sometimes more difficult to find them, other times, it's easier." Taiga Fund tends to invest in "mature businesses that offer products or services with sustainable value propositions and that will continue to be in demand over time," according to Wessel-Aas. "We seek entry points at attractive valuations that can be driven by a lack of investor interest in the stock at that particular time, or due to

www.hedgenordic.com – May 2021 HEDGENORDIC

perceived low growth in the company, or risks that we consider being temporary."

"It is dangerous to say that that we have been out of favor as a style, because I am not sure if our style is really defined as value as such," argues Wessel-Aas. "We like growth, we just don't like to overpay for growth," he emphasizes. "We think that you are generally able to get low growth at a discount to the value that the stock represents. At least relative to the ability to get a discount on high growth, which is generally overpriced over time," elaborates Wessel-Aas.

In an environment characterized by slow growth pre-pandemic, which was further exacerbated by the outsized economic impact of COVID-19, "companies that could evidence growth have been very valuable and investors have been rewarded for making those bets," according to Wessel-Aas. "But with growth coming back as economies, not necessarily financial markets, enter more normal circumstances, many companies may grow more quickly than they had been prior to the pandemic," considers Wessel-Aas. "In that environment, high growth is going to be less attractive on a relative basis," he continues. "And from that perspective, our low valuation type investments in perceived low growth companies will be more rewarding on a relative basis."

"There is certainly a time for value stocks, ordinary portfolios, or normal companies to outperform relative to popular tech companies," argues Wessel-Aas. "That has been long lagging. We saw after the internet bubble burst in the early 2000s, those years in the aftermath of the burst were the most attractive for boring, ordinary businesses," he points out. "Ordinary is the new elixir," says Wessel-Aas. "We are committed to continuing to meet our return targets over time," regardless of how the general market sentiment and how other investors are acting or what they favor.

"You cannot form an opinion on the sustainability of a business or its activities without having a view on its ability to invest in that sustainability."

TAIGA'S SUSTAINABILITY MINDSET

The portfolio management team running Taiga Fund is focused on limiting downside risk. "Margin of safety is where we start out in any investments. We always start with the downside," explains Wessel-Aas. This focus on downside protection includes assessing all environmental, social, and governance (ESG) issues surrounding a business. "Doing the bottom-up analysis that we naturally do in order to discover risks in the underlying business that you invest in makes you aware of all of these issues, including E, and S and G that you could describe as non-financial risks," explains Wessel-Aas.

"While we recognize that sustainable investing is obviously a fashionable topic and something investors need to consider, it is tricky to describe exactly how you think about these issues and how you develop processes around them internally and actually make decisions on that basis," acknowledges Wessel-Aas. For that reason, the Taiga team has developed a framework that defines how Taiga Fund is approaching responsible investing.

"We take a broad perspective on sustainability," starts Wessel-Aas. "It is for instance much broader than how it is defined in the EU taxonomy for sustainable activities, which is a subset of sustainability and tiny relative to all of the issues that you have to be aware of," argues the Oslo-based money manager. "It is also very important for us that sustainability for a business implies an ability to survive and invest in its operations," Wessel-Aas continues. "There is a profitability element that cannot be ignored. You cannot form an opinion on the sustainability of a business or its activities without having a view on its ability to invest in that sustainability."

"Secondly, the ethical component of investing is very important," argues Wessel-Aas. "If you are looking at every stock independently from a bottom-up perspective, you will have a personal view of what is ethical," he adds. "There is a moral and reputational aspect to what you do and what you are willing to be invested in, and the threats that you see as being acceptable or not," says Wessel-Aas. "That leads to exclusions and decision-making, which is a very important aspect to how this portfolio is constructed over time. However, we do not want to be defined by what is fashionable and how others are thinking about that. Our framework is a reflection of our view and our understanding of what we think is ethically acceptable and not."

"Finally, there is an element of engagement, which we have always considered as an important component to ownership," Wessel-Aas tells HedgeNordic. "This represents active ownership from our perspective, which involves the ability to engage with companies through dialogue, with management, access to the board of directors, paying attention to the truthfulness in their representations and their communication," says the fund manager. "The ability to engage is an element which we value and an aspect that we always consider when making an investment in a stock."

Sustainability, ethics and engagement are three components captured in Taiga Fund's responsible investing framework. "That is how we have been thinking about sustainable investing all the way," says Wessel-Aas. "Being named after the largest forest in the world with its crucial role in the global ecology, we have always adhered to strict views on sustainability," he says. "Although we take a fairly broad view as to what it all entails, sustainable investing is ingrained in our philosophy and processes."

www.hedgenordic.com – May 2021 HEDGENORDIC

Investing in Culture

By Eugeniu Guzun – HedgeNordic

Successful founders and CEOs need the right skill set to manage a business and attract and optimize talent. Nina Hammerstad, formerly Chief People and Operation Officer at the world's largest sovereign wealth fund, has decided to use her skill set to embark on an entrepreneurial journey in the hyper-competitive investment management industry. Hammerstad established Oslo-based partner-owned firm REQ, which consists of two separate legal entities: asset management arm REQ Capital and real estate-focused arm REQ Alternative Investments.

"I have always enjoyed building things," Nina Hammerstad, formerly at Norges Bank Investment Management, tells HedgeNordic. "Building a business from the ground up and shaping its culture is a powerful motivator. It is important to have competent people to work with," she continues. "In my previous roles, I evaluated a lot of managers and came across a few that really stood out, and we now work together," she says. REQ has grown to 11 staff, "a down-to-earth group of people with a competitive mindset," according to Hammerstad.

ACQUISITIVE COMPOUNDERS

One of the managers who stood out was veteran fund manager from Odin, Oddbjørn Dybvad, who will manage one of the two equity funds under the umbrella of REQ Capital – REQ Global Compounders. As the name suggests, the long-only equity fund managed by Dybvad seeks to invest in compounders – companies that are able to reinvest capital at high rates of return over time – with strong corporate cultures. "Reinvestment is a critical component of any successful investment idea, and our companies have plenty of room to reinvest capital both organically and through acquisitions," explains Dybvad.

Nina Hammerstad, CEO - REQ Capital

> "I have always enjoyed building things. Building a business from the ground up and shaping its culture is a powerful motivator."
>
> – Nina Hammerstad

"Our companies often compound capital by using free cash flow to acquire small private companies," Dybvad describes the typical holding of REQ Global Compounders. "Our acquirers have the ability to deploy the majority of their free cash flow to acquisitions and have tremendous future optionality," he elaborates. "We often tend to see that optionality not captured in the numbers you see today. In our experience, this source of future value creation is often underestimated by the market."

"Our strategy to invest in these acquisition-driven compounders could resemble private equity funds with permanent capital without a fee structure," Dybvad tells HedgeNordic. High-quality businesses with huge runaway for growth stemming from plowing back capital into the business also tend to preserve capital in down markets, argues the fund manager. "It has been our experience that quality companies with consistently solid, relatively non-

Oddbjørn Dybvad, Co-Founder and Portfolio Manager - REQ Capital

cyclical earnings growth tend to preserve capital in down markets."

Management teams with great capital allocators at the helm represent one of the three main ingredients of Dybvad's approach. "The second feature of our strategy is decentralized organizations with a lot of autonomy," explains Dybvad, who authored a book titled Investing in Value Creators. "These are high-performing conglomerates" of the type Warren Buffett has built out of Berkshire Hathaway over many decades. "Finally, we like "skin in the game" by investing in companies where management has a lot of equity ownership in the company," he says. "They treat the business as their own and have a long-term view that often does not involve giving the market guidance on short-term profit expectations."

"The key characteristics of our companies are excellent capital allocation, decentralized organizations, and management with "skin in the game" that acts like a long-term investor."

– Oddbjørn Dybvad

THE IMPORTANCE OF CULTURE

"The key characteristics of our companies are excellent capital allocation, decentralized organizations, and management with "skin in the game" that acts like a long-term investor," summarizes Dybvad. With the team running REQ Global Compounders having a long-term investment horizon that is "directly tied to management execution," corporate culture has emerged as one key focus point in the security selection process. "A strong, enduring culture is the single biggest competitive advantage in a fast-changing world" is the asset manager's motto. The importance of organizational purpose and culture as a differentiator is just as important for the progress of REQ Capital as it is for the underlying holdings of its equity funds.

"A company culture is an asset when your competitors know what you do, how you do it, but they still cannot duplicate it," Hammerstad highlights the importance of culture. "We very rarely hear public investors talk about people, culture and leadership. So we think there are great opportunities for investors who spend a lot of time on this important topic," she continues. "Our many years of investment experience have led us to believe that spotting super talent before others is one of the most underrated skills an investor can develop."

"We try to find management teams that are excellent both inspiring human capital and that are also excellent investors," Dybvad tells HedgeNordic. "These cultures become high-performance companies. People go in the same direction because of the leadership," the fund manager emphasizes. "Capital allocation is an important part of the strategy and culture. Collectively these companies become high-performance companies that outperform over time."

TOP DOWN CULTURE

"Culture starts at the top," explains Nina Hammerstad. "The CEO is the Cultural Executive Officer. Our experience is that executives often do not fully realize the extent to which "who they are" influences all aspects of their business. Investors often do not fully appreciate the importance of management and its impact on culture."

Based in Oslo, finding strong corporate cultures in the Nordics is a more straightforward process for the firm's soon-to-be-launched REQ Nordic Compounders managed by Synnøve Gjønnes. "We do our own primary research by talking to many former employees in the companies we consider as candidates for our funds, mainly in the Nordic countries," explains Hammerstad. "The insights we gain from a structured process of talking to ex-employees are underrated. We have yet to discover anyone on the sell- or buy-side in fund management doing the same type of work, although this is quite common in the private equity arena."

"We were surprised by the amount of feedback from this source of primary research," emphasizes REQ's CEO. "Ex-employees are willing to talk openly about their experiences and we are pretty quick to identify the consensus culture of the firm," she continues. "We have excluded companies from our portfolios based on this source of primary research."

Assessing the corporate cultures of companies outside the Nordics represents a more daunting task. Even so, the team at REQ Capital is "in the process of developing a powerful Cultural Index Model where we use Artificial Intelligence and Natural Language Processing to gather insights from employee written reviews on the recruiting portal Glassdoor," Dybvad tells HedgeNordic. "We are very optimistic about this project and expect it to become an addition to research on international companies."

"As we have evolved as investors, we have discovered that qualitative factors have a great impact on investment returns," emphasizes Dybvad. "Historical numbers and "moats" do not provide all the clues. It is often qualitative factors such as company culture and management's approach toward capital allocation combined with organizations with lots of autonomy that provide excellent long term returns to investors," he elaborates. "Taken together, these elements significantly improve the odds in our favor of generating strong long-term stock returns."

www.hedgenordic.com – May 2021 HEDGENORDIC

Timing It Right

By Eugeniu Guzun – HedgeNordic

Mikael Pettersson
Portfolio Manager
Coeli

In the February-March period of 2020, market participants went from thinking everything was flawless to hopeless amid heightened concerns about the spread of coronavirus outside of China and its ramifications for the global economy. Malmö-based money manager Mikael Petersson followed Warren Buffett's advice of betting big "when there's blood in the streets" to launch a second fund, a concentrated long-only equity fund, Coeli European Opportunities.

"We realized some time after the launch of our long/short equity fund that we got so many interesting investment proposals in smaller companies to which we could not allocate time and capital because of some liquidity constraints," says Petersson, who founded long/short equity fund Coeli Absolute European Equities in early 2018. The team at Coeli had everything prepared for a new fund launch in the summer of 2019. "We put the project on hold while waiting for the right opportunity to launch," Petersson tells HedgeNordic. That opportunity came during the Coronavirus-induced market turmoil in the February-March period last year.

"In mid-March, we took the decision to launch on April 1," says Petersson. "The simple thesis was: if you are not buying equities here and now in a market crash, you should probably never invest in any equities," recalls the fund manager, who used to work alongside Steven Heinz at London-based hedge fund Lansdowne Partners in the late 1990s and early 2000s. "The decision to launch was spot-on," reflects Petersson. His approach of "hardcore stock-picking with a high level of concentration and a focus on small- and midcaps" has paid off handsomely. Coeli European Opportunities is up over 80 percent net-of-fees since launching just a year ago. "We were proactive and it paid off."

Petersson employs a time-tested investment approach to run the long-only equity fund. "We rely on the same approach used to run the long/short equity fund," says Petersson. "We are looking for misunderstood companies, offering good value, with significant value potential and where the management teams are focused on creating value," he elaborates. Despite an overlap of positions

> "In mid-March, we took the decision to launch on April 1. The simple thesis was: if you are not buying equities here and now in a market crash, you should probably never invest in any equities."

between the two vehicles, the long-only equity fund has the flexibility to own larger positions in smaller companies. "With the fund's quarterly liquidity, we do not need to focus on the daily flows in and out of the fund," emphasizes Petersson. "We can own up to 15 percent in a single company, compared to ten percent for the hedge fund."

ADDITIONAL SPICE: UNLISTED COMPANIES

The fund's quarterly redemption terms with investors enable Petersson and analyst Fredrik Östlind to invest in less-liquid, higher risk-reward opportunities but also allocate up to ten percent of the fund's portfolio to high-potential unlisted companies. "I am a specialist in listed equities and we are very busy with that," says Petersson. "But we have this deal flow from the unlisted space coming in, which represents an extra spice for both the long-only and long/short equity fund," he continues. "We are not out there looking for something, we have individuals and organizations knowing that we do this, so we have this flow of investment opportunities that is not available to many people."

"It is not a core business for us, but so far, we have done tremendously well and have had huge successes with our unlisted investments," Petersson points out. The first investment done by long-only Coeli European Equities in the unlisted space was clinical-stage biopharmaceutical company Sensei Biotherapeutics. "European Opportunities invested in Sensei Biotherapeutics in September 2020 at $4 and the company IPO-ed five months later at $19, with a share now trading around $14," says Petersson. The long/short equity fund has made even more rewarding investments in the unlisted space.

> "I am a specialist in listed equities and we are very busy with that. But we have this deal flow from the unlisted space coming in, which represents an extra spice for both the long-only and long/short equity fund."

"Our first investment in the unlisted space was in a German technology company called Cryptology," recalls Petersson. "We invested at €20 three years ago and its now trading around €180 in the market. We sold out in the fourth quarter last year," he continues. "Our second investment was Atai Life Sciences, where we participated in the first capital round at €18 in September 2018. In the fourth capital round a month ago, they raised $157 million at €155," describes another successful investment in the unlisted space. "The market has been very favorable for this asset class and as companies and investors have discovered us, we have a strong deal flow coming to us," says Petersson. "We are clearly benefitting from a strong international network." Both funds also have some indirect investments into Bitcoin, made when Bitcoin was trading at significantly lower levels, according to Petersson. "Let us see the outcome of that, but it is looking promising."

PERFORMANCE AND EDGE

With Coeli European Opportunities up over 80 percent in a little over a year, "so far we have delivered on our promises," says Petersson. "We have made few mistakes, we have been reasonably right with the market timing of the launch, but most importantly, we have many names that have had very strong returns," he continues. All holdings in Coeli Absolute European Equities and Coeli European Opportunities share one common characteristic: management teams focused on value creation. Petersson is looking for capable management teams that know how to best put to use internally-generated cash flows.

"As investors, we provide capital to public and private companies, so we want to understand how management teams allocate our capital," explains Petersson. "We want to know whether share buybacks are creating value, or whether reinvestments are generating attractive returns on incremental capital," he continues. "If the management is not switched on and cannot explain capital allocation decisions, we just walk away."

The process of understanding company capital allocation decisions requires a lot of research and discussions with management teams. "We probably do more research work than 95 percent of the market and we think we are quite good at valuing companies," says Petersson. "Obviously, it helps that we are well connected and that we have been doing this for more than 20 years."

Janne Kujala, Head of Nordic Equities team - Evli

Unicorns Roam in the North

By Janne Kujala – Head of Evli's Nordic Equities team

"If you had to be reborn anywhere in the world as a person with average talents and income, you would want to be a Viking." This citation from The Economist reflects the fact that the Nordics are known around the world for a high quality of life, innovativeness, democracy and stability.

The Nordic countries have succeeded in combining economic efficiency and growth with fair distribution of income and social cohesion. Though the Nordic model is not perfect, the region, which consists of

"The public equity markets in Sweden are surprisingly deep, broad and developed for a smallish European country."

www.hedgenordic.com – May 2021 HEDGENORDIC

small export-oriented open economies, has produced an outsized number of global companies, a vibrant start-up ecosystem and long-term stock market returns unmatched by those in other parts of the world.

Companies such as Spotify (music streaming), Supercell (mobile gaming), Klarna (online payment services), Skype (internet voice and video chat service) and Mojang (developer of Minecraft) are prime examples of why both private and public investors should be interested in investment opportunities in the region.

STOCKHOLM STOCK EXCHANGE EXCELS IN THE SMALL CAP SEGMENT

While Spotify and Skype may have grown to unicorn size inside the walled gardens of venture capital funds unattainable to most investors, there is also a public side, with easier access, to the unicorn nursery. That is the Stockholm stock exchange – and its small cap segment.

Investors in this asset class have reaped some extraordinary results. The Carnegie Swedish Small Cap Index, a commonly used benchmark, has had an annual return of 16.4 percent in EUR in the past ten years. Such numbers compare favorably with the higher end of returns achieved by investors in venture capital funds – but with the added benefit of daily liquidity.

The public equity markets in Sweden are surprisingly deep, broad and developed for a smallish European country. The number of companies listed on the Stockholm stock exchanges exceeds 800 names, of which roughly 50 can be considered large companies with market caps above 10 billion euros. Sweden has also been one of the most active IPO markets

> “As more investor focus is directed towards larger companies, it leaves an active stock picker more opportunities to generate outperformance in the small cap space.”

in Europe in recent years, with dozens of listings in 2020 alone.

THE PUBLIC MARKET PRODUCES LESSER-KNOWN UNICORNS

This fertile breeding ground has produced several companies that would be called unicorns by venture capitalists. But since public markets lack the glamour and the global celebrity owners common to VC-land, it’s often not likely that you have ever even heard of these companies.

An example of such an unsung hero is communications platform company Sinch. The name might not ring any bells, though assuming that you have a smartphone, you are very likely to have used Sinch’s services – for example, when getting your boarding pass from an airline via a messaging app. Sinch listed on the Stockholm main market in 2015, and it had a market cap of about 7 billion SEK (700 million EUR) in 2019. In April 2021 Sinch has a market cap of more than 100 billion SEK. At a valuation over 10 billion euros, in VC parlance, it would be that rarest of rare beasts: a decacorn. Actual venture capitalists have taken note: Softbank took a stake in Sinch in 2020.

Another example, but with perhaps some name recognition – at least among those who either ski or bike – is MIPS. MIPS helmets, discreetly recognizable by a yellow dot in the back, are considered (and have proven in tests) to provide the best head protection in accidents. MIPS doesn’t, however, manufacture or sell helmets. Instead, it’s an intellectual property company, licensing its technologies to helmet brands. MIPS listed in Stockholm in 2017 at a market cap of around 1 billion SEK (100 million EUR) and is today valued at a unicorn-worthy 17 billion SEK (1,7 billion EUR).

MATCHING PERFORMANCE AND SUSTAINABILITY: EVLI SWEDISH SMALL CAP

Passive indexing or algorithmic trading do not dominate the markets in small cap stocks the way they do in large cap stocks. As more investor focus is directed towards larger companies, it leaves an active stock picker more opportunities to generate outperformance in the small cap space.

The Evli Swedish Small Cap Fund was established in 2008 and has outperformed its benchmark, the Carnegie Sweden Small Cap Index, by 2.5 percent (as at 29.4.2021) in EUR annually since its inception. And, in case you are wondering, Evli Swedish Small Cap has been an investor in Sinch and MIPS since 2019. The Stockholm stock exchange hosts several unicorn companies. Small-cap stocks provide an opportunity to generate outperformance.

The Nordics have been the forerunners in sustainability. At Evli, ESG has long been integrated into the selection and investment process. Our Swedish Small Cap also applies additional exclusion criteria, not investing in companies engaged in gambling, weapons manufacturing, alcohol, tobacco or fossil fuels extraction. The fund has lately had a very low carbon intensity of 34 t CO_2/\$M sales. Morningstar ranks Evli Swedish Small cap in the top decile in sustainability among 730 funds in its global category.

Small Managers, Big Alpha

By Eugeniu Guzun - HedgeNordic

Alexander Hyll
Founder and Portfolio Manager
Adaptive Paradigm Alpha.

Andreas Aaen
Founder and Portfolio Manager
Symmetry Invest.

Christer Bjørndal,
Co-Founder
CARN Capital.

Not too often in the world of finance are things painted only in black and white. On some topics though, it seems, academic studies and practitioner literature can largely agree. One of these rare theories, at large, suggests that smaller managers tend to outperform their larger peers. Past research also finds that investment performance deteriorates as fund size increases. HedgeNordic asked several young, emerging managers in the Nordics whether a relatively smaller size represents an advantage and at what point size starts affecting performance?

"Most, if not all, portfolio managers who have managed both a large and a small fund would agree that it is more optimal for returns to operate a smaller fund," considers Christer Bjørndal, Co-Founder of Norwegian asset manager CARN Capital. "You can also see it in data on fund performance, which shows a negative scale effect on returns when funds get too large. Typically, the larger the fund, the poorer returns," he continues. Nimbleness, as reflected by the ability to move in and out of positions, can enable smaller managers to capture opportunities that larger managers cannot.

THE SWEET SPOT

"Liquidity and sizing get harder to manage the larger the fund gets," argues Bjørndal, who oversees a firm running a long-only and a long/short equity fund. The long/short vehicle – CARN Latitude – ranked second in the "Best Nordic Equity Hedge Fund" category at the 2020 Nordic Hedge Award. "It is often the case that the most attractive investments are not available to larger funds due to size," Bjørndal tells HedgeNordic. "This can be offset to some extent by hiring more people, becoming a better investor, optimizing processes, among other things, but it will inevitably reach a point where size hurts performance," he emphasizes. "It is almost a fundamental law within asset management. We believe it is important to limit the size of the fund, ideally at the point where these two factors are optimized and not hurting performance."

> "The most important part is to constantly improve but always stay true to the foundation."
>
> – Andreas Aaen

"The size of the market niche you operate in and liquidity constraints are important when determining how large you can become," explains Bjørndal. Bjørndal's views are backed by other Nordic managers. "We believe there is a goldilocks AUM for any given strategy where you have both the best available tools and talent, and where capacity issues have not yet had too large diminishing returns on alpha," says Alexander Hyll, the founder of Linköping-based long/short equity fund Adaptive Paradigm Alpha. "Finding and maintaining this size can therefore be a key advantage in offering the best possible asset management for clients," he emphasizes. "During

"Most, if not all, portfolio managers who have managed both a large and a small fund would agree that it is more optimal for returns to operate a smaller fund."

– Christer Bjørndal

times of extreme events, our relatively smaller size has let us make risk management decisions and also execute on them without issues of localizing liquidity."

Accountant-turned-fund manager Andreas Aaen, who manages his long/short equity fund Symmetry Invest out of the region of Aalborg in Denmark, agrees, saying that "it is all about finding the sweet spot." Symmetry Invest has grown from DKK 100 million to DKK 400 million over the last two years, giving Aaen the flexibility to steer his money management business in the right direction. "We have used this to lower the fixed management fee, invest in more people and a lot of data and subscriptions," says Aaen. "If the manager reinvests the additional fees into building a better business, then size is an advantage at least until position sizing becomes a problem."

"A small size is an advantage, but being too small is a disadvantage," argues Aaen, who founded Symmetry Invest in early 2013 to manage his own money and capital from friends and family. "Just looking at the journey since inception, Symmetry Invest's returns compounded at around 20 percent a year for the first five years when the fund managed from DKK 5 to 100 million in assets," Aaen tells HedgeNordic. "But over the last three years, we have compounded at 40 percent per year with DKK 200-400 million in assets due to us reinvesting in the business and using size to our advantage."

THE TIPPING POINT

Smaller managers have the flexibility to invest in excellent risk-reward opportunities that would not have a significant impact on a larger manager's portfolio. Warren Buffett himself pointed out that smaller investors can play their advantage to outperform larger investors. At some point, therefore, size does become a problem. "Liquidity is limited and slippage can become large, which leads to a limit for how much capital can be allocated to a given opportunity," argues Hyll. "Markets also have a finite amount of alpha that can be extracted," he explains. "At any given time, there may be a set of more appealing opportunities for a strategy, so an exceptional size can limit cherry-picking of opportunities, therefore diminishing returns."

"We see both in academia and practice that size hurts performance," points out Bjørndal. "The larger one becomes, the harder it is to maneuver effectively. At a certain point, it will start to hurt performance," he emphasizes. Aaen, who co-manages Symmetry Invest with Henrik Abrahamson, agrees that "at some point, size can and will become an obstacle if you are not able to grow your capabilities along." On the question of how much is too much, the three money managers seem to suggest the same well-fitting answer: "it depends." For Adaptive Hedge Fund Management, CARN Capital, and Symmetry Invest, size has yet to become a problem.

FORGET SIZE, FOCUS ON WHAT YOU DO BEST

Smaller and emerging managers can continue to reap great rewards over time for their investors by focusing on what they are good at. "The most important part is to constantly improve but always stay true to the foundation," emphasizes Andreas Aaen. "If the business was founded on a concentrated small-cap strategy, you cannot suddenly become a diversified large-cap fund because you end up with too much assets under management," he continues. "But staying true with the strategy, you can use size to become better and better at what you do."

The team at CARN Capital has been keen on staying true to its original approach and focus on the smaller-cap universe. "We see it as an advantage to be smaller as it opens the investment universe for a more attractive space to operate in. For us, that is within the small- and mid-cap segment," Bjørndal tells HedgeNordic. "In practice, it increases the investment universe to a niche where we see higher potential for adding alpha over time," he elaborates. "Our limited size is in this respect a comparative advantage for us. To be able to invest in smaller companies has been, and will continue to be, an important source of return for CARN."

"We believe there is a goldilocks AUM for any given strategy."

– Alexander Hyll

In the Face of COVID-19: Unusual Crisis Performance

By Danielius Kolisovas

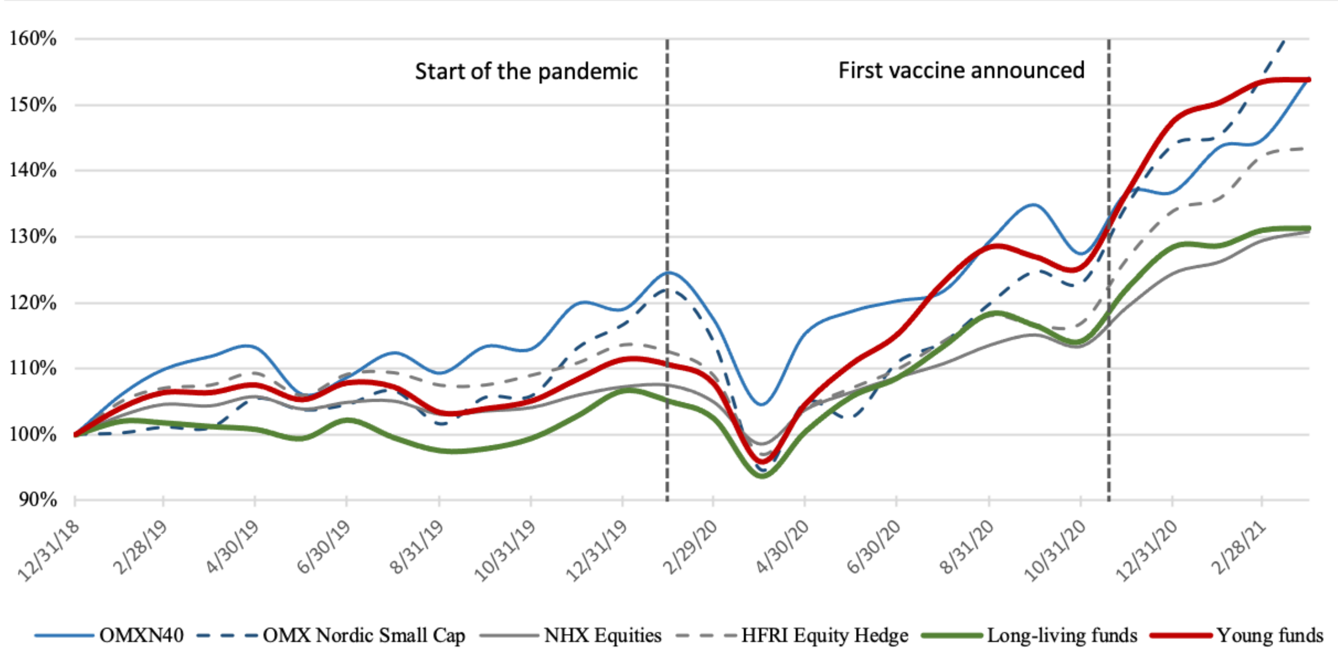
In January 2021, the BBC published a report on how the coronavirus pandemic changed the world economy. As the number of Covid-19 cases grew in the first months of the "crisis," major stock market indices experienced steep falls that were comparable with the drawdown in 2008. Governments around the globe imposed extensive lockdown measures affecting a wide variety of services, unemployment rates increased, retail footfall dropped significantly, and global production chains came under serious pressure.

After recovering the lost ground during the February-March period, the major European, Asian and US stock markets have advanced further ahead following the announcement of the first vaccine to be available in November 2020. Despite suffering their worst quarter on record in the first quarter, Nordic equity hedge funds delivered a return of 16.1 percent

"Has Covid-19 denied the "Law of Gravity" of the financial world? Did fund managers deliver excess returns, or alpha, in this unusual Covid-19 period?"

www.hedgenordic.com – May 2021
HEDGENORDIC

Figure 1. The impact of pandemic on the stock and Nordic hedge fund indices.



Source: HedgeNordic, HFRI, OMX, BBC

last year, making 2020 the second-best performing year since HedgeNordic started tracking the industry in 2005.

In HedgeNordic's 2021 "Nordic Hedge Fund Industry Report," I presented some data showing the ability of long-living hedge funds to generate long-term alpha both in quiet and turbulent times. However, the Covid-19 crisis does not appear to have touched the financial markets. One may ask, has Covid-19 denied the "Law of Gravity" of the financial world? How did hedge fund managers adjust their equity investment strategies? And finally, did fund managers deliver excess returns, or alpha, in this unusual Covid-19 period?

PERFORMANCE DECOMPOSITION

Let's discuss these issues by analysing equity hedge funds using panel data regression models on cross-sectional data of pooled hedge fund returns. The funds were grouped into pools based on the following rules. First, all currently-reporting (alive) equity hedge funds launched prior to 2010 were classified as long-living funds, whereas those alive funds launched after May 2013 (i.e., after the Greece default crisis was considered over) but prior to the beginning of 2019 were classified as young funds. Second, two time-series periods were selected: 13 months covering the Covid-19 period (February 2020 – February 2021) and the same duration of 13 months prior to the Covid-19 turbulences (January 2019 – January 2020). Third, all funds were split into "high volatility" and "low volatility" based on the volatility of their returns as reported in the HedgeNordic database. These classifications allowed to compile 8 separate models, the results of which are presented in the Table to the right.

Models in the period before Covid-19 have lower adjusted R^2, and risk factors determining the performance of those hedge funds were more widespread. Whereas models during Covid-19

Table 1. Summary of panel data regression models

Risk factors	Young hedge funds				Long-living hedge funds			
	Low volatility		High volatility		Low volatility		High volatility	
	Before Covid	During Covid	Before Covid	During Covid	Before Covid	During Covid	Before Covid	During Covid
Alpha	[-0.0038]	[-0.0007]	0.0077	0.0161	0.0051	[0.0004]	[0.0043]	0.0171
Stock index	0.3057	0.1592	-	0.3119	0.1670	-	-	0.5978
Stock size spread	0.3259	0.3845	0.2005	-	0.2899	0.3768	0.4071	-
10-year yield	-	-	-	-	-	-	-	-
Baa-10Y	-	-	-	-	5.6655	-	-	-
MSEMKFRF	-	-	0.4079	0.6309	-	-	0.4575	-
PTFSBDRF	-	-	-	-	-	-0.0182	-	-
PTFSFXRF	-	-	-0.0889	-	-	-	-	-
PTFSCOMRF	-	-	-	-	-	-	-	-
PTFSIRRF	-	-	-	-	-	-	-	-
PTFSSTKRF	-	-	0.1036	-	-	-	-	-
Adj. R^2	0.3875	0.5674	0.3483	0.6304	0.4548	0.5548	0.2084	0.3913
Mean return	0.0008	0.0176	0.0147	0.0349	0.0035	0.0130	0.0052	0.0292
Std. Deviation	0.0323	0.0566	0.0429	0.0855	0.0274	0.0530	0.0601	0.0801
Sharpe ratio	2.48%	31.10%	34.27%	40.82%	12.77%	24.53%	8.65%	36.45%

Risk factors: Stock index – national monthly major stock exchange index return minus the risk-free rate of return (RFRR); Stock size spread – national Small Cap index return less national major stock index; 10-year yield – monthly yield of the governmental 10Y bond minus risk-free rate of return; Baa-10Y – monthly return of Moody's Baa bond minus monthly return of FRB 10Y constant maturity bond; MSEMKFRF – monthly return of MSCI Emerging Market index minus RFRR; PTFSBDRF, PTFSFXRF, PTFSCOMRF, PTFSIRRF and PTFSSTKRF – are monthly returns of the PTFS factors of Bond, Currency, Commodity, Short-Term Interest Rate and Stock Market minus RFRR.

Note: Alpha factors in [square brackets] are statistically insignificant

www.hedgenordic.com – May 2021 HEDGENORDIC

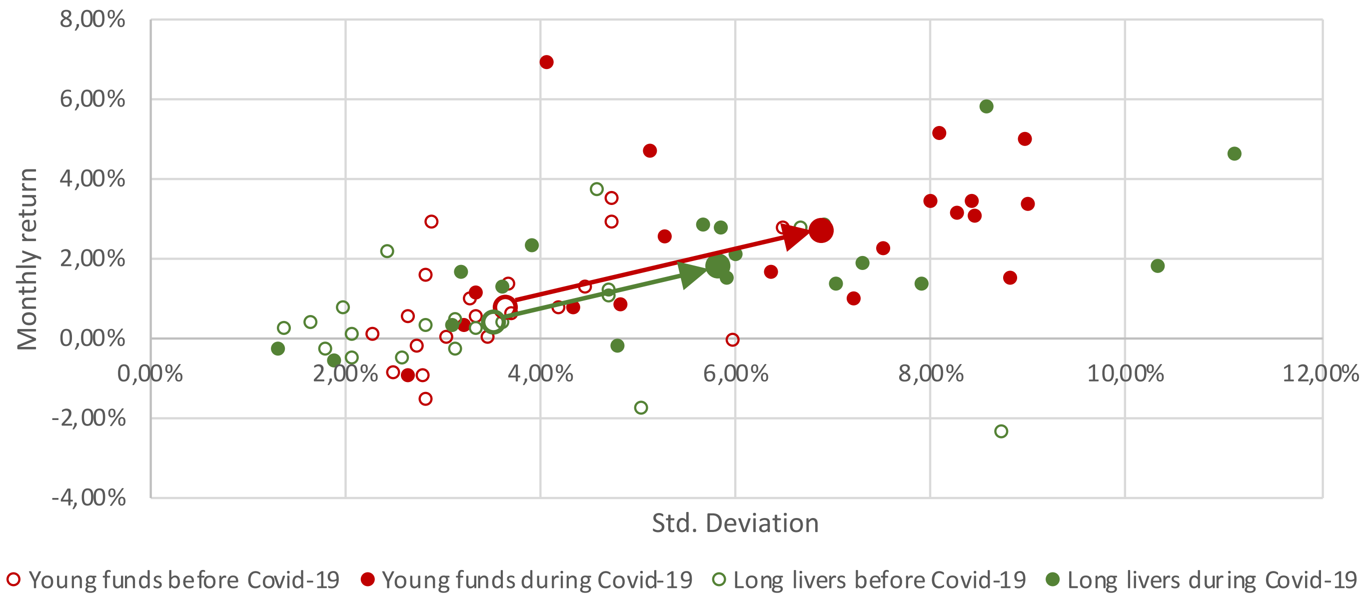
period have higher adjusted R^2 and became more coherent with strategy parameters and tighter to the market trend. Although models with such low number of hedge funds and short duration time-series usually encounter lower adjusted R^2, there is a trend of Covid-19 diminishing alternative investment risk factors (PTFSBDRF, PTFSFXRF, PTFSCOMRF, PTFSIRRF and PTFSSTKRF) from the hedge fund performance.

The other rather unusual trend can be seen in the models of high volatility pools – both Young and Long-living equity hedge funds shifted their Small Cap and Emerging Market stock positions into Large Cap long positions reflected with the main Nordic stock indices. Surprisingly, Large Cap indices' volatility is higher than MSCI Emerging Market index volatility and Small Cap indices' volatility before Covid-19 period and during it: Large Cap indices' volatility is 0.0494 and 0.0905 respectively; Small Cap indices' – 0.0461 – 0.0839 respectively and MSCI Emerging Market index volatility is 0.0467 and 0.0670 respectively. Even if intended as a preventive measure, such shift towards Large Cap positions did not reduce the volatility in returns.

RISKS BEHIND COVID-19 PERFORMANCE

Portfolio theories explain that higher returns stem from higher risks presented in the increased beta indicator, or alpha-generating investment decisions. Looking from the risk-adjusted performance prospective, Covid-19 Sharpe ratios are superior to ones before the Covid-19 period. The scatter in Figure 2 presents the trend of higher return and volatility. The shifts of Long living funds index and Young funds index are surprisingly parallel. Such parallel shift can either confirm the hypothesis of a coherent change in strategies with the beginning of the pandemic or can reflect a certain rigidity in the strategies despite the challenging situation. It is obvious, however, that higher performing and therefore higher risk Long-living and Young funds benefited the most during the Covid-19 period with average annual returns of 35.04% and 41.88%, respectively.

Figure 2. Risk-Return scatter



Note: Larger bullets represent corresponding equally weighted indices.

However, did this abnormal period cause alpha changes? Alpha indicators presented in the "Nordic hedge fund industry report 2021" were positive during the quiet time periods and during crisis periods, reaching 10.56% per annum for high Sharpe ratio funds. Those alphas were biased as long-term time series models diminish the impact of some of the market risk factors. The annualised crisis alpha of high volatility hedge funds during Covid-19 reached the range of 19.32%-20.52%, nearly double the long-term historical statistics. Crisis alphas of low volatility funds, however, are ambiguous.

I have enquired several investment strategists on such tremendous increase in alpha and to hear their own experience in aligning their alternative investment strategies to cope with Covid-19-like challenges. The replies were a bit surprising: although all appreciated such high return, the sustainability is what they care about the most. And they admitted: it's hard to beat stock indices using alternative strategies nowadays.

TAKE COVID-19 SERIOUSLY

Like the World Health Organisation warns the public to take the Covid-19 threat very seriously, investors shall also take the "crisis" situation for granted. The Financial Crisis Inquiry Report issued a decade ago and other studies named credit risk concentration, high level of leverage, liquidity risk and concentration of exposures with the same prime brokers as the main reasons behind the "squeezes and losses" experienced by hedge funds.

Banks and other regulated financial institution must perform stress-tests simulating the crisis scenarios and prepare the bank recovery and resolution plans which may also rely on public financial stability recovery measures. Hedge funds are not a subject of recovery and resolution framework for EU credit institutions and investment firms; therefore, as a risk professional, I strongly recommend hedge fund managers to run the severe stress tests and consider recovery and resolution measures by following their own risk appetite and past hedge fund crisis management experience.

Bio: Danielius Kolisovas is a researcher with over 15 years of risk management experience holding leading positions in Central Bank of Lithuania, investment bank Finasta and crypto company Blockchain.com. Kolisovas advised the Office of the Government of Lithuania and other public institutions. He holds a master's degree in Finance from the University of Greenwich and is FRM certified from GARP. Kolisovas is also PhD candidate in Economics at Mykolas Romeris University where he has been teaching classes on Financial Risk Management and Alternative Investment since 2011.

www.hedgenordic.com – May 2021
HEDGENORDIC

Fundies vs. Quants

By Eugeniu Guzun - HedgeNordic

> “The investor’s chief problem – and even his worst enemy – is likely to be himself.”
> – Benjamin Graham

In finance, we too often like to think in buckets. Assets are classified as either growth or value, investment products as either passive or active, research processes as top-down or bottom-up, and investment approaches as either systematic or discretionary. The latter will concern us for the purpose of this article.

Alternatives manager AQR Capital Management attempts to explain the two approaches as follows, “... systematic (commonly associated with the term ‘quant’) generally applies a more repeatable and data driven approach, relying on computers to identify investment opportunities across many securities; in contrast, a discretionary approach involves in-depth analysis across a smaller number of securities and relies more on information that is not always easily codified.”

Based on discussions with several Nordic hedge fund managers, this article seeks to highlight some of the main advantages and disadvantages of systematic investment strategies compared to discretionary strategies.

RESILIENCE AGAINST HUMAN PSYCHOLOGY

“The investor’s chief problem – and even his worst enemy – is likely to be himself,” once wrote Benjamin Graham, the famed value investor. Behavioral biases affect most investors, if not all, and their investment decisions. A systematic and data-driven process, however, can minimize the impact of behavioral biases on decision making.

Pasi Havia, who manages quant-based stock-picking fund HCP Quant, reckons that the main advantage of a systematic strategy is “that human emotions are not involved in the investment process.” There is growing evidence that the average investor’s market returns significantly lag behind benchmark indices, partly because of their error-prone behavior. “It has been proven in several academic studies how our own emotions are probably the biggest reason for underperformance,” says Havia. He goes on to say that “once the algorithm is in place, it will not panic in a market crash.” The algorithm “simply does what it has been instructed to do.”

Other Nordic hedge fund managers corroborate Havia’s view. Ola Björkmo, who runs systematic market-neutral fund QQM Equity Hedge alongside Jonas Sandefeldt, points out that “a quantitative

www.hedgenordic.com – May 2021
HEDGENORDIC

Alexander HyllCEO and Fund Manager
Adaptive Hedge Fund Management

Pasi Havia, Portfolio Manager
Helsinki Capital Partners

Ola Björkmo and Jonas Sandefeldt, Portfolio Managers
QQM Fund Management

process allows for a quick, unemotional reaction to new information." Alexander Hyll, who employs a quantamental investment approach to run long/short equity fund Adaptive Paradigm Alpha, points out that "quantitative strategies negate much of the effects of biases by taking human decision making out of the equation." The Linköping-based fund manager emphasizes that a systematic approach "allows finding opportunities that may have overwise been missed, as well as being able to make a fairer assessment of the data than a human could."

PROCESSING POWER AND SPEED

Pasi Havia, the portfolio manager of Finnish systematic equity fund HCP Quant, identifies that another advantage of a systematic investment approach is the ability to "process bigger amounts of information than any human army of analysts would

> "History doesn't repeat itself, but it often rhymes."
>
> – Mark Twain

ever be able to." More importantly, a systematic process has the ability to analyze massive amounts of data in a relatively short period. "A quantitative strategy is able to process vast amounts of data fast and execute without emotions involved," summarizes Havia.

"The amount of data that can be analyzed with the assistance of computation far supersedes human capacity," highlights Alexander Hyll, who manages a Ray Dalio-inspired fund that seeks to capitalize on global paradigm shifts. Although "insight and creativity are abilities that computers do not possess, quantitative methods have power and precision far above human capabilities." Ola Björkmo of Stockholm-based QQM Fund Management shares the view, saying that "quantitative processes can utilize all relevant information on each stock across a large investment universe on a daily basis."

REPLICATING THE HUMAN MIND

One cannot really compare any computer with the human brain. No computer, however powerful and sophisticated, can replicate the human mind. "Discretionary strategies revolve around a human´s understanding of a subject, which means that the analysis conducted by a human has more depth than a quantitative analysis," Alexander Hyll tells HedgeNordic. "Quantitative strategies can suffer from being overgeneralized, without a layer of understanding, to fit more situations than may be warranted."

Pasi Havia, who uses a fundamentals-based systematic strategy to run HCP Quant, points out that one disadvantage of a systematic strategy stems from the interpretation of company fundamental data. "In some cases, it is obvious and explainable for a human why there can be discrepancies in an income statement or a balance sheet, for example," says Havia. A fundamentals-based quantitative strategy, however, "will often just read the data as reported, which might be misleading."

"History doesn't repeat itself, but it often rhymes," Havia references Mark Twain's well-known saying. "Quantitative strategies are often trained on past history and can work well within certain boundaries." The human mind, however, could be better at confronting "situations that are unknown for mankind," suggests Havia. "When something unexpected happens that is way off the charts and has not happened before in history (for instance double-digit standard deviation event), quantitative strategies can face challenges," he reckons. "Unknown is unknown. It is hard to train something you do not yet know."

GARBAGE IN, GARBAGE OUT

For a systematic, data-driven investment strategy, data quality is paramount. "Quantitative strategies are highly dependent on the quality of data," emphasizes Havia. Many of us know of the "garbage in, garbage out" mantra. "If a strategy is fed with incorrect information, the output is also nonsense," says the fund manager of HCP Quant. "This is not to say that discretionary strategies could work with low-quality data either," points out Havia, "but data quality is a bigger challenge for a quantitative strategy."

Linköping-based fund manager Alexander Hyll emphasizes that "quality of data varies both in terms of method for collection, generalization, and depth." He suggests that the success of a systematic strategy, as well as a data-driven discretionary strategy strongly depends on data quality. "To perform high-quality analysis, a lot of work and money need to go into collecting and controlling data."

THE BEST OF BOTH WORLDS

Although systematic and discretionary managers have their virtues and pitfalls and may differ in many ways, there is a common ground shared between the two camps. "Both quantitative and discretionary fundamental strategies have their advantages and disadvantages," highlights Pasi Havia. But "they both aim for the same goal" of achieving the investment objectives of different types of investors. "It is good that there is a rich amount of flavors to choose from," says Havia. Björkmo and Sandefeldt, the duo managing QQM Equity Hedge, agree. "We believe that fundamental discretionary and quantitative strategies complement each other in a portfolio."

On the one hand, "quantitative methods have power and precision far above human capabilities. On the other hand, insight and creativity are abilities that computers do not possess," says Alexander Hyll. "To gain a full understanding, we need the depth of human understanding with the width of technology – a quantamental investment strategy."

www.hedgenordic.com – May 2021 HEDGENORDIC

Long/Short Equity Managers Wear Multiple Hats

By Eugeniu Guzun – HedgeNordic

Miikka Hautamäki, Managing Partner – AIM Capital

The ability to dampen volatility in equity portfolios may not have been in particularly high demand in the pre-pandemic period, as stocks had been moving up in unison in usually calm market conditions. The market environment was not especially fertile for long/short equity managers in the decade before the Covid-19 pandemic, which begs the question: what is the role and future of long/short equity hedge funds? After all, the future of long/short equity managers is crucial for the broader hedge fund industry, as the strategy is a significant part of the hedge fund universe, accounting for a meaningful portion of hedge fund assets.

There is no one preeminent rule of thumb that defines the role of long/short equity hedge funds in portfolios. The role may depend on each investor's objectives, the existing composition of their portfolios, or many other factors. For its portfolios, Helsinki-based alternative investment manager AIM Capital views low-net or zero-net strategies as the most compelling strategy in the current environment. "In our core allocations, we seek to maintain a low correlation to equities and therefore focus on strategies that have predominantly market-neutral characteristics, as is the case in our AIM Diversified Strategies Portfolio," Miikka Hautamäki, the chief executive officer of AIM Capital, tells HedgeNordic.

"Broadly speaking, we tend not to invest much in generic long/short equity strategies as we feel that the embedded equity beta can be captured in a more cost-effective way."

www.hedgenordic.com – May 2021
HEDGENORDIC

> "However, the types of equity strategies that we find relevant in our portfolios are market-neutral strategies and sector specialists, both of which can generate differentiated alpha."

"Broadly speaking, we tend not to invest much in generic long/short equity strategies as we feel that the embedded equity beta can be captured in a more cost-effective way," argues Hautamäki. "However, the types of equity strategies that we find relevant in our portfolios are market-neutral strategies and sector specialists, both of which can generate differentiated alpha," he emphasizes. "The allocation between these styles depends on the objective of the portfolio," says Hautamäki, who runs two funds of funds and bespoke advisory mandates for institutional investors.

"In some of our more 'aggressive' portfolios and managed accounts, we have focused on TMT and Healthcare sector specialists, as these are the sectors where significant alpha opportunities have existed," Hautamäki tells HedgeNordic. However, the pockets of alpha are subject to change due to changes in market conditions. "As is the case with all hedge fund strategies, the opportunity set changes over time and economic cycle, meaning that there have been periods when we have had no sector-specific equity long/short managers in the portfolios," says Hautamäki. In the current environment, an allocation to market-neutral strategies could increase the resilience of investor portfolios by providing valuable downside risk-mitigating benefits in addition to potential alpha sources.

MANAGER SELECTION

Whereas many have dubbed the classic broadly diversified FoHFs setup obsolete, AIM Capital's Diversified Strategies Fund maintains an edge that allows the fund to survive and thrive. The edge revolves around long-lasting relationships with the highest-quality managers and concentrated investment approach. Manager selection, therefore, is crucial for its objective to deliver absolute return across all market environments with low correlation to stocks and bonds.

"We have been investing in hedge funds since 2001. Based on our observations and experiences of hedge fund performance in different market cycles, we have differentiated our approach by focusing on managers that have a proven and tested investment process producing persistent and uncorrelated returns, even in extreme market conditions," Hautamäki tells HedgeNordic. "As a consequence, AIM Diversified Strategies investments have gravitated to the best resourced hedge funds such as Citadel Advisors, D.E. Shaw & Co. and Two Sigma."

"Through our long-standing relationships with some of the leading hedge fund managers around the world, our fund provides access to many high-quality and difficult-to-access funds," explains Hautamäki. "In terms of exposure by investment manager, the fund is concentrated because we believe only a small percentage of managers are worth investing in," he emphasizes. A meticulous selection process is required to find the small percentage of managers worth investing in.

"In addition to the normal due diligence requirements that we set to all our managers, evidence of alpha-generating ability in general is the obvious primary requirement" for investing in new equity managers, according to Hautamäki. "Specifically, though, we look for managers that can steer away from excessive commonality and crowding risks. We look at how the manager has navigated periods of volatility," he continues. "Resources and capability to adapt to changing markets and ability to generate returns in all environments is key."

Hautamäki goes on to add that "we are also keen on understanding the firm culture and how it has evolved." Lastly, "the assessment of the opportunity set against the risk of alpha decay, as well as the manager's style and fit with our specific portfolio requirements is a key consideration when making the final investment and sizing decisions," the CEO of AIM Capital tells HedgeNordic.

"We believe the next five years are likely to be more challenging due to structurally lower growth and changes in the inflationary regime. This may have profound implications for the markets and hedge fund alpha," Hautamäki describes a future scenario. "We believe some equity managers are better positioned and have a culture better suited for adaptation to changes in the markets."

www.hedgenordic.com – May 2021 HEDGENORDIC

From left to right: Carl Rydin and Stefan Roos

Demystifying Short Selling

By Eugeniu Guzun – HedgeNordic

Short selling has always been a tough job, and the Reddit-fueled GameStop trading frenzy at the beginning of the year may have made the job even more challenging. Videogame retailer GameStop has been in trouble for a long time, and thereby, a classic target for short sellers in the hope of profiting off the company's worsening fundamentals. The short squeeze triggered by retail traders through an avalanche of small trades – stirred up on Reddit's WallStreetBets forum – has often been cast as a triumph of merry men over the big bad hedge fund managers, putting short sellers in the spotlight again. So is short selling an evil, a necessary evil, or a much-needed necessity? In this article, two short sellers from the Nordics are sharing their views on shorting and its role for financial markets.

WHY SHORT?

"With a financial ecosystem that is driven primarily by one thing, stocks going up, we believe it is healthy for the market to have short sellers expressing a different view from the crowd," argues Carl Rydin, a portfolio manager at long/short equity fund Origo Quest 1. "The supportive view is that short selling provides additional market efficiency through better price discovery and greater liquidity," continues Rydin. "With a market moving further towards passive investment vehicles with no price sensitivity, this argument supporting short sellers as part of the market becomes even stronger."

Anders Palmqvist, the CEO and CIO of Archipelago Investments – which runs market-neutral equity fund Chelonia Market Neutral, corroborates Rydin's arguments. "The main benefit of shorting, also supported by academic studies, is a more efficient market with improved liquidity, but also higher returns for long term pension funds and investors, as they are lending their large equity holdings against interest to the market via stock lending desks," Palmqvist tells HedgeNordic. "With regulators and others strongly advocating passive funds tracking an index solely on the back of low fees, the resulting massive flows into passive investments are very much like what we witnessed in synthetic asset-backed CDOs in 2008

> "With a financial ecosystem that is driven primarily by one thing, stocks going up, we believe it is healthy for the market to have short sellers expressing a different view from the crowd."
>
> – Carl Rydin

www.hedgenordic.com – May 2021
HEDGENORDIC

in that price-setting in the market is not done by fundamental security analysis, but massive capital flows based on models of risk that proved untrue." Magnus Angenfelt, the fund manager running Chelonia Market Neutral, adds that short selling "makes the market more perfect and takes away valuation anomalies driven by passive index funds."

"Another role for short sellers in the market has been spotting wrongdoing and company frauds," further argues Rydin, who joined Origo Fonder back in 2017. "One would think the understaffed regulator will be there to detect misconduct, money laundering and accounting irregularities, but history shows that short sellers or investigative journalists have demonstrated they were able to find some of these issues before the regulators," the portfolio manager tells HedgeNordic. "Investment bankers or talented sell-side research analysts typically won't be the ones identifying them, as they are too incentivized not to."

Palmqvist shares the same line of thought, saying that "shorting also gives a more balanced view on some hyped stocks or potentially fraudulent companies." According to Palmqvist, who founded Archipelago in 2016, "cases like Wirecard show why bans on short-selling are badly misguided, and at the time the short sellers faced relentless criticism even from the German regulator." Palmqvist goes on to add that "hopefully, shorting can also result in smaller losses for less-informed investors, if they are made aware that an investor is short a stock, they could see this as a potential red flag or alarm signal." "If someone dares to take unlimited risk by going short, maybe they buy less of the next Wirecard or Nikola in the future?" Palmqvist is pondering.

Profiting off a company's demise is just one of the many reasons for engaging in short selling, argue both Palmqvist and Rydin. "Like market makers or stock option traders delta-hedging on behalf of pension funds wanting downside protection or general equity market hedging, relative value trades, ESG or Sustainability reasons," says Palmqvist. "There could be several different reasons for market participants to sell short a security, including hedging reasons and profit reasons," adds Rydin.

> "We believe it is easier to identify losers than winners."
> – Magnus Angenfelt

Magnus Angenfelt, Portfolio Manager - Archipelago Investments

"If a large long-term investor in a stock is worried about the short-term market impact related to Covid-19, he or she can decide to hedge the investment for downside protection for a short period of time and without necessarily limiting – all or part of – the potential long-term upside in the stock," argues Palmqvist. "There are also many different strategies that include short selling, such as fundamental research-driven investors thinking a stock is overvalued, a quantitative computer-driven fund trading on signals, or an investor simply hedging a part of the portfolio and not necessarily looking to outright profit from the short position," further adds Rydin.

FUNDAMENTALS-BASED SHORTING

The teams running both Origo Quest 1 and Chelonia Market Neutral rely on fundamental analysis to find their shorting candidates. "Since we are fundamentally research-driven at Origo, our short-thesis often requires equal (if not deeper) fundamental analysis compared to our research in potential long positions," Stefan Roos, the founder and CIO of Origo Fonder, tells HedgeNordic. "In order to contradict conventional opinions and thereby identify companies with unsustainable business models, accounting irregularities, balance sheet risk, and/or companies operating in industries with structural declining characteristics, short sellers

www.hedgenordic.com – May 2021 HEDGENORDIC

Anders Palmqvist, CEO and CIO of Archipelago Investments

typically deploy deep fundamental research and look beyond CEO comments or investor presentations."

Anders Palmqvist believes that fundamentals-based shorting is "of particular importance in bull markets like today where we see many new investors, perhaps less informed, entering the market." Instead of investing based on "old fashion fundamental stock analysis, investing has become some sort of "gamification," argues Palmqvist. "Regulators should also actively inform retail investors about the potential risk that these passive index products involve no security-level analysis whatsoever that is normally required for true price discovery."

"Just simply because short sellers have a monetary motivation doesn't mean it's unethical."

– Stefan Roos

"The shorting approach is very individual, and should be so. It must fit with your personality," argues Chelonia Market Neutral's fund manager, Magnus Angenfelt. "At Chelonia, we try to follow two rules: Newer short on pure valuation. Be sure you have time on your side." The Origo team appears to be following the same rules when shorting. "Another aspect we focus on is the timing of when to put on a short," explains Roos. "Valuation itself is never enough to short a stock for us as it can always go from expensive to super expensive and beyond," he emphasizes.

"Further, evolutionary trends, disruptive opportunities and threats impacting companies negatively play an important role when we short," explains Angenfelt. "We believe it is easier to identify losers than winners, with potential winners often being too expensive," he continues. "It is also less competitive as most long-only active managers primarily focus on winners. Passive funds obviously own everything in the index regardless of valuation and disruptive threats, and as a result, broken business models are often valued as business as usual. A rising tide lifts all boats," argues Angenfelt.

IS SHORTING ETHICAL?

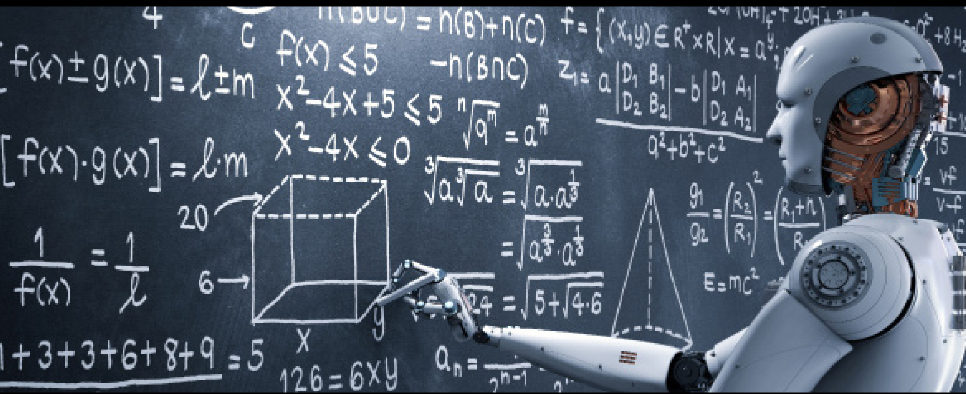
"In its essence, it is certainly not unethical," answers Roos. "Just simply because short sellers have a monetary motivation doesn't mean it's unethical," he argues. "There are obviously short selling participants that do not follow the rules and regulations by using naked short selling or very aggressive activist short campaigns. We certainly do not support this behavior," Roos tells HedgeNordic. "Having said that, our view is that short selling as a concept is not only ethical but healthy for the market as a whole."

"Most shorting in the market fills the primary purpose of risk mitigation, which is an important function in the market, and maybe even more so in strong bull markets," argues Anders Palmqvist. "So yes, shorting is not only ethical, it is a prerequisite for investors, pension funds, insurance companies, hedge funds, being able to hedge market risk."

Palmqvist also believes the practice of shorting can be used to drive and encourage sustainability awareness at targeted companies. "If you believe the companies are not delivering on relevant ESG metrics, are too slow in the transition, are green-washers, or worse are taking no action and are environmental polluters, hedge funds can short their stocks and bonds," says Palmqvist. "The polluters' access to capital markets and financing conditions are then indirectly worsening, and longer-term, this shorting or risk of becoming a short target will potentially – or hopefully – force these companies to take necessary climate action sooner rather than later."

HEDGENORDIC

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



www.hedgenordic.com

GENERAL TERMS AND CONDITIONS

These are the terms and conditions which govern the use of „HedgeNordic Industry Report", an online magazine edited and distributed by electronical means and owned, operated and provided by Nordic Business Media AB (the "Editor"), Corporate Number: 556838-6170, BOX 7285, SE-103 89 Stockholm, Sweden.

DISCLAIMERS AND LIMITATIONS OF LIABILITY

1. The Content may include inaccuracies or typographical errors. Despite taking care with regard to procurement and provision, the Editor shall not accept any liability for the correctness, completeness, or accuracy of the fund-related and economic information, share prices, indices, prices, messages, general market data, and other content of „HedgeNordic Industry Report" ("Content"). The Content is provided "as is" and the Editor does not accept any warranty for the Content.

2. The Content provided in „HedgeNordic Industry Report" may in some cases contain elements of advertising. The editor may have received some compensation for the articles. The Editor is not in any way liable for any inaccuracies or errors. The Content can in no way be seen as any investment advice or any other kind of recommendation.

3. Any and all information provided in „HedgeNordic Industry Report" is aimed for professional, sophisticated industry participants only and does not represent advice on investment or any other form of recommendation.

4. The Content that is provided and displayed is intended exclusively to inform any reader and does not represent advice on investment or any other form of recommendation.

5. The Editor is not liable for any damage, losses, or consequential damage that may arise from the use of the Content. This includes any loss in earnings (regardless of whether direct or indirect), reductions in goodwill or damage to corporate.

6. Whenever this Content contains advertisements including trademarks and logos, solely the mandator of such advertisements and not the Editor will be liable for this advertisements. The Editor refuses any kind of legal responsibility for such kind of Content.

YOUR USE OF CONTENT AND TRADE MARKS

1. All rights in and to the Content belong to the Editor and are protected by copyright, trademarks, and/or other intellectual property rights. The Editor may license third parties to use the Content at our sole discretion.

2. The reader may use the Content solely for his own personal use and benefit and not for resale or other transfer or disposition to any other person or entity. Any sale of Contents is expressly forbidden, unless with the prior, explicit consent of the Editor in writing.

3. Any duplication, transmission, distribution, data transfer, reproduction and publication is only permitted by
   i. expressly mentioning Nordic Business Media AB as the sole copyright-holder of the Content and by
   ii. referring to the Website www.hedgenordic.com as the source of the information.

   provided that such duplication, transmission, distribution, data transfer, reproduction or publication does not modify or alter the relevant Content.

4. Subject to the limitations in Clause 2 and 3 above, the reader may retrieve and display Content on a computer screen, print individual pages on paper and store such pages in electronic form on disc.

5. If it is brought to the Editor's attention that the reader has sold, published, distributed, re-transmitted or otherwise provided access to Content to anyone against this general terms and conditions without the Editor's express prior written permission, the Editor will invoice the reader for copyright abuse damages per article/data unless the reader can show that he has not infringed any copyright, which will be payable immediately on receipt of the invoice. Such payment shall be without prejudice to any other rights and remedies which the Editor may have under these Terms or applicable laws.

MISCELLANEOUS

1. These conditions do not impair the statutory rights granted to the readers of the Content at all times as a consumer in the respective country of the reader and that cannot be altered or modified on a contractual basis.

2. All legal relations of the parties shall be subject to Swedish law, under the exclusion of the UN Convention of Contracts for the international sale of goods and the rules of conflicts of laws of international private law. Stockholm is hereby agreed as the place of performance and the exclusive court of jurisdiction, insofar as there is no compulsory court of jurisdiction.

3. Insofar as any individual provisions of these General Terms and Conditions contradict mandatory, statutory regulations or are invalid, the remaining provisions shall remain valid. Such provisions shall be replaced by valid and enforceable provisions that achieve the intended purpose as closely as possible. This shall also apply in the event of any loopholes.