HEDGENORDIC

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NORDIC HEDGE FUND INDUSTRY REPORT 2022

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INTRODUCTION

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

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

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

HEDGENORDIC PUBLICATION PLAN 2022:

June: Private Markets
September: Powering Hedge Funds
October: Systematic Trading
November: Alternative Fixed Income
December: ESG & Alternatives

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Editor´s Note …

it all looked so well.

While Nordic hedge funds had a decent showing in 2021 with the Nordic Hedge Index gaining 6.1 percent, the new year did not start well. In fact, since the Index has been calculated in 2005, this is the first time the first two months returned negative results. With all strategy categories ending March in the green, Nordic hedge funds ended the first quarter on a better note. Still, the Nordic Hedge Index recorded the second-poorest Q1 since 2005, second only to 2020 when the pandemic struck.

Let us step back from the difficult start to 2022 and seek out some positives by looking at the Nordic hedge fund industry's performance in recent years. In the wake of some challenging years for Nordic hedge funds as a group, the past three years marked something of a change. Nordic hedge funds wrapped up a third consecutive year in joyful fashion, with the industry achieving its best three-year performance in more than a decade.

After years of dwindling performance since mid-2015, culminating with the market crash in the first quarter of 2020 caused by the outbreak of the coronavirus pandemic, the Nordic hedge fund industry has embarked on a strong recovery period. The industry's rolling 36-month annualized return has steadily improved from a negative 0.9 percent over the three years ending March 2020 to an annualized return of 6.9 percent over the 36 months ending December 2021.

Whereas 2021 was a good year for the Nordic hedge fund industry as a whole, some managers did not fare so well. In the first half of last year, Swedish IPM Informed Portfolio Management (IPM) ceased investment activities and returned all capital to investors after operating for more than two decades. Launched in January 2020, Frost Asset Management's Scandinavian-focused fixed-income relative value fund closed down after incurring a loss of 17.6 percent in October alone.

On the bright side though, the pace of closures slowed down to the lowest level since 2016. Even more interestingly, not all of last year's hedge fund closures were driven by poor performance. Despite gaining about 27 percent in the first ten months of 2021, RPM Risk & Portfolio Management's RPM Galaxy was merged into the Swedish CTA specialist's second vehicle. Credit-focused hedge fund Hamiltonian Global Credit Opportunities also closed at the end of April last year, a few months after reaching $100 million under management, after its portfolio manager Sean George announced the decision to leave Sweden for new challenges abroad. George was later named portfolio manager at Grace Court Capital, a credit fund division of Millennium Capital Partners in London.

Despite the difficult start to 2022, the Nordic hedge fund industry is finding freshness in its life, with new launches coming up, more volatility – hence opportunities – across markets and securities to exploit and performance improvements. Our aim at HedgeNordic is to keep everyone up to date with what is happening in the Nordic hedge fund industry by introducing new launches, explaining complex strategies and welcoming new people joining the industry. This publication is meant to help us achieve this objective.

This year's Nordic Hedge Fund Industry Report kicks off with a discussion of the continuing "Hedge Fund Pandemic" – albeit at a slower pace, before we turn to "Brummer's Entrepreneurial Route to a Multi-Manager Platform" with "20 Years in the Business and Still Learning Every Day." Henrik Rhenman and Susanna Urdmark of Rhenman & Partners then have a discussion around "Healthcare – A Healthy Source of Returns and Downside Protection" before Magnus Vie Sundal from Borea Asset Management shares insights about "Borea's Well-Timed Launch," Borea Utbytte – last year's best performer in the Nordic Hedge Index.

In "Lynx Celebrates Strong CTA Performance," Lynx Partner Martin Källström discusses why CTAs are enjoying a performance resurgence and Swedish Lynx Asset Management is right in the midst of this surge. Fredrik Sjöstrand, the CIO of Scandinavian Credit Fund I, says their direct lending fund is "Doing Well Even in the Worst of Times" and continues to deliver positive single-digit returns for a sixth consecutive year despite "a very poor year by our standards" in 2021. Determined to continue "Achieving Paradigm Alpha," Linköping-based money manager Alexander Hyll and his team are re-launching Adaptive Paradigm Alpha as a fully authorized alternative investment fund with the same strategy and name during the second quarter of this year.

"Excalibur Unsurprised by Rate Rises" tells the tale of how veteran fixed income traders Thomas Pohjanen, Björn Suurwee, and Marek Ozana are adapting to the new market climate. We then go on to introduce the strategy powering "Not the Typical Volatility Fund" managed by the Quant and Overlay team at Danske Bank Asset Management, where Chief Portfolio Manager Jacob Øland Jensen suggests "Volatility Should not be Your Wild Card." Hilbert Group CEO Niclas Sandström, who co-founded a "One-Stop Institutional Shop for Crypto," discusses the diversification benefits of cryptocurrencies, the importance of their strong infrastructure and walks us through Hilbert's crypto-focused fund range.

Michal Danielewicz and Jens Wiberg Larsson, the founders and managers of St. Petri Capital's thematic-focused long/short equity fund, had warned about the re-emergence of inflation well before inflationary pressures started creeping up all around the world and now say that "In My Book, Everything Points to Inflation." In "Elo's Approach to Hedge Fund Allocation," Mika Jaatinen, Portfolio Manager of Hedge Fund Investments at Finnish pension insurance company Elo, discusses the advantages of investing in hedge funds and explains their approach to hedge fund allocation.

It has become a tradition that we highlight new launches in the Nordic Hedge Fund Industry report, and 2022 shall be no different in that aspect as we feature "The Tenoris Approach to Risk Mitigation." We round off the publication with a summary of how the Nordic hedge fund industry performed in recent years, focusing on "What a Difference Three Years Make!"

Kamran Ghalitschi
PUBLISHER, HEDGENORDIC

The Hedge Fund Pandemic Continues – Albeit at Slower Pace

By Eugeniu Guzun – HedgeNordic

The number of active hedge funds in the Nordic region first exceeded 180 funds back in 2016, with the number of active funds hovering around 180 up until the end of 2018. Since then, the Nordic hedge fund industry has seen more closures than new launches for three consecutive years, driving down the number of active funds from 182 at the end of 2018 to 140 at the end of last year.

On the bright side, the pace of closures slowed down to the lowest level since 2016. On the not-so-bright side, the pace of new launches was lowest for the last seven years, at least. An estimated 16 Nordic hedge funds tracked by HedgeNordic closed down or merged into other funds last year, compared to 32 in 2020 and 30 in 2019. A total of 147 hedge funds closed down or merged into other funds over the seven years spanning from the beginning of 2015 through the end of 2021.

Seven new hedge funds were launched in the Nordic region during 2021, a figure that does not reflect new fund launches that are not yet part of the Nordic Hedge Index. A total of 113 new funds kicked off operations in the Nordics over the past seven years. Despite the Nordic hedge fund industry welcoming at least ten new funds every single year, the industry has recorded more closures than launches in five of the past seven years and for three years in a row.

LOOKBACK

Of the 147 Nordic hedge funds that shut their doors during the past seven years, 47 were equity-focused. In each of the past seven years, equity funds accounted for between 35 percent and 40 percent of the Nordic hedge fund industry. The fraction of closures in this strategy group out of the total number of closures ranged between 37 percent and

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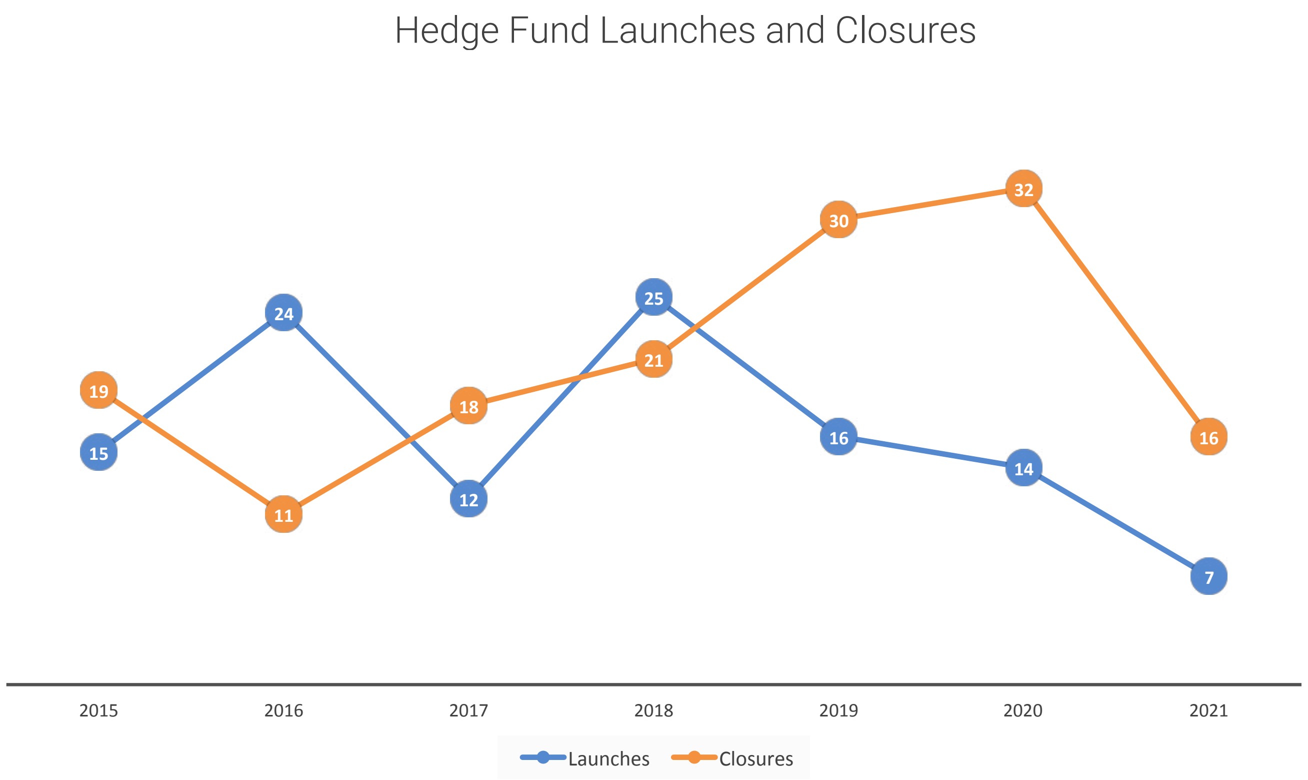

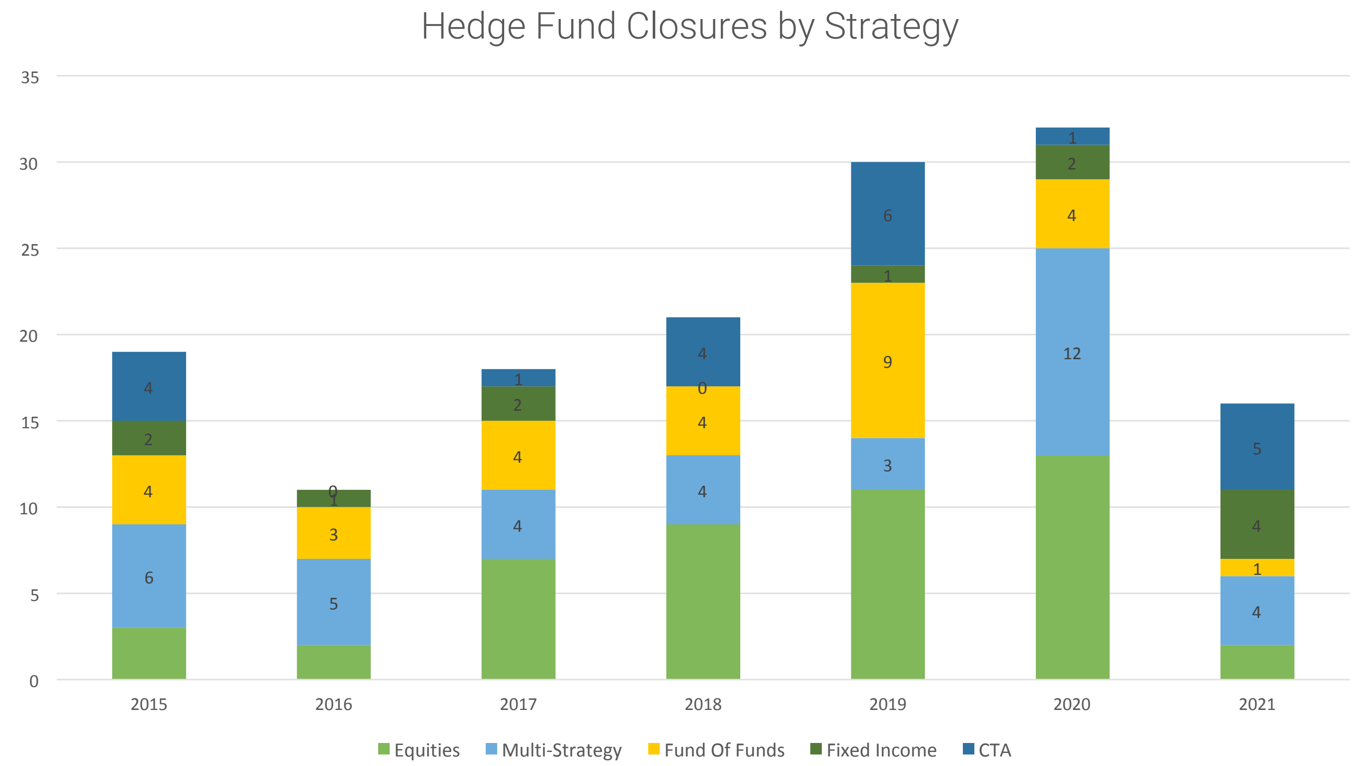

43 percent in each of the four years prior to last year. Despite representing the largest strategy group in the Nordic hedge fund industry, equity funds accounted for only 13 percent of all fund closures in 2021.

Fixed-income hedge funds, meanwhile, accounted for 25 percent of all fund closures last year. The fraction of closures in this strategy group out of the total number of closures ranged between as low as zero percent to as high as 11 percent in the prior six years despite fixed-income funds accounting for an increasing share of the Nordic hedge fund industry. The share of fixed-income funds in the Nordic hedge fund industry has gradually increased from 13 percent in 2015 to 23 percent in 2020 and 2021.

After years of experiencing more closures than new launches (29 closures in the past seven years versus five new launches), the fund of funds strategy group enjoyed its best year ever in terms of performance in 2021 and recorded only one closure. The survival of the fittest has reduced the number of active funds of hedge funds in the Nordics, with the still up-and-running funds of funds demonstrating an ability to deliver stable and consistent returns.

The Nordic hedge fund industry has been known for housing some of the world's largest, oldest and best established CTAs, including Lynx, SEB Asset Selection, Estlander & Partners, among others. After several years of not-so-great performance for Nordic CTAs, the number of active CTAs in the Nordics has declined from over 20 in 2015 to ten at the end of 2021 after five CTA funds closed their doors during the year. Among last year's closed funds were award-winning CTAs and managed futures funds such as IPM Systematic Macro, RPM Galaxy and Shepherd Energy Portfolio.

THE BIGGEST (COMPLETED AND ANNOUNCED) CLOSURES OF 2021

In the first half of last year, Swedish systematic investment manager IPM Informed Portfolio Management (IPM) ceased all investment activities and returned all capital to investors after operating for more than two decades. IPM's flagship systematic macro strategy, which relied on a systematic and fundamental approach to trade across currencies, government bonds and equity indices, struggled to deliver returns in recent years, especially in the first quarter of 2020. IPM Systematic Macro Fund's share class reflected in the Nordic Hedge Index lost a cumulative 20 percent over the 36 months through the end of March 2021 after a first-quarter loss of 12.4 percent. IPM, previously owned by finance group Catella, saw its assets under management drop from over $8 billion to below $1 billion in 2021 prior to its closure.

Fixed-income markets experienced heightened volatility towards the end of October last year, as higher than expected inflation readings in a number of wealthy economies led to an explosion in interest rate volatility and repricing of central banks' path of expected future policy rates. The heightened volatility claimed a few victims, including Brummer & Partners-backed Frost. Launched on January 2 of 2020, Frost Asset Management's Scandinavian-focused fixed-income relative value fund closed down last year after incurring a loss of 17.6 percent in October. Frost was down 23.4 percent in 2021 through the end of November.

With a loss of 51.4 percent for 2021, Max Mitteregger's long/short equity fund Gladiator Fond will be merged with Adrigo Small & Midcap L/S under Adrigo's management in 2021. Gladiator Fond has managed to recoup some of last year's losses after advancing 16 percent in the first two months of 2021. Following nearly 17 years at the helm of Gladiator Fond, Mitteregger will continue to serve as Senior Advisor to East Capital Group's Adrigo platform.

Not all of last year's hedge fund closures were driven by poor performance. Despite gaining 27.2 percent in the first ten months of 2021, RPM Risk & Portfolio Management's RPM Galaxy was merged into the Swedish CTA specialist's second vehicle due to limited investor interest. RPM Galaxy, a fund of funds seeking to invest in large and established CTA managers, was merged into RPM Evolving CTA Fund.

Credit-focused hedge fund Hamiltonian Global Credit Opportunities also closed at the end of April last year, a few months after reaching $100 million under management, after its portfolio manager Sean George announced the decision to leave Strukturinvest Fondkommission and Sweden for new challenges abroad. George was later named portfolio manager at Grace Court Capital, a credit fund division of Millennium Capital Partners in London.

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Jonas Börjesson, Partner and Co-Head of Investor Relations Brummer & Partners

Photo Credit: Gustaf Waesterberg

20 YEARS IN THE BUSINESS AND STILL LEARNING EVERY DAY

Brummer's Entrepreneurial Route to a Multi-Manager Platform

By Eugeniu Guzun – HedgeNordic

In the current uncertain market environment, institutional investors are concerned about what they are seeing on the investment horizon and have been increasingly looking for liquid alternatives to allocate capital. "Investors are contemplating where to go from here," points out Jonas Börjesson, Partner and Co-Head of Investor Relations at Brummer & Partners. "We are in unchartered territories."

"There are a lot of risks and opportunities out there, starting from rising inflation to rate hikes, geopolitical tensions, and unfortunately a war, worries about slowing economic growth, company profits, among many others," elaborates Carl-Johan Brodowsky, Partner and the other Co-Head of Investor Relations at the hedge fund powerhouse. "This means more volatility, which is a good starting point for us and our multi-strategy vehicle to take risk as there are more idiosyncratic opportunities to exploit."

THE BRUMMER & PARTNERS MODEL

For more than 25 years, Brummer & Partners has nurtured an entrepreneurial model that enables portfolio managers with specialist skills around the world to set up their own fund management companies, jointly owned with Brummer & Partners, and to capitalize on idiosyncratic dislocations and opportunities. To enable the portfolio managers' complete focus on alpha and risk management, they are supported by a solid infrastructure in the Brummer & Partners group offering risk control, fund administration, distribution, reasonably sticky assets and everything else a fund manager may need.

"Our long-term approach and true partnerships attract high-level portfolio managers across the globe," emphasizes Brodowsky. "We build successful asset management businesses hand-in-hand with the managers," he continues. "We want them to shape

Carl-Johan Brodowsky, Partner and Co-Head of Investor Relations Brummer & Partners

Photo Credit: Gustaf Waesterberg

“As opposed to a fund-of-hedge funds, a solid multi-strategy like BMS allocates risk based on sophisticated analyses in real time. Even meticulous institutional investors are impressed when we monitor our process of analyses, our stress testing and risk allocation.”

Jonas Börjesson

their own firms and funds, this is key in attracting the right interest alignment and creating the drive to generate performance through alpha, which is and always will be, our steadfast focus.”

EVOLUTION OF A MULTI-STRATEGY

That interest alignment in generating alpha has been essential in the 25 year-evolution of the hedge fund group. Starting out as a seeder of single-strategy hedge funds, Brummer & Partners has for decades devoted its evolution to the fund Brummer Multi-Strategy (BMS). Established in 2002, BMS is an active well-balanced multi-strategy portfolio that should generate competitive risk-adjusted returns by allocating risk to an optimal number of strategies in the Brummer & Partners group, strategies that over time have low correlation to each other and to market developments or beta. “The unifying goal of all portfolio managers is to generate alpha and the objective for BMS is to construct the best possible portfolio, and a risk-reward profile that is uncorrelated, hence diversifying.”

A genuine multi-strategy approach should seek to offer diversification, liquidity, crisis alpha (downside protection) and return potential in any market environment. Up and running for 20 years, BMS has achieved an inception-to-date Sharpe ratio above one and an annualized return of about six percent in SEK through the end of March 2022, with the fund incurring only three down years since inception (low single-digit losses). “The core of the success really stems from the all-weather type of portfolio with different types of liquid strategies that have low correlation to each other and to risky assets,” says Börjesson.

“The evolution is a matter of fine-tuning our processes. We still learn every day, and we have taken several important steps into a solid multi strat that adds long-term investor value,” continues Börjesson. “As opposed to a fund-of-hedge funds, a solid multi-strategy like BMS allocates risk based on sophisticated analyses in real time,” he emphasizes. “Even meticulous institutional investors are impressed when we monitor our process of analyses, our stress testing and risk allocation.” Although informed investors have the capacity to build their own hedge fund portfolios, it is becoming more challenging as dispersion in hedge fund returns has increased.

“It takes a lot of time, effort, expertise and experience to find good managers, keep track of them, and more importantly, to build a well-balanced and robust portfolio that can withstand all market environments,” according to Börjesson. “It is not a simple task for institutional investors to construct, monitor and rebalance their own portfolio of single strategies,” he argues. The process of building a robust all-weather portfolio and keeping track of all positions and risk exposures within the portfolio requires time, effort and experience.

The setup at Brummer & Partners enables full transparency across all managers, and across thousands of positions in hundreds of markets. “We can monitor positions and risks on a real-time basis,” says Carl-Johan Brodowsky. “And our partnerships with the portfolio managers mean partnerships in expertise, knowledge, intelligence, and insights in real-time,” he emphasizes.

NEW STRUCTURE TO CAPTURE MORE TALENT

Jonas Börjesson also mentions that their multi-strategy platform represents a dynamic type of business. “A multi-strategy portfolio should be adaptive and the turnover of strategies within a multi-strategy approach is expected and natural,” says Börjesson. “We always strive to build and manage the best possible portfolio for our investors. If one building block is not up to the standard, we will act.”

As part of the constant evolution, Brummer & Partners now enjoys a greater ability to tap into an expanded talent pool after creating a new structure called “PM pods.” This allows the onboarding of new managers to run dedicated investment mandates exclusively for BMS investors. In late 2021, Brummer & Partners announced the recruitment of technology-focused portfolio manager Henrik Nyblom from Swedbank Robur Ny Teknik – one of Europe’s largest tech funds – to run the first pod, a segregated mandate within BMS.

“The PM pods make our platform attractive to new talent by giving them flexibility, freedom

“Our partnerships with the portfolio managers mean partnerships in expertise, knowledge, intelligence, and insights in real-time.”

Carl-Johan Brodowsky

and opportunities," says Brodowsky. Some niche strategies may have limited ability to deploy a lot of capital, which means that "some specialized strategies may not be appropriate or feasible for a full fund launch," according to Brodowsky. "There is fierce competition for talent within the global multi-strategy space, and this structure gives us another tool in our toolbox to bring in new managers and new talent."

DEVOTED TO CONTINUE

BMS has managed to advance 2.9 percent in the turbulent first three months of 2022, with systematic trend-following strategies contributing to performance as the other strategies such as sector specialist equity market-neutral strategies holding ground. The leveraged version of BMS, BMS 2xL, has advanced 5.6 percent. "There are no major directional bets in the portfolio," explains Brodowsky. "Most of the portfolio consists of idiosyncratic risk-taking and very little directional risk. We are a risk-focused organization, so everything starts from a risk perspective and that has been reflected in our portfolio," argues Börjesson.

"In the last years, we have been living in a QE-driven environment with excess capital, low rates, no inflation, hence a challenging environment for hedge funds in general," acknowledges Börjesson. "Looking forward, as we are now getting back to more normal markets, we will have very good opportunities to at least repeat what we have done over the last 20 years," he considers. "All in all, with our institutional set-up, skills and edge, we are humbly convinced that we will be able to capitalize on the opportunities that we outline ahead and to continue to deliver uncorrelated returns to our clients," concludes Börjesson. "To us, it's also a matter of evolution as we constantly improve our own models, our processes and the way we operate."

> "Most of the portfolio consists of idiosyncratic risk-taking and very little directional risk. We are a risk-focused organization, so everything starts from a risk perspective and that has been reflected in our portfolio."
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> Jonas Börjesson

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Rhenman & Partners Asset Management: Henrik Rhenman, Founding Partner and CIO, Susanna Urdmark, Co-Head and Senior Portfolio Manager, Kaspar Hållsten, Portfolio Manager, Hugo Schmidt, Analyst

Healthcare – A Healthy Source of Returns and Downside Protection

By Eugeniu Guzun – HedgeNordic

With commodity prices soaring due to growing pressure on Russia in response to invasion of Ukraine and with central banks belatedly responding to already high inflation stemming from the pandemic, many market participants are concerned about the world heading back to the 1970s "stagflation" environment. While nothing is recession-proof, the healthcare sector has historically proved to be relatively insensitive to economic fluctuations.

"Healthcare was a sector that outperformed during the stagflation period in the seventies and it is quite easy to understand why," says Henrik Rhenman, who co-manages Rhenman & Partners' healthcare strategy together with Susanna Urdmark. "Economic growth may be slowing down, but healthcare is always in demand," he adds. Health services, after all, are in need even during a recession. "Additionally, the sector has somewhat higher pricing power than most sectors," elaborates Rhenman. "I wouldn't say healthcare is the sector with the strongest pricing power but it is certainly better than average."

"Stable demand for healthcare and reasonable pricing power makes the healthcare sector a less risky place to be during an uncertain and stagflationary environment," concludes Rhenman. Susanna Urdmark goes on to emphasize that the healthcare industry and its participants face fewer headwinds from the surge of commodity prices, even though non-commodity-related input costs such as wages, rents, and others are also on the rise.

"Compared to many other sectors, healthcare is less vulnerable to soaring energy prices and commodity prices," says Urdmark. "The inflationary pressures on input costs coming from higher commodity prices are significantly lower in this sector compared to others." Urdmark also points out that in many markets, healthcare consumers face a less heavy financial burden due to potentially higher health care costs because of their limited out-of-pocket spending.

SOURCE OF ATTRACTIVE RETURNS

Although investors frequently look to the healthcare industry for its defensive nature, fewer investors may think of it as a sector with significant potential to generate growth and returns. However, this industry offers investors the opportunity to invest in companies that are constantly innovating to improve quality of life, raise productivity and similarly, generate attractive returns on investments. Since its launch in mid-2009, Rhenman & Partners' fund has proved that the healthcare industry is full of return-rich opportunities and exhibits strong return potential.

"When we started the fund, we set out a goal of achieving a 12 percent annual return after fees over time," says Rhenman. The long-biased long/short equity fund has managed to deliver an annualized return of 18 percent since inception through the end of March 2022. "We are confident that by

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setting a realistic goal of 12 percent, we can have a good chance in achieving that in most types of environments, as long as we are nimble and realistic in our stock picking," he emphasizes. "One could say that we have set a goal that is too easy, considering what we have been able to achieve, but it is very important that we do not take on more risk if we are in an environment that is less generous to our type of investment style and our sector."

STRONG EXPERTISE AND EXPERIENCE REQUIRED

"We see healthcare as a very exciting sector, where we forecast structural growth for the foreseeable future, and believe that, through the right kind of diversification, we can offer our investors attractive returns at a risk level that is manageable," corroborates Urdmark. "The strong performance of the sector is really explained by the medical advances that we have seen over the past 30 years or so, and the formation and evolution of the biotech sector have been driving this development," she elaborates. However, successful healthcare investing does require expertise, skill and effort. "Especially within biotech, but also within the broader industry, successful investing requires a high degree of knowledge and experience to manage and achieve a good balance between risk and reward."

Although the Rhenman & Partners investment team has accumulated decades of experience in the healthcare industry, with Henrik Rhenman originally a biochemist before embarking on his asset management career and Susanna Urdmark following the sector as an analyst and working as CFO for a Swedish pharmaceutical company, the team has created an additional source of expertise. On a quarterly basis, Rhenman and his team have been meeting their Scientific Advisory Board, composed of well-established practicing medical experts with their own large network of researchers and specialists, to gain insights and understanding of new drugs, techniques, treatment methods and clinical trials.

"We are preparing a solid agenda of some 20 different company- or scientific-specific questions that we bring to the Advisory Board every time we meet," explains Urdmark. "We meet and sit down in this forum to discuss different topics, which helps us either get a clear signal that this idea is really interesting or has potential, or this is too early," she elaborates. "Sometimes we may even hear that the board just does not like what we thought they would like, but this process helps us calibrate the risk-reward of our investments and take on the right level of risk matching the reward."

> "Stable demand for healthcare and reasonable pricing power makes the healthcare sector a less risky place to be during an uncertain and stagflationary environment."
>
> Henrik Rhenman

CAUTIOUSLY POSITIONED

The team predominantly relies on a bottom-up analysis process to turn its $1 billion in assets under management into an attractive risk-reward portfolio, with this process considering a wide range of fundamental aspects, future prospects and valuation levels. "Our selection is very much bottom-up, but we have a top-down overlay at all times," says Rhenman. "Our actual portfolio construction is all about selecting good companies that have good prospects, making good progress and generating attractive returns on their investments, but we always have to consider the macro environment."

Of late, the environment in which all fund managers including Rhenman & Partners Asset Management operate has become more uncertain with a worsening geopolitical and macroeconomic outlook following Russia's invasion of Ukraine. "The main question on top of our minds is how do we deal with this uncertainty right now," says Rhenman. "And the answer is that we are careful, we are cautious," he elaborates. "We are more risk-averse than usual and we are very humble. There is no way we can outsmart the markets in terms of interpreting the next initiative from Russia, Ukraine or other parties. It is very difficult to predict how the war will play out and we are not even trying to."

This cautiousness, stemming from the uncertain geopolitical and macroeconomic environment as well as the November congressional midterm elections in the United States, has been reflected in the team's portfolio construction. "In a US election year, the healthcare-focused corner of the stock market usually becomes more constructive after the elections," explains Rhenman.

"Healthcare will always be political, not political at all times, but the political narrative on healthcare goes in waves," he elaborates. "We are likely to have a calmer situation after the November elections and that is going to support the generalists, coming back for exposure in the healthcare sector." With the Republican Party expected to take control of at least one of the houses of Congress, the healthcare industry should enjoy an additional wave of investor demand as a division of power makes it more difficult to push through major policy changes affecting the industry.

"If we take the geopolitical risk aside, the outlook for the sector is very strong," sums up Urdmark. "Even though we are risk-averse in this environment, and we wish there was a better sentiment for the biotech industry, which has been an important source of returns over the years, there are still great companies doing innovative research with high return potential," she continues. "We see a better risk-reward in large-cap companies, in particular global pharmaceutical and health services sectors, which are better shielded from these macroeconomic uncertainties and other uncertainties that we have to consider."

> "Especially within biotech, but also within the broader industry, successful investing requires a high degree of knowledge and experience to manage and achieve a good balance between risk and reward."
>
> Susanna Urdmark

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Borea's Well-Timed Launch

By Eugeniu Guzun – HedgeNordic

Magnus Vie Sundal, Portfolio Manager
Borea Asset Management

"It was a bit lucky that we nailed the timing of the launch, but at the same time, we saw an opportunity and we grabbed it."

The outbreak of the Covid-19 pandemic triggered a violent market crash back in early 2020, which, assuming perfect foresight, presented a dearth of attractive investment opportunities across many asset classes. Norwegian asset manager Borea Asset Management swiftly launched a special fund in September of that year to capture a set of attractive risk-reward opportunities within the Norwegian banking sector. That fund, Borea Utbytte, was last year's best-performing member of the Nordic Hedge Index with a full-year return of 61.8 percent.

The background behind the launch of Borea Utbytte launch goes a few years back. "Our experience in the banking sector goes back around eight years, when we started with a discretionary mandate for a client who was interested in hybrid capital," starts portfolio manager Magnus Vie Sundal. In mid-2019, Borea Asset Management launched Norway's first fund solely investing in Additional Tier-1 (AT1) – also dubbed hybrid – securities issued by the approximately 100 Norwegian savings and commercial banks.

Borea Obligasjon returned 8.7 percent in the pandemic-hit 2020, as the Borea team acquired hybrid debt securities yielding as much as 14 percent, in the depths of the first-quarter market crash. While AT1 securities repriced quickly in the months that followed, "we noticed a substantial mismatch between equity pricing and hybrid capital pricing," according to Sundal. The Borea team moved quickly to launch Borea Utbytte, to capitalize on that mismatch.

"We launched Borea Utbytte on September 30, and October was a negative month, one of the few negative months we have had with this fund," Sundal recalls the early days of Borea Utbytte. Then came November, when Pfizer announced promising news on their vaccine. "That was a factor that sparked a rally in these sectors that had been suppressed for a while," he continues. "It was a bit lucky that we nailed the timing of the launch, but at the same time, we saw an opportunity and we grabbed it." Borea Utbytte went on to return a cumulative 83 percent since its launch through February this year.

BROAD MANDATE

Structured as a Norwegian special fund, Borea Utbytte has a broad mandate on paper, but not in practice, according to Sundal. "While we aim to retain flexibility, we also aim to be a boring fund most of the time. We like to compare ourselves to the "tortoise and the hare," says Sundal. "We are long-only 95 percent of the time, looking to capture the benefits of long-term exposure to Norwegian macro risk," continues the portfolio manager.

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For managers looking to sell stocks short in the Norwegian banking sector, there are liquidity constraints in this market that limit the short selling the stocks of “a few handful of the biggest banks,” says Sundal. “We would engage in short selling only when we turn very skeptical on the banking sector as a whole.”

The special fund structure enables the team running Borea Utbytte to leverage up to 150 percent of the fund’s assets under management. “We can borrow up to half of our assets under management, but in normal times, we run with a net market exposure of between 115 percent to 120 percent,” says Sundal. “Given that the pricing has come up significantly in the banking sector, we are closer to 100 percent for the time being.”

OPPORTUNITY-GRABBING BOREA UTBYTTE

Although Borea Utbytte was initially put on the market as an opportunity-grabbing fund, portfolio manager Magnus Vie Sundal still believes in both the short-term and longer-term return potential of the fund and its sector focus. “When we started the fund, the average price-to-book value was about 0.8 in the Norwegian banking sector, now it is around 1.35, and the historical average is slightly above 1,” says Sundal. “This metric peaked around 1.9 pre-financial crisis. How expensive banks shall become this time, depends on the yields of alternatives. With current underlying performance, we do not believe banks are too expensive.”

Despite the Norwegian banking sector trading at a high price-to-book level, the sector still has more to offer in today’s market environment, according to Sundal. “The average Norwegian commercial and savings bank gives investors a return on book equity of 11 percent,” he explains. “Even at today’s pricing of 1.4 times book value, the sector offers an earnings yield of around 8.0 percent, which is very attractive compared to many of the alternatives.”

"While we aim to retain flexibility, we also aim to be a boring fund most of the time. We like to compare ourselves to the ‘tortoise and the hare’.”

LONG-TERM CASE FOR NORWEGIAN BANKS AND BOREA UTBYTTE

“The banking sector, at least historically, has gone in cycles, and we jumped on an opportunity that we saw in the market,” reiterates Sundal. “We got on a good part of the cycle, so we had the stellar return last year of about 62 percent,” he continues. “But one of the reasons we really wanted to start this fund as a long-term product is that Norwegian banks have performed very well over a very long period of time.”

Borea Utbytte’s bank-focused benchmark has generated an annualized return of about 14 percent since the start of the millennium, compared to a 9 percent annualized return for the broader Norwegian stock market. “While 14 percent seems unlikely going forward we still believe the Norwegian banking sector will continue to outperform also the future.” Sundal argues that Borea Utbytte is supposed to be boring. “Many years, the fund will be in the shadows of booming stock markets or more in-vogue ESG or energy stocks, but over time, we expect the sector to outperform the broader market.”

“When it comes to the Norwegian banking sector, there is one element that is under communicated or not understood well enough,” highlights Sundal. “Banking is really about macro risk. As long as businesses and individuals manage to service their debts, pay on their mortgages and their loans, the sector as a whole will do well,” elaborates the portfolio manager.

“We may have a concentrated economy on energy, but we do have a reserve fund, the oil fund, that gives us the confidence that things will work out well,” says Sundal. “We are not saying that stockholders should rely on the government to be the lender of last resort, but we do have a lot of tools in Norway to handle macro risks and support the economy with fiscal stimulus through challenging times. That greatly benefits the banking sector.”

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Martin Källström, Partner and Senior Managing Director
Lynx Asset Management

Lynx Celebrates Strong CTA Performance

By Hamlin Lovell – HedgeNordic

CTAs are enjoying a performance resurgence, and Swedish Lynx Asset Management is right in the midst of this surge. In 2021, equities and commodities made the best contributions; in the first three months of 2022, commodities have continued to be big contributors, while fixed income and interest rates – which lost money in 2021 partly due to reversals – have also become profitable markets as a clear uptrend in rates has developed due in part to building inflationary pressures.

Lynx allocates risk to models and markets based on return forecasts as well as volatility and covariance estimates. The year-to-date performance volatility of the Lynx Program has been benign despite risen market volatility. Some individual markets, such as Hong Kong and Chinese equities, or energy, have seen some violent counter-trend reversals, which might wrong-foot some trend models, but Lynx is well diversified and experienced at dealing with volatility surges. "It is actually easier to manage volatility spikes in an already volatile market environment, than it is to deal with a sudden shock such as the Covid crisis coming after an extended period of low volatility," says Martin Källström, Partner and Senior Managing Director at Lynx.

CTAs in general are raising assets, and Lynx has been growing its share of the inflows. Lynx saw its second largest ever annual net inflow of over USD 1.1 billion in 2021, and its assets have since reached an all-time high of over USD 7.5 billion. "Even though the large net inflow last year came mainly from our existing investors, we are now increasingly engaged with new investors interested in mitigating the risk in their portfolios and see the improved opportunity set for our strategy going forward," says Källström.

INFLATION AND CENTRAL BANK POLICY DIVERGENCE

Lynx's thought leadership papers point out that most financial market shocks over the past 40 years have been deflationary, but the next one – which may have already started – could be inflationary. "Since the large asset price shifts seen in the summer of 2021, many sophisticated institutional investors have become increasingly concerned about how bonds and equities would perform should inflation rise. Finding investment strategies that could diversify traditional portfolios and perform in an inflationary period is challenging. Investors are increasingly looking at strategies like the Lynx Program to take on that role," says Källström.

CTAs could well provide inflation protection. Lynx has analysed the Barclay CTA index back to its inception in 1980 and found that its returns were highest in those periods with the highest quartile of inflation, when equity returns were also lowest. Lynx does not use the 1970s to estimate how CTAs might perform in an inflationary climate, due to limited data on funds and the smaller number of tradable markets at that time. But it is clear that trend following CTAs are well positioned to latch onto uptrends in commodity prices as well as associated downtrends in other asset prices, such as fixed income in 2022. Lynx's models increased their commodity exposure in 2021 and took advantage of strong performance in markets such as energy.

Policymakers' responses to the new economic climate and inflationary pressures are also enhancing the opportunity set. "For instance, developed market central banks, which had been behaving in a synchronized way for many years, are now acting more independently, with some clearly committed to raising interest rates while others may not yet be ready to adjust their policies," says Källström.

GREEN TRANSITION, SUPPLY CHAINS AND SANCTIONS

Inflation is partly due to ESG oriented policies, including bans on "fracking" for gas in the UK and Netherlands, and reduced exploration activity from energy companies in response to institutional investor voting, that reduce the supply of some commodities. The green transition is also increasing demand for metals like copper and nickel that will power the electrification of vehicles and economies. Meanwhile, there were various supply chain bottlenecks, partly related to Covid, even before Russia's invasion of Ukraine and the consequent sanctions, formal export and import bans, and informal "self-sanctioning," exacerbated and complicated supply chain issues. All of this fans the flames of some commodity price trends, even if the data is not being directly analysed: "our non-price, fundamental data inputs do not attempt to explicitly model factors such as sanctions, since it would be too difficult and because their impact should be adequately reflected in market prices," says Källström.

> "It is actually easier to manage volatility spikes in an already volatile market environment, than it is to deal with a sudden shock such as the Covid crisis coming after an extended period of low volatility."

MODEL EVOLUTION AND SYSTEMATIC MACRO

Lynx's approach is constantly evolving in other ways. Machine learning techniques are used in both the 70% trend-following and 30% diversifying strategies buckets. In 2021, five new models were added and two were deleted, which is quite typical for any given year in the strategy's evolution. In 2021 Lynx also hired four key employees from the former Stockholm based systematic macro manager, IPM - Informed Portfolio Management, which closed down operations last year. "The ex-IPM team are working with Lynx's existing research team on systematic macro research based on fundamental economic hypotheses, and Lynx could now contemplate a systematic macro launch at some stage," reveals Källström.

PROTECTIVE RETURNS

The Lynx Program has a very explicit objective to generate attractive returns while also diversifying and protecting portfolios in prolonged equity drawdowns. One of the key features contributing to the latter objective is that it retains exposure to shorter term models, which Lynx expects will provide more portfolio diversification benefits, even though their standalone Sharpe ratio might not be as high. "A faster and more reactive strategy gives us more chance to protect portfolios, whereas a longer-term strategy is more about risk premia. We do not want our style to drift away from providing diversification benefits," argues Källström.

ESG, ORDERLY FINANCIAL MARKETS AND ORDERLY TRANSITION

Lynx is not running ESG or impact strategies per se, but the firm has a distinctive approach to ESG, which considers its impact on financial markets, society and the planet. Realistically, Lynx's ESG benefit is as an active participant in financial markets, providing liquidity and price discovery, helping hedgers, and reducing volatility, which also oils the wheels for other market participants. And Lynx sizes its positions to manage market impact.

These functions are also important for commodities such as natural gas as the world transitions from a brown to green economy. Natural gas has in 2021 and 2022 seen extraordinary volatility and made new all-time highs in Europe and Asia. Lynx argues if investors stop trading certain contracts, that could further increase volatility and interfere with price discovery, which would in turn impose costs on end users and make the transition process more difficult.

That said, Lynx is prepared to exclude some commodities, such as thermal coal and Malaysian palm oil, on ESG grounds, and others might be ruled out on liquidity grounds.

NEW ESG DERIVATIVES AND ENGAGING WITH EXCHANGES

Lynx is generally open minded about trading new ESG versions of derivatives, providing they have sufficient liquidity. For instance, Lynx has recently started trading some ESG equity indices, to complement rather than replace traditional indices since the new contracts are not currently liquid enough to trade given their size. They are also considering carbon emission futures as liquidity has increased markedly in recent years. "We are committed to being an early participant in new ESG instruments but cannot be the first mover," says Källström.

But Lynx aspires to have a positive impact through encouraging ESG-oriented innovation in financial instruments. Since Lynx invests in derivatives rather than cash equities, it cannot vote proxies and instead of engaging with companies it is more worthwhile to engage with exchanges to spur them to introduce new ESG derivatives and improve contract specifications for established contracts to make them more sustainable. The deliverable criteria of a futures contract might for instance restrict the provenance of certain commodities or minerals to avoid sanctioned countries, war zones, polluted areas, or regions that are destroying rainforests. "We are getting very positive feedback from our engagement with exchanges and we believe this is a very concrete way for us to make impact," says Källström.

Doing Well Even in the Worst of Times

By Eugeniu Guzun – HedgeNordic

“Unless we face any serious credit events, our portfolio will be yielding around 5.5-6 percent net-of-fees to investors.”

Direct lending fund Scandinavian Credit Fund I has experienced a couple of years of sub-target returns either due to forced selling caused by investors’ flight-to-safety amid the Covid-19 outbreak or due to specific issuer-related problems. Even in the worst of times, Scandinavian Credit Fund I continues to deliver positive single-digit returns to investors for a sixth consecutive year, with an annualized return of 4.4 percent over the three years ending 2021 and an annualized return of 5.8 percent since launching in January 2016.

“Unless we face any serious credit events, our portfolio will be yielding around 5.5-6 percent net-of-fees to investors,” says Fredrik Sjöstrand, the CIO of Scandinavian Credit Fund I. The direct lending fund delivered an annual return of 5.8 percent in 2019, followed by 4.3 percent in 2020 and 3.2 percent last year. “It doesn’t look that great when looking at the trend, but we don’t expect any more issues that will

Fredrik Sjöstrand, CIO
Scandinavian Credit Fund I

"Alternative lending is experiencing a continuation of what we have seen over the last ten years. The banks have been deleveraging due to capital requirements, and the upcoming Basel IV standards will put even more strain on corporate lending."

hold back the portfolio's current yield of 5.5-6 percent after fees." Increasingly underwriting floating-rate loans due to the rising interest rate environment, Scandinavian Credit Fund I continues on its objective to fill the void created by banks' reluctance to issue and hold loans to smaller companies due to tougher banking regulations.

"Alternative lending is experiencing a continuation of what we have seen over the last ten years," Sjöstrand says about the current state of the direct lending market. "The banks have been deleveraging due to capital requirements, and the upcoming Basel IV standards will put even more strain on corporate lending," he elaborates. The Basel IV standards, due for implementation in January of next year, will further increase global bank capital requirements. "There are different players that are entering the market trying to take a chunk out of the banking sector's corporate lending business."

Scandinavian Credit Fund I has been focusing on a less-competitive segment of the market in the Nordics, providing loans of between SEK 20 million and SEK 200 million to smaller and mid-sized companies in the Scandinavian region. The low-interest rate environment of the past decade has forced direct lending players such as Scandinavian Credit Fund I to accept lower rates from borrowers. Signs are pointing to change. "We have been forced to lend at lower rates in the narrowing spread environment," Sjöstrand explains the impact of the low-rate environment on direct lending. "As spreads are widening, we can start lending at higher rates," he emphasizes. "It's great to see spreads return to normalcy, which, of course, will lead to a higher expected return of our direct lending portfolio."

The team running Scandinavian Credit Fund I mostly opted for giving out fixed-rate loans during the fund's first few years of operations. With inflation and interest rates on the rise, the team led by Sjöstrand has increasingly been opting for floating-rate loan agreements with borrowers. "When we are doing new loans in this environment, as we have been doing over the past year, we are increasingly swapping into floating-rate notes," says Sjöstrand. The direct lending fund may well be back on its track to deliver between six to eight percent per year. "That is something that will hopefully materialize during 2022."

STRATEGY RISKS AND INVESTOR-PERCEIVED RISKS

Direct lending offers investors the opportunity to achieve attractive returns with less downside risk and market-to-market volatility. These benefits, however, come at a cost: illiquidity. "Credit risk is the main risk associated with direct lending strategies," says Sjöstrand. "That is what we are eating and sleeping with," he adds. "But for investors who do not understand the mechanics of direct lending, the liquidity risk becomes the main issue when too many investors try to redeem their investments too early all at once." That is what hurt Scandinavian Credit Fund I in the first quarter of 2020, when the fund decided to impose redemption "gates" to deal with the mismatch between the illiquidity of its investments and the sudden liquidity preference of investors.

But as long as the team behind Scandinavian Credit Fund I performs proper due diligence on borrowers to avoid credit events and investors do not head for the exits at the wrong time, Sjöstrand's direct lending fund can deliver on its promise to return uncorrelated high single-digit returns. "The main risk our investors face is that we do not do our homework in a proper way when it comes to credit analysis," highlights Sjöstrand. The team seeks to address credit risk by "conducting a thorough research on borrowers before entering the loan and then carefully monitoring loan performance."

The business of direct lending can handle credit risk through risk-mitigating discussions enabled by better and quicker access to management. "The coronavirus pandemic, for instance, has forced us into much tighter relationships with corporates," says Sjöstrand. With one group of borrowers that Sjöstrand refers to as "focused credits," the team running Scandinavian Credit Fund I maintains a continuous relationship "where we constantly look into the numbers, talk to the management, and so on." Superior risk control may be achieved due to better access to information and management.

With inflation on the rise and ongoing supply chain issues – exacerbated by Russia's invasion of Ukraine – and many other problems, it remains difficult to assess the vulnerability of borrowers amid a difficult economic environment. "We are trying to factor all issues and challenges into our credit decision-making process," says Sjöstrand. "The things that we had to factor in two years ago may be different from what we are factoring in today, but we always have a forward-looking assessment into each borrower."

INVESTOR EXPECTATIONS, PLACE IN A PORTFOLIO, EXPANSION

Scandinavian Credit Fund I delivered a return of 4.3 percent in 2020 after being forced to sell its liquidity position at a loss during the liquidity squeeze triggered by the Covid-19 outbreak. At the end of last year, Scandinavian Credit Fund I experienced an investment write-down to one of its positions. Despite these struggles, the direct lending fund has enjoyed six consecutive years of positive returns to deliver an annualized return of 5.8 percent since launching in early 2016.

"We will never give a return of 10 or 20 percent per year," says Sjöstrand. "But even if we had a very poor year by our standards as in 2021, we still manage to achieve strong returns relative to other alternative fixed-income funds," he continues. "If an investor wants to have a cushion in the portfolio, Scandinavian Credit Fund I has proved its ability to do just that."

Having approached only Nordic investors so far, the team at Kreditfonden now plans to roll out Scandinavian Credit Fund I beyond the Nordic borders. "We are channeling our efforts towards growing our investor base, targeting continental Europe," says Sjöstrand. "As Swedish investors are more equity-oriented, they may not appreciate a six or seven percent return despite the low downside risk," argues the CIO of Scandinavian Credit Fund I. "Direct lending appears more accepted outside the Nordic region, which we are trying to change, but it does no harm to broaden our investor base by targeting the southwest part of Europe."

Alexander Hyll, CEO and Fund Manager; Gustaf Lange, COO; Arin Kamangar, Fund Manager; Simon Hyll, Chief Technical Officer

By Eugeniu Guzun – HedgeNordic

Adaptive, Ready for a Bigger Audience

Achieving Paradigm Alpha

> "The key goal is to identify long-term opportunities, predict where economic profit pools are moving to in the value chain and to position our portfolio accordingly."
>
> Alexander Hyll

Structural shifts are a constant in an ever-transforming world around us, creating new opportunities and challenges for industries, businesses, and individuals. Determined to capitalize on structural winners and losers from these shifts, Linköping-based money manager Alexander Hyll launched Adaptive Paradigm Alpha back in early 2020. Following two years of successful management and several additions to the organization, Hyll and his team are launching a fully authorized alternative investment fund with the same strategy and name during the second quarter of this year.

The cornerstone in managing Adaptive Paradigm Alpha is identifying paradigms, which Hyll defines as measurable causal relationships between structural trends. "The next step is to identify large companies which take part of a certain paradigm. Our ambition is not to invest in early-stage companies," emphasizes Hyll. "Instead, the key goal is to identify long-term opportunities, predict where economic profit pools are moving to in the value chain and to position our portfolio accordingly."

To find relevant and feasible paradigm shifts, Hyll and the team organize the research process by monitoring major trends, such as technology, demography, and sustainability, that are continuously developing across the world. "While these three do not make up the full list, the vast majority of new paradigms fall within these categories," Hyll continues. Technology, for instance, is increasingly playing a more critical role in the evolution of society, playing a powerful role in driving the most influential structural trends impacting consumer-facing industries.

Similarly, changing sociodemographics are altering consumption patterns, creating new lifestyles and habits such as increased demand for environmentally friendly food, clothing and energy, among many other things. Last but not least, "the green shift to preserve our earth creates a number of possibilities," points out Hyll. "Tomorrow's demand for cleaner electricity, transportation, and heating is reshaping global consumption for metals and materials."

Many smaller – yet structurally strong – paradigms are born out of these three major trends, with the team at Adaptive Paradigm Alpha aiming to build a portfolio reflecting between six to eight paradigms at any given point. "The research process often spans several months and encompasses both quantitative and fundamental analysis, before a paradigm qualifies for our watch list," elaborates Hyll. "The objective of our "quantamental" approach to researching paradigms is to identify opportunities for relative outperformance, which increases the predictability compared to stock-picking on an absolute basis."

Adaptive Paradigm Alpha has identified a wide range of paradigms – just below twenty in total since inception, with returns from positions evenly distributed with a slight bias toward the long side. "Our balanced long-short attribution is a testimony to the repeatability and robustness of the fund's strategy," Hyll remarks.

RISK-MITIGATING OPTIONS STRATEGIES

So far, Adaptive Paradigm Alpha has been successful in capturing alpha from current and already-exited paradigms since launching in January 2020. The fund has delivered an annualized return of 10.3 percent since inception with an annual volatility of 2.3 percent, which translates into an inception-to-date Sharpe ratio of 4.4. The low volatility in returns stems from the team's use of option strategies to capture alpha from paradigms while limiting downside risk.

"The fund uses option spreads to represent equity exposures to be able to customize the pay-out for positions," explains Hyll. "We do this to limit the potential downside, but we also cap the upside to create a more cost-effective position," he elaborates. In environments of dry liquidity in equity options, Adaptive Paradigm Alpha may employ a mix of cash equities to capture identified paradigms.

In addition to the extensive use of options strategies, which enable the Adaptive team to optimally control risk, additional safeguards are put in place for risk management purposes. "We fully beta- and currency-hedge every position to isolate paradigm-specific exposure," says Hyll. The fund also relies on a hard stop at a negative ten percent for each position, which "is employed to reduce the impact of bias in investment decisions."

GETTING READY FOR A BIGGER AUDIENCE

Launched by a team of three, with Alexander Hyll as the main architect, Simon Hyll as Chief Technical Officer and Gustaf Lange as Chief Operating Officer, the team around Adaptive Paradigm Alpha has gradually grown to cement existing strengths as well as open new doors of opportunities. Lukas Börjesson joined Adaptive directly out of university as a quant-focused analyst, Arin Kamangar later joined as co-portfolio manager and the founder of IPM Informed Portfolio Management, Anders Lindell, joined as co-owner and board chairman.

"Anders brings extensive experience, both as a mentor for me but also as a business leader, having co-founded and held positions as CEO and Chairman of the board for Sweden's previously largest hedge fund," says Hyll. "While he is not involved in the day-to-day management of the fund in the role as Chairman of the Board of Adaptive, he helps us move forward by applying his knowledge of all fund management-related aspects, ensuring that the management company is set up to be able to deliver on our objectives."

Based out of Linköping, the Adaptive team also seeks to benefit from the wealth of technical expertise of Linköping University's current students and graduates. "Linköping University is well-known in Sweden for STEM-field research, with many graduates in engineering and mathematics each year," highlights Hyll. "Most of these graduates leave the region when they graduate, especially if they want to work in finance since there are very few such opportunities in the region," he continues. "By being located in Linköping, we have an opportunity to attract this talent that might want to stay here and work in finance."

Martin Singull, a professor in multi-variate statistics at Linköping University, is a part of Adaptive's investment advisory board for regular discussions on methods of how to improve its quantitative models. "We know there is a wealth of expertise at Linköping University, and we have established ourselves in Linköping to be able to benefit from that", comments Hyll. "And recently Ather Gattami, a leading scientist and expert within artificial intelligence and head of research at AI Sweden, has joined the investment advisory board to augment the fund's strategy with regards to machine learning and AI driven research."

"We want to continue developing our methods and become a reputable manager known for consistency and reliability. How big that can make us will be for the future to tell, although we hold big aspirations. We take one step at a time."

Alexander Hyll

READY FOR FULL-SCALE LAUNCH

Adaptive Paradigm Alpha was initially registered as an alternative investment fund by Swedish Finansinspektionen, with the fund's management company operating as a sub-threshold alternative investment fund manager. Hyll and his team have now received authorisation from Finansinspektionen as a full-scope Alternative Investment Fund Manager, thereby broadening the potential investor base for Adaptive Paradigm Alpha. "The authorization is a big landmark for us, as it provides the platform from which we can distribute and market our investment services to a broader range of investors than we could as a registered manager," says Hyll.

"Our management mainly caters to professional investors," explains Hyll. "However, since we have some non-professional investors that have been with us from the start, we will be looking to distribute the fund via select distributors as well to accommodate these investors," he elaborates. Now granted authorization, Adaptive Paradigm Alpha will be offered to both professional and non-professional investors in Sweden in the second quarter of this year.

"Our immediate objective in the near term is the launch of the fund to a broader audience," emphasizes Hyll. "In the medium to long term, we want to continue developing our methods and become a reputable manager known for consistency and reliability," he elaborates. "How big that can make us will be for the future to tell, although we hold big aspirations. We take one step at a time." Designed to provide uncorrelated returns, downside protection and high risk-adjusted returns, Adaptive Paradigm Alpha now has the team, the backing and proof to do what it says on the tin: achieve paradigm alpha.

Thomas Pohjanen, CEO and Portfolio Manager
Excalibur Asset Manager

Excalibur Unsurprised by Rate Rises

Veteran fixed income traders adapt to the new market climate

By Hamlin Lovell – HedgeNordic

> "Generally we do more relative value trading when central bank policy is steady, while shifts in central bank policy between hawkish, neutral and dovish will lead to more directional trades."
>
> Thomas Pohjanen

Excalibur was named after King Arthur's sword, and co-founder, Thomas Pohjanen, argues that its objective – delivering average returns of 4-6% per year with low downside risk – is as difficult as pulling a sword out of a stone. But Excalibur has risen to the challenge, had only two losing calendar years in 21 years and has a strong positive skew: its up months and years are bigger numbers than its down months and years. Over this period, a number of other fixed income hedge funds have shut down after unexpected losses.

The Excalibur return profile is rather like a tortoise that crawls along most of the time and occasionally speeds up by putting on a set of roller-skates, often when option positions pay off. This is very different from some fixed income arbitrage strategies, which appeared similarly steady for multiple years before falling off a cliff and incurring large losses in 2021, similar to what happened also in 1998 or 2008. Long periods of tranquil markets, recently due to central bank policies, encourage some managers to increase leverage in order to magnify diminishing spreads and risk premia into reasonable returns. "This approach can be like picking up pennies in front of a steamroller. Our leverage is relatively conservative," argues Pohjanen, who headed fixed income market making at Nordea, where he worked with Bjorn Suurwee and also ran a proprietary trading book, before the duo set up Excalibur.

The normalization of bond market volatility in 2021 and 2022 has revealed who is naked when the tide goes out. It has exposed the weakness of some approaches in three main ways: rates have spiked, risk premia have widened and yield curves have flattened (and even inverted in some areas) confounding many managers who had expected steeper yield curves.

RATE RISES AND RISK PREMIA IN HISTORICAL PERSPECTIVE

The speed of interest rate rises between mid 2021 and early 2022 has not come as a great surprise to Pohjanen. Though he did not have precise interest rate forecasts, the strategy was positioned for the direction of travel. Over a 35 year career in market making, proprietary trading and hedge fund management, Pohjanen has seen even larger interest rate spikes before. In 1994, when US interest rates doubled from 3% to 6%, and the fourth Eurodollar future spiked by 450 basis points. Or for that matter in 2004-2005, when the same contract increased by 250 basis points. So far, as of mid-March 2022, Pohjanen has only seen 200 basis points of increase as a comparison.

He is also no stranger to blow outs in risk premia. Working in the US between 1989 and 1993, he witnessed declining risk premia that ultimately led to the Savings and Loans crisis and a major paradigm shift. He also saw similar phenomena in 2007-2008 around the GFC.

GETTING AHEAD OF THE CURVE

Official reported headline inflation is in fact at the highest levels of Pohjanen's career, and this is the direct cause of rising interest rates and rate expectations. The team does not directly trade inflation instruments, but is mainly active at the short end of the interest rate curve, which has been somewhat slow to react until quite recently. Just as most credit managers view credit ratings agencies as being "behind the curve", Pohjanen aims to use his data analysis to anticipate central banks' policy reaction functions. It seems clear that the US Federal Reserve continued describing inflation as "transitory" for rather too long before admitting that it could become persistent in late November 2021.

"We hate to lose money and have only one third negative months. Timing is the real craftmanship of running a well balanced fixed income fund, as markets will over-react in both directions and bear markets can see violent rallies, which can whipsaw investors."

Thomas Pohjanen

And the ECB and Sweden's Riksbank have also been late to recognize broader inflation pressures. "As late as February 2022, the forward curve was pricing Swedish rates at zero until 2024. We had been disagreeing with the short end of the curve for some time. It is starting to reprice now and we are making good profits in March. Central banks want 75-80% certainty that they are right, but we can apply thorough and methodical analysis to be ahead of them," says Pohjanen.

The team build trade structures with a hockey stick return profile, using instruments including swaps, swaptions and options that provide some long volatility exposure. The aim is for losses to be limited to premium paid while profits could be many times greater. The best calendar years have seen the strategy deliver high single to low double-digit returns.

NIMBLE AND FLEXIBLE TRADING

As well as expressing directional views on rates, the team at Excalibur is actively trading around positions and varying risk levels to accentuate the upside and truncate the downside: "We hate to lose money and have only one third negative months. Timing is the real craftmanship of running a well balanced fixed income fund, as markets will over-react in both directions and bear markets can see violent rallies, which can whipsaw investors. The analytical toolbox blends fundamental with some technical analysis, which is used to fine tune entry and exit points. Tops and bottoms are for fools, but we strive to be as close as possible to them".

The teams initial response to the Russian invasion of Ukraine was simply to reduce risk: "war is risky and hazardous. We do not know which weapons will be used or which battles will be fought. But by March we dialed some risk back up, having judged that the conflict was probably not going to derail the global economy and would probably not escalate from a local into a global conflict".

Performance has been positive in March, but risk levels are not as high as after the Covid crash: "We are still cautious because we do not know what Putin may do, which may derail any strategy based on normalized higher interest rates".

RELATIVE VALUE AND DIRECTIONAL TRADES

Profits do not only come from accurate trading calls. There can also be some positive carry, which sometimes comes from relative value trades. Excalibur mainly trades US, Swedish and German interest rates, but will occasionally venture into peripheral European government bond markets, perhaps trading spreads between Italian and German government bonds: "this spread blew out after the Covid crisis and we expected the ECB would take action to reduce the spread as part of its policy transmission mandate. This year, the spread has also widened a little bit, but not as much as in 2020. Our main focus this year is directional rather than relative value trading".

The central bank climate helps to determine the balance between relative and outright trades: "generally we do more relative value trading when central bank policy is steady, while shifts in central bank policy between hawkish, neutral and dovish will lead to more directional trades. Policy divergence can however also strengthen the case for relative value trades – and currently the US is ahead of Europe in the business cycle".

The strategy also trades corporate credit, and has started to add exposure now that spreads are widening to more attractive levels.

LIQUID AND SCALABLE

Excalibur has seen some inflows take assets to SEK 640 million, but this remains about 90% below peak assets of SEK 6,000 million, which seems surprising given the long term consistency of returns. After the Great Financial Crisis in 2008, Excalibur was used as an ATM by investors who were nursing losses and lock ups in other funds. And then after a flat period of performance, some investors redeemed from the "tortoise" Excalibur and invested in "hares" such as private equity and real estate, which have clearly benefited from the extended period of very low, zero and negative interest rates. Excalibur could profit from higher and more volatile interest rates, and is a liquid strategy, which could easily scale up all trades and run much higher levels of assets.

Björn Suurwee, Deputy CEO and Portfolio Manager
Excalibur Asset Manager

Marek Ozana, Portfolio Manager
Excalibur Asset Manager

Not the Typical Volatility Fund

Volatility Should not be Your Wild Card

By Eugeniu Guzun – HedgeNordic

> "This is a multi-asset, multi-strategy fund that applies different strategies, all within the volatility space or with a connection to the volatility space."
>
> Jacob Øland Jensen

Elevated macroeconomic or geopolitical uncertainty bringing bouts of extreme market turbulence have frequently plagued financial markets. And arguably, the most frequent, painful and costly mistakes in investing are made during periods of high volatility. Some may even consider volatility an investor's biggest enemy. There are strategies, however, that bloom in such environments and rely on volatility as their main source of life.

Danske Bank Asset Management's Quant and Overlay team, part of the Solutions and Alternatives investment organization that also houses Danske Bank's fixed-income hedge fund team, has designed an investment strategy that generates returns "by understanding the fundamental and structural drivers of market volatility" across asset classes. "This is a multi-asset, multi-strategy fund that applies different strategies, all within the volatility space or with a connection to the volatility space," explains Jacob Øland Jensen, the strategy's Chief Portfolio

Jacob Øland Jensen, Chief Portfolio Manager
Danske Bank Asset Management

Mads Vestergaard Jensen, Senior Portfolio Manager
Danske Bank Asset Management

Photo Credit: Morten Larsen Photgraphy

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Manager. "With Alternative Investments being one of our strategic focus areas, we are happy to have expanded a very successful range of hedge funds with this multi-asset approach."

While most traditional volatility-focused managers predominantly harvest the "volatility risk premium," which results from implied volatility overstating the subsequent realized volatility in options, the Danske Bank Quant and Overlay team focus on capturing returns from multiple sources in the volatility space. "We don't usually say that we focus on harvesting volatility risk premia, as this term encompasses a very narrow definition and we do way more than that," says Øland. "The pure volatility risk premium is the source of return that most investors are aware of and perhaps even most exposed to, but for us, it is only a small part of the risk in the portfolio."

"The traditional volatility risk premium stems from the fact that market participants pay more for option protection than the protection is worth, just like insurance," explains Øland. The volatility risk premium, in essence, is a form of financial insurance. "This is a risk premium that is as close to fundamental in nature as you can probably get," he argues. "Risk averseness is ingrained in human DNA and it is well documented that the average investor is willing to pay an excess premium for this financial insurance." Managers often systematically sell combinations of calls and puts or build straddles and strangles to effectively and consistently capture volatility risk premia and other structural imbalances.

Although the volatility risk premium represents a rich and persistent source of returns for investors, the team behind Danske Invest Global Cross Asset Volatility has opted to design a broader portfolio to harvest volatility-driven sources of returns. "The richest risk premium in the volatility space is the traditional volatility risk premium. No doubt about that," argues Øland. "This risk premium is very persistent. We do not expect that people will stop paying a premium for insurance," he continues. The reason for building a well-diversified set of strategies that go beyond harvesting traditional volatility risk premia is because "capturing this premium is a bit of a timing game." Additionally, "the diversification within the fund is very much a design feature," says Øland.

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NOT PLAYING THE TIMING GAME

Both long- and short-volatility strategies are subject to the "timing game." Short volatility strategies, for instance, can generate steady returns by earning capped premiums in return for selling options – thereby earning steady returns until a big move in the underlying's price can lead to large, and potentially unlimited, losses. Furthermore, such drawdowns will often occur at the same time as risky assets underperform. Meanwhile, long-volatility strategies, which have a positively asymmetric payoff profile with the downside limited to the cost of buying options coupled with unlimited upside, can generate outsized profits when large movements in the underlying do happen. These long-volatility strategies, however, can "bleed to death" after prolonged periods of subdued volatility.

"We use a multi-strategy approach by tapping into various return sources in the volatility space to generate more time-independent returns," argues Øland. Danske Invest Global Cross Asset Volatility has been deploying eight systematic strategies, only one of which focuses on capturing traditional volatility risk premia, to monetize on multiple drivers of volatility. These systematic and repeatable strategies seek to harvest sources of returns stemming from the convexity embedded in volatility, structural imbalances within different asset classes or regional markets, as well as volatility price differences across and within asset classes.

To design the strategies, the Danske Bank Quant and Overlay team forms testable economic hypotheses, for example, on whether market participants are willing to pay a premium for buying protection in various asset classes via options. "To test an economic hypothesis, we subject it to numerous years of data to test whether we see this hypothesis playing out in the real world," explains Øland. "If the hypothesis turns out to be validated by the data, we define a rulebook for implementing a systematic strategy."

Each of these systematic strategies focuses on a specific source of volatility-stemming alpha across several asset classes that include equities, interest rates and currencies. "We see real value coming from the cross-asset approach," emphasizes Øland. "Instead of just being in a single asset class, we seek to find these types of fundamental, structural, or relative value opportunities in several asset classes," he continues. "We exploit the structural imbalances that are most attractive to find the best fit and most attractively-priced volatility trades for the portfolio."

EMBEDDED DOWNSIDE PROTECTION

By design, Danske Invest Global Cross Asset Volatility thrives either in a low- or high-volatility environment, less so during transition periods from low volatility to high volatility or vice versa. "Looking from a very top-down level, many of our systematic strategies perform in a low volatility environment or in extremely high volatility markets," explains Øland. "In a volatility regime shift between high and low volatility or vice versa, that is where you could expect headwinds for some of our strategies."

A number of the strategies are defensive in nature or have built-in risk-mitigating features – such as signals, negative beta or positive convexity, enabling Danske Invest Global Cross Asset Volatility to hold up very well in periods of increased volatility such as February this year, or March of 2020. According to Øland, their fund's risk-mitigation properties are achieved through three main venues. "First, we have systematic strategies that are defensive in nature that can deliver a positive return if equities sell-off. That is the purest protection with negative correlation to equities."

"Second, we have systematic strategies that have risk-mitigating features embedded, for instance, signal-based volatility strategies that usually sell volatility but switch to buying volatility if some conditions are met," says Øland. "These signals usually kick in when markets are in turmoil." Third, the team has the ability to deploy tactical strategies for buying tail protection on a discretionary basis when necessary. "The tactical mandate is more opportunistic in nature and involves looking at the current market pricing of options and volatility instruments in general," explains Øland.

"All systematic strategies have embedded risk, so

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we use the tactical mandate to adjust that risk, so that the full portfolio is aligned to our market views," elaborates Øland. "We are willing to pay for such protection through our tactical mandate. We didn't design the tactical overlay to necessarily deliver the same risk-adjusted returns as the systematic strategies," according to the strategy's chief portfolio manager. "We don't see the tactical strategies as a stand-alone portfolio, rather as the ideal complement to our systematic strategies to make the fund even more attractive." The deployment of tactical strategies is a key feature of the investment strategy employed by Danske Invest Global Cross Asset Volatility. "We also use the tactical portfolio to generate returns, especially in periods where the systematic strategies look less attractive."

PLACE IN A PORTFOLIO

Danske Invest Global Cross Asset Volatility specifically aims at exhibiting low correlation to risky assets, primarily in stressed markets, and at delivering between four to six percent after fees at an annualized volatility of about ten percent. The fund has performed as intended with a three-year track record of 5.2 percent annualised net excess return, a return/volatility ratio of 0.7 and a clear demonstration of providing diversification to traditional risky assets. "We see this fund as a replacement for something like the high yield exposure in a broader portfolio, not for the most aggressive or most risky parts of the portfolio," says Øland. "We believe investors should see the fund as an attractive component of a portfolio, bringing strong standalone risk-adjusted returns while being a better diversifier than many single asset class or macro hedge funds or traditional assets of a similar risk level. For exactly these reasons, our institutional investors as well as our internally managed flagship portfolio solutions invest in the Global Cross Asset Volatility fund and have enjoyed the strong risk-adjusted returns."

"The fund is very much designed to be a portfolio component with low correlation to risky assets, especially in stress conditions, while also delivering good risk reward on its own," according to Øland. For investors not interested in the wild cards that market volatility often deals, the strategy employed by Danske Invest Global Cross Asset Volatility can be a very valuable addition to their portfolios.

> "The fund is very much designed to be a portfolio component with low correlation to risky assets, especially in stress conditions, while also delivering good risk reward on its own."
>
> Jacob Øland Jensen

One-Stop Institutional Shop for Crypto

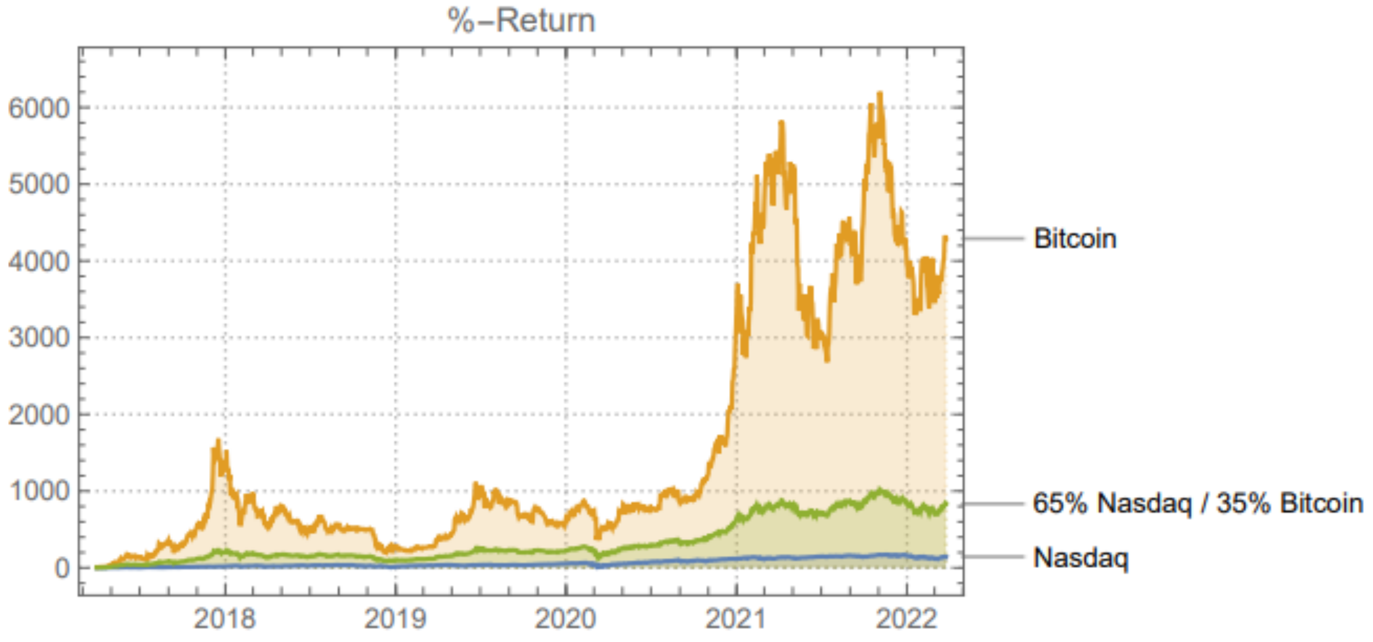
By Eugeniu Guzun – HedgeNordic

Cryptocurrencies might be the most fascinating, yet head-scratching and controversial, investment opportunity in recent history. The outstanding performance of Bitcoin and altcoins – alternatives to Bitcoin – relative to any other existing asset class has led to an avalanche of retail investors embracing cryptocurrency investing and has, at least, caught the eye of institutional investors.

It is somewhat difficult to picture that Bitcoin was only officially launched in 2009. During this relatively short amount of time, cryptocurrencies have evolved from being a niche digital asset to one widely used in several applications (e.g., method of payments, decentralized applications, non-fungible tokens, etc.). Both retail and institutional investors are now flocking to the crypto space for potential outsized returns and diversification benefits to their portfolios. The bottom line is, cryptos cannot simply be ignored any longer.

Bitcoin has substantially outperformed the tech-heavy Nasdaq Composite over the past five years, indicating that investors putting their wealth in Bitcoin would have done tremendously well. According to calculations by the team at crypto-focused Hilbert

> "We are a blue-chip company in the digital assets space with a high-quality setup and infrastructure."



Group, a Sharpe-maximizing trading strategy would allocate 65 percent of a portfolio in Nasdaq and 35 percent in Bitcoin. "Such trading strategies would yield a Sharpe ratio of about 1.50, which is to be compared with the Sharpe ratios of 0.90 for a Nasdaq-only allocation and 1.35 for a Bitcoin-only allocation," says Niclas Sandström, the CEO and co-founder of Hilbert Group. "Although Bitcoin had 1.5 times higher Sharpe ratio than Nasdaq, it would have been favorable to allocate about twice as much wealth to Nasdaq compared to Bitcoin."

"For most investors, however, allocating twice as much wealth to Nasdaq compared to Bitcoin probably sounds too much," argues Sandström. Even so, a ten percent allocation to Bitcoin in an otherwise full-blown equity portfolio would have led to a Sharpe ratio of 1.20 and a drawdown that is one-quarter lower than holding a Nasdaq-only portfolio. "There is no justification in assuming that out-of-sample returns can be estimated from past realized returns," acknowledges Sandström. "While these two trading strategies had roughly equal volatility, the return of a portfolio with ten percent allocated to Bitcoin was almost 1.5 times that of Nasdaq over the last five years."

HILBERT GROUP: STRIVING TO BE THE NORDIC REGION'S CRYPTO-FOCUSED BLUE CHIP FIRM

With institutional investors increasingly aware of the diversification benefits and return potential of cryptocurrencies, more clarity on regulation and investment-grade infrastructure remain some of the last barriers to mass institutional adoption of cryptocurrency. On the heels of increasing institutional adoption, Nasdaq First North-listed Hilbert Group has been building a fully integrated platform with a strong infrastructure that can serve as a one-stop shop for investors seeking to seamlessly onboard the cryptocurrency market. The digital asset investment firm's platform offers access to crypto-focused investment funds, data and analytics, as well as private equity investments, among others.

"We are a blue-chip company in the digital assets space with a high-quality setup and infrastructure," says Niclas Sandström, the CEO and co-founder of Hilbert Group. "Many of the big institutions that we have been in contact with put a lot of emphasis on the infrastructure around our firm and our funds," he emphasizes. Some of their most commonly asked questions include: "Do you have the right banking set up? Do you have the right administrators? Who is the custodian and how do you actually execute the asset subscription and redemption?"

Niclas Sandström, CEO and co-founder
Hilbert Group

"Institutional investors put a lot more emphasis on that because operational risk can be very large, even larger than market risk in the cryptocurrency space," warns Sandström. The team at Hilbert Group has put together a due diligence questionnaire (DDQ) that assists investors and their third parties in the due diligence process to understand the operational setup around Hilbert Group's funds. "Going through an operational DDQ is more frequently demanded as the first request from investors even before talking about strategy and performance," points out Sandström. "That is a positive shift in the industry that we have been observing," he continues. "Hilbert is fully staged for that as our focus on the operational setup and transparency have been in our DNA from day one."

With transparency requirements different between non-listed and public companies, Hilbert Group's focus on transparency can be supported by the decision to list the company on the Nasdaq First North Growth Market in October 2021. "It is a very cumbersome process to become a public company," says Sandström. Transparency and trust are essential in the still-young cryptocurrency space, a nascent asset class that is changing at a breakneck pace with no signs of slowing down. "Being a public company certainly adds to the trust factor alone," argues Sandström, who co-founded Hilbert Group with Magnus Holm.

HILBERT'S CRYPTO-FOCUSED FUND RANGE

With a growing number of institutional investors looking to allocate a percentage of their portfolios to digital assets, Hilbert Group's asset management arm has two funds that can meet some of that investor demand. The Hilbert investment team has mostly focused its efforts on managing Hilbert Digital Asset Fund, its flagship fund that seeks to offer broad exposure to the crypto market. In late 2021, Hilbert Group launched a second fund, Hilbert Syrius Bit+ Fund (HSBF), in a joint venture with Hong Kong-based strategic advisory firm Oracle Strategies Limited.

> "Our objective with Hilbert Digital Asset Fund is to achieve as high a return as possible. The price you pay for high returns is volatility."

Launched in January 2019, Hilbert Digital Asset Fund "is algo traded altcoin-focused fund with the bulk of the portfolio always exposed to altcoins, other coins than bitcoin," according to Sandström. The fully-invested fund relies on a long-only strategy that systematically rebalances the portfolio of a large number of altcoins based on what Sandström and his team call "volatility harvesting." According to Sandström, "this fund employs a higher risk, higher return strategy, with the alpha coming from the portfolio rebalancing according to a pre-defined set of criteria."

The alpha stemming from "volatility harvesting" has reached an annualized 30 percent since inception. Usually maintaining diversified exposure to more than 50 altcoins at any given point in time, Hilbert Digital Asset Fund has managed to generate an annualized return of 105 percent since launching in early 2019. "Our objective with Hilbert Digital Asset Fund is to achieve as high a return as possible," says Sandström. "The price you pay for high returns is volatility," warns the co-founder of Hilbert. "But we are comfortable with that and our investors should be comfortable with that." After all, Hilbert Digital Asset Fund is designed to be an institutional quality product that gives broad-based exposure to the cryptocurrency space.

Hilbert Syrius Bit+ Fund relies on a systematic algo-based strategy that focuses on the most liquid segments of the cryptocurrency space, namely Bitcoin and Ethereum. "The fund can have a small allocation to altcoins of up to ten percent of the portfolio," according to Sandström. Hilbert Syrius Bit+ Fund seeks to outperform Bitcoin on a risk-adjusted basis by focusing on limiting drawdowns. "This fund is a lower-risk, lower-return product that seeks to generate attractive returns with much lower volatility than the most liquid segments of the crypto space."

"The core strategy is powered by Oracle Strategies' AI-based algorithms that adjust the risk-exposure according to the inherent cycles within cryptocurrencies," explains Sandström. "The strategy is trend-following utilizing AI methods," he elaborates. "A large part of the time since inception the fund has had a big chunk of the portfolio in cash, with cash positions reaching 60 or even 70 percent at some points this year." In up-trending markets, Hilbert Syrius Bit+ Fund seeks to capture most of the upside. As downward signals start hitting the screens, the fund systematically switches bigger and bigger portions of the portfolio into cash.

With two up-and-running funds, a white-label fund and trading offering, plus more fund launches planned in the future, a proprietary trading desk, and a data and analytics arm, Hilbert Group is focusing its pioneering efforts into becoming a one-stop shop for Nordic institutional investors looking to learn more about the cryptocurrency universe and tap into the potential of this space. "When bigger institutional investors will start jumping on the bandwagon on a larger scale, Hilbert Group will be there to serve their needs," concludes Sandström.

Michal Danielewicz, founder and portfolio manager – St. Petri Capital

In My Book, Everything Points to Inflation

By Eugeniu Guzun – HedgeNordic

Michal Danielewicz and Jens Larsson, the founders and managers of thematic-focused long/short equity fund St. Petri L/S, had warned about the re-emergence of inflation well before inflationary pressures started creeping up all around the world. And indeed, an inflationary surge is evident and the word "inflation" is on everyone's lips, fueled by Russia's invasion of its neighbor, Ukraine. The duo, thematic investors and students of structural change for over 20 years, believe the deflationary effects from two powerful, decades-long structural shifts may be easing and thereby will let loose the already strong inflationary pressures.

In the decade after the financial crisis, the world embarked on a big cycle of money, credit and debt creation driven by both monetary and fiscal stimulus. With interest rates hovering around zero for many years, seemingly all effort has been undertaken to get individuals, businesses and governments loaded up with the maximum amount of debt. Yet, contrary to what any formal theory of economics suggested, inflation remained subdued. The deflationary effects from structural shifts kept inflation in control, argues Danielewicz. These effects may not be so powerful any longer.

THE DEFLATIONARY STRUCTURAL CHANGES

"Three of the main structural changes that Jens and I have observed over the last years include globalization, technology revolution and demographics," starts Danielewicz. At least two of them have had deflationary effects over the past few decades. "Aside from the many benefits of globalization on economic growth and well-being, globalization was actually extremely good for low inflation with production being offshored to cheaper locations," argues the co-founder of St. Petri Capital. "The second structural change, technological revolution, has led to massive productivity growth for all of us, which again, was tremendously deflationary."

"These structural tailwinds that created a very good environment for equities and kept inflation under control could potentially become future

"These structural tailwinds that created a very good environment for equities and kept inflation under control could potentially become future headwinds."

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headwinds," emphasizes Danielewicz. Globalization – a phenomenon that has defined the world's economy in recent decades – appears to be taking a step backward due to the Covid-19 crisis and more recently, Russia's invasion of Ukraine and the associated economic sanctions inflicted on Russia.

"This subtle deglobalization process is not having a positive effect on global value chains and pricing," warns Danielewicz. Global trade as a percentage of global economic output had been increasing since China joined the World Trade Organization (WTO) in 2001, but this share reached a peak a couple of years ago before embarking on a downward slope. "The current geopolitical tensions will further limit any benefits of globalization on global price deflation."

The technological revolution, another deflationary structural shift, has also been slowing down in recent years, according to Danielewicz."The slope of change in the technological evolution may no longer be as steep as it used to be," he acknowledges. "Don't get me wrong, I am still a great believer in technology and technology accounts for a big part of our portfolio," he emphasizes. Yet, one has to remember that "the technological revolution has been ongoing for 60, 70 years, and the slope of change cannot be as steep as it used to be," according to Danielewicz. "The technological revolution has been a significant contributor to productivity gains and has been deflationary." These deflationary effects are starting to wane in magnitude.

More "nascent" structural changes such as the fight against global warming and climate change, as well as increasing defense spending in response to Russia's invasion of Ukraine are adding to inflationary pressures. "The new structural changes related to global warming and climate change, reflected in our portfolios as part of the green energy wave and sustainability themes, require potentially a very large volume of physical assets such as steel and copper, among others," explains Danielewicz. "If you combine the continuation of green energy and the recent focus on defense spending, which all compete for the same resources, with slowing demographics, maybe slowing technological revolution and global disintegration, everything points to higher inflation."

> "A lot of things are happening right now, so we are trying our best to understand and capture what is structural."

ST. PETRI'S THEMES

Danielewicz and Larsson usually build the portfolio of St. Petri L/S around eight to 12 themes, with the allocation to each theme depending on the maturity of the theme. "Every theme follows an S-curve with its own maturity life cycle," says Danielewicz. Unsurprisingly, the "inflation wave" represents the team's largest long exposure. "We very much like companies with pricing power that would be anchored within basic materials and industrials," explains the portfolio manager. "These two sectors are associated with increased pricing power and can withstand higher inflation. The common theme here is the inflation wave."

Despite sharing a cautiously positive outlook on the technological evolution, "tech is still our second-largest exposure in the portfolio," according to Danielewicz. The exposure mainly focuses on infrastructure technology, hardware and software. "Some of our long exposure lies in companies that will enable themes such as the green energy transition and accelerate the sustainability wave," continues Danielewicz. A new theme in the portfolio is dubbed the "security revolution."

"On the short side, most of the exposure is still allocated to the "low volatility exuberance" theme," says Danielewicz. This theme mainly features "highly-valued companies that tend to underperform when interest rates are increasing due to inflation," explains the portfolio manager. "The low volatility theme continues to be the largest pool of short ideas." The St. Petri team is also cautious on consumer-related companies within consumer staples and consumer discretionary sectors that are facing rising input costs.

LOOK BACK TO LOOK AHEAD

After almost doubling investors' money during 2020 with an advance of 98.3 percent, St. Petri L/S edged down 3.8 percent in 2021 followed by a gain of 1.0 percent in the first two months of 2022. Wary of the re-emergence of inflation, Michal Danielewicz and Jens Larsson had positioned the portfolio for rising inflation and higher interest rates. "Jens and I have been proponents of rising inflation for a while now, our narrative started back in the second half of 2020 due to enormous monetary and fiscal stimulus during the initial days of the pandemic," explains Danielewicz. "In retrospective, our call on rising inflation may have been too early."

The St. Petri Capital team expected higher inflation and an associated increase in nominal interest rates, which generally impact "long-duration areas of the stock market," according to Danielewicz. These areas include highly-valued companies sensitive to rising rates. While this helped St. Petri L/S during the first four months of 2021, as both inflation and interest rates moved up in tandem, a subsequent market consensus that inflationary pressures were temporary "diverged from our main scenario." According to Danielewicz, "our performance started to decline in May and gradually continued to decline throughout the remainder of the year as inflation continued to go to levels not seen in four decades but interest rates started to fall."

"You can be right and still lose money," acknowledges Danielewicz. The team's unchanged "outlook and playbook" for 2022 has already started bearing fruits. "The largest contribution to performance this year comes from last year's underperforming themes that we held on to, mainly the low volatility exuberance theme," says the portfolio manager. "The inflation wave is doing quite well, so the market is perhaps starting to recognize and price in some of our thinking in terms of what is going on with the world."

"A lot of things are happening right now, so we are trying our best to understand and capture what is structural," emphasizes Danielewicz. "We have dedicated our professional careers towards understanding disruption and structural shifts and what implications those shifts might have on equity returns," he continues. While few things seem to happen on the surface during periods of range-bound equity markets, there is a breadth of changes underneath the surface that can create significant alpha for investors. "We define structural changes as a force that is quite long in duration, a force that will persist throughout many and different economic cycles and will create value for investors irrespective of how broader markets perform."

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Mika Jaatinen, Portfolio Manager of Hedge Fund Investments – Elo
Photo credit: Jukka Jalkanen

Elo's Approach to Hedge Fund Allocation

By Eugeniu Guzun – HedgeNordic

The hedge fund universe is heterogeneous, with the objectives, complexity, costs, and risk-return profile of each hedge fund varying widely. However, institutional investors mostly turn to hedge funds in their pursuit of an investment that is uncorrelated with the rest of their investments. For Finnish pension insurance company Elo, the primary advantage of investing in hedge funds is the diversification benefit from adding an asset class that offers uncorrelated returns relative to traditional equity and fixed-income investments.

"Hedge funds offer investors exposure to a return stream that has low correlation to traditional assets such as stocks and bonds," explains Mika Jaatinen, Portfolio Manager of Hedge Fund Investments at Elo. "For us, this low correlation is key," he emphasizes. "Funds themselves gain this low correlation either by investing in relative value strategies, directional macro strategies, highly complex quant strategies or opportunistic event-driven strategies." Coming in many shapes and colors, hedge funds exhibit a relatively weak correlation with other asset classes, as well as play important risk-reduction and return-generating roles in a portfolio.

"Hedge funds certainly have a proven place in the financial ecosystem," argues Jaatinen, who is responsible for hedge fund allocation at Elo since 2007 as part of Pension Fennia before Elo was formed in 2014. "They can offer investors ways to diversify their balance sheet exposure in a fairly liquid way," elaborates the portfolio manager. "Hedge funds can also offer

"Hedge funds offer investors exposure to a return stream that has low correlation to traditional assets such as stocks and bonds."

investors access to investment strategies that are hard or even impossible to implement internally," he continues. Yet, the biggest benefit of investing in the industry "comes from the uncorrelated return profile of hedge funds."

ALLOCATION FOLLOWS MACRO CYCLES

"Hedge funds can offer a different type of return stream. Something that is not totally relying on long-only exposures to traditional asset classes," says Jaatinen. Relative value strategies, for instance, are designed to pick both winning and losing stocks, with the dispersion between winners and losers serving as the main source of their returns, according to Jaatinen. "There is clearly more volatility and dispersion in the markets right now," highlights Jaatinen. "More volatility, the more there will be dispersion and that equals more alpha opportunities for hedge funds as a whole."

The opportunity sets harvested by hedge funds, which are shaped by shifts in the macroeconomic environment, determine the extent of Elo's allocation to the hedge fund space. Elo's hedge fund allocation has gradually declined from 9.5 percent of the overall portfolio at the end of 2017 to 7.1 percent at the end of 2020 before rebounding to 7.4 percent at the end of last year.

"Elo's allocation to hedge funds has fluctuated over time based on macroeconomic cycles and general market opportunity set," explains portfolio manager Mika Jaatinen. "Hedge funds perform best when there is enough volatility and dispersion available in underlying asset classes," he emphasizes. "Volatility and interest rates were at historically low levels before the pandemic. The same was true for credit spreads." This created a very challenging environment for hedge fund players.

"The pandemic brought along more dispersion and threat of possible inflation. That has improved the opportunity set for hedge fund strategies considerably," considers Jaatinen. "Possible inflation brings along more volatility in all major asset classes," which may reinforce the drive into hedge funds by institutions. "There will be more defaults, rise in commodities prices and reprising of equities and credit," argues Jaatinen. "This means good opportunities for macro-, CTA-strategies during the greatest turmoil and opportunities for relative value and opportunistic strategies in credit and equity after things have settled a bit."

"The pandemic brought along more dispersion and threat of possible inflation. That has improved the opportunity set for hedge fund strategies considerably."

INTRO TO ELO'S HEDGE FUND PORTFOLIO

Investors typically allocate capital to hedge funds to access return, risk and diversification characteristics that are not easily accessible in other investments. The hedge fund universe is heterogeneous and there is a wide variety of strategies and styles that can help investors access those characteristics. Finnish pension insurance company Elo has built a diversified hedge fund portfolio, worth €2.2 billion at the end of 2021, to capture those idiosyncratic characteristics. "Elo's hedge fund portfolio is consisting of a wide array of various hedge fund strategies," says Jaatinen. "All the main underlying asset classes are present – equities, bonds, credit and commodities futures – and our hedge funds are using these assets in various ways."

Relative value, directional and quantitative hedge fund strategies are tapping mostly equity, bond and futures markets as their source of returns, explains Jaatinen. Meanwhile, opportunistic strategies such as distressed credit and activist strategies are mainly using credit and equities as their source of returns. "Hedge fund strategies are not just offering us uncorrelated return streams, but they are also giving us exposure to investment styles that are not executed internally," argues Jaatinen. "The combination of all of this, Elo's hedge fund portfolio, is a fairly market neutral entity, with low correlation and steady return stream."

To build a successful hedge fund portfolio, the team at Elo follows a thorough review and due diligence process on potential hedge fund investments. "We get information from various sources. We meet managers and industry experts. We use third-party analyses and databases. We also use our own internal quant analysis tool for assessment of risk, peer comparison and overall suitability of individual funds for our current balance sheet," Jaatinen describes Elo's review process. "In addition to that, we try to follow and monitor prospective managers for years, before we engage with them," he emphasizes. "Proper due diligence is important not just because it decreases risk, but because it increases opportunities for our long term outperformance."

More importantly, "a hedge fund holding is not just investment for us, it is also a long term relationship between Elo and fund managers," highlights Jaatinen. "We can exchange information between ourselves. Managers are feeding us information about new risks and opportunities in the financial markets and various regions," he elaborates. "This information turns into new investment decisions or makes us aware of new potential risk somewhere. It's a mutually value-adding relationship."

MAIN CHALLENGE: ESG

Investors are mostly allocating to hedge funds to achieve alpha and risk mitigation, with the latter stemming from diversification benefits, tail risk reduction, or diminished correlation. Most hedge fund investors and fund managers themselves have come to understand that neither of these objectives can be maximized without a commitment to sustainability. "Allocation is always a balancing act between expected risk and return in various asset classes and opportunities," says Jaatinen. "Hedge funds can offer various kinds of solutions for you balance sheet diversification, but there are also other targets and policies that need to be met, like ESG."

"The importance of a hedge fund manager's approach to ESG depends on the strategy the manager is practicing," explains Jaatinen. He goes on to add that an ESG focus is more meaningful for an equity long/short manager than for a fixed income relative value manager "as ESG issues are more pronounced in equities than in interest rates." According to Jaatinen, "if the manager is ESG focused or has an ESG integration policy, we would like that policy to reflect both their core competencies and preferably also generate ESG alpha for our portfolio."

"Currently there are not enough hedge fund managers that can offer ESG-focused products for institutional investors like Elo," acknowledges Jaatinen. "Funds currently offered are either too small or they do not meet our investment criteria operationally," he continues. "We are actively engaging with ESG within our hedge fund portfolio, but it's going to take some time due to the availability of these funds. Luckily many of our current hedge fund holdings are incorporating an ESG approach into their existing strategies."

The Tenoris Approach to Risk Mitigation

"We prioritize risk mitigation so much more than return generation. One cannot expect much of a return on any investment in the long run without focusing on risk mitigation."

Henric Nordin
Founder and Portfolio Manager Tenoris One

By Eugeniu Guzun – HedgeNordic

New up-and-coming funds such as Tenoris One contribute to the heterogeneity that had already been inherent in the Nordic hedge fund industry. Launched by Henric Nordin and Jacob Andersson in 2020, Tenoris One is a multi-strategy, multi-asset fund investing in a wide range of assets, including hard commodities, soft commodities, currencies, stock market indices, and individual stocks, among others. This "multi-asset" focus stems from the duo's objective to achieve attractive returns with low risk.

"Our objective is to offer a solid return, but we are more focused on the risk side of our portfolio," explains Henric Nordin, who has a non-traditional background for the money management industry as a management consultant. "We prioritize risk mitigation so much more than return generation," emphasizes Nordin. "One cannot expect much of a return on any investment in the long run without focusing on risk mitigation."

The duo's approach to risk mitigation involves building a concentrated portfolio across a diversified mix of asset classes. "The ground on which we are always standing on is that we have a very diversified portfolio, extremely diversified," Nordin tells HedgeNordic. "We look into a very broad set of assets, ranging from hard commodities such as gold, silver, copper and aluminum, less-traditional soft commodities such as coffee and cocoa beans, to stock market indices, individual stocks and others," he continues. The focus, however, is on making investments outside the traditional asset classes such as equities and bonds.

THREE LEGS

Henric Nordin and Jacob Andersson focus not only on investing flexibly across different asset classes but also employ a multi-strategy approach across those asset classes. "The main leg of the fund, perhaps in the range of 70 to 80 percent of its exposure, is based on a systematic strategy working with huge amounts of data to capture trends based on technical analysis indicators," explains Nordin. "Our approach is based on finding and following trends in different assets in order to achieve what we call true diversification."

"Our goal is always to be involved as little as possible when it comes to investment decisions in the quantitative strategy," says Nordin about the technical analysis-focused approach developed together with Jacob Andersson, trader in the power market. "This approach is based on the premise that we don't think our decision-making process is better than our system," he emphasizes. "We always follow the system and the system is guiding us both in terms of assigning the weights to different asset classes as well as which positions we want to take."

Tenoris One's investment approach sits on two additional strategy legs: a so-called "permanent" strategy, and a "dynamic" strategy. The permanent strategy involves investing in a "number of

> "We look into a very broad set of assets, ranging from hard commodities such as gold, silver, copper and aluminum, less-traditional soft commodities such as coffee and cocoa beans, to stock market indices, individual stocks and others."

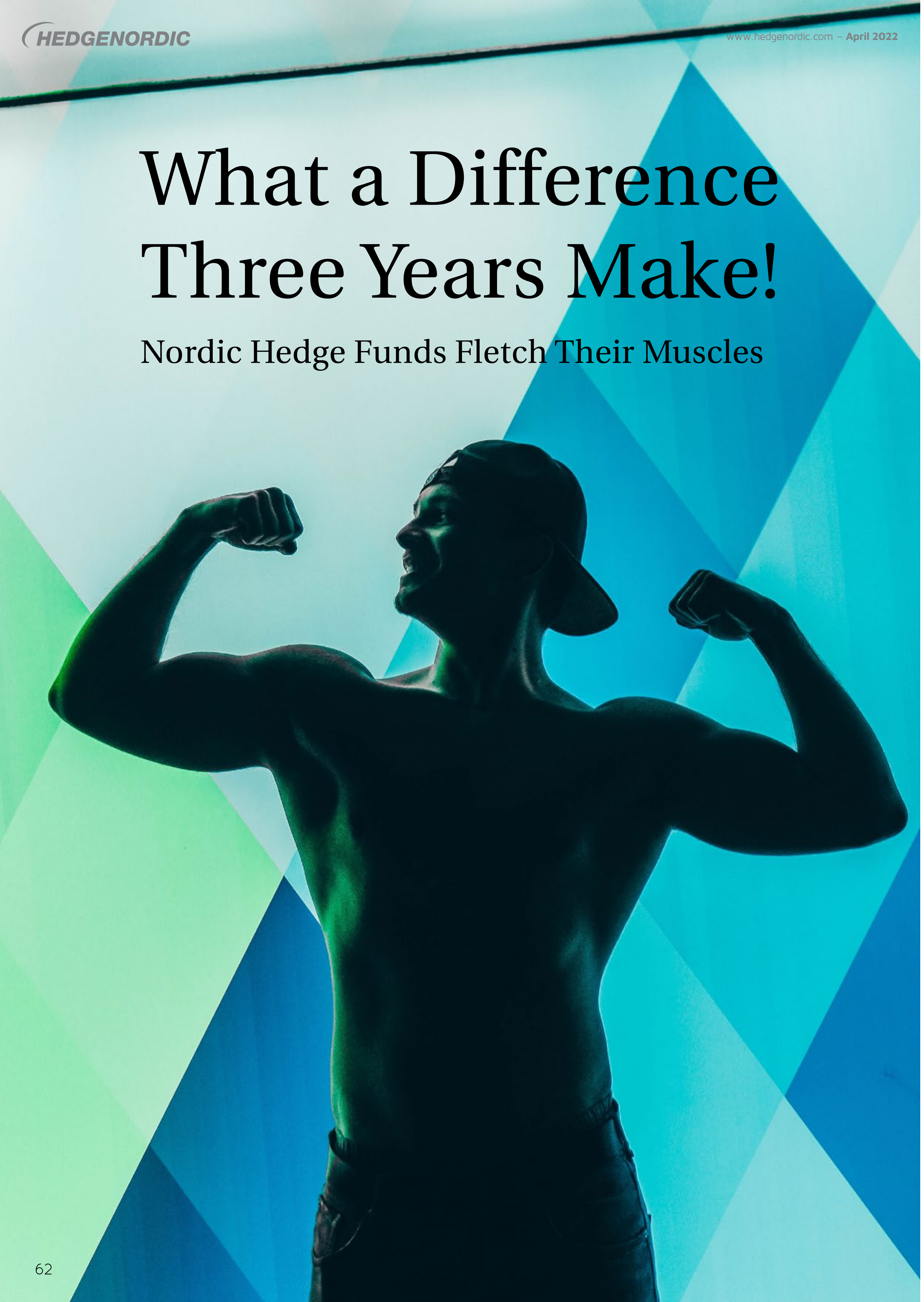
assets that will make sense no matter the market conditions," explains Nordin. The dynamic strategy, which may account for up to ten percent of Tenoris One's exposure, "is very much focused on fully-discretionary decisions meant to capture various spontaneous opportunities arising in the market," according to the fund manager. This is a small part of the total portfolio that depends on exogenous, broader-market events such as market crashes, among others.

"We do want to have these three legs to stand on because if one would not work in a given market environment, at least one of the other ones will hopefully make up for that," argues Nordin. With their fund launched only in October of last year, Henric Nordin and Jacob Andersson have yet to engage the "dynamic" leg of their approach. "We haven't really used the dynamic strategy so far because we haven't seen any opportunities since we started," says Nordin. "This dynamic part focuses on capturing huge opportunities that arise every second or third year. We want to avoid making all the decisions based on gut feeling, we never gamble on the fund's overall return with our discretionary decisions."

INVESTOR EXPECTATIONS

Up 5.5 percent in 2021 and about four percent since launching in October 2020 through the end of February this year, Tenoris One seeks to achieve an average annual return in the range of seven to 12 percent with a standard deviation that is lower than five percent. "With some investors expecting returns of 25 percent a year or very high double-digit returns during the current market conditions, Tenoris One perhaps is not the best option for them," argues Nordin. This fund caters more to risk-averse retail and institutional investors who can be satisfied with six, seven or eight percent per year.

"We are playing a different sport compared to other hedge fund managers and investors with high exposure to the ups and downs of equity markets," Nordin points out. "Tenoris One is an alternative for investors seeking something that is totally different from everything else, or at least, the majority of everything else," he continues. "Whatever we do, we will not step away from our goal to maintain low risk."



What a Difference Three Years Make!

Nordic Hedge Funds Fletch Their Muscles

By Eugeniu Guzun – HedgeNordic

2021 was yet another good year for the Nordic hedge fund industry. In the wake of some challenging years for Nordic hedge funds as a group, the past three years marked something of a change.

2021 was a story of high risk and high reward for the Nordic hedge fund industry, characterized by the continued strong performance of long-biased equity hedge funds. Nordic hedge funds wrapped up a third year in joyful fashion, with the industry achieving its best three-year performance since the three-year period ending 2007. With an annualized return of 6.9 percent over the past three calendar years, the Nordic hedge fund industry achieved the best performance over three calendar years in over a decade.

After dwindling performance since mid-2015, culminating with the market crash in the first quarter of 2020 caused by the outbreak of the coronavirus pandemic, the Nordic hedge fund industry has embarked on a strong recovery period. The industry's rolling 36-month annualized return has steadily improved from a negative 0.9 percent over the period ending March 2020 to an annualized return of 6.9 percent over the 36 months ending December 2021.

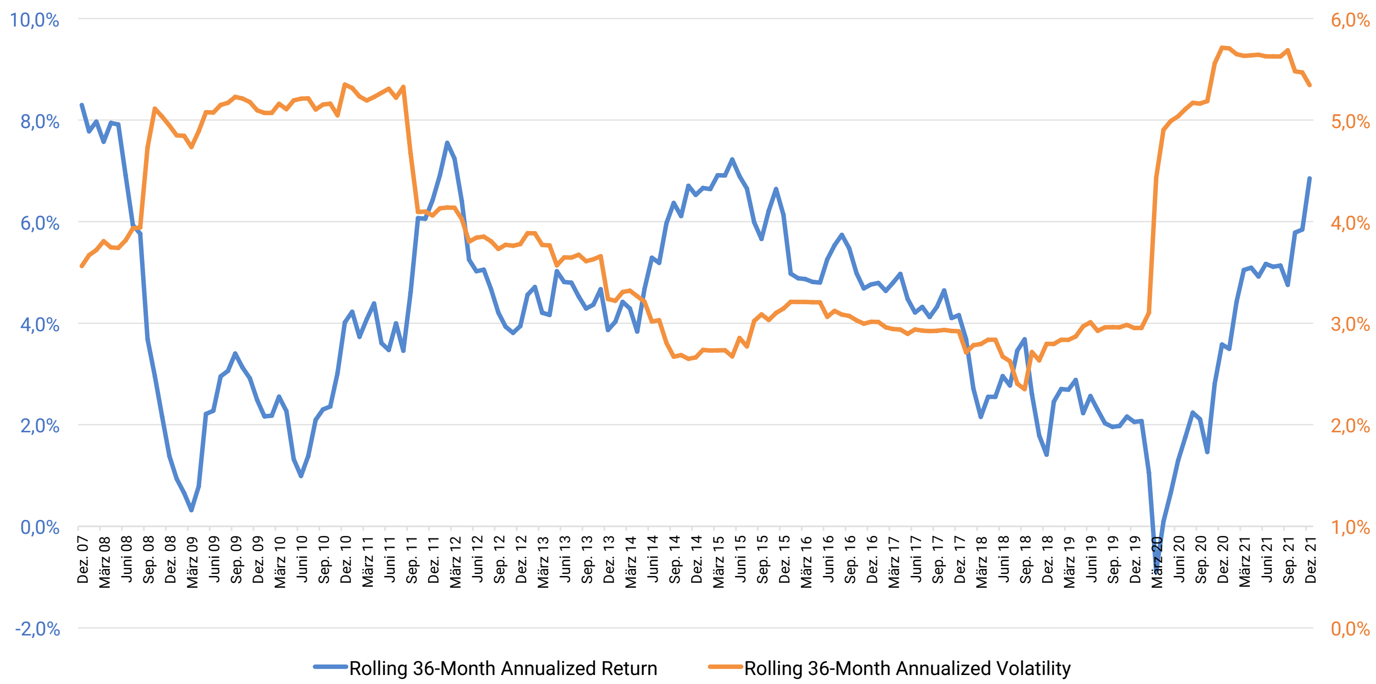


Figure 1. Rolling 36-month annualized return and volatility of the Nordic Hedge Index. Source: HedgeNordic.

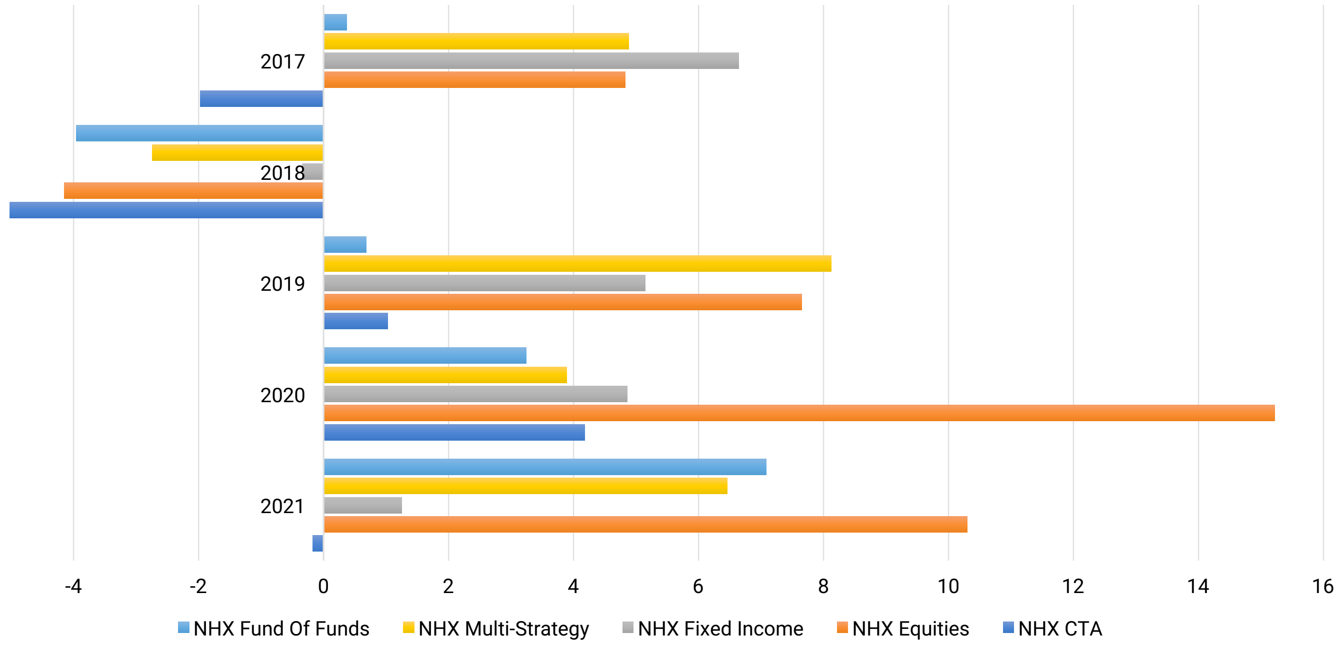


Figure 2. Annual performance of the five NHX sub-strategies in each of the past five years. Source: HedgeNordic.

However, the industry's latest strong performance has been accompanied by higher-than-average volatility in monthly returns. The annualized return of 6.9 percent delivered by the Nordic Hedge Index (NHX) over the three years ending December 2021 was accompanied by an annualized volatility of 5.3 percent. In comparison, the volatility since HedgeNordic started tracking the industry back in 2005 was at 4.1 percent.

SUB-STRATEGIES

At a strategy level, 2021 was characterized by the continued strong performance of equity hedge funds, a surprisingly strong showing by funds of hedge funds, and a challenging environment for CTAs and fixed-income funds. Nordic equity hedge funds as a group outperformed the other NHX sub-categories for two consecutive years, with the equity sub-index achieving annualized returns of 11.0 percent over the three years ending December 2021 and 6.6 percent over the past five years.

Multi-strategy hedge funds followed suit with annualized returns of 6.1 percent over the past three years and 4.1 percent over the past five years, respectively. Despite a difficult 2021, Nordic fixed-income hedge funds generated annualized returns of 3.7 percent over the previous 36 months and 3.5 percent over five years.

With an average annual return of 7.1 percent, Nordic funds of hedge funds celebrated their best year since 2006. This group generated an annualized return of 3.6 percent in the past three years and a lower annualized return of 1.4 percent over the previous five years. Nordic CTAs, meanwhile, delivered negative cumulative returns both over those periods.

UNDER THE BONNET

The above return and volatility figures are based on the average monthly returns of all hedge funds included in the Nordic Hedge Index. But the headline return figures for the Nordic Hedge Index mask big differences in performance between managers. At a composite level, the Nordic Hedge Index, just as

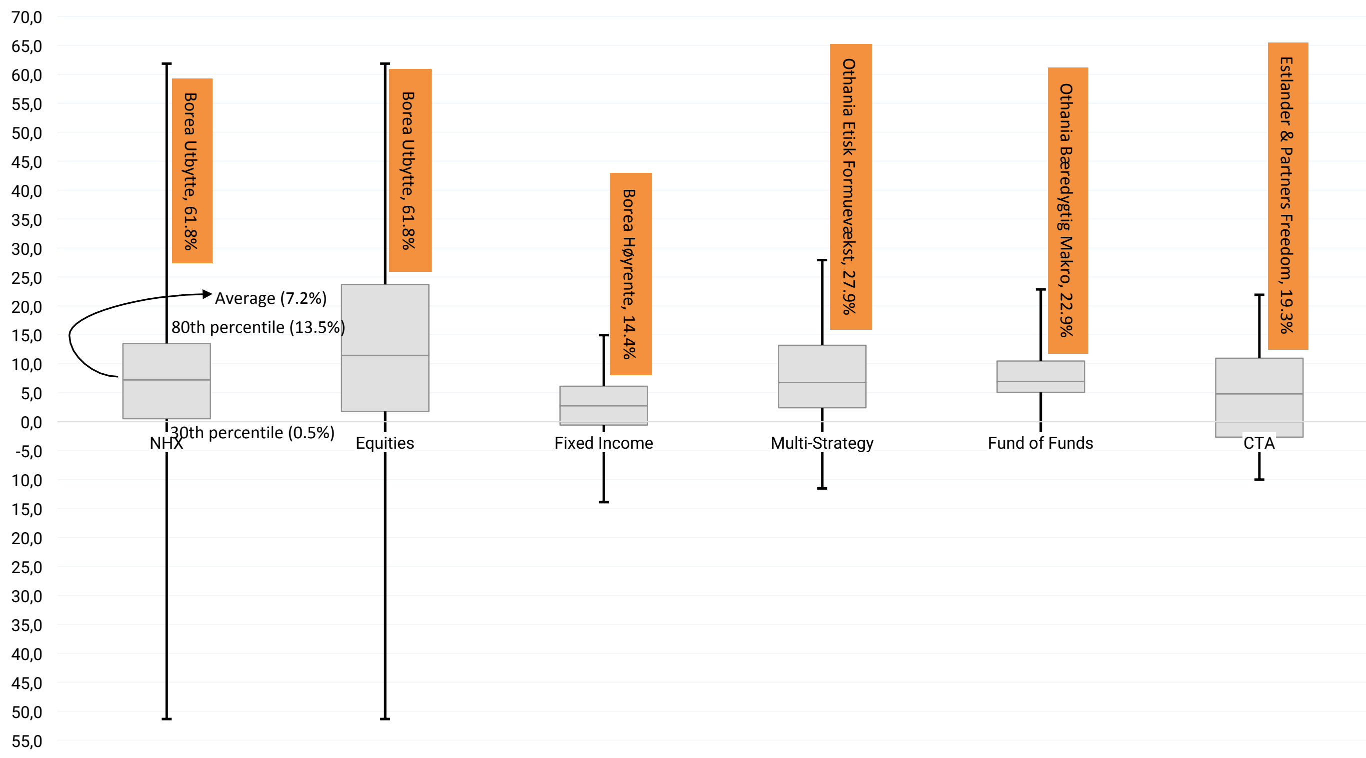


Figure 3: Five-number performance summary of the Nordic Hedge Index and its sub-strategies. Source: HedgeNordic.

most other indices, can obscure wide spreads in the distribution of returns.

While the about 140 constituents the Nordic Hedge Index gained 7.2 percent on average in 2021, the top 30 percent of funds advanced 22.4 percent on average and the bottom 30 percent was down 5.3 percent on average. With the 80th percentile at 13.5 percent and the 30th percentile at 0.5 percent, half of the Nordic hedge fund industry that excludes the top and bottom performers returned between 0.5 and 13.5 percent. The 80th percentile means that only 20 percent of Nordic hedge funds returned more than 13.0 percent in 2021.

Meanwhile, the top 30 percent of equity-focused hedge funds within the Nordic Hedge Index returned 33.6 percent on average last year, while the bottom 30 percent were down 6.1 percent. At the same time, the top 20 percent of equity hedge funds had annual returns starting with 23.7 percent in 2021. The small group of funds of hedge funds enjoyed a strong 2021. The top 30 percent gained 14.7 percent on average and the bottom 30 percent edged down 0.7 percent on average. At the 30th percentile of 5.1 percent, more than 70 percent of Nordic funds of hedge funds had returns of at least 5.1 percent in 2021.

Multi-strategy hedge funds, which returned 6.8 percent on average last year, saw higher dispersion in returns than funds of hedge funds. The top 30 percent gained 16.5 percent on average in 2021 and the bottom 30 percent were down 4.0 percent. At the 80th percentile of 13.2 percent, the top 20 percent of multi-strategy hedge funds had returns of 13.2 percent or more, with this group of top 20 percent gaining 18.2 percent on average.

SURVIVORSHIP BIAS

The above discussion about averages hiding disparities focuses on the performance of up and running members of the Nordic Hedge Index. The Nordic Hedge Index, however, reflects the performance of both existing funds and already-defunct funds, thereby, tackling the survivorship bias associated with some indices. With no less than 16 Nordic hedge funds delisted from the Nordic Hedge Index last year – funds either closed down or

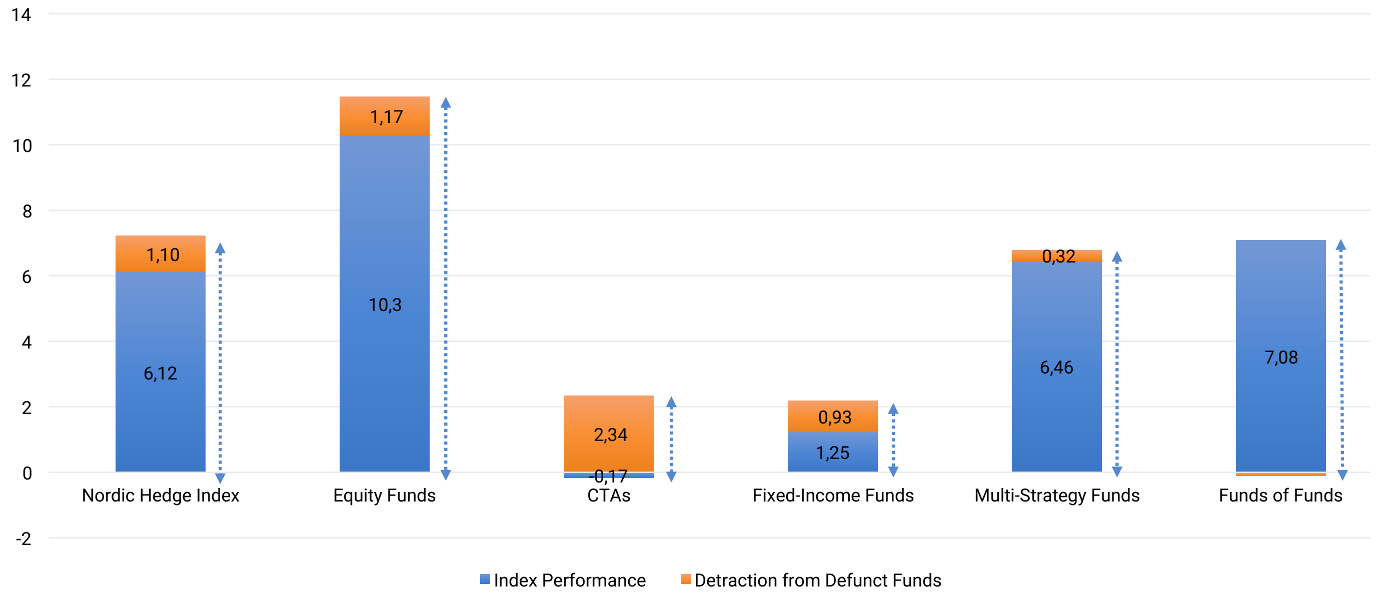


Figure 4. The impact of delisted funds on the performance of the Nordic Hedge Index. Source: HedgeNordic.

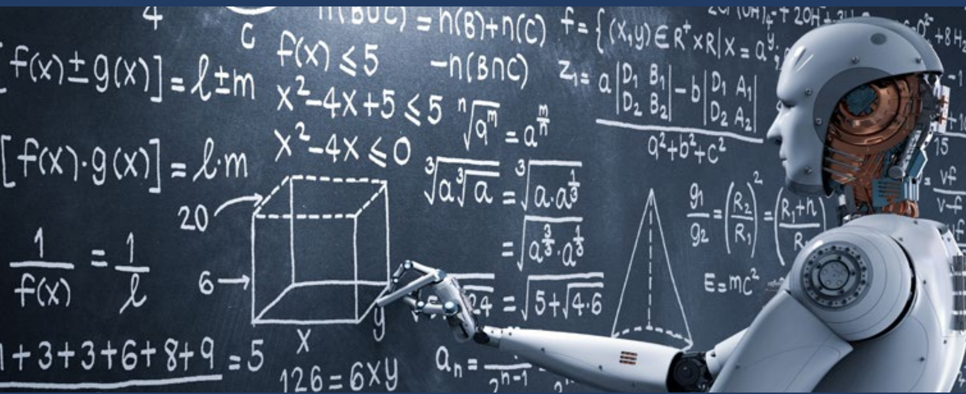
merged into other funds, an inappropriate calculation methodology for the Nordic Hedge Index could have resulted in significant survivorship bias.

The Nordic Hedge Index was up 6.1 percent last year, yet the 141 current members of the Nordic Hedge Index returned 7.2 percent on average in 2021. The 110 percentage points difference reflects the performance detraction from the funds that closed during 2021, which, unsurprisingly, performed worse on average than up and running funds.

The most noticeable difference between the performance of a sub-index and the performance of active funds underlying that sub-index is observed for CTAs. The 11 up and running CTAs within the Nordic Hedge Index gained 2.2 percent on average last year, while the NHX CTA edged down 0.2 percent as five CTA funds closed down during 2021. Among last year's closed funds were award-winning CTAs and managed futures funds such as IPM Systematic Macro, RPM Galaxy and Shepherd Energy Portfolio.

Live equity hedge funds returned 11.5 percent on average last year, whereas the NHX Equities was up 10.3 percent. Similarly, the existing multi-strategy hedge funds were up 6.8 percent on average in 2021, while the NHX Multi-Strategy ended the year at a slightly lower figure of 6.5 percent. There was no noticeable difference within the funds of hedge funds category as no funds closed down during 2021 in what was a good year for this strategy group.

“Your single access point to the Nordic Hedge Fund Industry”



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