MARCH 2018

HEDGENORDIC

The Nordic Hedge Fund Universe at a Glance

Movers & Shakers in the Nordics

What makes a good Hedge Fund?

In Focus: Multi Managers

A dying breed or at the brink of comeback?

NORDIC HEDGE FUND INDUSTRY REPORT - 2018

Contents

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HEDGENORDIC

INTRODUCTION

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

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

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

NordSIP is a leading news website focused on Sustainable Investment viewed from the Nordics.

The site brings together institutional investors, fund managers and third party service providers concerned with ESG. News, opinions, interviews and analysis are provided are showcased on a daily basis.

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Facts & Figures on the Nordic Hedge Index (NHX)

3.21
Average Sharpe Ratio of NHX Fixed Income Constituent

77%
Ratio of NHX constituents with positive returns in 2017

118,8%
Highest cummulative return of any NHX sub category since index inception (2005): NHX CTA

The Editor...

A tough year for Nordic Hedge Funds

After years of steady traffic on global financial markets, winds of change may have caught up with us towards the end of last year, continuing into the new year. The spike in inflation in early February that sent shivers through markets may be the first bad breath hint to the kiss of death for the Goldilocks years, and a wake-up call to a new normal.

With the early possible early signs of inflation creeping up (maybe by 2019?), American threats of protectionism and a possible global trade war there is plenty to look out for. The EU itself is still digesting the Brexit vote, and everyone is still trying to understand what this confluence of events could mean.

With market uncertainties and geopolitical sabre-rattling all around us. The question is whether there is still room for optimism. At a recent conference I attended, the AIF in Amsterdam in early March, a speaker was asked to list the "most important upside risks for 2018/2019" (I was late pulling out my pen but it went something like this):

"A pick up in productivity growth, fiscal stimulus and increased government spending in Europe, Trump getting some things right, and improvements in policy in the EU region."

> **"Is there still room for optimism?"**

The Nordic Hedge Index (NHX) had a tough 2017, especially compared with its international peers. The NHX subcategory that finished the year weakest were CTAs, who consequently also started weakest into the first quarter of 2018. The CTA space will find it harder and harder to prove their case of not being a one-hit-in-a-decade wonder, too. 2017 surely was a disappointment, and the hefty kick where it hurt in February of this year was not encouraging.

On the first pages of the report, we made an effort to dissect to the Nordic hedge fund space and present data, numbers, some facts and fiction we hoped you´d find relevant. This edition of the Nordic hedge fund industry report will look into what institutional investors (and jury members to the Nordic Hedge Award) consider to be some characteristics of a good hedge fund, and investigate if hedge funds and family offices are distant cousins, and carry some of the same DNA. The report also looks at how how Nordic pension funds invest in equities and what role ESG plays in that.

We are introducing three new launches that come with very different prefixes: Danish CABA Capital, alongside a fellow Danish team, this one the award winning fixed income team of Nykredit, who are sending their new fund, Evira, to the races.

With Adrigo Small & Midcap L/S one of Sweden's oldest managers launched its first fund, since its flagship set sail in 2006, and finally Nordic Cross who set out not to launch a new fund, but an entire boutique with a range of funds. We introduce a new series in this report with a segment of the hedge fund industry "in focus" and have selected fund of hedge funds under the microscope.

We spoke to many interesting managers for this publication from across the Nordics and discussed their strategies and views on markets and the world, on risk, on risk appetite and much more, as we share on the following pages.

Kamran G. Ghalitschi
CEO / Publisher HedgeNordic

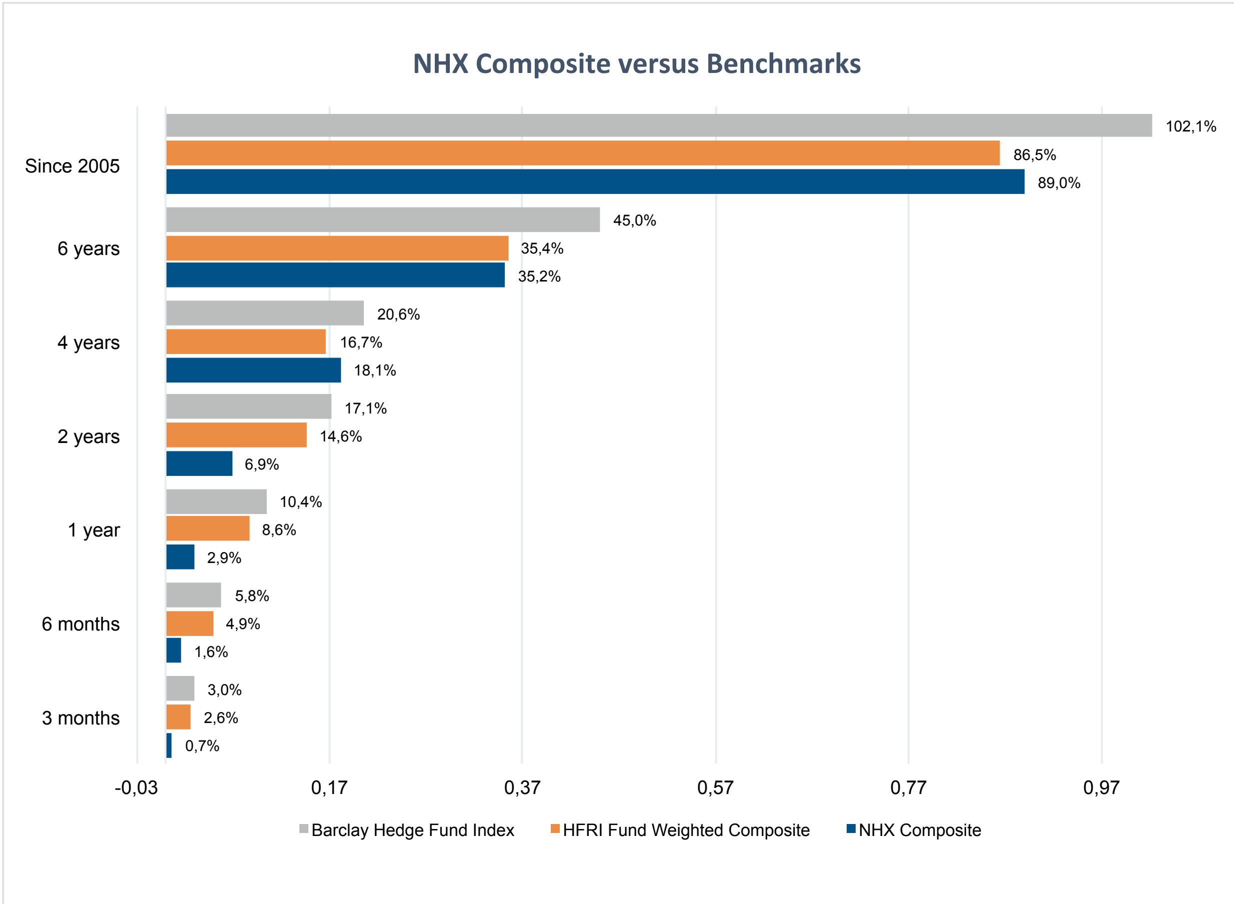
www.hedgenordic.com - March 2018

THE NORDIC HEDGE FUND SPACE AT A GLANCE - A REVIEW

by Eugeniu Guzun– HedgeNordic

The Nordic Hedge Index, hereafter the NHX Composite, tracks the performance of the Nordic hedge fund industry since the beginning of 2005. Despite lagging international peers in the past couple of years, Nordic hedge funds have broadly performed in line with their global counterparts over the past 13 years. The NHX Composite has generated a cumulative return of 89.0 percent since the beginning of 2005, which compares with the returns of 86.5 percent and 102.1 percent produced by the HFRI Fund Weighted Composite Index and the Barclay Hedge Fund Index, respectively.

PERFORMANCE COMPARISON BETWEEN NHX COMPOSITE AND BENCHMARKS



Source: HedgeNordic, BarclayHedge, and Hedge Fund Research.

However, the realized volatility of the NHX Composite on an annualized basis is significantly lower than that of the international indices. The annualized volatility of the NHX Composite stands at 3.8 percent, which compares favourably with the volatility of 5.8 percent and 6.8 percent for the HFRI Fund Weighted Composite Index and the Barclay Hedge Fund Index, respectively.

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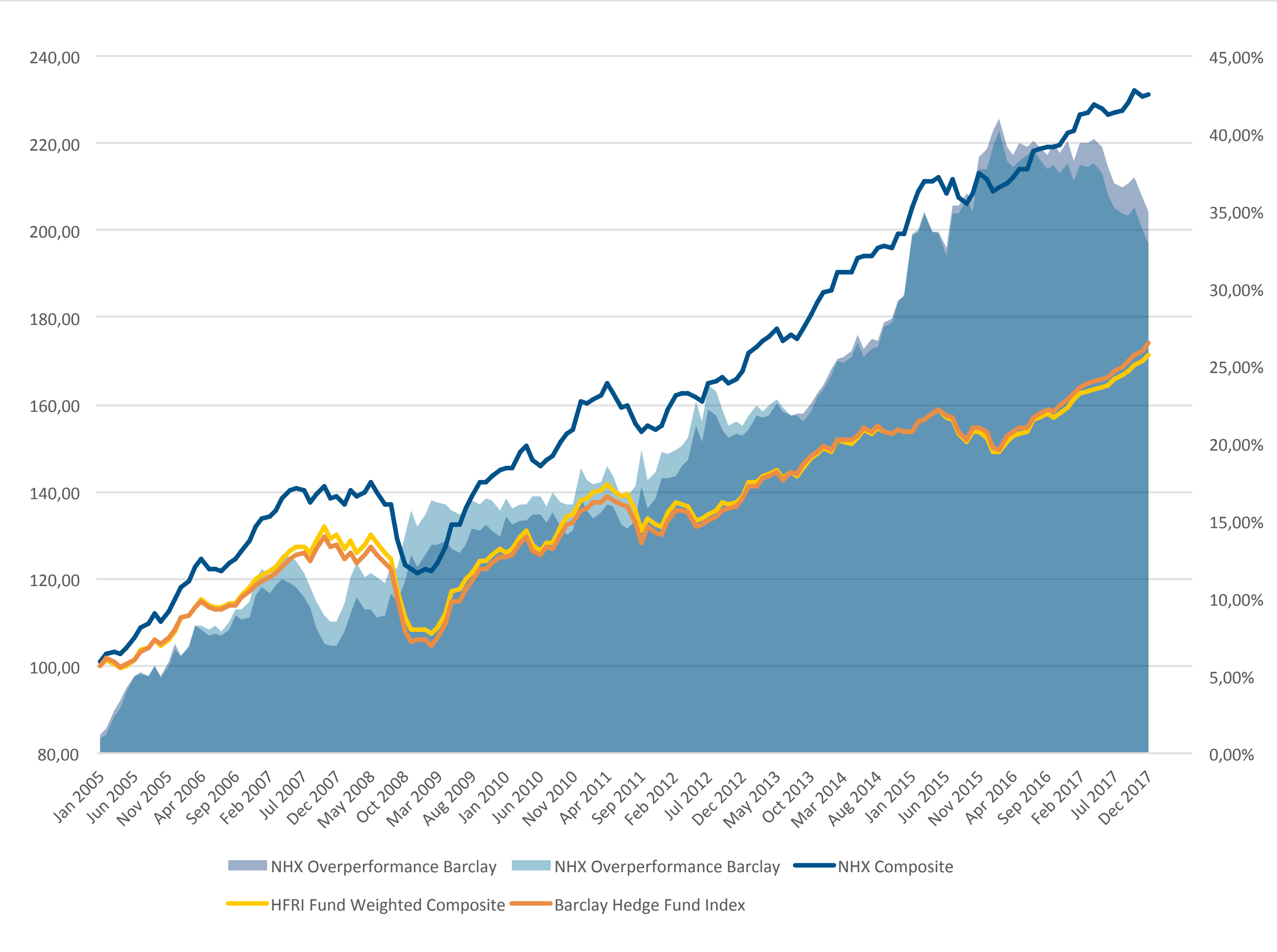
PERFORMANCE COMPARISON BETWEEN NHX COMPOSITE AND BENCHMARKS (Adjusted to 5% Annualized Volatility)

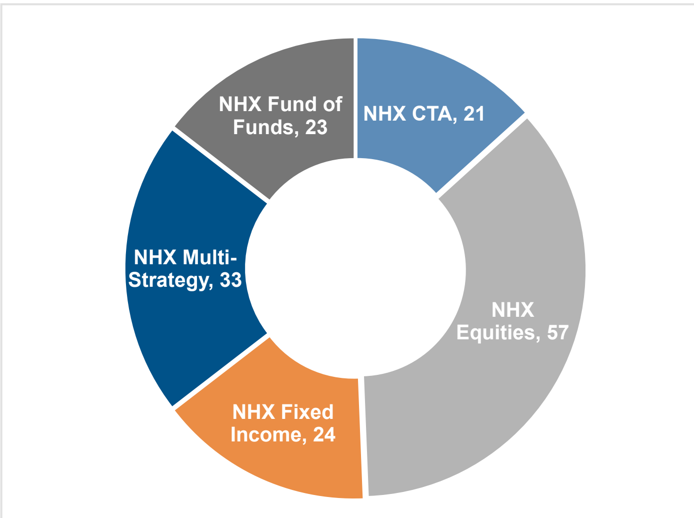


Source: HedgeNordic, BarclayHedge, and Hedge Fund Research.

When adjusting for the level of volatility, Nordic hedge funds outperform their international peers by a wide margin. Since 2005, the outperformance of the NHX Composite compared to the HFRI and Barclay indices accumulated to more than 30 percent, when the performance of all three indices is scaled to 5% volatility, which appears clearly in the graph above.

Historically, the NHX Composite has included a large number of equity strategies. Equity-focused hedge funds account for slightly more than one-third of the overall NHX universe, with a total of 57 members. The NHX family also contains 21 CTAs, 23 funds of funds, 24 fixed-income funds, and 33 multi-strategy funds.

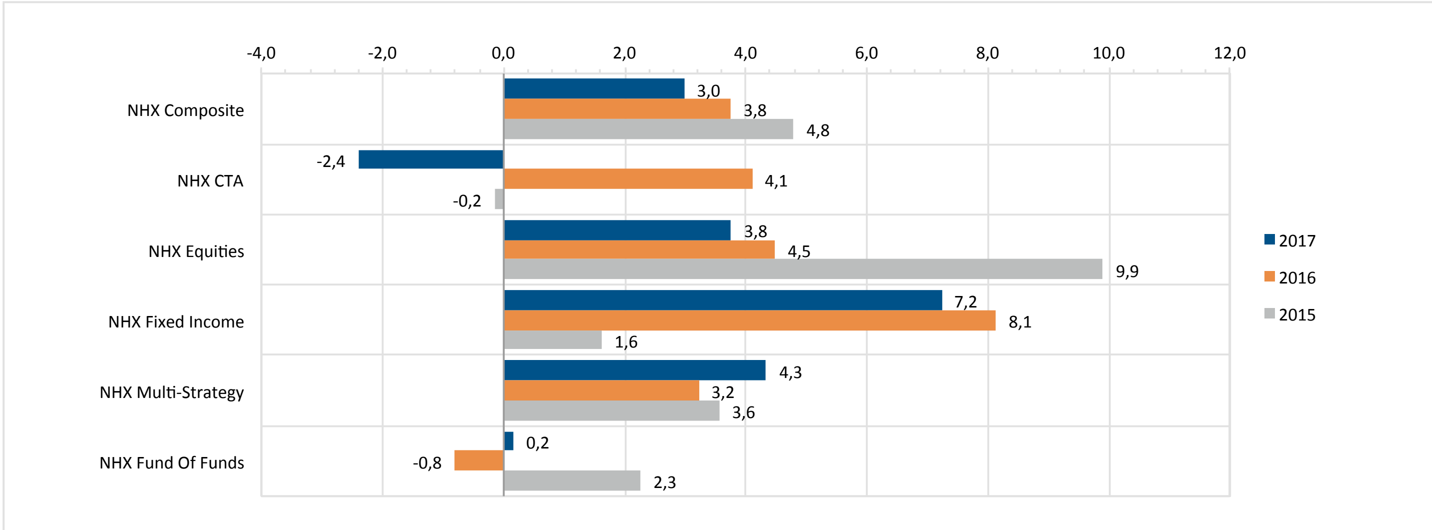
NORDIC HEDGE FUND (NHX) INDEX STRATEGY BREAKDOWN



Source: HedgeNordic

Fixed-income hedge funds collectively formed the best-performing NHX sub-category in the past two years, after gaining 7.2 percent in 2017 and 8.1 percent in 2016. Equity-focused hedge funds gained the most among Nordic hedge funds in 2015 and trailed only fixed-income funds in the subsequent year with an average gain of 4.5 percent. The graph below shows the performance achieved by each of the five NHX sub-categories in each of the past three years.

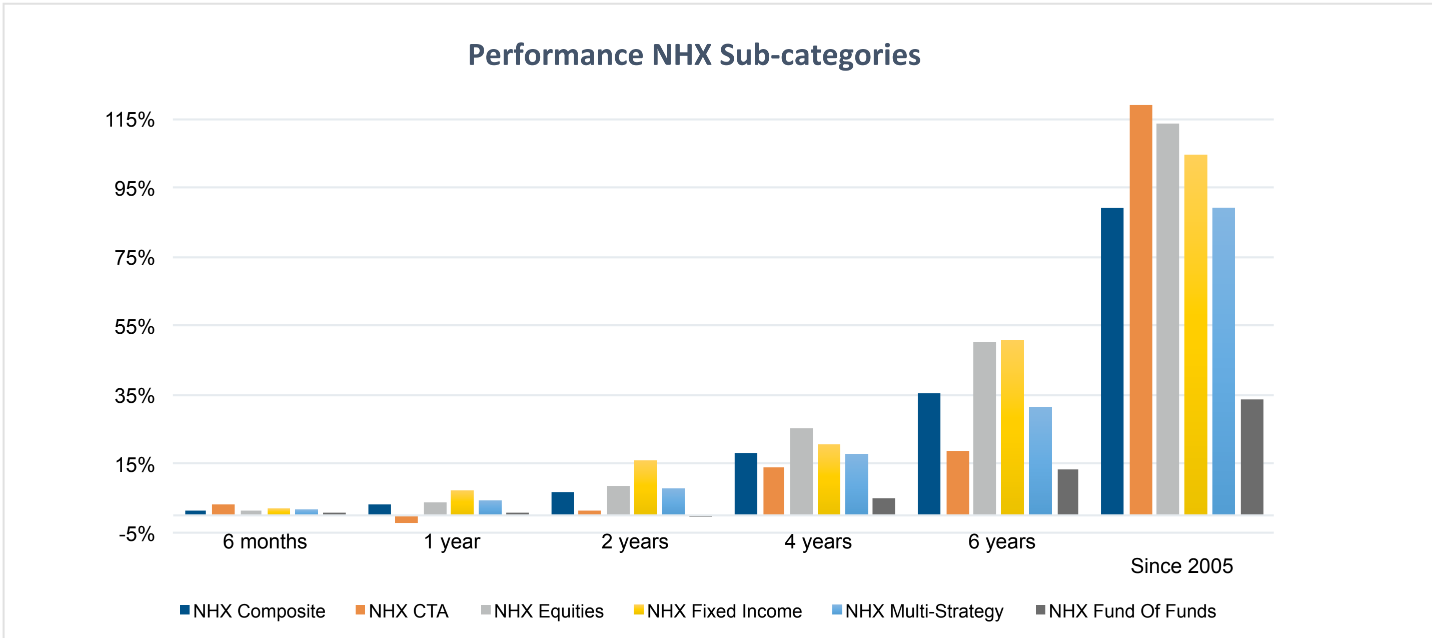
PERFORMANCE COMPARISON BETWEEN NHX SUB-CATEGORIES, 2015-2017



Source: HedgeNordic

Despite their recent underperformance, CTAs produced the highest return on average since 2005, delivering a cumulative return of 118.8 percent. On the other hand, equity-focused and fixed-income hedge funds outperformed the remaining fund categories, including CTAs, by a wide margin in the past six years. Equity hedge funds generated cumulative gains of 50.4 percent since the beginning of 2012 through the end of 2017, while fixed-income strategies returned a cumulative 50.8 percent over the same time period.

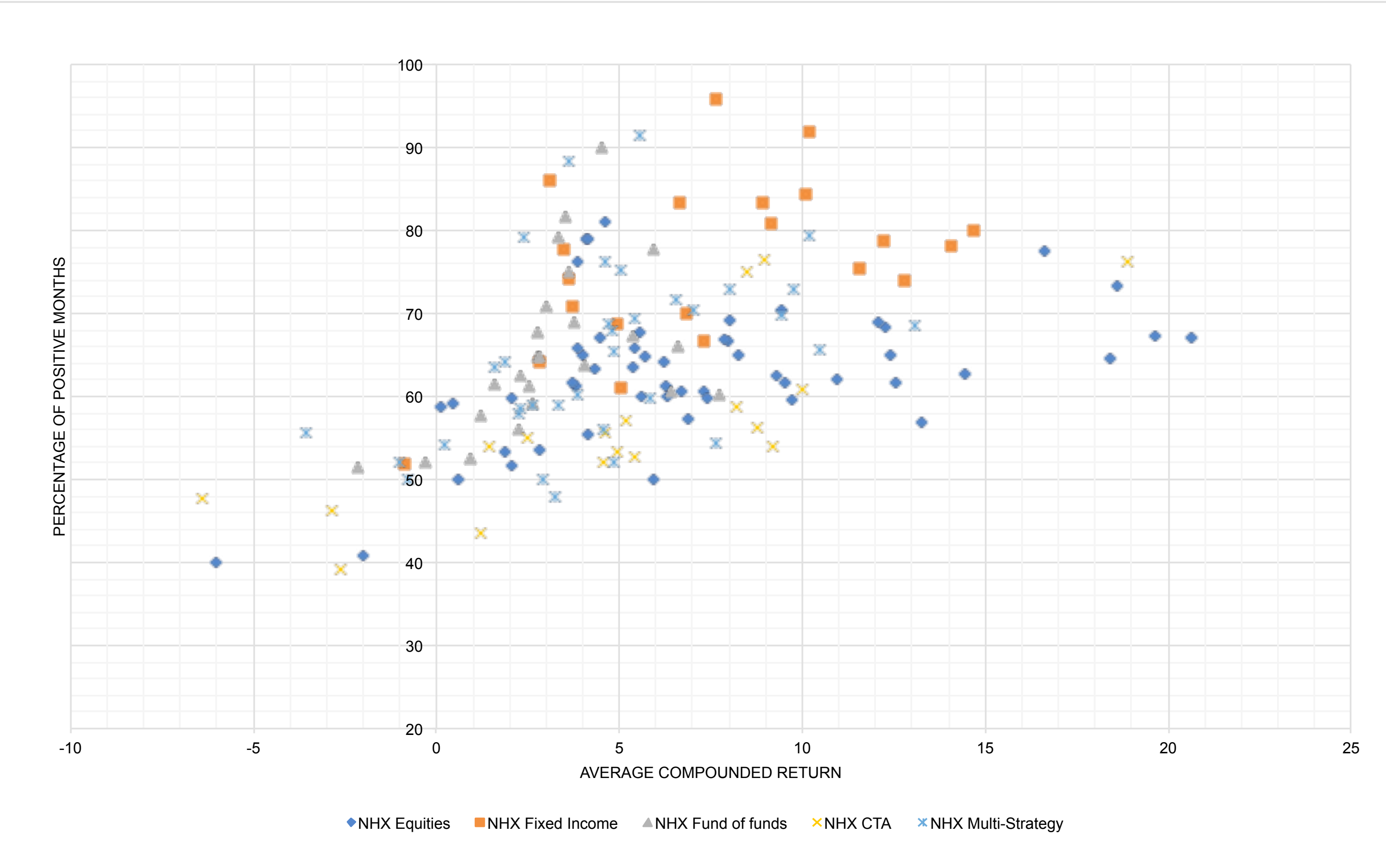
PERFORMANCE COMPARISON BETWEEN NHX SUB-CATEGORIES, CUMULATIVE RETURNS



Source: HedgeNordic

Despite the long-term dominance of CTAs in aggregate since 2005, those dominating the list of best-performing NHX member hedge funds were equity strategies. Five equity hedge funds, namely Rhenman Healthcare Equity L/S, HCP Focus Fund, Borea Global Equities, Mjeltevik Invest IS, and Taiga Fund, and one CTA (i.e. Alfa Sigma Opportunities) generated an average compounded return of more than 15 percent, of which the healthcare-focused fund managed by Rhenman & Partners Asset Management produced a compounded return in excess of 20 percent.

AVERAGE COMPOUNDED RETURNS AND PERCENTAGE OF POSITIVE MONTHS FOR NHX CONSTITUENTS

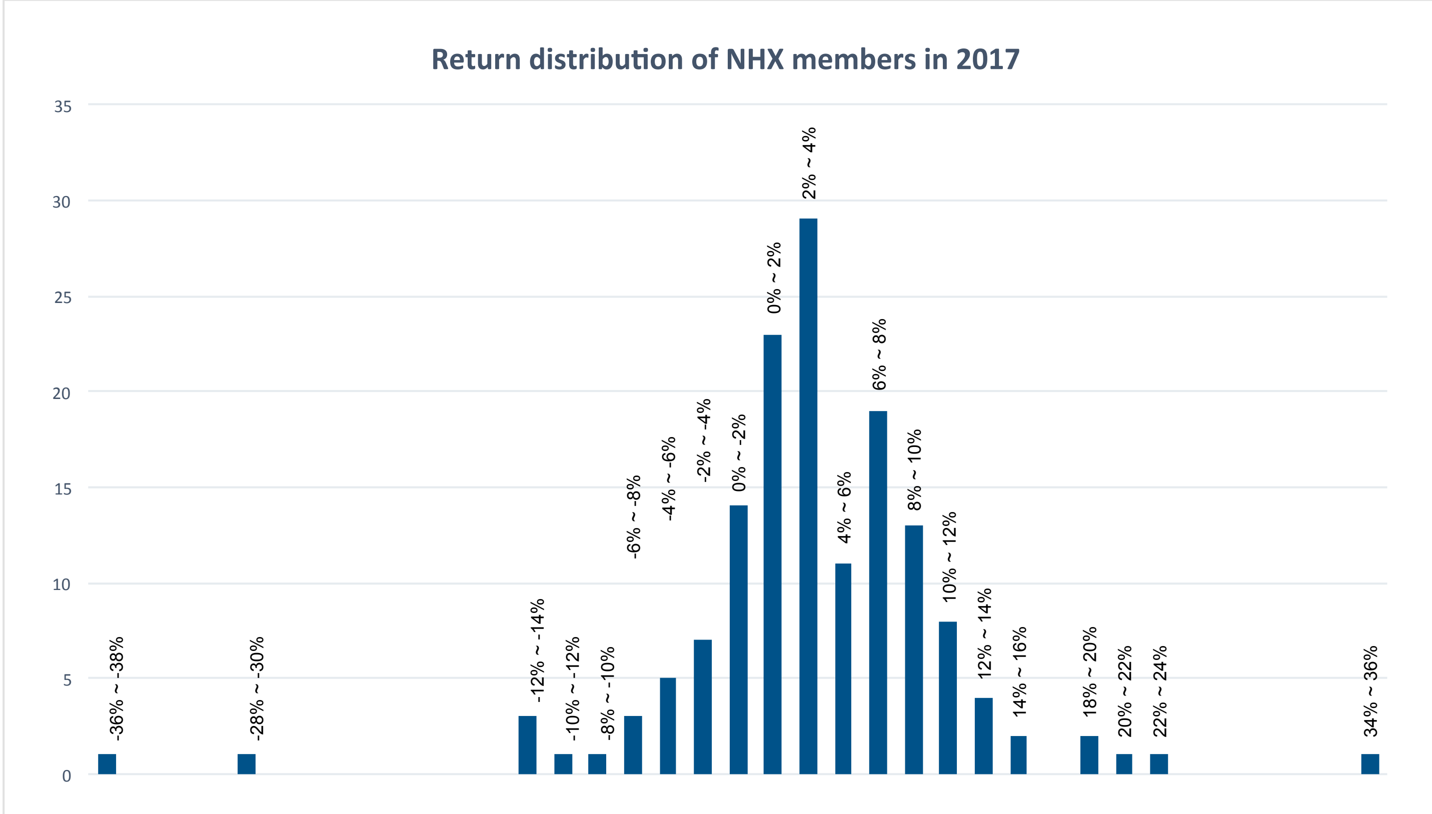


Source: HedgeNordic

Conversely, only one CTA currently included in the NHX generated an average compounded return of more than 10 percent. The construction of the NHX Composite minimizes the effects of survivorship bias by reflecting the performance of already-defunct funds. Therefore, the outperformance of CTAs against the remaining sub-categories stems from the outstanding performance of several CTA funds that, like shooting stars, shone brightly before disappearing. These funds no longer operate and have thus disappeared from the NHX.

On a positive note, Nordic fixed-income hedge funds, as shown by the same graph, generate attractive returns on average, while keeping their returns positive most of the time. A total number of seven fixed-income funds generated average compounded returns of more than 10 percent. The majority of fixed-income funds generate positive returns in more than 70 percent of all months.

RETURN DISTRIBUTION OF NHX CONSTITUENTS IN 2017



Source: HedgeNordic

Focusing on the 2017 performance alone, most hedge funds within the NHX Composite returned between 2 and 4 percent for the year. A total of 23 hedge funds returned between 0 and 2 percent last year, whereas 19 funds posted an average gain in the range of 6 to 8 percent. The Nordic hedge fund industry also observed some outliers last year. Two existing NHX members, namely Gramont Equity Opportunities Fund and Estlander & Partners Alpha Trend II – Class P, lost more than 28 percent in 2017, while Rhenman Healthcare Equity L/S gained in excess of 34 percent.

Biggest percentage gainers by NHX sub-category and country.

Equities and Sweden
34.5%
Rhenman Healthcare Equity L/S

Finland
21.0%
HCP Focus Fund

Norway
19.3%
Borea Global Equities

CTAs
12.6%
Alfa Sigma Opportunities

Fixed Income and Denmark
18.1%
Nykredit MIRA

Fund of Funds
6.4%
Brummer Multi-Strategy

Multi-Strategy
15.2%
Formuepleje Penta

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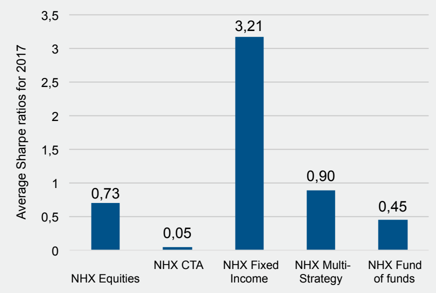
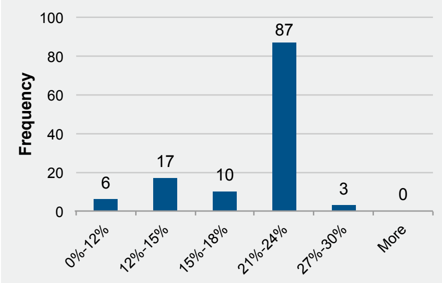
NHX Key Facts at a Glance

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

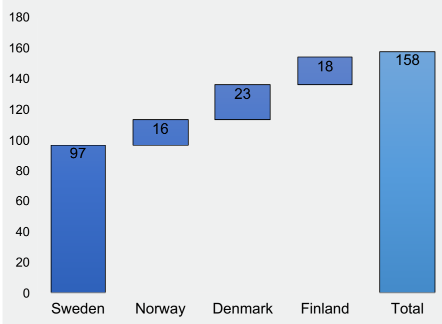
Average sharpe ratios by NHX sub-category



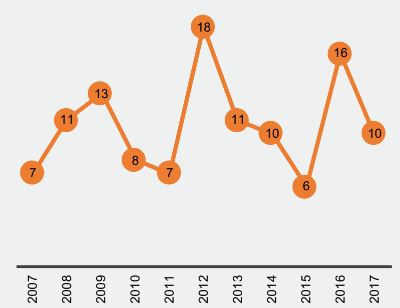
Performance fees charged by Nordic hedge funds



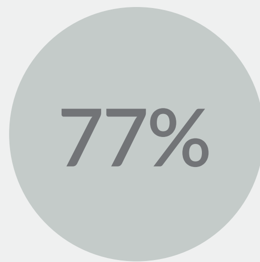
Country Breakdown



Hedge Fund Launches



Portion of Fund Gainers



Based on 2017 performance

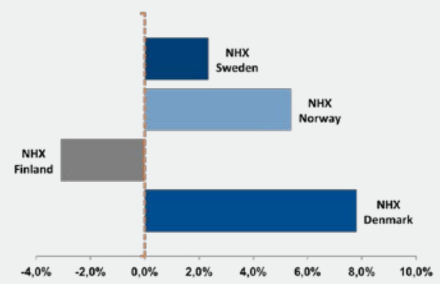
Largest Fund by AuM

Brummer Multi-Strategy

38.0 Billion SEK ~ 4.6 Billion USD

As of December 29, 2017

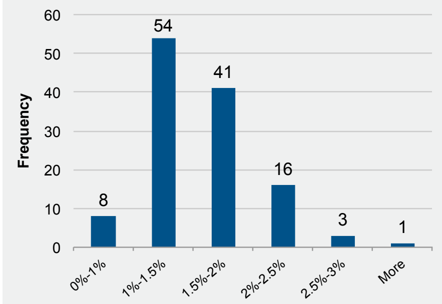
Hedge fund performance by country

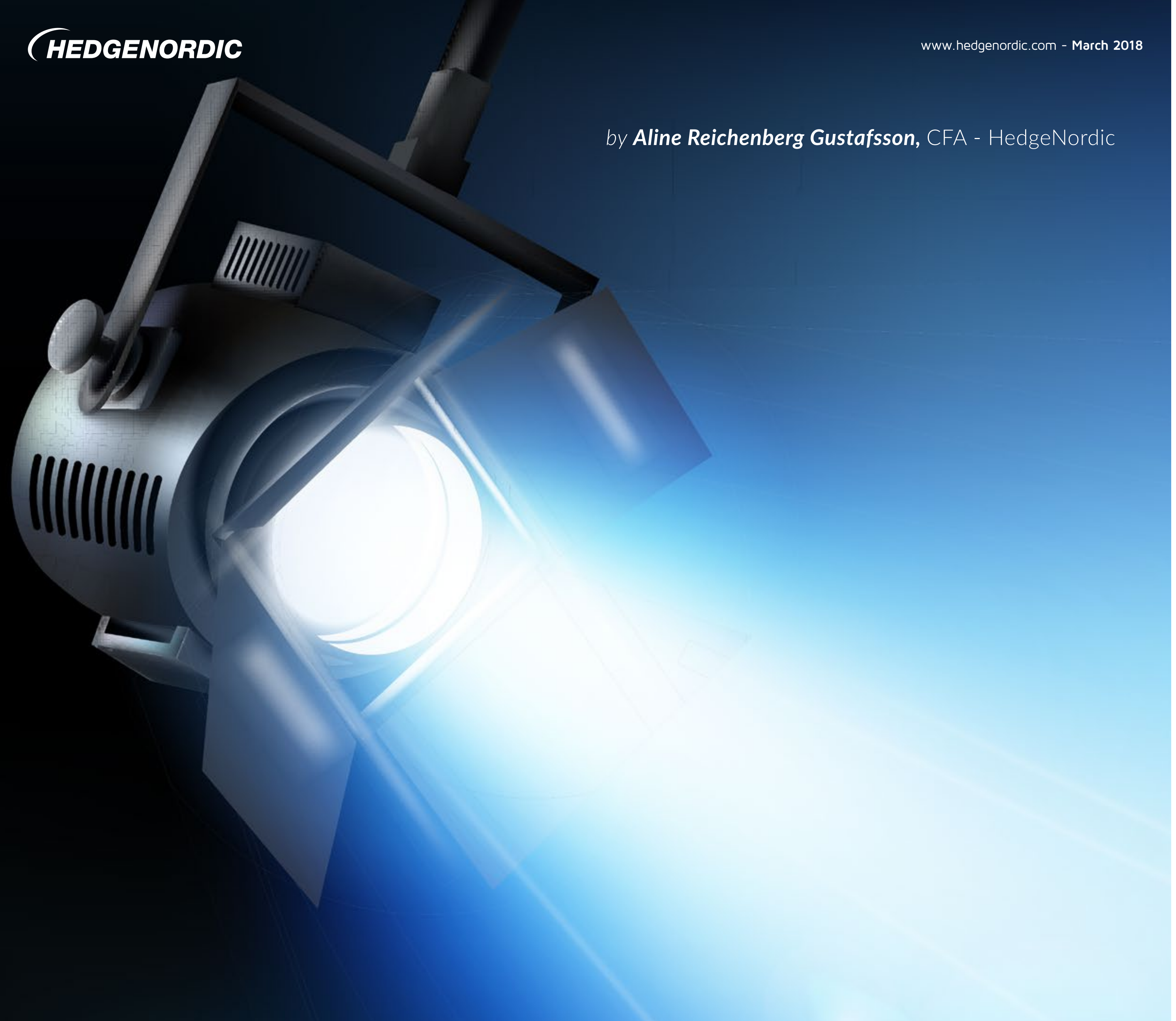


2017 Launches

- Volt Diversified Alpha Fund
- IAM Nordic Multi Strategy Fund
- CABA Hedge
- Nordic Cross Total Return Bond Fund
- Nordic Cross Stable Return
- Nykredit EVIRA Hedge Fund
- Asgard Fixed Income Risk Premia
- Adrigo Small & Midcap L/S
- Evli Factor Premia
- Nordic Cross Small Cap Edge

Management fees charged by Nordic hedge funds





by **Aline Reichenberg Gustafsson,** CFA - HedgeNordic

What Makes a Good Hedge Fund

Market Neutral and Volatility Strategies Under the Spotlight

The Nordic Hedge Award has been recognising the best Nordic hedge fund managers every year since 2012. After a quantitative screening finds the nominees in each category, a jury composed of Nordic institutional investors determines the winner. The jury's selection criteria go beyond numbers, by taking into account other elements that investors typically consider, such as reputation or fund organisation. We have asked two of this year's Nordic Hedge Award jury members to share their personal view on what they look at when making an investment decision in a hedge fund. Claudia Stanghellini, Head of external management at Swedish National pension fund AP3, and Malin Hallén, Senior Portfolio Manager, Manager Selection at Swedbank Robur, have accepted to answer our questions.

When considering a hedge fund, the first question is how the strategy fits within the firm's broader asset allocation. For example, AP3 excludes directional managers from its hedge fund allocation. "We don't want to pay for beta at hedge fund prices," justifies Stanghellini. "Hedge funds should not correlate with the equity market to be part of our absolute-return bucket." In addition to external hedge funds, AP3 also includes its internal alpha strategies, which are in-house long/short hedge fund mandates, as well as risk-premia strategies, in the absolute-return section of its overall portfolio. "Some people assign risk premia to the beta allocation of their portfolio, but we don't. But it depends on what type of risk premia you choose and we try also to build a risk-premia portfolio which is uncorrelated to the market. Currently, we have more risk allocated to these strategies than to hedge funds, as we are looking to harvest risk premia in the long-term."

"We don't want to pay for beta at hedge fund prices."

At Swedbank Robur, portfolio construction is, of course, crucial, explains Hallén. "It is a mix of art and science," she says. "Our hedge fund allocation is primarily included to add diversification but also value to our traditional asset classes. Our view of the market will determine how much we allocate to each bucket. The hedge fund portion of the portfolio has to fit with what the rest of the portfolio looks like." Currently, the hedge fund selection consists mostly of absolute return strategies such as equity market neutral and trend following strategies. "Within a strategy, the weights of the different funds are adjusted depending on our conviction, and on the correlation, they have with the other hedge funds in the portfolio, as well as the portfolio as a whole for example. In general, we want our holdings to complement one another in terms of investment strategy, approach and performance and risk patterns and so forth."

Numbers are evidently paramount in any manager selection process, but for both Stanghellini and Hallén, there is more to it than a mere quantitative screening. "There isn't a single most important factor," starts Hallén. "They all need to make sense, and we need to acquire a conviction in the management process, as well as the organisation behind the fund. The most important is the quality and the experience of the team. Once we have assessed that, the rest is more likely to follow."

"In general, we want our holdings to complement one another in terms of investment strategy, approach and performance and risk patterns and so forth."

At AP3, Stanghellini reminds us, the "4Ps" are a guiding principle. " People, Process, Performance and Protection, these are the first things we consider. Practically, we like to see at least three years of track record, because we want to see how the managers handle drawdowns and risk. They must show that they have control of their portfolio in a stressed market. We don't look for the next hedge fund stars who will produce 50 percent performance in one year with painful drawdowns when markets move against them. We want to have a fund with stable performance, that is mostly alpha. Our managers must have the ability to deliver on target given their mandate. Cost is an important consideration in our overall portfolio strategy, and a hedge fund's fee structure must be in line with our means." In addition to the actual selection criteria, AP3 also looks for a long-term strategic partnership with its hedge fund managers, Stanghellini reveals. "We select skilled managers in niche markets. At the same time, we want to grow our capabilities internally and look for managers that are open to share and discuss research, investment ideas and market views with us. We like knowledge sharing."

Hallén mentions a new consideration in her selection process. "This may not be the most important criteria right now, but it has become more prominent in our manager selection process. We have added sustainability to our due diligence process a couple of years ago. It is a factor we take into consideration. We favour managers that have signed the PRI and incorporate those principles on a day-to-day basis. We are aware that it is easier for some strategies, such as equity long/short, than for others like trend followers. Hedge funds have started incorporating sustainable investing practices across the board; the change is happening as we speak, and we are happy to see that."

"We want to grow our capabilities internally and look for managers that are open to share and discuss research, investment ideas and market views with us. We like knowledge sharing."

Concretely, Stanghellini and Hallén are looking for hedge fund strategies that complement their firm's portfolio, and therefore they need to be de-correlated from traditional asset classes. "We don't cover all the styles," says Stanghellini. "We have selected some strategies, such as global macro and CTA, niche long/short structured credit, or even emerging market hedge funds. We try to find strategies that fit into the wider allocation, and that we cannot manage internally because we don't have the expertise or the scale." Stanghellini concurs with Hallén's view.

"In strong beta markets," Stanghellini continues, "interesting managers are those that are more market neutral. Volatility strategies are also interesting, even though they are getting crowded perhaps. It is still a niche space." At Swedbank, volatility strategies have also been part of the portfolio. "Our long volatility position paid off in the recent market downturn. This type of market is notoriously difficult to navigate, especially for CTAs and trend followers. There is one fund however which distinguished itself during the recent turmoil, a Nordic shorter-term trend following strategy, Estlander & Partners Freedom. All our CTA positions had negative performance during the turmoil, but this one was down less than one percent. Among our market-neutral positions, on average the performance was slightly negative, but a bright spot was Pictet Asset Management's Agora fund. It has managed to deliver a consistently positive return, even in choppy markets."

"We have added sustainability to our due diligence process a couple of years ago. It is a factor we take into consideration."

Both Hallén and Stanghellini believe in long-term commitments once they have invested with any given manager, provided things pan out as expected of course. "Our holding time is long-term if the manager is on target," says Stanghellini. "We target high single digits for volatility around or over 10 percent, and a Sharpe ratio of at least 0.7 for each of the funds."

Swedbank Robur has gradually integrated hedge funds into its portfolio since 2012. "We have not exited that many of our investments, to be honest," says Hallén. "In some cases, we did, because the fund didn't fit into our portfolio construction, or because we saw better opportunities elsewhere. Our shortest holding period was one year; the fund didn't live up to our expectations, but there were several other factors at play. It was an exception."

Claudia Stanghellini,
Head of External Management - AP3

Claudia has 22 years of experience in finance, of which 16 at AP3. After obtaining a MSc in Actuarial Sciences at City University in London, she joined Sun Life Financial as an Actuarial Analyst for 5 years.

She started at AP3 in 2002 as a Quantitative Analyst. Two and a half years later she became a portfolio manager in the Global Equity team where she specialised in selecting long-only managers. In 2007, as AP3 operated a separation between alpha and beta strategies, Claudia's focus extended to alternative asset strategies.

Today, Claudia is responsible for manager research, manager selection and portfolio construction of externally managed strategies for the alpha and beta portfolios. She covers traditional long-only strategies, hedge funds and risk premia strategies across all asset classes. Claudia is also member of the Risk Management Committee at AP3.

Malin Hallén,
Sr. Portfolio Manager. Asset Allocation – Swedbank Robur

Malin Hallén is a Senior Portfolio Manager within the Asset Allocation team at Swedbank Robur. She is currently managing a range of primarily multi-asset funds, investing across equity, fixed income and alternative investments; both directional and market neutral strategies. The total assets under management exceed 30 billion SEK. Part of the job involves manager selection responsibilities where she covers both traditional long-only and hedge fund strategies across all asset classes. Malin has 19 years of experience in finance, of which 9 is at Swedbank Robur.

Before joining Swedbank Robur in 2009, Malin worked at Handelsbanken Kapitalförvaltning, External Funds and Alternative Investment with responsibility for External Funds within Handelsbanken. Malin has also spent close to 10 years at Skandia as a Senior Fundanalyst and Portfolio manager, where she had a broad coverage across asset classes including hedge funds. There she was a member of SkandiaLinks and Skandia Global Funds investment committees as well as board member of Skandia Investment Advisory Services AB.

She is a certified EFFAS Financial Analyst (CEFA), authorized Financial Analyst (AFA), and a member of the Swedish Society of Financial Analysts.

CHANGE AND CONTINUITY:
How Nordic Pension Funds Invest in Equity

by ***Richard Tyszkiewicz*** – Senior Director - bfinance

Fifteen years ago, when we began working with Nordic institutional investors, approaches to listed equity investing were very different indeed.

The rise of passive equity investing, the refinements in alpha beta separation, the development of risk premia analysis and the increasing prominence of ESG have all fundamentally changed equity portfolios – hopefully, we believe, for the better. Meanwhile, asset allocation at a high level has shifted in favour of alternative asset classes, altering the task that listed equity investments are expected to accomplish.

Yet these much-debated changes, outlined in greater detail below, mask certain elements of consistency and continuity. Fifteen years ago, the majority of equity manager selection activity by these investors, whether for global or regional markets, focused on long-only strategies with a preference for bottom-up stock picking, a clearly explicable investment process and a pooled vehicle structure for ease of administration.

Today there is still a strong appetite for long-only active equity managers with many of the same key characteristics, although in many cases these must now clearly complement passive or smart beta strategies – and each other – rather than stand alone.

These constructions and combinations are increasingly innovative. For example, following a successful test with internally managed domestic equities, Sweden's AP7 gradually moved their whole listed equity portfolio to a structure based on 100% passive market exposure complemented by unfunded "pure alpha" long-short mandates. Another sophisticated investor has developed a long-term strategy around combining complementary active managers in a very effective "all-weather" in-house fund of funds.

Cost compression

The shift towards passive investing has perhaps been the most visible development in Nordic investors' equity allocations, followed closely by the related trend of investment insourcing – the move to manage a greater proportion of investments in-house, sometimes running them on a more systematic enhanced model.

The insourcing trend is, in part, a by-product of the quite rapid consolidation taking place in the Nordic pensions industry. Once a pension fund reaches a certain critical mass it can justify the internal resources needed for asset management. As seen in the Dutch market, the next step in this growth process can be to offer asset management services to third party clients.

The swings in favour of passive management and insourcing both have a strong basis in investment prudence and have certainly contributed to lower expenses for equity investments, although these have often been partly offset by additional spending on the alternative investment side. We have also seen notable reductions in the fees offered to Nordic investors by active equity managers, particularly among more systematic strategies.

> **"The shift towards passive investing has perhaps been the most visible development in Nordic investors' equity allocations."**

Yet new practices have not always been entirely voluntary. For some investors, increasingly stringent cost constraints have dictated behaviour. Stakeholder pressure has also been a critical factor: justifying the expense of active management through short-term ups and downs in the market can be immensely difficult. We have observed cases where investors have proceeded further down the "cost-saving" path than their senior investment staff believe will be optimal for long-term investment outcomes.

Alpha/beta separation

The rise of passive investing has also been part of a general trend among Nordic institutional investors to get a better understanding of – and control over – the alpha sources in equity portfolios. The greater awareness of risk factor exposures and their contribution towards returns, in addition to the disappointment with some active managers that were suspected of "closet index" investing, led some of our clients towards restructuring their portfolios around a passive core, sometimes supplemented by carefully combined smart beta strategies and benchmark-agnostic unconstrained "satellite" managers.

The message has been clear and powerful: investors no longer intend to pay active management fees where they are not due.

Yet onlookers should not be deceived into thinking that this means active management is out of favour among Nordic pension funds. We are still running a consistent stream of searches for active equity managers for Nordic institutions. Indeed, we note a resurgence in the popularity of active managers among some contrarian Nordic investors who view the general shift into passive as an excellent opportunity to add some of the best active houses into their portfolios.

ESG acceptance

Nordic investors have long been a driving force in the increasing prominence of sustainable investing. Over the past fifteen years, ESG has definitively progressed from "ethical" side-show to mainstream industry phenomenon. Many of bfinance's clients in the region are long-standing participants in international initiatives to help advance environmental, social and governance (ESG) issues in the investment industry.

Indeed, every single equity manager selection exercise that we have conducted in the Nordic Region has required that the manager be (or become) a signatory to the Principles for Responsible investing. Viewed in the region as a basic minimum requirement, it is taken as a sign that managers are at least aware of the importance of ESG issues to their clients. That being said, there is a strong awareness among the community that many signatories have been bolting ESG functions onto existing processes rather than implementing genuine integration. This approach is rapidly becoming unacceptable to Nordic institutions, who in most cases are looking for managers with the ability and thought leadership to help their clients understand complex sustainability themes and help them develop their own sustainable investment policy.

> **"There is no doubt that Nordic pension funds have either led or been 'ahead of the curve' on many of the most significant shifts in the equity landscape."**

Interestingly, some of the best managers to come through our ESG assessment do not score particularly well within the PRI framework. Some of them do not even market themselves as ESG managers. Our Nordic clients typically look for managers that have a long track record of integrating non-financial criteria in their stock selection, most often on the basis that a focus on all aspects of ESG will favour sustainable companies for solid long-term investment.

Impact investing evolution

Driven initially by Nordic foundations with various philanthropic and developmental aims, 'impact investing' has become increasingly popular among some of the larger investors in the region. These strategies seek to achieve various explicit positive outcomes alongside financial returns.

This approach is generally oriented towards private equity, thanks to the direct access to and involvement with portfolio company management. Nevertheless, there is increasing appetite from Nordic institutions for impact investing in public equity markets. The greatest challenge is the accurate measurement of the positive outcomes that investors are seeking to achieve. Industry participants are hard at work trying to improve data access and agree on some form of standard reporting that would allow for better assessment of impact managers' performance.

There is no doubt that Nordic pension funds have either led or been 'ahead of the curve' on many of the most significant shifts in the equity landscape. Better active management fees, more sophisticated portfolio design and smarter asset manager analysis have all contributed to improvements. The past decade has seen particularly interesting innovations, although the driving pressures – particularly on the cost side – have not always been entirely positive in their effects.

Active management has emerged from this phase with a somewhat smaller, but perhaps no less important, role in portfolios. Diversification, genuine alpha generation, ESG and impact goals are of critical importance in today's Nordic pension market.

Richard Tyszkiewicz,
Senior Director - bfinance

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IS IT A BIRD, IS IT A PLANE...?

Petri Tuutti

NO, IT´S VISIO!

by Jonathan Furelid – HedgeNordic

> "Our main priority has always been to deliver competitive absolute returns and to do that with controlled risk."

By focusing on what matters - bringing absolute returns to end investors - Finnish asset manager Visio has proven its worth since launching in 2010. The fact that investors fail to frame them in a style box is of secondary importance, the firms founder and CIO, Petri Tuutti, argues.

There is an old slogan from the iconic jeans label Levi's saying that "quality never goes out of style". While that is probably all true, Finnish asset manager Visio has never been too concerned about the label attributed to their style of trading, but rather focused on bringing quality of returns to end investors. And indeed, trying to stick Allocator in a box with a clearly defined label will clearly cause a challenge. The fund is typically very directional, but has market neutral overlays, it trades large cap to small cap stock, corporate bonds, options and futures. The fund has a value approach at its core.

Although that has certainly been a challenge from a marketing perspective, with investors typically failing to frame the investment program in a pre-defined hedge fund category, the performance profile of the fund since launching in 2010 speaks for itself. The Visio Allocator fund has delivered on its promise to outperform equity markets to a significantly lower risk than that of stocks, earning it a five star Morningstar rating and recently also giving them the Morningstar award as the best allocation fund in Finland.

"Our main priority has always been to deliver competitive absolute returns and to do that with controlled risk. We are investing alongside our investors in the fund which means that there is an alignment of interest from day one", Petri Tuutti, Managing Director and CIO of Visio Asset Management explains.

Tuutti has a long background managing investment portfolios. In the 1990's he managed equity portfolios for the Finnish mutual insurance company Fennia and was also the first equity portfolio manager at Varma, Finland's largest pension fund. In 2000, Tuutti co-founded Avenir, a multi-strategy hedge fund that was managed under the Brummer and Partners umbrella organisation. Tuutti left Avenir to set up Visio in 2008.

The Allocator fund is currently co-managed by three portfolio managers. Next to Tuutti, who founded the company in 2009, the team also includes Antti Aalto who joined the firm from Danske Markets in 2012 and Sami Listola, who joined from Finnish asset manager FIM only last year.

STOCK-PICKING AT THE CORE

The Visio Allocator fund is an absolute return fund focusing on Nordic equity markets. At the core the strategy employs a stock-picking approach that Tuutti describes as being Visio's edge. The portfolio typically consists of 20-30 Nordic large- and mid-cap stocks with some small cap stocks blended in. On top of that, the portfolio trades an equity market neutral strategy, an equity hedging strategy and also invest into corporate bonds.

"The corporate bond strategy should be seen as a complementary to our equity trading, whenever we find opportunities that offer good risk return characteristics. This means that the proportion of bond allocations can vary significantly over time, in 2010 and 2011 when interest rate spreads were high and the return potential in high yield was significant, we held 60 percent of the allocation in corporate bonds, today, that number is below 10 percent", Tuutti says.

Since the start of the fund, the majority of profits have come from fundamental equity positions where Visio estimates the intrinsic value of a company and builds a balanced portfolio of what they see as mispriced Nordic securities. Most of the profits have come from positions in large cap stocks, Tuutti says.

"90 percent of the profits we have made in equities is from positions in large caps, only 10 percent relates to mid- and small cap positions."

Through the balanced equity portfolio, Visio targets to exceed equity market returns over a business cycle. Tuutti stresses that it is the ability of Visio to stay more defensive in difficult periods in equity markets that explains the outperformance over time.

"Succeeded by actively managing the downside in these periods we have to stay ahead of the equity markets while keeping portfolio volatility lower than the European stock markets on average. This is where our index hedging and market neutral portfolios come into play", he explains continuing:

"We are very active on the derivatives side, using futures for hedging purposes as well as to increase or decrease sector exposures. Options are also frequently used to manage individual positions and to hedge risks."

THE BENEFIT OF BEING LOCAL

Tuutti emphasizes that the Nordic focus is very important for bringing Visio´s value added to the portfolio over time.

"I think it is a combination of the fact that we know the culture, the companies and the investors here, you know how people usually act which makes a big difference when making investment decisions. Also the Nordic region as such offers many interesting opportunities since it is reflecting the opportunities in the developed world overall."

"90 percent of the profits we have made in equities is from positions in large caps, only 10 percent relates to mid- and small cap positions."

Tuutti also mentions that the inherent characteristics of the different Nordic markets make a case for good diversification benefits. "By combining the different Nordic countries in a portfolio provides basis for good diversification, Norway for example relies more on energy and Denmark being a defensive market are good examples of that", he says.

CURRENT POSITIONING AND WAYS FORWARD

Being value-driven at the core, Visio has no negative or positive bias built into their investment strategy. The long exposure in equities is based on the amount of cases offering excellent return potential relative to their risk using a fundamental bottom-up view. Except for a period in the very early days of the fund, when they were positioned for a risk-off scenario, Visio has held a long bias since late 2011.

"Both economic and company specific fundamentals have been supportive for quite some time which has made us hold on to our positive view for many years and to be significantly invested in stocks", says Tuutti. The recent sell-off and heightened volatility levels in equity markets have not materially changed this view.

"Looking at what happened in early February gives a fairly good idea of what can happen in the markets when momentum takes overhand. This is being emphasized by the increased use of momentum based ETF's. We are currently using and looking to further develop such indicators to better capture the momentum impact of equity market performance, both on the long and the short side", Tuutti explains.

Are institutions flexible enough for real diversification?

Aline Reichenberg Gustafsson, CFA – HedgeNordic

In a low bond yield environment accompanied by rich equity valuations, relying on differentiated strategies and new asset classes is more important than ever. Not many low-hanging fruits are left ripe for the picking, as institutions are hunting for every bit of sound alpha available.

One strategy however, locally managed in Stockholm but investing in assets across the pond, could provide a welcome diversification. But are Nordic institutions flexible enough to open their portfolios to a new asset class? We spoke to Gustaf Hagerud, CEO of Resscapital, who explained the advantages of investing in the market for US life insurance policies, while discussing the challenges he encounters when talking to local investors.

In essence, Resscapital´s strategy consists in taking over life-insurance contracts from individuals who no longer need them. Instead of letting their policies lapse, people can sell them and collect a lump-sum. The investor continues to pay premiums to the insurer and collects the policy payout at the end of these people's lives. Practically, the mechanism very much resembles a fixed income investment, as it involves a schedule of cash flows. The

Jonas Mårtenson, Sales Director & Founder

timing of the final payout is uncertain for each individual investment, but over a large number of policies, the average can be estimated fairly accurately. The valuation of the individual contracts relies on a statistical model and on the actualisation of expected cash flows. The measured volatility of the fund mainly depends on a mark-to-market model that takes into account recent transactions, even if the plan is to hold most assets to maturity, in principle. It is easy to see how such an asset class is absolutely uncorrelated from any other.

"Of course, investing in life insurance policies carries its own risks," explains Hagerud. "Longevity is one of them. Like for any insurance-linked security investment, there is an informational asymmetry. The seller always knows more than the buyer. What we do to remediate this problem is that we rely on the solid expertise of independent medical underwriters." Another reason institutions would be prudent not to invest directly in such securities is that the transaction itself and the management process of the policies once purchased are fairly complex. The market for life insurance policies is highly regulated in the US to ensure customers really benefit from the advantages of being able to sell their policies at a fair price instead of letting them lapse without any payoff. "We have developed a strong knowhow when it comes to coordinating the process with the different links in the transactional chain," adds Hagerud, "as well as ensuring that we limit any operational risk once the policy is in our portfolio. We have also accumulated more than five years of experience in valuing these assets in the context of our fund."

In 2017, when Resscapital's fund, Ress Life Investments started approaching the hailed USD 100 million mark, the company decided to hire Hagerud to take the fund to institutional investors. Until then, the fund had grown steadily with the support of individual investors, family offices and medium-sized institutions under the leadership of founder Jonas Mårtenson, who now focuses his efforts exclusively on marketing. Mårtenson comments: "With his institutional background, as Head of Asset Management at the Swedish public pension fund AP3, as well as his expertise in global tactical asset allocation from AP1 and Alecta, Gustaf can really help us to position the fund for larger investors. We believe that Ress Life Investments can provide diversification to them, with a return level that they may not obtain otherwise. But the investment process of pension funds is very different from that of the investors we approached until now. They have bigger teams and are more sophisticated in their asset allocation and manager selection."

> **"The measured volatility of the fund mainly depends on a mark-to-market model that takes into account recent transactions, even if the plan is to hold most assets to maturity."**

During his first few months on the job, Hagerud spent time talking to his former colleagues and peers, as well as a wider array of Nordic and European institutional investors. "We typically get a very positive response from these institutions. They are particularly attracted to the uncorrelated nature of the returns we provide. Another feature that investors appreciate is that there are two ways

> **"Often we find that investors put the fund in the alternative investments bucket, together with funds that have a significantly higher risk profile, such as private equity, for example."**

in and out of the fund. Ress Life Investments is an open-ended fund with the possibility to subscribe or redeem like in many alternative investment funds, but it is also a listed company on the Copenhagen Nasdaq stock exchange. For redemptions, we require a seven-month notice, in order to be able to sell off policies in this illiquid market, while taking care of the interests of investors with a longer investment horizon."

Despite this opportunity to add return to most portfolios without increasing the level of risk, especially in this low yield environment, there seems to be a structural impediment for some institutions to invest in Ress Life Investments. "Often we find that investors put the fund in the alternative investments bucket, together with funds that have a significantly higher risk profile, such as private equity for example," says Hagerud. "Our risk profile is much closer to fixed income however with a volatility estimated at around 3.5 percent, but we offer a higher return with a target of 7 percent, and our Sharpe ratio is superior to many of the higher-risk alternatives. We also offer a level of fees that is competitive for our risk category."

All in all, the investment cycle for larger investments can also take quite a long time, especially when it comes to an unfamiliar asset class. "Compared to the US where this is a well-known investment area, it may take a little longer to convince European investors, and Nordic investors even more so. They need time, as they first need to understand how the market works, and then get to know the product and its characteristics."

As the payout is triggered by the death of the policyholder some investors are uncomfortable and have questioned such instruments from a moral perspective. "We have worked a lot with this aspect," Hagerud explains. "For some time now, we commissioned an ethical assessment of the investment strategy that shows how the market for life insurance policies actually favours the consumers, as it procures a financial payoff for something that would otherwise be worthless. Now we have taken one step further and set up a sustainable investment policy to show how we take ethics as well as other responsible investing questions at heart. As a result, we have become signatory of the UN Principles for Responsible Investing (PRI) last year."

Gustaf Hagerud, CEO

With all the stars lined up, Ress Life Investment is now well positioned to grow its assets but capacity is limited in the current product. "We only have space to grow the fund to about two and a half times its current size of approximately USD 90 million," continues Hagerud. "Our marketing strategy is to target those investors focused primarily on that unique offering we have to procure stable, yet totally uncorrelated returns. We are growing also outside the Nordics, mainly in the rest of Europe where are already have some investors. Interestingly, we are also seeing strong interest in Asia."

"OUT OF ALMOST 850 FUNDS ONLY 10 ARE CATEGORISED AS HEDGE FUNDS"

"Out of the almost 850 funds only 10 are categorised as hedge funds by Morningstar, proving that it has not been a favoured route by hedge fund managers."

by Pirkko Juntunen – HedgeNordic

PPM Reform

Tough Swedish premium pension system getting tougher for alternatives

New stricter entry criteria are expected to come into force on July 1 for the Swedish premium pension system, PPM. The tougher rules are expected to lead to fewer funds within the system and in the long run result in the platform becoming a professional buyer which would likely further cull the numbers.

How will this affect hedge funds? Is it likely going to increase the opportunities for alternative funds to be offered on the platform?

Current rules stipulates that funds registered on PPM must be UCITS-compliant, have daily trading as well as having certain levels of transparency. These criteria have already deterred hedge fund managers from entering. Out of the almost 850 funds only 10 are categorised as hedge funds by Morningstar, proving that it has not been a favoured route by hedge fund managers. In

THE FIRST HEDGE FUNDS ENTERED THE PPM SYSTEM IN 2009 AS UCITS FUNDS.

particular, the rebate system on fees may have been a major disincentive for hedge funds. Many hedge fund strategies have capacity constraints where maximising margins is key given the AUM, rather than compromise the strategy for 'uncontrolled' inflows in the current PPM system. However, fee pressures are also increasing within alternative UCITS funds which may point to PPM being viewed as an attractive platform in the future.

While large established players with a broad spectrum of products may be overall winners, there will be an opportunity to increase the proportion of good, well-run alternative products, such as hedge funds, within the PPM.

Some say hedge funds are complicated and expensive, others argue the benefits of a stable return irrespective of market conditions. This would make hedge funds particularly attractive now due to the fear a correction as equity valuations look expensive across the board.

However, concerns about the ability and indeed interest of the general public to select a well-diversified portfolio remain. Adding hedge funds and other alternatives without reforming the platform would therefore not serve any purpose is the argument. Industry participants and commentators all seem in agreement that professionalising the PPM platform through the ongoing reform process is a good thing. They argue that while large established players with a broad spectrum of products may be overall winners, there will be an opportunity to increase the proportion of good, well-run alternative products, such as hedge funds, within the PPM, particularly in the second phase of the process.

In the first step of the government proposal, which is out for consultation, asset managers will be required to have a minimum of a three-year operating history, a three-year track-record of every fund offered as well as a minimum of SEK500 million in assets in each fund. In addition, a maximum of 50% of a fund's asset can come from PPM inflows. All existing contracts will be void and asset managers will have to re-apply to join the reformed system. The asset management companies that wish to continue offering funds on PPM will have until October 1 this year to do so. Ole Settergren, head of the analytics department and intermittent head of the new fund platform department at Pensionsmyndigeten, the Pension Agency, which is the administrator of PPM, said it is expected that the new system will start operating at the beginning of 2019.

Existing funds that do not meet the new criteria, or if the companies choose not to re-register, will be booted out of the system. Investors will be informed and have to option of making an active selection where to transfer their funds. If a choice is not made assets will go to AP7 Såfa, the government default option within the system, Settergren explained. This has of course also led to speculation about what to do should AP7 grow in size, i.e implications for investment strategy among other concerns. As a government entity this will likely lead to more enquiries to seek a solution, if need be.

The background to reforming the PPM is various scandals within the system and in particular unscrupulous telesales techniques that has seen investors being taken advantage of. In addition, the end outcome was not in the forefront when the current system was introduced. At least it was not clearly communicated, leading people to make poor choices and perhaps not realising the effect this will have on their pension. The government wanted to increase consumer protection and has been pushing for stricter product information, transparency and sustainability issues for the fund industry, not just within PPM.

Making the rules even stricter may not seem to bode well for alternatives. However, the overhaul will for sure open up the system, particularly as more focus will be on the evaluation of the providers by a new fund platform department within the agency as well as three investment consultancies.

According to Morningstar statistics there are currently 10 funds categorised as hedge funds on the PPM platform. The first hedge funds entered the PPM system in 2009 as UCITS funds. The current funds are managed by Atlant Fonder, Advisor, Ålandsbanken, Zmartic Fonder, SEB Investment Management, NN Investment Partners, Norron, Pacific Fonder (2 funds) and Amundi Luxembourg. Advisor, Ålandsbanken, NN Investment Partners Norron, Amundi and SEB and would all be over the SEK500million fund AUM hurdle. Out of the six all, bar Ålandsbanken, also have the three-year performance track record required for the funds registered under the new stricter rules.

Currently only 21 out of the 105 asset managers offering funds in the Swedish premium pension system will be unaffected by the new stricter rules expected to come into effect on July 1 of this year.

Out of the 837 funds on the system 314 will not meet the new criteria. These funds have assets totalling SEK 321 billion. Out of the 105 asset managers offering the funds, 36 will see all their funds on the system affected, whereas 81 will see some of their funds affected, and only 21 will remain unaffected, according to statistics from the agency. Some 2.4 million investors within the system will be affected by the changes.

Under the new rules the agency will have extended powers as a gatekeeper of the system, enforcing the stricter criteria. The new fund platform department being created within the agency will oversee the quality of the funds. Erik Fransson is joining from SEB, where he has held several senior positions including working with the firm's fund platform, to head up the operations starting March 6. It is expected that the current team of 18 will be increased to 30.

Currently only 21 out of the 105 asset managers offering funds in the Swedish premium pension system will be unaffected by the new stricter rules expected to come into effect.

As the new department is being constructed the agency has appointed three consultancies to help with evaluating the fund companies wanting to enter the platform in its new form. The consultancies are Omeo Financial Consulting, Transcendent Group as well as Arkwright Group. Mats Langensjö, an investment and pension veteran recently joined Arkwright.

The government has stated there will be a second stage in the PPM-reform process. This will likely mean that the fund platform will become an institutional buyer, suggesting that the number of funds could then be slashed further. Having a distribution-platform professional such as Fransson at its helm is seen by industry participants as a good move for the future of Swedish pensions.

There has been and continues to be a lot of speculation about the final design of the new PPM. Settergren said there are no specific requirements on how many funds or the type of funds that will finally end up on the system. PPM is often not viewed as a single entity but should the second step in the reform materialise, making it an institutional buyer, it will surpass the AP funds in size. It currently has SEK1000 billion in assets, and by 2060 when the system has matured this will have grown to SEK4000 billion.

Last summer Skandia commissioned a report on the Swedish pension system, penned by the aforementioned Langensjö. In his report Langensjö suggests a new platform where choice remains but is relevant to the outcome, ie secure pensions by maximising returns and minimising losses. The relevant choice term would mean that the fund platform would act as one institutional entity. He proposes seven portfolio choices which would be vetted and would have clear risk-return profiles and outcome scenarios presented. The fund platform would remain but individuals who would opt out of the seven portfolios would be made aware that they are stepping away from a professionally vetted and monitored system and will be responsible for the outcome themselves. Those who do not make an active choice would still go to AP7.

A system with a defined ambition and relevant choice profile would not necessarily need the current level of liquidity and therefore open up to other fund structures than UCITS. Speculations about the end result continue but due to the strong political implications, including the upcoming elections, and interests of other powerful entities, whatever the outcome is it is likely to become a compromise in true Swedish style. Hopefully this compromise will have more foresight than the original design, keeping the end-goal of secure pensions in mind.

A RISK PARITY APPROACH TO SYSTEMATIC MACRO

by Jonathan Furelid – HedgeNordic

Stockholm-based multi-strategy manager Aktie-Ansvar which runs long-only as well as hedge fund strategies, in May of last year introduced a remodeled version of its systematic macro fund "Kvanthedge". A new team of portfolio managers had been hired to refine the previous models and to add diversifying strategies in order to improve the risk/return characteristics of the fund. So far, results have been highly encouraging, according to lead portfolio manager Björn Löfdahl.

"Not only has performance been good but the new models have added to diversification and our novel approach to setting risk limits has really paid off during the turbulent markets that we experienced in the beginning of this year", Löfdahl explains.

The models he refers to are new carry models in the currency, fixed income, equity and commodity spaces as, increasing the number of underlying contracts traded.


Björn Löfdahl


Boualem Djehiche


Tobias Grelsson

"Apart from having a new investment team on board, we have a broader set of assets and strategies, a new portfolio allocation methodology as well as a new approach to setting risk limits. We have added carry strategies, primarily playing the shapes of curves in the futures markets as well as commodity strategies trading energies, metals and soft commodities from a value perspective using fundamental data inputs."

The new team, which besides Löfdahl includes programmer Tobias Grelsson and mathematics professor Boualem Djehiche, is slowly but surely making advances in their efforts to create what Löfdahl defines as a risk parity approach to systematic macro.

"We are a very closely knit team, with myself typically forming the investment strategies while Tobias takes care of the implementation of the models. Boualem is overseeing our work and comes with invaluable inputs as to how investment ideas are being defined as well as how they come to best use from a portfolio perspective."

RISK PARITY WITHOUT THE PITFALLS OF VOLATILITY TARGETING

According to Löfdahl, the notion "risk parity" does explain to a large extent how the portfolio is being set up, but he points to the fact that Kvanthedge does not use volatility targeting for position sizing, which brings an important distinction to what they do, according to the manager.

"Our approach can be compared to what is commonly known as risk parity, where we want clusters of correlated assets to be allocated the same amount of risk. We run the fund with a volatility limit but unlike the typical risk parity fund, we prefer to look at tail risks in order not to underestimate the impact of stressed market scenarios."

> "ACCORDING TO LÖFDAHL, THE NOTION "RISK PARITY" DOES EXPLAIN TO A LARGE EXTENT HOW THE PORTFOLIO IS BEING SET UP."

Should we solely use volatility as a way of assessing risk, we would typically be at the highest risk exposure when things turn ugly, I do not feel comfortable with that."

The benefits of the Kvanthedge approach to risk management were well demonstrated in the most recent market volatility spike that saw many quant strategies experiencing extreme losses over a couple of trading days.

"As we do not by definition increase leverage in low volatility regimes, we came into this stressed market scenario with relatively low gearing, meaning also that we did not have to make massive adjustments in the aftermath of the event. As opposed to many other quant and risk parity funds we gained significantly on the day of the volatility spike as we had a risk-off positioning in place. We also benefited from a volatility strategy that was constructed to be long volatility in a large enough volatility move, while still able to harvest carry on ordinary volatility days.

The fact that we are primarily non-directional in nature but rather rely on fundamental relationships and dislocations expressed as relative positions also helped weather the turbulence", he says.

ADDING NEW MODELS AND MARKETS PAYS OFF

As the new strategy approaches nine months of live trading, Löfdahl says that there are clear signals of the new teams´ signature becoming visible, which according to the manager, is a consequence of the broadened portfolio in terms of strategies and markets

"I think some of the new set of models introduced and the fact that we now trade commodities has had the greatest impact", says Löfdahl

Looking forward, there are no immediate plans to add to existing models but there is ongoing research looking at what models could be added or withdrawn to further enhance the risk/return characteristics of the portfolio.

"I do not foresee us to have a huge turnover of models but we are of course continuously evaluating those that are currently running in the portfolio."

In terms of what a regime shift in terms of volatility would mean for the performance of the fund, Löfdahl sees an environment of increased market volatility as being less of an issue, in fact it could rather create better opportunities as long as there is divergence in valuations across markets and asset classes.

"I do not see it as a major problem should market turn increasingly volatile as long as there is some divergence creating relative value opportunities.

Even if such opportunities fail to materialize, the fund can generate returns anyway thanks to its market-neutral carry strategies", he concludes.

REAL ESTATE IN THE NORDICS: AS LOCAL AS IT CAN BE

by ***Aline Reichenberg Gustafsson***, CFA – HedgeNordic

Given the inherent nature of real estate, the fact that most of it cannot easily be moved around, investing in this asset class is mostly a local business. For an investor looking at a balanced asset allocation, however, it makes sense to think of real estate as any other asset class and try to achieve as much diversification as possible. When Finnish Asset Manager, United Bankers decided to launch an open-ended vehicle targeted at Finnish individual investors and smaller institutions, the aim was to offer a local, yet sufficiently diversified product with stable core-plus real estate investments. This is why the team chose to broaden its focus from Finland to include the whole Nordic market. HedgeNordic sat down with Jarkko Lehtonen, Portfolio Manager for UB Real Assets, to understand how the team can combine local expertise with a market that may be more diverse than it appears.

"We wanted to diversify internationally, within the Nordics, from being focused only on the Finnish market" starts Lehtonen. "It seemed like a logical step. We thought that having a well-diversified portfolio of commercial properties in the Nordics would be broad enough for any private and smaller institutional investors wanting to benefit from our expertise while reducing the exposure to a single market."

Thus Lehtonen and his team set off to build an investment process that would fit this strategy. First, Lehtonen mentions a challenge that is unique when comparing the Nordics to other geographic areas. "Think about the fact that we have four different currencies in the Nordics. Even if you consider that the Danish Krone is pegged to the Euro, it still produces a challenging dynamics when allocating capital across the region. Right now, for example, the Swedish Krona is particularly weak compared to the Euro so we can take advantage of this opportunity." Because of the local nature of the market, real estate prices tend to adjust much slower to currency movements than other assets, which can easily be transferred like bonds. This means that for Lehtonen who can be opportunistic when deploying his capital, timing an investment with currency movements may generate tangible benefits. "We can also hedge our currency positions, but we have the flexibility to decide whether to do it or not. Right now, we don't think that the Swedish Krona will remain this weak permanently, so we prefer not to."

"YOU CAN'T THINK OF COUNTRIES AS MARKETS. SOME JOKE THAT EVEN FOR US IN HELSINKI, IT MAY BE DIFFICULT TO INVEST IN TURKU."

Beyond this particular aspect, Lehtonen highlights that an investor doesn't need to travel very far from home to realise how local the real estate market is. "You can't think of countries as markets. Some joke that even for us in Helsinki, it may be difficult to invest in Turku," he says with a smile. Turku is a resort city, not that far from Helsinki on the western coast of Finland. "If the city is big enough, it becomes a market by itself, and you need to become an expert."

For this reason, Lehtonen's team tries to forge partnerships with the strongest actors in the other Nordic countries, to benefit from their local expertise while bringing capital to the table. "At the moment, we focus on the larger towns in Sweden for example, because it takes time to build relationships with the right experts in smaller locations all over the country," he explains. "We like to invest alongside local actors. Expertise about micro-locations is essential. You can look at the map, but it is the locals who know if the micro-location is attractive or not." Given the open-ended structure of UB's vehicle, Lehtonen privileges liquid investments. Being a minority partner in a project also provides the benefit of providing a certain level of flexibility. "Selling part of a project is easier than selling the whole, and there is a secondary market for these types of deals."

"PRICING IS RELATIVELY TRANSPARENT IN NORDIC COUNTRIES, AND WE CAN TURN THIS TO OUR ADVANTAGE."

One type of partnership is particularly practical for liquidity purposes. "Syndicates are quite popular in Norway, and they have been for the past 25 years," explains Lehtonen. "The set-up is such that a property company (prop-co) which issues financing can own several properties. Investors acquire shares in the prop-co and get dividends paid out to them. If we need to sell, say 10% in this sort of company, it is easy to find a counterparty. Buyers have immediate access to cash flow, which can be attractive." However, this advantage seems to be, again, rather local. "We have found only few players in the syndication market in Sweden and even these companies' might have a Norwegian parent. In Sweden, you see a lot of listed property companies instead. There are even listed portfolios. We have invested in some of these projects, listed on the small market, Aktietorget. We have even looked at some companies on First North, but haven't invested there yet."

"COMPARED TO THE OTHER NORDIC COUNTRIES, FINLAND OFTEN OFFERS MORE ATTRACTIVE YIELDS STILL, ESPECIALLY BEYOND THE HELSINKI METROPOLITAN AREA."

In Finland, syndications or listing of property companies are rare. "We don't have this kind of business segment at all," says Lehtonen. "But in Finland we are much more comfortable investing alone in properties because we possess that local knowledge." Also, compared to the other Nordic countries, where valuations are generally and uniformly quite rich, believes Lehtonen, Finland often offers more attractive yields still, especially beyond the Helsinki metropolitan area. "Prime commercial properties are priced very similarly across the Nordics. In Helsinki, Oslo, Copenhagen and Stockholm, the yields are almost the same. Stockholm is perhaps slightly ahead of the others. In Finland, it is different from the rest of the Nordics: when you go outside of Helsinki, the yield gap is a lot higher, than if you go from Stockholm to Uppsala for example."

"Of course, it is not very clever to say that Sweden is expensive without taking all the factors into account. In absolute terms, it is; relatively to the other Nordic countries, the yields are typically lower. But lower initial yields indicate that the market expects a relatively higher value or rental growth in Sweden than elsewhere. On our side, we want to speculate as little as possible on the future. We prefer to see that all the investments we make have enough return potential without relying on future growth, that is uncertain. That is why we have had difficulties finding properties in Sweden that meet our criteria.

"Pricing is relatively transparent in Nordic countries, and we can turn this to our advantage," Lehtonen comments. "Do we want to invest in a logistics asset near Stockholm, which is not located in a prime area? Or do we want to invest in the Helsinki area, in a comparably better location at the same yield? We have the opportunity to cherry pick, even on a Nordic scale. Since we have grown our capital progressively, we haven't had too much to invest at once. Our screening has given us many options to choose from. It is more productive than if we had the same strategy in just one market. This means that we have also been opportunistic, without looking too much at the allocation between different countries. After two years of operation, our funds´ allocation is quite heavily leaned towards Norway, which we did anticipate to a certain extent, though."

Jarkko Lehtonen,
Portfolio Manager for UB Real Assets

FORMUE...WHO?

A GREAT DANE YOU MAY NOT HAVE ON YOUR RADAR....YET

by ***Hamlin Lovell*** – HedgeNordic

Since January 2018, the new Market in Financial Instruments Directive (MiFID II) has effectively outlawed "soft commission" in the EEA. Until then, trading commissions were commonly used to pay for research or other services. Since 2013 already, the Retail Distribution Review (RDR) stops fund managers from paying commissions to those advising retail clients in return for recommending funds.

Denmark's Formuepleje was arguably ahead of its time when the firm was founded in 1986: it was MiFID II compliant long before MiFID I was even conceived. "We have never had any trading desk in the company. We wanted to build an asset management company and not a broker. We do not use soft commission and also pay no commissions to banks or distributors," says Director Soren Astrup. This approach was based on a vision of avoiding potential conflicts of interest that were perceived in some other fund managers' business models. With EUR 8 billion worth of assets, Formuepleje now claims to be the largest asset manager in Denmark independent of bank interests.

> **"With EUR 8 billion worth of assets, Formuepleje now claims to be the largest asset manager in Denmark independent of bank interests"**

Quoting an all-in fee, including all non-fee costs and charges, is also mandated by MiFID II. Once again, Formuepleje has been doing this for many years. For example, one of its hedge fund strategies, Penta, charges 2.38%, which includes fees paid to external managers, and fees paid to service providers, such as directors, accountants, depositaries, custodians etc. "All investors pay the same fees, but larger clients can get a rebate based on their total engagement with the mother company," explains Astrup.

An anti-dilution levy, also known as "swing pricing" or variable bid/offer spreads, is an aspect of the transparent culture that is not a compulsory regulation. Up to 1% can be charged on subscriptions or redemptions, payable to the fund (and not the manager), to mirror the costs of establishing or unwinding the portfolio - so that long-term investors do not bear the brunt of these frictional costs. "The fee varies according to costs, and for larger investors it is levied on the basis of calculated costs. In practice, 1.00% has been the highest amount charged, and the fee can be somewhat lower in times of low volatility," says Astrup.

> **"They have been able to fund at negative rates, as low as minus 60 basis points, partly by exploiting inefficiencies in the FX forward market."**

Back in 1980s Denmark, a performance fee was also quite innovative. Formuepleje charges a 10% performance fee. There is a perpetual high-water mark with no resets (but also no hurdle rate, which investors might seek if interest rates normalise). Performance fees are designed to align interests between investors and fund managers. So too is co-investment, and staff have EUR 75 million invested in their own funds, on the same terms as external investors. The firm's other assets come from 12,000 investors, including private investors, high net worth individuals, private banks, and institutions, such as insurance companies, pension funds and a Danish foundation that sponsors the arts.

HEDGE FUND STRATEGIES

Most of Formuepleje's assets are in long only and real estate, but here HedgeNordic focuses on the hedge fund strategies. Formuepleje's signature strategy, Safe, which is approaching a 30 year track record, and its Penta strategy, incepted in 1995, have a base case allocation of 25% equities and 70% fixed income. They follow a philosophy of "leveraging the least risky part of the portfolio, which is the mortgage bonds" says Astrup. This might sound a bit like risk parity, but whereas most risk parity strategies are long only, Formuepleje's interest rate duration ranges between minus 2 and 6 . A neutral stance is defined as 2.5 years and the portfolio was around 3 years in February 2018. "Leverage for Penta's bond book can reach four times in normal market conditions, but would be lower when risk aversion is high," says Astrup.

FIXED INCOME

Negative interest rate policy (NRP) has had interesting implications for Formuepleje, as for some other Danish fixed income managers. They have been able to fund at negative rates, as low as minus 60 basis points, partly by exploiting inefficiencies in the FX forward market, using mainly local counterparties such as Danske Bank, Nordea, SEB and. "This has resulted in an average spread of around 100 basis points between funding costs and investment income, including the margin to banks and prime brokers," says Astrup. This "carry trade" strategy has also benefitted from the capital appreciation of Nordic fixed income.

The bond allocation is mainly government and mortgage bonds, in Sweden and Denmark. In addition to interest rate risk, prepayment risk is important for Danish mortgages. "We have developed our own modelling of prepayment risk to optimise models and portfolios and put together a strong team of experienced portfolio managers to navigate the market," says Astrup.

In the same way as global or fixed income arbitrage managers, Formuepleje can take active views on the yield curve. Currently, the manager is running positive duration at the front end of the curve, up to two years; somewhat less at the five to ten-year area; and negative duration between ten and thirty years. Technically, this is known as a "curve steepener", which could profit from a steepening of the Danish and/or Swedish yield curves.

The Safe portfolio can also invest in high yield corporate debt, but Penta does not. "Safe has a moderate leverage of up to two times, while Penta has the option of leveraging up to four times. This higher leverage creates a problem if liquidity disappears. We remember how in 2008, the market for high yield was washed away as volatility jumped to extremes never seen before. So we always want to be in control of the liquidity," explains Astrup. Indeed, the manager's risk framework was redefined after the crisis, with the aim of minimising volatility. Various new limits and restrictions were introduced. Formuepleje can hedge out currency risk, and has selectively done so for USD and GBP risk.

EQUITIES

"We do not run equities in-house right now, because we have found a rather superior team outside of our own organisation. It would be almost impossible to build a team like this in-house that would be able to compete on a price/quality ratio," says Astrup. The firm has since 2012 outsourced long only equity selection to Alliance Bernstein, though Formuepleje retains a veto, and has control over the asset allocation decision. "The base case is 25% in long equities, and it could range from 0% to 35%, though it is hard to imagine 0% in real life," says Astrup. The allocation has been tactically adjusted, and was scaled back ahead of the Brexit vote.

Separately from the Alliance Bernstein account, Formuepleje can also make tactical calls on particular sectors or geographies. A good example was an excursion into futures on the Russell 2000 index of US mid-cap stocks in 2017. "We took the view that domestically-oriented US companies could be especially strong beneficiaries of top line growth, and of the Republicans' tax reforms," says Astrup.

In addition to the long only equity allocation, there is an equity market neutral sleeve, which has generated an average alpha of 1.80% per year, from the long side, over a twelve-year period. No alpha comes from the short side, because index futures are used to hedge out the beta. Leverage of up to three times is applied. "For now, the market neutral strategy is a building block for the hedge funds, though it might be rolled out on a standalone basis at some stage," says Astrup.

Formuepleje could raise its own profile, and that of its hometown, Aarhus, 2017 European city of culture, when it pursues an IPO and list the management company on the Copenhagen Stock Exchange. The manager has offices in London and Luxembourg and the plan is to become more international, broadening out distribution, which is currently mainly in Sweden and Denmark. The firm also has regulatory marketing permissions for institutional investors in Norway.

Søren Astrup, Formuepleje

by Kamran Ghalitschi - HedgeNordic

Nordic New Launches

Keep ´em coming!

New launches in the global hedge fund space during the third quarter of 2017, the latest data available, exceed liquidations for first time since Q2 2015; Growth areas for 2018 include Blockchain/Cryptocurrency, Risk Parity, Technology, Healthcare and Activist.

New hedge fund launches exceeded liquidations on a quarterly basis for the first time in over two years, as improved investor risk tolerance and declining costs drove total hedge fund industry capital to a record $3.16 trillion in third quarter of 2017. Global new fund launches totalled 176 in the quarter, narrowly exceeding the 170 launches recorded in same quarter last year and bringing the year-to-date total to 545 funds, according to the latest HFR Market Microstructure Report.

When asked what it took to have a billion Dollar hedge fund launch, Bob Leonard, global head of capital introduction at Credit Suisse told BusinessInsider: An experienced team; a verifiable track record; institutional business with people on staff who know how to run the business side of things; and initial start up capital, according to Leonard. But a word of caution: don't expect to raise money quickly like the old days.

The Nordic region saw a slight slow down in new launches in 2017 according to data gathered by HedgeNordic.com and listings in the Nordic Hedge Index (NHX). During the year we saw a total of ten new funds come to market, down from sixteen new launches during 2016. The highest number of new launches in the region we have recorded were 18, in 2012.

Nordic Cross Stable Return, CABA Hedge, Nordic Cross Total Return Bond Fund, IAM Nordic Multi Strategy Fund, Volt Diversified Alpha Fund, Gamma Iceland Opportunity Fund, Asgard Credit Fund and Nykredit EVIRA. We are still waiting for the first new launch of 2018 to be added to the NHX.

Nordic Cross sparked some particular buzz as this was the largest new launch, of not just a fund but an entire operation, and likely the largest new Nordic launch since Nordkinn came to market in the summer of 2013.

Since 2015, the Nordic Hedge Award also distinguishes "the best new Nordic fund launch". The initial winners of this new category were Markus Wahlberg with his fund Elementa, and Fredrik Sjöstrand with Scandinavian Credit Fund I. The winners of this category are determined through a special jury, of other Nordic hedge fund managers. On this years jury last years´winner Fredrik Sjöstrand (Scandinavian Credit Fund I), Ola Wessel-Aas (Taiga Fund), Simon Reinius (OPM) Tommi Kemppainen (Helsinki Capital Partners) and Nicolai Kjer Rasmussen (Nykredit Asset Management) made up the jury.

On the next pages we will introduce four of theses newly launched funds of 2017 with EVIRA, CABA Hedge, Adrigo Small & Midcap L/S and Nordic Cross.

NYKREDIT LAUNCHES LEVERAGED CORPORATE CREDIT STRATEGY

by **Hamlin Lovell** – HedgeNordic

Denmark's Nykredit has a solid track record in long-only European corporate bonds. Nykredit Invest Engros EuroKredit has had top quartile returns within the European corporate bond peer group, over one, two, three, four, five and six years, ending in December 31, 2017, according to data from Morningstar Direct. It has also outperformed credit benchmarks (BAML EMU Corporates BBB-A Total Return, and EAA Fund EUR Corporate Bond).

Nykredit also has over a decade of experience running leveraged, hedge fund strategies that hedge out interest rate risk historically for Danish and Swedish covered bonds and mortgage bonds, in the award-winning MIRA and KOBRA strategies.

EVIRA (an acronym of the Danish name European Corporate Bonds Interest Rate Hedged) fuses both types of expertise. Argues Chief Portfolio Manager, Nicolai Kjer Rasmussen, "our knowledge of running leveraged accounts is like building a car, which can run on diesel, petrol, electricity, or hydrogen. We can also manage different credit asset classes in a hedge fund structure".

MAINLY INVESTMENT GRADE

As EVIRA has primarily long exposure to corporate credit, it should naturally have a higher correlation to equities and credit than Nykredit's older hedge fund strategies. "How high the correlation is depends on the proportion of high yield bonds in the portfolio, and in particular the lower-rated bonds, which behave most like equities" says Rasmussen. EVIRA invests mainly in bonds with a credit rating of, BBB or BB (though it can allocate up to 10% in unrated bonds) but from time to time investment grade

Nykredit Asset Management Fixed Income Team

investments will be used. There is a strict sell discipline upon rating downgrades. Bonds falling to B+ are sold within 3 months and those going below B+ are sold within 10 days. “We cannot afford too many fallen angels, due to the leverage and default probabilities” points out Rasmussen. The core concept is that it is better to own less secure loans (eg with less covenant protection) from strong companies, than to own more secure loans, made to weaker companies.

EVIRA can invest in banks’ hybrid and tier 2 capital, but cannot invest in additional tier 1 (AT1) as they have the right to postpone coupon payments explains Rasmussen.

PREDOMINANTLY EUROPEAN

EVIRA’s geographic remit is mainly Western Europe, which can include Southern European countries like Spain, Italy ,Portugal and Greece. (There is no Greek or Portugese exposure for now). EVIRA will not have a bias to the Nordic region. It doesn’t have a direct limit for US corporates but if the currency for USD goes above 10 %, the fund need to hedge the currency exposure. At present it has a 6 % exposure to USD, but the exposure comes from a European issuer that has issued bonds in USD. In general terms currency exposures need to be in Danish Kroner, Euros, British Pounds, US Dollars, Swedish Krona or Norwegian Kroner. A maximum of 10% exposure in each currency to non- Euro/DKK is allowed, the remaining currency risk is hedged back to EUR/DKK.

> “Our knowledge of running leveraged accounts is like building a car, which can run on diesel, petrol, electricity, or hydrogen.“

REPO LEVERAGE

Whereas many credit hedge fund strategies obtain leverage through using derivatives, such as credit default swaps (CDS), EVIRA at present only invests in cash bonds, and gets leverage from repos.

EVIRA’s leverage stress test means that the manager cannot use active leverage of more than 3.5 times. This means that the NAV could fall by 60%, before leverage hit the 6 times ceiling and made EVIRA a forced seller. (EVIRA might be compelled to sell sooner, if haircuts changed, and/or lenders called back the credit). The repos typically have maturities of two to four weeks. In February 2018, leverage comes from only one source, , though Nykredit won’t rule out to have other counterparties if the strategy hits hard close..

The costs of leverage for the EVIRA strategy depend on bonds’ credit quality, and are naturally much higher than for MIRA or KOBRA, which trade Aaa-rated covered bonds.

Due to less liquid investments, that each issuer only can have a size of 15 % of NAV and the size of the total repo facility the capacity of the EVIRA strategy is at present EUR 100 million.

EVIRA assets under management are EUR 70 million in early 2018. Investors are a mix of institutional investors, family offices, and some high net worth individuals, with seed money partly coming from new clients, and also drawn from existing investors in the MIRA and KOBRA strategies.

INTEREST RATE RISK

EVIRA has a blend of fixed rate and floating rate exposure. Interest rate risk is only hedged for the investment grade, fixed rate exposure, because high yield bonds tends to correlate more with the equity market than interest rates and though has a lower rate sensitivity and floating rate bonds typically reset coupons at three month intervals. Futures and swaps are the prime mean used for rate hedging.

RETURN TARGET

EVIRA targets average annual returns of 8-10% through a full credit market cycle, substantially by leveraging up credit spreads. In early 2018, the expected return is running somewhat below target for two reasons. “The average spread of 2-2.25%, after hedging rate risk, is quite tight as yields have compressed throughout Europe. And leverage of 1.7 times is below the base case target of 3 times” says Rasmussen. If corporate yields normalise, Rasmussen expects rate hedges should contain losses from the rate component of yields, but that the strategy could incur some losses from widening of credit spreads.

> The average spread of 2-2.25%, after hedging rate risk, is quite tight as yields have compressed throughout Europe.”

CREDIT SPREAD TOLERANCE

EVIRA’s target limit for maximum credit spread sensitivity is a 30% loss from a 1% blow out in credit spreads, but it is currently running well below that. Spread widening (of around 40 basis points) contributed to losses of -2.64% in February 2018, reducing 2018 year to date returns to -1.25% after a strong January. The strategy had made 4.92% between September 2017 and January 2018. For its first six months, the strategy is annualising at about 7%, a bit below the lower end of the 8-10% target. Any further widening of credit spreads is likely to impose some short-term losses, but could improve the long-term opportunity set by allowing the fund to increase its running yield.

NYKREDIT´S HEDGE FUND STRATEGIES

The basic philosophy behind Nykredit Asset Management’s hedge Fund strategies is to isolate the core value of covered bonds. In their hedge fund strategies Nykredit AM are looking to optimize the core value of covered bonds, which is not related to the general interest rate risk. To optimize the risk adjusted return of the strategy leverage is used by using financial instruments. The general interest rate risk on the bonds is hedged in derivatives or long/short strategies. The main focus is the Nordic Covered bond market, and the strategies have as well the possibility to add AAA exposure from USD, GBP and EUR investments. In the strategy we use financial instruments to leverage the investments and to achieve an exposure to or hedge specific risk elements.

by Jonathan Furelid - HedgeNordic

Nordic Cross in Multiple Hedge Fund Launch

A new alternative investment boutique from Sweden gathers 2 billion SEK, proving there is still hope for new hedge fund launches in the Nordics.

In 2016, an award-winning hedge fund team from Catella decided to partner with the CARAM group to set up their own alternative investment boutique – Nordic Cross Asset Management. Although not evident to start a new hedge fund in an environment characterised by dwindling investor fees and high operational costs, the team behind Nordic Cross had no second thoughts.

By the time the first two funds were launched in 2017, they had investor commitments of over 1 billion SEK. As the third fund was launched in December 2017, the boutique was already running 2.2 billion SEK across its range of UCITS funds.

The Nordic Cross team – a well-oiled machinery

A majority of the investment team behind Nordic Cross, Ulf Strömsten, Mikael Hanell, Magnus Nilsson and Fredrik Tauson, previously worked together at Swedish asset manager Catella where they successfully ran the Catella Hedgefund flagship fund alongside more niched products focused on small-cap stocks, fixed income and credit markets. As Nordic Cross launched, a derivatives expert, Emil Nordström, was hired from Carnegie.

”We were a closely knit team already at Catella, myself running the Catella hedge fund having a great deal of support from Hanell, Nilsson and Tauson when forming investment ideas and finding ways of implementing them in the most efficient way", says Ulf Strömsten, CIO of Nordic Cross.

According to Magnus Nilsson, the addition of Nordström is however what really sets Nordic Cross apart from how the funds were managed at Catella. "By using Emil´s expertise in derivatives, we are finding ourselves being much more active on the risk management side, it simply offer us more tools to manage downside risk".

At Nordic Cross, Strömsten heads the multi-strategy fund "Stable Return", Nilsson and Tauson focus on the "Total Return" fund while Hanell's main responsibility is the recently launched "Small Cap Edge" fund. Nordström overlooks the risk profile of all funds. Apart from the investment team, the business development and sales efforts of the firm are overlooked by the founding partners Joakim Stenberg and Sebastian Uddén. Mats Andersson, previously CEO of Catella Funds, now serves as the company's CEO.

A sustainable investment approach

The three funds offered by Nordic Cross are all Nordic-focused and aim at delivering absolute returns through the use of active portfolio management. The funds are designed to offer the possibility to generate positive returns independent of market direction. As early adopters in the hedge fund industry to comply with rules of responsible investments, the firm is using the support of a third party provider to systematically scan the investment universe to assure a sustainable investment approach.

"We take the sustainability question very seriously, our firm belief is that there is a correlation between the performance of our funds and how we approach investments as responsible investors", Strömsten says.

The **Nordic Cross Total Return Bond Fund** is an unconstrained fixed income fund that have the possibility to go short duration. According to portfolio manager Magnus Nilsson, the fund has a broadly defined risk mandate. "On the long side, the fund could hold low-risk exposures as well as positions imposing higher risks. Among defensive positions are cash, cash deposits and government bonds while the more aggressive positions include certificates, mortgage bonds, investment grade bonds and corporates. We could also enter into high yield bonds but that part is capped at 40 percent."

The fund will be focused to the Nordic region with 50 percent of the exposure being held in Scandinavia while the other half in Northern Europe, hence no exposure to the US, Asia or emerging markets, according to Nilsson. The return target of Nordic Cross Total Return Bond Fund is set to 2.5-3 percent above the STIBOR reference rate

> "We take the sustainability question very seriously, our firm belief is that there is a correlation between the performance of our funds and how we approach investments as responsible investors."
>
> Ulf Strömsten

over an investment cycle and the fund will be using both long and short positions to reach that target. "Since this is an alternative investment fund, we have the mandate to go both long and short and to hedge positions. With regards to the fixed income fund, this is done through adjusting interest rate and credit risk given our current market view", Nilsson explains.

Nordic Cross Stable Return Fund is partly using the same strategy as the Total Return Bond Fund but with an additional equity strategy that will have 60 percent of the risk mandate over time, according to Strömsten. The equity part consists of three sub-strategies; market neutral, long/short equity and event driven. "In the market neutral part of the portfolio, the idea is to have an equal value of long and short positions on at any given time. Among other things, we use pair trades to take long positions in companies that we like and short positions in those that we feel less good about", Strömsten explains continuing: "The long/short strategy is allowed to vary more in terms of net exposure allowing us to take directional positions in the market. The net exposure can vary between -30 to +30 percent. The overall allocation to this strategy is however smaller than that of the market neutral one. In the event-driven book we are active in placings, IPO's and more traditional restructuring cases where the organisational setup and/or the business model is being remodelled to better extract shareholder value."

In the most recently launched **Nordic Cross Small Cap Edge Fund**, Mikael Hanell is looking for undervalued small-cap stocks in the Nordics with a market value of less than 35 billion SEK, those positions are contrasted by short positions in companies with a market capitalization exceeding 20 billion SEK. The rationale behind the size difference is to capture the relatively strong growth of smaller companies, a phenomenon that has been a driver of stock market returns in recent years, according to Hanell.

"Our focus is on capturing the relatively stronger growth of small companies in the Nordics relative to the larger ones. The long/short approach means that the investor will get exposure to many of the exciting growth companies out there but to a much lower market risk compared to a long-only approach." "Given the environment we are in, where valuations are becoming stretched after years of stock market gains, we feel that there is a gap in the market for exploiting relative value opportunities rather than just going outright long. The goal is to have a portfolio of 15-25 long positions and 2-5 short positions and to use futures and options for downside protection. The fund also uses a quant strategy to capture the valuation difference between large and small companies", Hanell explains. The Small Cap Edge

> "The three funds offered by Nordic Cross are all Nordic-focused and aim at delivering absolute returns through the use of active portfolio management."

fund has had a good few months since its inception and was up 1.3 percent for the year as of the end of February 2018. So far, the fund has invested in sectors such as IT, medtech, education, finance and energy.

FACT BOX:

The CARAM Group

Nordic Cross is part of the CARAM (Carnegie Affiliated Managers) Group, a multi-boutique asset management group housing a selection of investment firms under one roof. Caram was formed in 2016 by the inclusion under the CARAM umbrella of C Worldwide and Carnegie Fonder.

CARAM has since expanded in alternative assets, and is now the largest independent asset management group based in the Nordic region with over €22 billion in assets under management.

www.hedgenordic.com - March 2018
HEDGENORDIC

A DANISH BANK'S EDGE TRANSITIONED TO A HEDGE FUND

by Jonathan Furelid – HedgeNordic

Newly launched fixed income hedge fund CABA Capital uses a strategy that has earned proprietary portfolios of Danish banks stable returns for years.

In May of 2017, Niels-Ulrik Mousten and Carsten Bach, decided to leave Danske Bank after 14 years of service in top positions, to start their own hedge fund - CABA Capital. Mousten had served as the chief executive of Danske Capital, while Bach was in charge of managing Danske Banks proprietary capital as head of investment management at Danske Markets.

"The decision to leave the bank and start CABA was a natural step for me. I had dreamt about starting my own hedge fund for 10 years and as new capital rules had made the bank reduce its own trading activities, I knew this was the time to get going", Bach tells HedgeNordic.

Since the launch of CABA, the company has added new people to the team including CEO, Mette Osterbye Vejen and portfolio manager Chris Nygaard Sörensen, both joining from Danske Bank.

In July 2017, the fund "CABA Hedge" officially started trading after having gathered DKK 200 million in seed capital, doubling the the targeted DDK 100 million. By the end of February 2018, the AuM-level stood at about DKK 700 million.

SUCCESSFUL STRATEGY CARRIED FORWARD

The fund uses the same strategy as employed by Bach when he invested the bank's own capital at Danske, namely to exploit the yield spreads between mortgage bonds and government bonds in Denmark and Sweden. The strategy had for long earned Bach and his team very solid returns to a low risk profile at the bank. As for CABA, the fund targets an average annual return of 8 percent over a five year period with a volatility that should be well below that of equities.

The reason that the spread between mortgage bonds and government can be systematically exploited is, according to Bach, that there are features particularly in the Danish market, that will support a continuation of this yield-gap, offering a structural positive carry.

"The Danish markets are the core markets in the fund, where the spreads have been positive for 25 years. They will remain so for a number of reasons. The Danish state is AAA-rated, the public finances look good on headline level. In addition to that, the Danish government has a very strong future tax base, since very large pension savings from mandatory labor market pension schemes are tax deductible for the saver until retirement", Bach says continuing.

"The perceptions of the Danish mortgages on the other hand are, that there is a level of default risk to these bonds. It is very small but it matters. There are also many issuances perceived as less liquid, and there are features to these bonds, which makes Denmark an expert market, for which investors demands interest rate compensation."

RISK CONTROL THROUGH ACTIVE MANAGEMENT

Although Bach see the yield spreads as offering continued good prospects, he stresses that there are risks to the strategy.

"The most important risk factor is the development of the yield spread, which could be negatively affected by things such as changes in global risk appetite, bank regulations, the cyclicality of economic conditions, currency crisis and politics, external shocks that by definition are very hard or event impossible to predict.".

> **"The perceptions of the Danish mortgages on the other hand are, that there is a level of default risk to these bonds. It is very small but it matters."**

The worst possible market environment for the strategy is when interest rates move fast, the reason being that the duration of the underlying bonds then also changes quickly meaning that it becomes harder to hedge out the interest rate risk. "The strategy likes stability, as soon as rates are moving dramatically then it makes it harder to delta hedge the exposure causing unwanted losses." The worst year for the strategy looking back was when it lost 20-25 percent in 2008, only to gain it all back, and more, in 2009.

According to Bach, the use of active management and experience are keys to successfully navigating through more difficult periods.


Chris Nygaard Sørensen


Carsten Bach


Mette Østerbye Vejen


Niels-Ulrik Mousten

"Active management is imperative for risk control. In order for us to reach the stated return target, we need to use gearing, which requires careful monitoring. We also want our risk exposure to be dynamic to reflect an ongoing assessment of valuations and flows. There are also dynamics related to model risk and supply and demand relationships that are particular for mortgage bonds. On top of that security selection and curve positioning come into play. There is a lot more to the management of the fund than buying mortgage, selling state, and going home."

FEBRUARY VOLATILITY SPIKE - A STRESS TEST

The volatility spike that saw markets sell off in February was CABA's first real stress test since launching the fund. Having made a strong start earning the fund about 4 percent in its first six months of trading and an additional 50 basis points in January, the fund dropped 3.6 percent in February.

> **"The volatility spike that saw markets sell off in February was CABA's first real stress test since launching the fund."**

"It was a tough month where rates moved quickly, volatility spiked and liquidity dried out, making it difficult to hedge out risks. The active management of the fund however proved to add significant value. Had we used max gearing at the time, the theoretical drawdown would have been about 13 percent", Bach says.

"The fact that I have lived through most crisis periods during my 25 years managing money in previous positions, helps you not to become complacent about risks and to remain focused on the big picture. Following the sell-off in early February, we added to risk in order to capture.

"WHAT INVESTORS SHOULD LOOK FOR IN A HEDGE FUND"

Although the portfolio manager does not want to give out projections on the general development of interest rates going forward, Bach claims that there is good reasons to believe that the fund will reach its return target in the current environment, thus offering investors an attractive and uncorrelated return stream.

"The investment strategy carries almost no interest rate or currency risk. We believe the current interest rates is the unbiased predictor of future rates, even though we would sometimes hold different views ourselves than the average market participant. Spreads can widen from here; then our opportunities will improve somewhat."

"In the current environment, we believe the 8 percent return target is achievable. This should be attractive for institutional investors, since the fund is also uncorrelated to equities and fixed income, and has a low level of volatility. From a portfolio perspective, the CABA strategy is therefore likely to reduce the overall risk without lowering return expectations. This is exactly what investors should look for in a hedge fund."

CABA continues to see strong interest for the fund with investors adding to allocations following the setback in February, according to the company. Seemingly, there are many investors wanting to tap into a strategy that for years have generated solid returns for banking groups in Denmark, remains for Bach and his team to live up to expectations.

NEW LAUNCH
Putting Nordic Small & Mid Caps to work

by ***Jonathan Furelid*** – HedgeNordic

In November of 2017, Swedish hedge fund manager Adrigo added another fund to its offering by launching Adrigo Small & Midcap, the first new addition to the range since the original fund launched back in 2006. The new fund, following a long/short strategy, is managed by industry veteran Staffan Östlin and targets investments in Nordic small-cap companies with significant growth potential that are largely overlooked by analysts.

Staffan Östlin,
PM for Adrigo Small & Madcap

Unlike the Adrigo Hedge Fund which is focused on large and highly liquid companies, the Small & Midcap fund aims to discover investment opportunities in Nordic companies that are much smaller in size. We could go as low as 1-10 billion SEK in market capitalization but in some cases even lower", says Östlin who manages the newly launched fund alongside analyst Johan Eriksson.

Östlin, who joined Adrigo from Swedish hedge fund Origo Capital, has extensive experience from the Nordic equity markets having worked over 30 years in analyst and equity research sales positions in Sweden as well as in New York.

"I started my career in the equity markets in October 1987, needless to say the timing was not perfect. Since then I have covered the Nordic industrial sector as an analyst for many years. The small cap space has always been of great interest to me since this is where you can really add value as analyst. The smaller companies receive much less attention making the case for a chase of hidden gems. The opposite holds true as well of course, the big shorting opportunities are among those smaller companies that are much more sensitive to changes in market trends and overall business activity."

Concentrated portfolio of companies in transformation

The Adrigo Small & Midcap fund runs a highly concentrated portfolio of 15-25 companies of which 5-6 are referred to as "core holdings". The portfolio managers are primarily looking for companies undergoing some kind of transformation.

"We allow the core positions to have a significant portfolio weight, typically, translating into 45-55 percent of the total portfolio", says Östlin continuing:

"Our investment perspective for the core holdings is long term in nature, meaning 3-4 years. The long term thinking is crucial for us since we are looking for companies that are undergoing some sort of transformation, these things typically are not done overnight."

Complementing the core holdings are positions that are more dynamic in nature and where position sizes are much smaller with shorter investment horizons. A dynamic position is typically 2-4 percent of the portfolio and is held up to a year.

> **"The smaller companies receive much less attention making the case for a chase of hidden gems."**

The final layer of positions is what Östlin refers to as the micro-caps. These companies in some cases even fall below the limits set forth by other micro cap funds.

"We could go as low as 150 MSEK in market capitalization in these cases", Östlin says.

Among companies that are currently owned by the fund, Swedish supplier of medical products Arjo is one of the big positions, other holdings include Norwegian logistics company Wallenius Willhelmsen and Swedish industrial company Momentum.

In order for an investment to be made, Östlin says that he wants to see potential for the stock to double over the next four to five years, which translates into a 15 percent annual gain. He is not too concerned about what sector the company belongs to but believes that the management and board of directors is of crucial importance.

The short book

With regards to short positions, Östlin and Eriksson look for stocks that are facing structural challenges or where changes in the core market or industry trends are working against the business model of the company. Östlin recognises however that shorting imposes other type of challenges except for just finding the case for a stock to decrease in value.

"On the short side we need to take into consideration financing costs and the risk of being squeezed in case we are wrong. We typically look for somewhat larger companies when shorting since the really small companies are difficult to find to reasonable financing costs and liquidity risk are allover present."

> **"On the short side we need to take into consideration financing costs and the risk of being squeezed in case we are wrong. "**

Among positions that have been shorted Östlin mentions Munters. "Munters stock was introduced to what we considered being a high valuation. The market, being euphoric at the time, was willing to pay the premia for what was considered a solid company with good growth prospects. As we saw the numbers from the quarterly report being well below expectations while analysts were still embracing the stock, we felt the time was right to enter a short position. This position has since been covered." So far the fund has only entered into company-specific shorts but the mandate allows to go short indices as well.

Good growth prospects ahead

Östlin sees good growth prospects ahead for Nordic small cap companies although he recognizes that valuations might be on the high side. "We see robust global growth translating into a strong demand picture for Nordic small cap companies. By using an active long/short strategy we believe that we are in a good position to extract alpha opportunities wherever they arise." Östlin also stresses the importance of transparency in the Nordic countries as allowing them to make better and more informed decisions. "This is our home turf and we are familiar with the accounting standards which makes a good case for transparent investments. There is easy access to the board of directors and the management among smaller companies which provides for a better understanding of the companies and the challenges they face. This provides for a very good starting point for us as niche investors."

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FUNDS OF HEDGE FUNDS IN METAMORPHOSIS

Evolving, consolidating and specialising as the industry matures

by Hamlin Lovell – HedgeNordic

The claim that fund of hedge funds (FOHF) are dead is greatly exaggerated. Their headline assets of around $600 billion, per HFR, have been declining as a percentage of hedge fund industry assets (now around $3.5 trillion, according to BarclayHedge). But FOHF are highly influential in acting as consultants and advisors to some of the world's largest pension funds, endowments, foundations, and sovereign wealth funds, which often invest via their own dedicated managed accounts, so that the assets do not appear under FOHF umbrellas.

Advantages

FOHF aim to add value through one or more of: access, diversification, asset allocation, strategy allocation, manager selection, risk management, and negotiating fee discounts and structures.

Historically, when little public information existed about hedge funds, the funds of funds offered access to hedge funds as an asset class – and some of them, such as Dixon Boardman's Optima Group, or Theta Capital's Euronext-listed Legends Fund, do still offer some access to closed funds.

Funds of funds also allow smaller investors to obtain more diversification where minimum subscription sizes, which can range from $100,000 to $25 million or more, are too high for them to diversify by going direct. Even in the UCITS world, some UCITS hedge funds have minimums of $1 million or more.

Asset allocation and strategy selection bets are taken by managers such as SkyBridge Alternatives, which has allocated large percentage of its multi-manager product to specialist US mortgage managers. Many FOHF claim that their manager selection due diligence routines, have avoided frauds such as Madoff, and blow-ups.

Indeed, FOHF may add value through risk management. Risks may be reduced through portfolio construction that provides a range of uncorrelated factor exposures. Some managers use risk aggregation formats (such as the non-commercial Open Protocol Enabling Risk Aggregation, or the commercial RiskMetrics) to help with getting a handle on fund risks, while others FOHF invest only through managed accounts that offer total position transparency, and potentially instant liquidity. Tactical trading of funds can involve regularly buying and selling funds, redeeming those that overshoot risk targets or breach risk guidelines.

Fees: Double fees, Netting risk and First Loss Structures

Funds of funds are now competing with investment consultants in two ways. For clients who are large enough to muster minimum tickets, both may simply provide a regularly updated "buy list", without actually managing the allocations. The business model here can be a fixed fee, as low as a few hundred thousand dollars a year, or maybe a few basis points of assets.

But the consultants do now manage money as well, through "implemented consulting", "fiduciary management" or "outsourced CIO" services. For these mandates, fees can also be quite low: perhaps tens of basis points, with no performance fees.

FOHF add a layer of costs, which may or may not be offset by using their buying power to get fee discounts from underlying managers. Cost-conscious investors encourage many funds of funds, including Kempen of the Netherlands, to negotiate fee discounts. Other managers use managed accounts, or co-investments into specific deals, partly to get lower fees.

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The biggest disadvantage of FOHF fees is arguably not the level of fees per se, but the absence of netting – so that investors are taking the netting risk. If half of a FOHF's funds make profits that are equal to losses incurred by the other half, then the FOHF still pays performance fees to the profitable funds, even though FOHF investors received aggregate performance of zero (or even lost money after FOHF fees and costs). Even when the majority of investee funds are profitable, the effective performance fee percentage incurred by FOHF investors is higher than the headline fee, and sometimes markedly so.

"The biggest disadvantage of FOHF fees is arguably not the level of fees per se, but the absence of netting."

Netting risk may be mitigated through an "internal FOHF" (which can also be dubbed a multi-strategy fund), where the same manager can offer multiple strategies, but this also greatly restricts the choice of funds. Some multi-strategy hedge funds that have hundreds of portfolio managers, each paid on their own P&L, have the same netting risk as most FOHF.

The most innovative fee structures include "first loss", whereby the underlying managers have to put up significant amounts of their own capital, and bear the first 10% or so of losses, but get a higher performance fee, perhaps as high as 50%. These vehicles have been good at preserving capital, and maintaining very steady returns. When most or all of the managers are profitable, the expense ratio is high, but investors do not pay performance fees for flat or negative performance.

Liquidity and 2008

A mismatch between FOHF liquidity, and their holdings' liquidity, became apparent in the financial crisis of 2008. This was partly due to some FOHF offering monthly or quarterly dealing, and allocating to some funds that had one, two or three-year lock ups. It was also due to 'style drift' with some ostensibly liquid managers investing into private equity assets such as African diamond mines. Frauds such as that perpetrated by Weavering manager and Swedish national, Magnus Peterson, (who now receives free food and lodging in the UK) did not help.

But the reality is that the evaporation of liquidity in late 2008 came as a big shock to most market participants. Strategies that might have been liquid enough to meet redemptions in 2007 or before, were paralysed as certain financial markets froze up. Stricken banks needed to shore up their own balance sheets rather than providing liquidity in markets, and many leveraged investors became forced sellers as credit was withdrawn. Holdings that had been classified as "level 2" and valued using a broker quote, were reclassified as "level 3" and had to be valued using models. Asset-based lending and direct lending strategies often struggled to repay redemptions because their borrowers could not find alternative finance from banks, while life insurance premium finance funds became illiquid for a more benign reason: humans are living longer, due to advances in medical treatments and technology.

All of this – and the failure of counterparties such as Lehman Brothers - led to gates, and side pockets, some of which turned out to be surprisingly good long-term investments. Lehman Brothers exposures have generated strong returns over the past nine years, for instance.

"Funds of funds are now competing with investment consultants in two ways."

There are persistent concerns about credit market liquidity, and a couple of long only credit mutual funds in the US suspended dealing in 2016, but we are not aware of any FOHF having had exposure. We have not heard of FOHF running into liquidity issues recently, but then overall financial market liquidity has been buoyed by central banks. We may only find out if there are liquidity mismatches, when and if investors make large redemptions.

Transparency

A perceived disadvantage of FOHF is lack of transparency, where they do not disclose their holdings – fully or at all. When I started in the FOHF industry in 2003, some players were secretive but I think this is now increasingly rare. Where FOHFs act as consultants, the clients obviously need to know the names of funds, in order to invest in them directly. Where there are comingled funds, FOHF financial statements should normally disclose holdings at least annually, while public funds such as UCITS in Europe, and exchange-listed vehicles, do so more often. Investors who want a transparent FOHF should be able to find plenty. The general thrust of multiple regulations, including MiFID II, is for more transparency, not less.

Evolving role

For the past decade, post-crisis, FOHFs have been consolidating, to cut costs and build critical mass. For instance, Permal, which manages on of the oldest FOHF - Haussman Holdings, launched in 1973 - was taken over by Legg Mason in 2005; bought Fauchier Partners in 2013, and then merged with EnTrust in 2016. Even the largest FOHF seem to think it makes sense to merge: in 2017, PAAMCO and KKR Prisma, each of which runs over USD 10 billion, announced a tie up.

This consolidation leads to the argument that the industry will become dominated by a few giants at one end of the spectrum, with niche specialists at the other end. Smaller and medium sized managers must be doing something different if they are to survive and remain independent. Specialist funds of funds could focus on managed futures/CTAs (eg Sweden's RPM), commodities, quantitative strategies, market neutral strategies (eg Sweden's Merrant), emerging markets, UCITS funds, alternative credit and direct lending, or on seeding new and emerging managers (eg IMQubator, where I worked between 2011 and 2013). Like all specialists, they will claim to have more knowledge and expertise in their own area. But clearly, the performance fee netting issue is multiplied when investors have ten different specialist FOHF.

"This consolidation leads to the argument that the industry will become dominated by a few giants at one end of the spectrum, with niche specialists at the other end."

The real reason why many smaller FOHF may in fact survive, is that they are often "friends and family" type vehicles, rather than hard-headed commercial businesses. The nature of the hedge fund industry is that some people like to invest with, and work with, those with whom they have forged strong personal relationships over many years.

About the Author:

Hamlin Lovell is Contributing Editor at The Hedge Fund Journal and has been contributing to HedgeNordic since 2015.

Hamlin started his career in 1997 as assistant economist in the UK Government Department of Social Security; he then moved into equity analytics starting with the Universities Superannuation Scheme (pension) and IDEAglobal (independent research provider).

In 2003, Hamlin became hedge fund analyst at two family offices, the first being The Capital Partnership then Duration Asset Management. In 2005, he became Co-Portfolio Manager at Millennium Global Investments, a diversified alternative asset manager, doing currency overlays, hedge funds and fund of funds.

Hamlin Lovell

In 2011, Hamlin joined IMQubator, a limited life closed end fund that seeds hedge funds, as Portfolio Manager, assisting the CIO. Since 2010, Hamlin has been contributing editor at The Hedge Fund Journal, the leading hedge fund industry monthly journal. He earned the CFA Designation in 2004, is a CAIA Charter holder since 2009 and received the FRM Designation in 2010.

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The building blocks of good Fund of Hedge Funds

A Liquid Alternative to… **Cash?**

by ***Aline Reichenberg Gustafsson***, CFA – HedgeNordic

Since the last financial crisis, funds of hedge funds have been largely replaced in institutional portfolios by internal manager selection. Some have blamed fees, others a lack of performance or transparency for the decline of the fund of fund concept. This may however be the time for a comeback, following a new concept born from the collaboration between fund of hedge funds manager Optimized Portfolio Management (OPM) and Caram Investment Solutions. Both organisations are part of the Caram group, a Nordic independent asset management group, with more than €20 billion under management. We sat down with Martin Alm, Portfolio Manager at OPM, to explore this new idea.

"Indeed, the use of fund of hedge funds is not very common in institutional portfolios," Alm admits. "It doesn't mean that covering hedge funds has become easier, especially for smaller institutions." What some investors underestimate, Alm explains, is the need to build a solid portfolio of funds. "It is important to manage a hedge fund portfolio instead of just meeting fund managers, and selecting the ones you like best."

Looking at single hedge fund positions, instead of considering the portfolio as a whole, can also cause institutions to focus too much on short-term performance. "Performance can be an issue, especially with uncorrelated strategies," Alm says, "and institutions may have trouble dealing with the higher risk of underlying funds." To illustrate his point, Alm suggests the example of CTAs, which can easily scale up volatility, unlike non-systematic strategies. A CTA that runs at 10 percent volatility will produce half the return of a CTA running at 20 percent volatility. Typically, however, the management fees will be

"It is important to manage a hedge fund portfolio instead of just meeting fund managers, and selecting the ones you like best."

the same for different funds, regardless of their volatility. Therefore, a fund with higher volatility will be relatively cheaper and should be preferred, all else being equal.

"Some institutional investors still have problems accepting CTAs with high volatility," Alm continues. "Often, the board of these organisations include people who are not investment professionals. They may have a large amount of capital to invest, but they find it difficult to accept unexpected moves in their positions, especially in markets that are unrelated to their area of expertise." For example, many investors sold out of CTAs after the "taper-tantrum" of 2013, when the US started talking about ending quantitative easing. Yields rose, and CTAs were long bonds, as the downward yield trend had been quite strong for a while. "This sudden move spooked people. A year later, CTAs performed well, as they benefitted from large oil and dollar moves, but some institutions stayed out of CTAs as they had sold them in the period where they couldn't understand the negative performance."

Having the right approach to portfolio construction is essential to understand the overall risk. "It is important to structure the portfolio in a way where you can tolerate the risk," states Alm. "You need to mix investments right to get the benefits of uncorrelated strategies, including crisis alpha for example. One of the benefits of a fund of funds is that the position an institution's board sees is already the result of a balanced mix." As the volatility of the individual funds is hidden, low correlation can work its magic without generating unnecessary concern.

"If we are good at diversifying, we will have low volatility. Increasing risk may just depend on having a more concentrated portfolio, or worse diversification."

The benefit of having one well-diversified fund of hedge funds should be an optimised return for a given level of risk. The main idea behind Caram Investment Solutions working together with OPM is to improve investors' performance in the context of illiquid alternative investments. Typically, when investing in private equity funds, investors commit a certain capital, which is successively drawn in a number of tranches across the duration of the fund's investment phase. Once investments mature and are sold off, investors receive the proceeds of their investments, most often also in tranches. As a result, a commitment is fully invested only during a fraction of the life of the private equity fund. The rest of the time, un-invested capital may serve other purposes, but it needs to be available at a couple of months' notice. This is where fund of hedge funds can be useful, believes the team behind Caram Investment Solutions.

Together with Caram, OPM has set a volatility target of five to ten percent for its fund of funds, which will primarily focus on systematic strategies. In the context of a fund of fund, maximising volatility may not make sense. "If we are good at diversifying," explains Alm, "we will have low volatility. Increasing risk may just depend on having a more concentrated portfolio, or worse diversification." At the moment, the fund is in a transition phase, however, where the goal is to increase the risk level to better match the proposition put together by Caram. The original OPM fund used to hold equity market neutral funds in the portfolio, which are usually positioned at the lower end of the risk-return spectrum. Given the redemption and subscription cycle, it may take Alm about three months to rotate out of all the positions he would like to change.

As part of the transition, Alm is looking at adding new funds. "We are increasing our allocation to trend-following strategies from 10-15 percent to about 40 percent, which means that we will go from two funds to four or five. We also invest in funds that can provide crisis alpha as well as short-term CTAs that can perform in sudden trend shifts, which is the time when traditional CTAs don't usually do

"One of the benefits of a fund of funds is that the position an institution's board sees is already the result of a balanced mix."

so well. These strategies do not correlate with each other. Of course, they could show weakness at the same time, but that is always a possibility when the correlation is zero. We still increase the likelihood of smoother returns and smaller drawdowns."

The recent market movements provide an example of what Alm's portfolio management process brings to the table, even if it is not bulletproof. "Of course, we were worried because we could predict what was going to happen," Alm says. "Markets had been going up with very low volatility.

Martin Alm,
Portfolio Manager, Optimized Portfolio Management (OPM)

Every trend-following strategy would be as long equities as their mandate would allow. Some funds we know were between 100 to 200 percent net long equities." A CTA typically invests in different asset classes that do not correlate with each other over time. But in the recent market, many funds were short the dollar against the Euro and the Pound, and long oil, as its price was trending up. All three reversed at the same time. With risk turned to the maximum, funds got badly hurt, some down 15 to 20 percent within two weeks. "We position ourselves so that short-term CTAs and systematic macro funds can mitigate these types of situations," adds Alm. "Short-term CTAs did well in 2015 for example. This time, they didn't do as well, but their losses were less important than that of their longer trend-focused peers."

For a fund of funds, as for any other hedge fund investor, being tactical in the short term is out of the question. Most of the funds are dealt monthly, sometimes with 30 days-notice. "We don't want to be sitting on cash," says Alm. "Our strategy is not to time investments, but to build a portfolio and to use our expertise in manager selection." These two elements go hand in hand. "We find the managers that we like and trust, but we only invest in those that fit into our portfolio."

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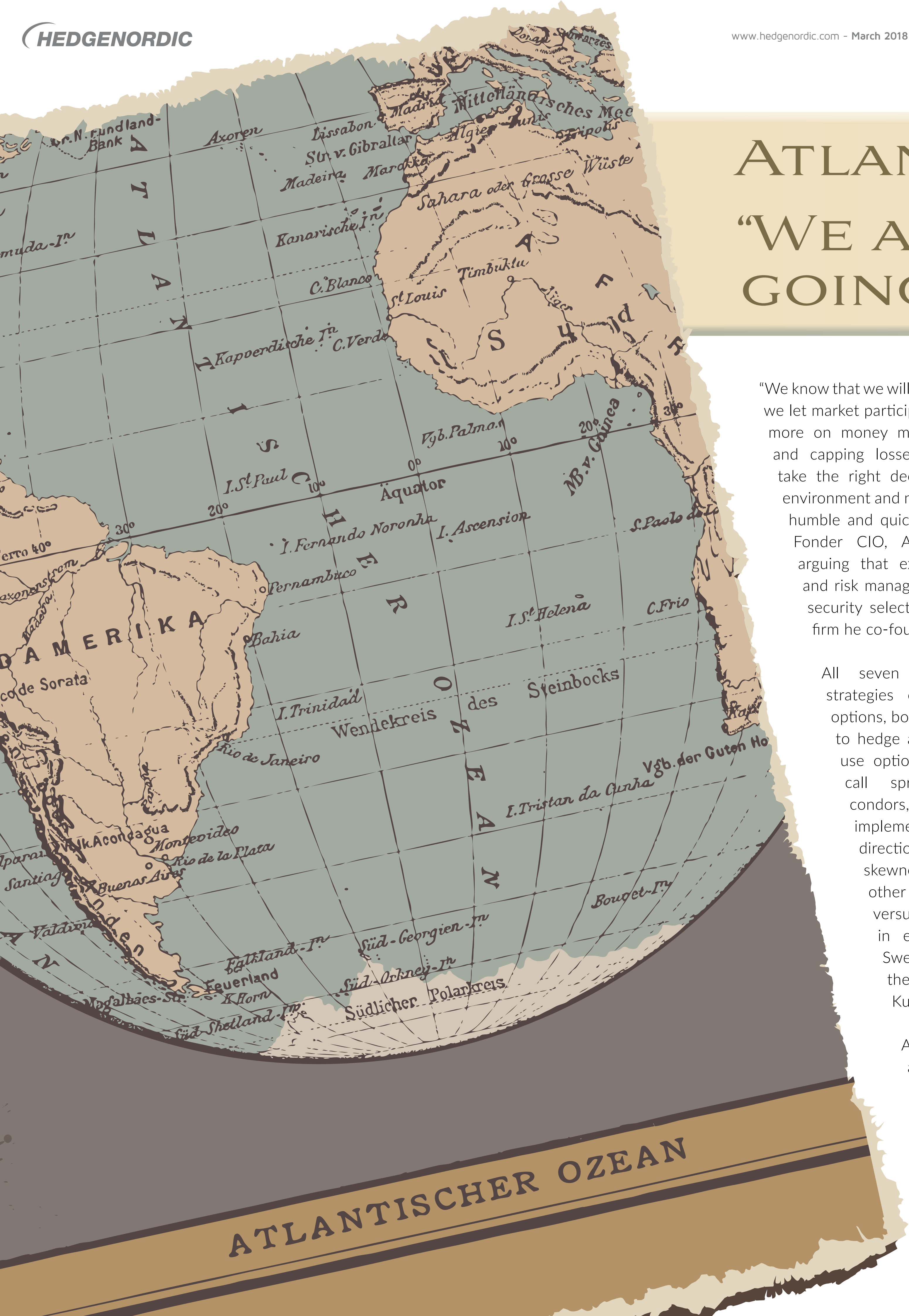

Atlant Fonder´s Kullberg: "We always expect to be wrong going into every trade!"

by Hamlin Lovell– HedgeNordic

"We know that we will often be very wrong, so we let market participants decide, and focus more on money management techniques and capping losses. That way, we can take the right decisions in a controlled environment and not under stress. We are humble and quick to cut losses", Atlant Fonder CIO, Anders Kullberg, says, arguing that expertise in derivatives and risk management – rather than in security selection - distinguishes the firm he co-founded in 2007.

All seven of Atlant Fonder's strategies can use futures and options, both to express views and to hedge and manage risks. "We use option structures, including call spreads, put spreads, condors, and butterflies, to implement views on market direction, levels of volatility, skewness, gamma trading, other "Greeks", implied versus realised volatility etc. in equity indices, namely Sweden's OMXS30 and the EuroSTOXX 50" says Kullberg.

Atlant's equity funds are mainly long-biased, with beta ranging between -10% and +200% but there is one bearish-biased strategy. In early February 2018, Kullberg increased the Atlant Multi-Strategy allocation to the short-biased Protect strategy. This proved to be opportune timing as Protect was up 5% year to date in 2018, offsetting losses on Atlant's other strategies, so that the multi-strategy vehicle managed to hold steady in 2018, (as of early February).

It is impossible to gauge how these strategies might have performed in 2008. At that time, Atlant ran only three, long-biased, funds with a relative return performance target of OMX plus 10% (which was met, as they lost about 10% less than the OMX). It was not until after the crisis that the company switched to an absolute return target, which also includes a target for maximum losses in any year. The long biased Atlant funds have a maximum annual loss tolerance of 10%. The most aggressive strategy, pursued through the Edge fund (which dates back to 2002, before Atlant was founded) has a downside limit of 20% and can ramp leverage up to 800%.

Later on, the firm launched funds exposed to investment grade corporate credit. Kullberg acknowledges that credit spreads have some correlation to equity markets. Consequently, derivatives are used to hedge out varying degrees of interest rate and credit risk, using instruments such as government bond futures and iTRAXX indices. Atlant's largest fund, Stability, runs SEK 2.5 billion and has averaged annual returns of 3.6% since inception in October 2008. "It is the only hedge fund in Sweden with ten consecutive years of positive returns" says Kullberg. However, he accepts that " it has been easy to make money with all asset classes rising" and adds "now we expect negative Swedish interest rates to rise so we are hedging this by going short of Swedish government bond futures". Atlant's Stability Offensive strategy uses high yield bonds, and a more active derivative strategy, in order to target higher returns, of risk free rate +5%.

Multi-strategy fund

By 2016, the range of funds had expanded to a level where Kullberg believed that a multi-strategy fund, composed of all seven internal funds, would offer adequate diversification to investors. Atlant Multi-Strategy also allocates to three funds managed by Atlant's 49%-owned affiliate, Pacific Fonder, pursuing global equity long/short, precious metals and another multi-strategy approach. The precious metals fund in particular adds one dimension of diversity as Atlant does not take commodity risk.

For now, Kullberg is keeping the allocations within the "family" of these two firms. "We previously managed a fund of external funds that produced disappointing performance, due to "style drift" from some managers whose performance deviated from expectations" he says. Kullberg is not confident about obtaining enough transparency from external managers, and claims that "other hedge funds of funds in Sweden are too secretive, so there is a market niche for a more transparent fund of funds".

Conversely, many multi-managers claim they can get a handle on underlying managers' exposures from risk aggregation reports, using formats such as the open source Open Protocol Enabling Risk Aggregation or the commercial MSCI RiskMetrics.

Some other funds of funds also say they get total position transparency from underlying managers, through managed accounts.

"WE PREVIOUSLY MANAGED A FUND OF EXTERNAL FUNDS THAT PRODUCED DISAPPOINTING PERFORMANCE, DUE TO "STYLE DRIFT"...

Restricting allocations to internal and affiliated funds means that Atlant Multi-Strategy contains a narrower range of hedge fund strategies than most multi-strategy funds or funds of hedge funds. Kullberg does not feel it is necessary to diversify into a greater variety of hedge fund strategies, such as global macro, managed futures, merger arbitrage or any others. He keeps open the option of allocating to third party funds however, and has been following a few of them for 15-20 years.

Fees

When allocating to its own funds, Atlant Multi-Strategy charges only one layer of fees, at the top level, hence Kullberg argues "it is more cost effective to use our own funds". When allocating to Pacific funds, Atlant Multi-Strategy is charging two layers of fees: its own fees, and fees on the underlying investee Pacific funds.

Asset managers' policies around affiliates' fees vary. Some of those running multi-manager products will not pay any fees to affiliates, as a matter of principle (and some are even precluded from allocating to affiliates in the first place). Certain managers, including some in the credit space, will get rebates or retrocessions of a percentage of fees on their allocations to affiliated funds. This means that investors, in effect, get a fee discount on the affiliated vehicles. Other managers, like Atlant, will simply pay normal fees on allocations to affiliated funds. This "double dipping" adds a limited amount to Atlant Multi-Strategy expenses, as only about 12% of AMS is allocated to the three Pacific funds.

Multi-strategy management fees are 1% while a depositary fee of 0.2% covers custody, administration, audit and fees to the financial regulator. There is also a 15% performance fee. Atlant uses a range of banks and some internet brokers for trading. All derivatives are now exchange-traded, with no over the counter (OTC) exposures. The MiFID II requirement for brokers to charge for research does not make a difference to Atlant as their research is done in house.

For now, the investor base is mainly Atlant's own staff (who account for a few percent of the firm's SEK 3.5 billion assets, and own 55% of the management company), family offices and retail money. Once Atlant Multi-Strategy has passed the three-year milestone, Atlant expects to start on-boarding more institutional investors, such as insurance companies. The assets come mainly from Sweden, but there have been allocations from a reinsurer investing via a Luxembourg bank.

The multi-strategy fund is a Swedish special fund. Like all of Atlant's funds, it has daily liquidity, and could probably fit into a UCITS structure. Atlant has already converted several funds to a self-managed, Swedish-domiciled, UCITS. "We may continue converting the funds to UCITS, one by one, as it takes time and money" he says. All Pacific funds are UCITS.

UCITS marketing passports can also cost money where national regulators charge fees for them, but might help managers, such as Atlant, to geographically diversify their investor base. Atlant has already started to expand distribution into other Nordic countries, and eventually may do so elsewhere in Europe. Yet there is no rush. "We only market in Sweden, but investors from all over the world have found us" says Kullberg.

by **Hamlin Lovell** – HedgeNordic

AN ICONOCLASTIC FUND OF FUNDS MENTALITY

Specialist FOHFs doing something different

The true essence of a fund of hedge funds (FOHF) is to provide investors with an uncorrelated return stream that they cannot source independently – or perhaps not at all.

Large, institutional, generalist FOHF may boast of: big teams of highly specialised analysts; separate teams for quantitative analysis, operational due diligence, risk management, risk aggregation, legal and compliance etc.; multiple offices worldwide; managed accounts offering total real-time transparency; and negotiated fee structures and reductions.

Smaller, specialist FOHF may focus on seeding or accelerating new or early stage managers; on strategies such as CTAs, macro, commodities, event driven, credit; on geographies, such as Asia, Europe or emerging markets; or on fund structures, such as UCITS funds.

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Ulf Sedig (left) and Rolf Hagekrans, Portfolio Managers

One example of a specialist FOHF is Merrant. Two guys based in Sweden, charging two layers of above-average hedge fund fees, have often generated better risk adjusted returns (a Sharpe ratio around 3), than generalist giants over the past eight years, and have been nominated for 40 awards. How is this lean team so different from the behemoths?

Being smaller could be advantageous for sourcing niche strategies, which are not scalable (examples of strategy allocations include: Long/Short equity; Vega trading & Volatility arbitrage; Merger arbitrage; Statistical arbitrage; CB volatility trading; Relative value; Pair-trading; Index reweighting; Dual listing trading; Share Class Arbitrage; Stubs trading; ADR trading; Implicit correlation trading).

Merrant's current assets are $264 million, and CEO, Ulf Sedig, expects maximum capacity is around $500 to $600 million.

His mind-set is different. After a nine-year bull market in equities, bonds and credit, the average hedge fund has become more correlated to these asset classes (some indices are 0.75 correlated to equities), making it harder to find diversifiers. Sedig's search for market neutral managers insists not only on low correlation (capped at 0.3 to equities and fixed income) - he also limits volatility to 5%, which rules out many CTAs and macro funds in a fund structure (most could offer a lower volatility mandate through managed accounts however). Additionally, Merrant looks at the third and fourth moments of the distribution – skewness and kurtosis - and has more appetite for upside than downside volatility. Sedig also ideally requires at least five years of daily data to carry out quantitative analysis. (Merrant could contemplate a day one launch if the managers had a carved-out track record, but has never seeded).

LIQUIDITY

Some managers doing direct lending, asset based lending, and PIPEs, using models to value "level 3" assets would meet these quantitative screens, but they are off limits because Sedig requires liquid strategies, marking to market. All assets are "level 1" and funds must offer monthly dealing, no exit fee, no lock up, and weekly performance data. But Merrant does not want "liquid alternatives": "the problem with daily liquidity on UCITS funds is that it can impair performance and high alpha" argues Sedig. (The lowest dealing frequency UCITS funds can offer is twice per month).

> "Then, qualitative, fundamental and operational due diligence typically whittles the pool down to 10-15 that are invested in - but in February 2018 the portfolio is just 7 funds."

LEVERAGE

Merrant has not used leverage at the fund of funds level and nor has it allocated to managers using balance sheet leverage (though some may obtain notional leverage). "Some mortgage managers are using 70 times leverage and if something goes wrong they will blow up" warns Sedig. Merrant also avoid managers that use options for short volatility strategies, but are fine with options for hedging.

These filters eliminate roughly 98% of the 7,000 hedge funds that Merrant monitors, leaving a shortlist of just 150. Then, qualitative, fundamental and operational due diligence (eg Merrant like to see risk management separate from portfolio management) typically whittles the pool down to 10-15 that are invested in - but in February 2018 the portfolio is just 7 funds.

ACTIVE MANAGEMENT

Merrant has held some funds for the whole 8 years but it is not a buy and hold strategy, and has not identified infallible managers. Active management is needed and Merrant typically redeems about 15-20% per year - if a stop loss is hit, or if monitoring suggests "style drift". Merrant also decided in late 2015 to exit from all fixed income related managers.

DIGGING DEEPER

If Merrant were merely carrying out quant screens, the strategy could run on auto-pilot, as some "roboadvisors" or "digital advisors" do, but the human touch is very much part of the process.

Sedig has first-hand experience of the financial markets, having started his career as a market maker at United Securities in the UK. "We combined in depth theoretical knowledge about option pricing, with practical experience. With volatility arbitrage and option trading strategies, we really need to understand what they are doing" he says. Sedig has had a rather eclectic career, also spanning corporate finance, venture capital and a company that designed systematic trading systems. Yet he has little appetite for systematic hedge funds: only one of the seven funds is a hybrid systematic/discretionary strategy, with the others all being discretionary.

GEOGRAPHY

Merrant has needed to search globally for managers. Only one fund has been Nordic based (and not in Sweden), with others having been found in the US, Europe and Asia. For instance, Merrant has historically had exposure to long/short equity managers in Japan, Taiwan and South Korea, where Sedig judges markets to be quite inefficient. Still, it is not easy to identify good managers – and Sedig found "the best ones had an Anglo-Saxon background and education".

TRANSPARENCY

Opacity is a common criticism of funds of funds. Merrant discloses investee funds to investors but not publicly on its website. Sedig expects full transparency from managers but does not require real time transparency. He is "prepared to get position line items with a time lag as a sanity check", but questions the value of risk aggregation exercises using all underlying positions.

> "Two guys based in Sweden, charging two layers of above-average hedge fund fees, have often generated better risk adjusted returns (a Sharpe ratio around 3), than generalist giants over the past eight years, and have been nominated for 40 awards."

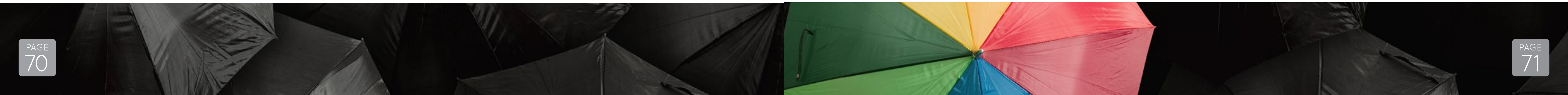
FEES

Merrant rarely negotiates lower fees and Sedig argues that "successful managers do not have to rebate fees". Merrant's managers charge management fees between 1% and 2%, and performance fees between 15% and 20%. Merrant itself charges management fees of 1% and performance fees of 20%: the highest I ever saw on a multi-manager product. Taken together, there are fixed fees of between 2% and 3%, with headline performance fees of between 35% and 40% (and absent netting, actual look-through performance fees work out somewhat higher). Net returns to investors are what counts, and they were strong for the strategy's first six years.

A niche approach will not necessarily work well in every kind of market climate however. Merrant's managers have not in fact found 2016 and 2017 to be an easy environment, and the strategy has had two years of basically flat net performance to investors. Sedig ascribes this to the lack of volatility. However, early 2018 has brought a return of volatility and Merrant made 0.30% in January followed by 0.65% in February.

2008 DEJA VU

Sedig has been resolute in maintaining his market neutral approach, and would not be surprised to see a market crisis as bad as 2008, at some stage: "when everyone is positive and nobody thinks markets can go down, after nine years of markets trending upwards, with high deficits, we are heading for more volatility. Liquidity is also fragmented, which is a real problem" he foresees. Sedig expects that volatility will increase as interest rates rise, and relishes the prospect.



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by Eugeniu Guzun – HedgeNordic

Newborn NHX Asset Growth Index - Growth in Nordic Hedge Fund Industry Slows

For just over a year now, since January 2017, HedgeNordic has been calculating and publishing the NHX Asset Growth Index (NHX AGI), an index computed using an equally-weighted indexed-based compounding methodology in an attempt to representatively measure the development of the AuM of the Nordic hedge fund industry.

The Nordic hedge fund universe consists of a few giants with capital over the $1 billion mark. The vast majority funds are much smaller, managing capital in the range of $100 million to $300 million. If the assets of a very large fund such as Brummer Multi-Strategy, which manages $4.6 billion as of the end of 2017, would decrease by 5% during a given period, the dollar-amount decrease may well offset much of the potential increase in assets enjoyed by other players in the industry. While the numbers and results would be accurate, we felt this may not be a fair representation of the industry as such. Therefore, we decided to normalize our data on AuM by setting the first value of each series to a baseline of 100.

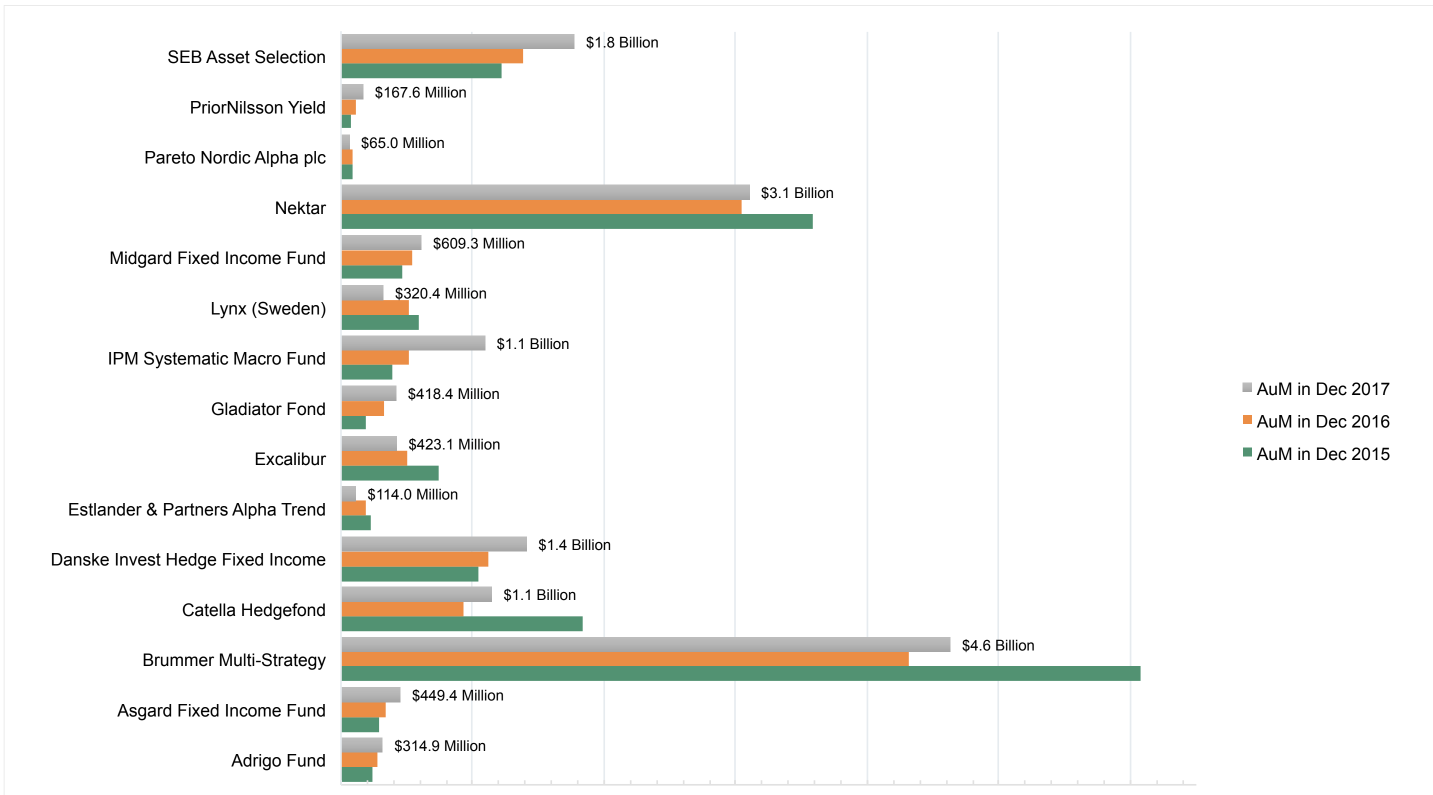
To construct the NHX AGI, the amount of assets managed by each representative fund as of the end of December 2009 were converted to an index value of 100, with the last day of 2009 representing the start date of the index. The starting index value for the NHX AGI was calculated as the arithmetic mean of the index values of all constituents, so the index value of NHX AGI stood at 100 at the start date. Under this approach, each fund's AuM, regardless of its size or any other factor, is equal weighted in the index. A net appreciation of 1% of assets in a billion-dollar fund has the same effect on the index as a net increase of 1% of assets in a 50-million-NOK fund.

Selection of funds making up the NHX AGI

The NHX AGI constituents were selected on the discretion of HedgeNordic. The aim was to have a representative gauge to measure the development of the assets managed by the Nordic hedge fund industry. That said, the selection process aimed at creating a representative basket by taking into account trading style, country representation, and fund size at the start date.

The graph to the right shows the 15 constituents NHX AGI and their respective AuM as of the end of 2017, 2016, and 2015. Despite suffering a $1.5 billion-decrease in assets over the past two years, Brummer Multi-Strategy retains the spot of the largest player in the Nordic hedge fund industry with $4.6 billion in capital as of the end of December 2017.

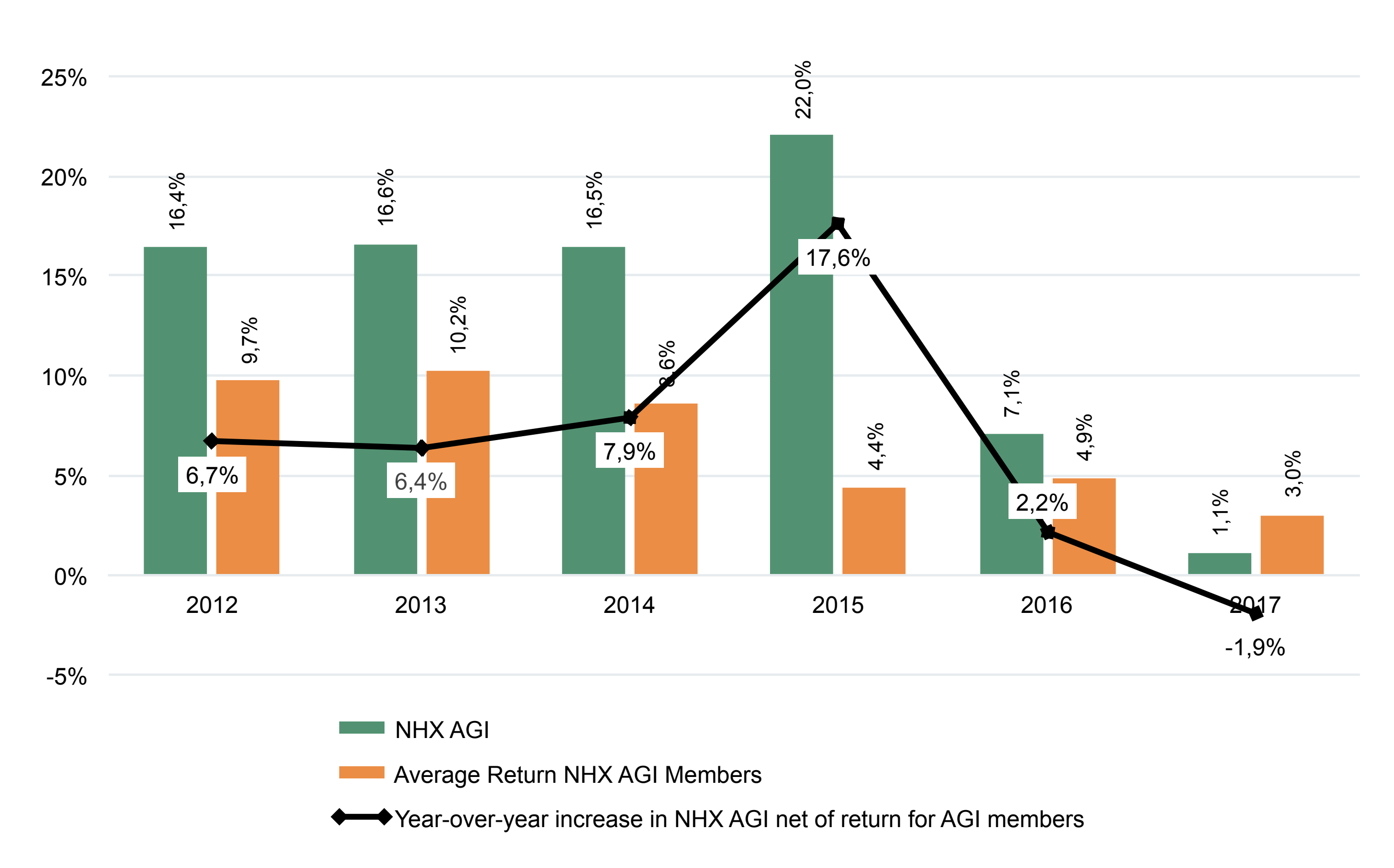
NHX AGI Members and Their Assets Under Management



Source: HedgeNordic

SEB Asset Selection, Brummer-backed Nektar, IPM Systematic Macro Fund, Danske Invest Hedge Fixed Income Strategies, and Catella Hedgefond are the other Nordic hedge funds within the NHX AGI managing over $1 billion in capital as of the end of 2017. IPM Systematic Macro and SEB Asset Selection enjoyed the largest dollar-amount increase in assets in the past two years, with the former experiencing a $699 million-increase in capital in the past two years and the latter enjoying a $552 million-increase over the same period. (Only reflecting the one share-class listed in the NHX Composite.)

NHX AGI Annual Change and Average Performance of NHX AGI Members



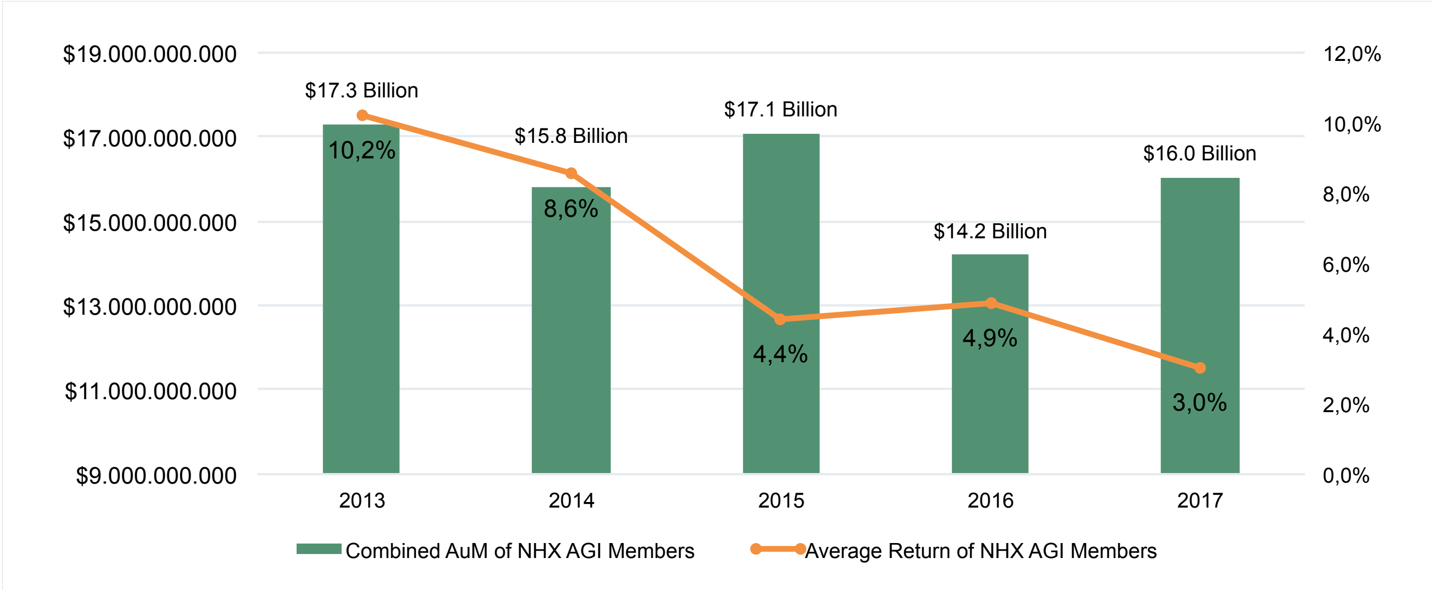
Source: HedgeNordic

The graph above compares yearly changes in the NHX AGI with the average return of the 15 members of the index. The annual growth of the NHX AGI significantly slowed in the past two years, which could partially be explained by the underwhelming performance of the Nordic hedge fund industry in general. Although the NHX AGI increased by 1.1 percent in 2017, much of the increase could be attributable to the 3.0 percent average performance gain delivered by the 15 NHX AGI members last year.

The new index admittedly has some imperfections. For instance, the current calculation model does not reflect changes in AuM due to the performance of the underlying funds and fails to capture net inflows and outflows. That said, the next graph reflects the actual volume of combined assets under management of the 15 NHX AGI components.

Another weakness can be the above mentioned isolated view to only one share-class of the fund. Total strategy AuM may be much larger across various fund structures, managed accounts etc.

Combined Volume of Assets Under Management of NHX AGI Members



Source: HedgeNordic

Collectively NHX AGI members managed $17.1 billion in assets at the end of December 2015, with the volume of assets dropping by approximately $2.9 billion in the following year. Much of the decrease can be attributed to the drop in AuM for Brummer Multi-Strategy along with the loss of nearly half its assets in Catella Hedgefond. The combined amount of capital managed by the 15 funds increased by $1.8 billion in 2017.

A group of other hedge funds within the NHX Composite Index, for which HedgeNordic has AuM data going back to December 2009, also experienced a significant increase in assets during 2017. These 13 hedge funds with a collective $882.3 million at the end of 2015, saw their assets rise to $1.1 billion by the end of 2016 and $1.7 billion by the end of 2017, respectively.

AuM of NHX AGI Members and Two-Year Percentage Change in AuM

Fund name	Year-over-year change in AuM in functional currencies							
Adrigo Fund	51%	21%	46%	47%	75%	32%	26%	2%
Asgard Fixed Income Fund	-13%	5%	34%	6%	-4%	9%	18%	17%
Brummer Multi-Strategy	46%	7%	2%	29%	16%	13%	-24%	-3%
Catella Hedgefond	-10%	-26%	4%	24%	85%	92%	-45%	11%
Danske Invest Hedge Fixed Income	116%	105%	93%	28%	8%	-10%	10%	11%
Estlander & Partners Alpha Trend	73%	11%	-25%	0%	-33%	-21%	-16%	-41%
Excalibur	185%	41%	55%	21%	3%	6%	-27%	-24%
Gladiator Fond	13%	36%	20%	58%	22%	31%	82%	15%
IPM Systematic Macro Fund	75%	22%	13%	-30%	50%	134%	29%	114%
Lynx (Sweden)	30%	50%	-13%	-20%	17%	65%	-6%	-44%
Midgard Fixed Income Fund	66%	67%	48%	33%	-7%	-13%	21%	-2%
Nektar	70%	39%	14%	19%	-10%	9%	-9%	-8%
Nordic Alpha plc	12%	-56%	5%	2%	1%	10%	-9%	-27%
PriorNilsson Yield	18%	-14%	16%	29%	20%	20%	64%	36%
SEB Asset Selection	-10%	11%	-46%	-10%	17%	29%	16%	13%
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**

Source: HedgeNordic

ROUND TABLE DISCUSSION

FAMILY OFFICES AND HEDGE FUNDS: A SHARED DNA?

BY GLENN LEAPER, PHD – HEDGENORDIC

The HedgeNordic Family Office-Hedge Fund Roundtable that took place on December 5th, 2017 in Stockholm proved to be a forum for frank and open exchange between family office and hedge fund managers about how family offices view hedge funds in their allocation, and the relative advantages and disadvantages hedge funds provide to family office strategies.

Under discussion were themes as wide-ranging as risk/return optimization, 'unconstrained allocators', the question of 'home bias' and the emerging role of Socially Responsible Investing (SRI) in portfolio allocation.
Hosted by family office **Navare Invest**'s Jonas Andersson, the featured participants from the hedge fund side were Mikael Wickbom (**Catella**), Mikael Spångberg (**Brummer & Partners**), Göran Tornée (**Adrigo Hedge**) Ari Björnsson (**Union Bancaire Privée**) and Laura Wickström (**AIM Capital**), in dialogue with family office managers Mats Planthaber (**Peak Asset Management**), Filip Hansen (**Allocate Management AB**), Carl Barnekow (**Coin Investment Consulting Group**) and Hans Fredrik Lysén (**Idea Invest**).

Family offices vary in their degree of allocation to hedge funds, for different reasons. There is also a strong demand for alternative investments in general beyond the purely hedge fund space, as Carl Barkenow suggested, despite Coin Investment Consulting Group (CICG)'s own relatively low 10 per cent allocation to alternatives. By contrast, Peak AM usually allocates rather more to hedge funds, and particularly to multi-strategy funds, at around 30-35 per cent, as some clients see them as a tool for capital preservation and long-term growth, said Mats Planthaber. Hans Fredrik Lysén's Idea Invest is a trend-following portfolio, meaning trends will influence the degree of its hedge fund allocation. Allocations around the Round Table varied, with some as low as 5-10 per cent and others well above 30 per cent.

Family offices are as interested in hedge funds for diversification purposes as for risk reduction objectives in the pursuit of good returns, it emerged. The very definition of good returns, however, can depend on what stage of the interest cycle managers find themselves in, as Brummer's Mikael Spångberg argued, underlining the need to consider the quality of the return beyond purely high or low returns, such as the achieved diversification effect of adding more to a traditional portfolio composed e.g. mainly of equities and bonds. It is also hard to achieve high returns without taking any risk at all, as Planthaber added, so the imperative also becomes to look for competent hedge fund mangers and opportunities that can help reach the targeted objectives. Allocate's Filip Hansen looks for correlations between properties and equities to achieve yield in his portfolio, turning to hedge funds to avoid being long-only, while CICG's Barnekow openly leans more towards diversification than performance, considering the different purposes hedge funds can be used for to ensure targeted returns.

The consensus suggested, therefore, that family offices, funded as they are by private individuals rather than large, structured institutions, are invested in hedge funds for broadly accurate reasons. As Family office managers look for de-correlation, diversification and improved risk/return profile in their portfolios, hedge funds can provide the right components corresponding to the rest of their assets. Brummer's Multi-strategy fund, for instance, offers family offices diversification with stable returns when traditional portfolios suffer (as they are projected to do in the current macroeconomic cycle, with equities at all time highs and a looming sharp correction in asset prices). Hedge funds can therefore be a good risk-mitigating tool for family offices. In addition, hedge funds are also beneficial due to their controlled approach to risk management, as Finnish AIM Capital's Laura Wickström

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submitted, with risk management becoming increasingly important amid high valuations, and many Finnish investors investing in illiquid investments to achieve diversification benefits.

LIQUID HORIZON, ILLIQUID INVESTMENTS

Though it may seem counter intuitive, such investors are looking to the illiquid side to diversify because hedge funds have also, by and large, struggled for the past few years, and also in reaction to the listed space becoming more synchronised over the past few years, particularly in raw materials and oil prices. Clients do not, however, always have knowledge of, or access to, new illiquid asset classes, despite the increasing interest in them, according to CICG's Barnekow. In addition, it may not always be clear what an illiquidity premium is worth, as illiquid returns are not marked to market, and definitions of illiquid investments differ in terms of time frames, where structural changes or other factors can make investors feel too 'locked in', making it a harder space for managers to invest in. UBP responds to this challenge by having various alternative strategies available in funds with weekly liquidity, Björnsson said.

Should family offices and investors accept more intermittent illiquidity to gain more returns, however? While part of the appeal of private investments is the ability to generate cash flows, are there better opportunities going forward, and is there still a liquidity premium available ex ante in private investments, as Wickström asked? The nub of the matter is that family offices are unconstrained investors, as Spångberg underlined, as they're usually unconstrained by liquidity, by contrast with institutions, which are often stuck on the fixed income side and cannot have underlying holdings in anything above investment grade. The question then becomes how one can optimise an unconstrained portfolio to add risk, and move upwards on liquidity or the risk premium scale? Several participants indicated their preference for a long-term investment horizon that backtracks equity and bond performances to measure hedge fund allocations against; with the unusually high valuations of the current cycle, however, hedge funds may in a position to provide better risk-adjusted returns.

HOME BIAS, OR HOME RISK?

So, what do home office managers look for first and foremost in a new hedge fund? AUM and pedigree was a standard criteria among the participants, with CICG's Barnekow underlining how bigger clients need to invest in big tickets to forestall a too limited impact on the investment portfolio. In addition, bigger institutions might look towards smaller boutiques who are better positioned to generate alpha, while smaller institutions might look toward larger brands to acquire name recognition of their own. Beyond standard deviation and the Sharpe ratio, Peak AM's Planthaber looks at a manager's track record, past performance and holdings to determine where their performance comes from. A strong issue was the notion of 'home bias', or a tendency towards investing in Swedish or Nordic hedge funds, which is reinforced by the notion that hedge funds can objectively appear as 'black boxes' to the investor. It might also be easier, as Idea Invest's Lysén remarked, to have the advantage of sitting down with the manager to acquire a proper definition of a fund's e.g. long/short equity strategy, which also underlines the need to perform due diligence.

Nevertheless, it is also critical to be able to spot new opportunities as they arise, as UBP's Björnsson emphasised. Wickström concurred, explaining that AIM Capital does not constrain itself in terms of brands or size: smaller managers, interest alignments and the manager's own capital investments can be positive factors from the investor's perspective, whereas large brand names provide robust infrastructure and corporate governance. Flexibility, as Brummer's Spångberg suggested, is key. In addition,





market factors can make the determination, such as for Allocate Management's Hansen, who prefers to look more outside the Nordics for his portfolio foundation in terms of allocating hedge funds due to the overpriced Nordic bond market, which is a big risk for Nordic hedge funds that use bonds as the safe asset in their portfolios. When the question was raised by Navare's Andersson whether family offices should use consultants or larger multi-managers like AIM or Brummer, responses are philosophical: resources are often limited, divided between portfolio asset allocation and the time and capacity of consultants at a certain price, but several managers expressed a preference for a mixed strategy of working both with consultants and a house advisory service to determine the best alignment of a fund's interests.

SRI: "LIKE A WAVE COMING FROM THE NORTH..."

A relatively new factor the managers almost universally found themselves taking into consideration is SRI/ESG. Tornée related how it has become one of Adrigo's big investment themes, with Socially Responsible Investing (SRI) snowballing and hedge funds beginning an industry-wide adaptation around three years ago. Consequently, Adrigo has no long or short exposure in offending sectors such as polluting, weapons, gambling or alcohol industries Spångberg concurred, emphasising Brummer's becoming a signatory to the UN PRI some years back and developing tailor-made RI policies for different spaces so as to define what Responsible Investment means from a fund management perspective and in terms of investment strategy. Demand has been coming from the client side, as Catella's Wickbom related, though there is debate as to how to implement SRI/ESG on the hedge fund side. Interestingly, he pointed out the confusion between ESG and strictly ethical questions, where investors sometimes enforce limitations due to ethical rather than strictly ESG reasons, demanding a need for both buy-side and asset managers to determine what, conceptually, is most important to them.

As for the family offices, Allocate Management's Hansen indicated his company's preference for socio-investing and keeping a critical eye out for unethical investments. Peak's Planthaber emphasised the need to listen to clients and adjust investment objectives based on their ESG preferences, while Lysén suggested that though the issue is under serious consideration, it hasn't translated into Idea Invest's investment objectives yet. UBP's Björnsson likened ESG to "a wave coming from the North and spreading across the continent," remarking he has noticed representatives from Swedish ESG companies in Switzerland and elsewhere as the investor demand for such services increases.

THE LAST WORD

In concluding, Brummer's Spångberg suggested family offices might be more rational than institutional investors, in that they want to achieve returns at acceptable levels of risk (in terms of volatility and/or drawdown), have a built-in diligence because of their small size, and view the market differently from traditional institutional funds, allowing for new perspectives. Björnsson underlined the qualitative differences between family offices with different needs that will therefore lead to different ways of allocating, where each can learn from the other both domestically and abroad. Hedge fund managers, on their part, need to be available to family offices to provide the right service level, provide transparency, and explain performance and other factors. There are many different products on offer, as AIM's Wickström said, but many hedge fund managers are unable to deliver diversifying investments with good long-term return potential. There therefore needs to be more focus on what actually constitutes a good long-term investment.

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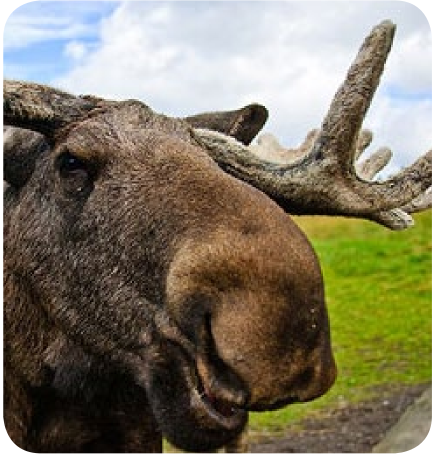

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