



Opalesque Roundtable Series '18

NORDIC

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Editor's Note

The Nordics provide a robust business environment for effectively running alternative investments funds such as hedge funds – for example, the Swedish FSA has been regulating onshore hedge funds since 1996, which has made them accustomed to the many features of hedge funds. The entire ecosystem, from regulators, service providers and investors, is well developed. The Nordics are also very attractive in terms of finding investment opportunities for various reasons.

Some of the Nordic asset managers believe that, from a macro perspective, many institutions will – particularly after this run across various markets – find themselves in situation where they have way more risk than they think they have. Contracting global monetary policies will continue to turn the most recent investment paradigm upside down. Many investors which have cut a lot of the de-risk strategies in their portfolios could end up in a corner (page 27). Good times may be coming back to (the real) hedge fund managers.

How fund managers can address the ESG dilemma

The Nordic countries are also thought leaders or front runners in terms of ESG requirements and implementation. There is more demand for ESG solution than ever before, and further demand will emerge driven from regulator. However, it's also clear that everyone wants different things in ESG.

The dilemma fund managers are facing is that each investor has his or her own guidelines, preferences and aims, and so it is difficult to please everyone. What could be a solution for fund managers? One suggested strategy is that fund managers pro-actively define and implement their own responsible investment strategy, which suits the overall investment strategy and maximizes the return from ESG analysis. Then it is up to the fund manager to explain it to the investor and through this find common ground (page 12-14).

The Opalesque 2018 Nordic Roundtable, sponsored by Eurex, took place in Stockholm with:

1. Gunnar Wiljander, **CEO, Nektar Asset Management**
2. Erik Eidolf, **CEO, Nordkinn Asset Management**
3. Eric Orving, **Deputy CEO, Bodenholm Capital**
4. Per Ivarsson, **Head of Investment Management, RPM**
5. Carl Rydin, **Investment Analyst, Origo Capital**
6. Achim Karle, **Global Equity & Index Sales, Eurex**

The group also discussed:

- Swedish AIF are a more cost-efficient and investor-friendly structure than any other in the market as no other fees outside of trade-related costs can be passed on investors (page 7-8)
- Increased interest in CTAs: How is CalSTRS mitigating equity risk? (page 8, 19)
- Game changer: How and why private equity firms are increasingly active in public markets (page 20)
- Why fixed income arbitrage will have an interesting time going forward (page 22, 25-26)
- Why Deutsche Boerse Group is already a winner from Brexit (page 23). Why hedge fund managers should look at Brexit (page 24)
- Investing in companies with a "self-help" component: More earnings independent of macro factors (page 25). Opportunities in deconglomeration strategies (page 21)
- The new Eurex ESG Futures family is coming (page 4, 12, 15). The problems of negative screening (page 16-17)

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles



(LEFT TO RIGHT):

Gunnar Wiljander, Erik Eidolf, Per Ivarsson, Achim Karle, Carl Rydin, Erik Orving, Matthias Knab

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Introduction

Erik Orving
Bodenholm Capital

My name is Erik Orving I work for Bodenholm Capital, a Stockholm-based hedge fund manager, with \$1bn AUM in one strategy/fund. Bodenholm employs 14 people, and we have an investment team consisting of 11 people. Our investment strategy is fundamental European equity long/short, with a low net exposure and a beta typically around zero.

Our long book is invested in specific segments of the equity market, where we have a high batting average and where our team has built a strong track record over the years. We invest with a multi-year investment horizon and the long portfolio is relatively concentrated to around 20 positions. On the short side, we focus on companies where our dedicated short selling team have identified accounting irregularities, often coupled with deteriorating business models and/or structural headwinds. The short portfolio is somewhat more diversified and normally have around 30 names. In summary, we try to build a relatively concentrated fund of high conviction names, where each position has a meaningful contribution to return, and a fund were performance is driven by stock selection and not by market movements.

Achim Karle
Eurex

My name is Achim Karle from Eurex Exchange, which is part of Deutsche Boerse Group. I started my career at Eurex 2006 in the Market Supervision department. From 2008 until mid 2009 I was based in London and was at that time also involved with handling the Lehman default process.

From 2010 until 2011 I was based in New York at the ISE, working in the project team on developing the new T7 trading system which we are now using at Eurex.

Back in Frankfurt I spent another five years in front office operations, our Market Supervision, also responsible for training the front office team on emergency situations, e.g. how to deal with market disruptions and safeguard measures. Two years ago I have joined the Global Eurex Equity and Equity Index Derivatives sales, where I am now the responsible manager for Scandinavia, Eastern Europe markets and as well for most of our German sell-side clients.

Furthermore, on regional responsibilities, I am the sales captain for three products, first of all the mini-DAX future, which is a very successful product. Secondly the iSTOXX Factor Index futures, a new product range which are smart beta futures in between passive and active asset management. And then third, as a very new product line, we are about to launch **futures based on a new ESG index family**. Those futures will be ESG compliant and / or low carbon compliant in different variations.

Carl Rydin
Origo Capital

I'm Carl Rydin from Origo Capital. I am based here in Stockholm where I co-manage Origo Quest 1, a long-short equity fund focused on Nordic small caps. We run a concentrated portfolio on the long side, typically around 15-20 names. We are long-biased with a net exposure of about 40%.

We are value investors and the principles within our research-approach are driven by understanding the fundamentals of a particular company and identify value drivers that have been ignored or potentially missed by the market. We take minority positions in publicly traded companies and focus on active management where we engage with the management team, the Board of Directors as well as other shareholders of the companies we own in order to promote change. This change works as a catalyst in order to drive or unlock value, typically involving new growth initiatives, improving corporate governance, spin-off non-core assets and/or divisions, as well as improving the competitiveness of the company by increasing profit margins.

Regarding my background, I was educated in the US and worked in corporate finance for six years where I advised on cross-border mergers & acquisitions between Europe and

North America. I later moved to the buy-side and worked for Lucerne Capital, a European long-short equity fund based in New York, before moving to Stockholm in early 2017.

Per Ivarsson
RPM

I'm Per Ivarsson from RPM where I am heading up the investment team. We are a Stockholm based specialist firm in the managed futures space. We set up and manage multi-CTA portfolios through managed accounts which allows for daily liquidity and full transparency down to transaction level, on a daily basis. This is important not only for managing the portfolios but also in providing transparency for our investors.

We currently run two flagships and we are also active in the risk consulting business where we act as an independent risk manager for a number of asset managers, including a number of Stockholm based hedge funds, under the AIF regulation. I have been with the company for 15 years now.

Erik Eidolf
Nordkinn

My name is Erik Eidolf, CEO of Nordkinn. We are a \$1.3bn fixed income macro hedge fund based in Stockholm and Oslo launched in 2013. Before Nordkinn, I ran Swiss FoHF Harcourt's Nordic business for 12 years and I started specializing in hedge funds from 1998.

Gunnar Wiljander
Nektar Asset Managements

I'm Gunnar Wiljander, CEO of Nektar Asset Management. Similar to Erik at Origo, I run the business side and am also responsible for the firm from a legal perspective while the CIO is running the portfolio side and so the financial risk of the business. I have been with Nektar since 2010.

We are a fixed income relative value and macro fund and have been around since 1998. We currently manage \$1.5bn. I have been in the market since 1986, started as a government bond trader and moved on to running trading operations and then focusing on hedge funds in 1998, so I'm involved with hedge funds for over 20 years now.

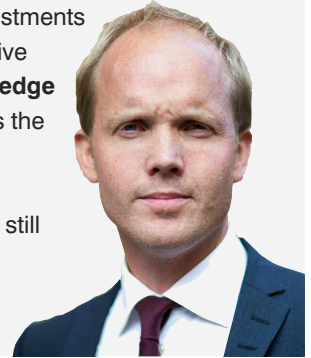
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Matthias Knab

I have been coming for quite some time now to Stockholm to produce this Nordic Roundtable and share updates, insights and developments from this region as they relate to alternative investments. What are some of the recent trends and developments you would like to comment on?

Erik Eidolf: The Nordics provide a robust business environment for effectively running alternative investments funds such as hedge funds. Being based in Stockholm and Oslo, our choice to register as an Alternative Investment Fund (AIF) in Sweden was deliberate. **The Swedish FSA has been regulating onshore hedge funds since 1996**, which has made them accustomed to the many features of hedge funds. In fact, as the entire ecosystem, from regulators, service providers and investors, is well developed, we argue that Sweden is an attractive place for running an institutional hedge fund. Lastly, and perhaps the most importantly, despite a strict regulatory framework imposed by the FSA, as a macro hedge fund we are still permitted to deploy the complete tool box of financial instruments in our trading.



Gunnar Wiljander:

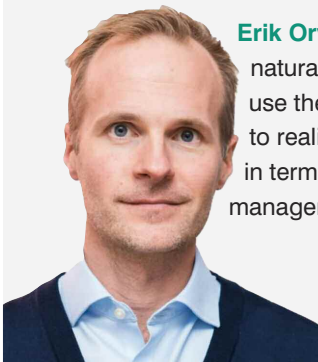
Which is also would be in Finland the case which is a jurisdiction with very equivalent legislation.

Matthias Knab

Where are your investors based? Are you marketing mostly to Nordic investors, which of course are very sophisticated, or also outside the region?

Erik Eidolf:

Nordkinn manages one fund, and by being focused on our Nordic edge, we have essentially only Nordic based investors. We believe that there is a mutual benefit in having local investors; it facilitates knowledge transfer in understanding each other as we are able to meet quite regularly. Close proximity between ourselves and our investors facilitates dialogue, which helps securing their trust in what we do.



Erik Orving: Similar to Nordkinn, we at Bodenholm have predominantly local investors, which is quite natural. However, I do think that there is a structural reason that enhances this local bias. It's because we use the **Swedish AIF fund structure**. It is different and investors on the continent or in the US don't seem to realize the specific strengths and benefits of the vehicle. Hence, it is a disadvantage of being too local, in terms of operational set-up, when looking for international investors and this is why we see many asset managers in the region launching fund structures domiciled in Luxembourg, Ireland, and Cayman.

Matthias Knab

So even though it's an AIF, there are some reservations in other European countries about it?

Erik Orving:

Yes, definitely.

Matthias Knab

Do you think these reservations are justified or is it just a lack of education?

Erik Orving:

It's just a lack of education. *For the investor, a Swedish AIF is a more cost-efficient and investor-friendly structure than any other I've seen in the market.*

Erik Eidolf: One of the key points here is that Swedish fund law prohibits any other fees and costs at fund level other than management fees, performance fees and pure transaction costs. This means that **Swedish AIF's are truly cost-efficient vehicles** and is also a token that Swedish fund law is designed to protect the interests of the investors rather than those of the fund management companies'.

In our capacity as a Nordic investment manager, I think it is unfortunate that the clever idea of AIF-passporting (i.e. allowing to transport marketing permits to institutional investors to other countries in Europe) is not working as efficiently in practice as it could and should. Our experience regarding AIF-passporting is that FSA's across Europe have different rules on fees for this. So, we believe that the EU has more work to do in harmonizing the regulatory practices to foster a truly open market.



Gunnar Wiljander: Nektar has offered a Bermuda fund for international investors since 2003, so we have had many investors from outside the Nordic region. We set up the Bermuda for two main reasons. One was the negative taxation of non-equity-related income in Sweden up until 2012. We had to ensure investors were not taxed for that, which worked fine for taxpaying individuals, but not if the investor came from the insurance or government sector that doesn't pay tax. Tax paying individuals can just retribute against their local tax, so they had no problem, but for some of the other institutional investors, this did not make sense. So, we had to have an offshore vehicle, which we still have, and it feeds directly into the Swedish fund.

Since 2018 we also have the option in Sweden to set up currency hedged share classes which is very positive as most international investors don't want to have their return in Swedish Krona. They want to have it in Euros, Dollars, Yen or Sterling. Most would like to have a Dollar or Euro return stream, and they can hedge it themselves, which some people do.



If you look at global jurisdictions to set up a hedge fund, the number one is for a number of years now Cayman, which is offering a very efficient and developed framework when it comes to things like bankruptcy law, directorships, tax neutrality, etc. Bermuda used to be the top location before, and in Europe jurisdictions like Luxembourg and Ireland also have some sort of credibility, but now, institutional investors prefer to have a Cayman vehicle, but we also have had people from abroad investing into our Swedish fund as well. One reason was that the Swedish fund is regulated and offshore is unregulated. And so, for example, we have had large French funds of funds investing in the AIF, so the regulated vehicle.

But you are right, most people outside of our Nordic region don't seem to appreciate the AIFM status, maybe also because there are not too many around here in Sweden or maybe Finland. *If you go to the continent and say a Swiss or French private bank would be looking for exposure to some alternative investments, the natural thing they would look for first would be UCITS, because often that is the only thing their compliance signs off and the rest is classified as offshore. This could mean that with a European AIF you can end up in the offshore bucket and the bank cannot distribute the fund broadly across their platform. So for example you might be able to raise \$200m from a private bank if it was a UCITS but with a Swedish AIF you may end up with an investment of \$10m or something. So, that would be a reason to go with UCITS, but **UCITS for us would be an inferior vehicle.** The drag on returns could be as high as 2% and we'd have higher operational risk, and therefore UCITS for us would be a ridiculous, inferior, stupid product, so we haven't done it.*

Still, we all need to make the point again that the Swedish regulated AIF structure is very investor-friendly and offer extremely low costs. You cannot pass on any costs to investors outside of trade-related costs, and still, investors don't recognize it. We have really had some goofy situations with that. For example, we may speak to an investor who has been with us for many years and now starts a discussion around costs, and once more we explained to him that we are not charging any of the costs he mentioned, adding that we had already made that point to him numerous times. It just seems that we cannot get this message across as everyone else is passing on directors, administration, even Bloomberg terminals, et cetera, quite openly, to the fund and thus the investors. So, while a Swedish AIF offers significant competitive advantages, people don't tend to recognize that. So, if you are going to sell to a big Middle East institution or Singapore, Japan, or whatever, you might as well have a Cayman structure and charge all the costs like everyone else rather than being the odd one with a Swedish AIF.

Carl Rydin: Moving the conversation from the legal structure to the overall opportunity set in the Nordic region, we believe **the Nordics are also very attractive in terms of finding investment opportunities.**

In our concentrated long portfolio, we have about four to five names where we like to take a very active position. We are in the small cap space and we really like the Nordic region because it's a very shareholder-friendly environment. Even as a minority shareholder, you do get to elect board members and management teams tend to be very responsive when good ideas are presented. Compared to the US, there is a much different activist setup across Europe, particularly in the Nordic region.

Another aspect of the Nordics is that there's a **very developed equity culture** and adaption here. You don't have to go further than Germany to see how hedge funds are being sort of battered in the media and having challenges when approaching a company from an activist standpoint or even with a constructive approach. I would say here in the Nordics, when you get involved with a company, it's generally a much friendlier environment and more constructive compared to other parts of Europe or internationally. This is something we really like. We are a relatively small fund which means we often have to find ways to collaborate with other investors and convince them that we have done the deep research on a certain company and we think that there are certain actions to be taken in order to unlock value. Here in the Nordics, we often see how even institutional investors like to catch onto such an activist campaign or theme. You can now see why we find the Nordic region very attractive just from an investment standpoint.



Also our investor base is predominantly Nordic-based. When we talk to investors outside of our region, in many cases the potential overseas investor could be looking for a general exposure or taking a bet on the Nordic region. We often need to make the point that we are following a specific stock picking approach to drive returns, which happens to be available in our region. In fact, we are fairly uncorrelated with the general Nordic equity market.

Per Ivarsson: We don't invest in the Nordic region, but we have an investor base here.

There are a number of things we observe in the investor community. Importantly, we see an increasing worry about the equity exposure. There might be some selection bias in that these investors talk to us because precisely because they are worried. However, we see an **increased interest in the CTA space**. *And also, if we are looking at the two tough periods we have had in 2018, first in early February and now in October, we saw reactions that were quite different from previous equity reversals. Now it seems investors have become more worried, and some see these periods as early warning signs for a major setback. We also note that they don't seem to be as worried about the fact that CTAs usually suffer in initial period of an equity downtrend. After strong positive trends in equity markets, the CTAs will inevitably be positioned long equities and when those trends turn, CTAs will initially suffer from the long position, but if the reversal continues and turns into a crisis the CTAs will shift equity position and make money from the continued downwards trend in equities and related trends in other markets.*



The February and the October events haven't scared potential investors away in the same way as in previous equity downturns. In some cases we see accelerated interest for CTA investments. That's quite a different scenario compared to two or three years ago.

Adding to Carl's point that in Sweden a lot of private individuals invest in equities, I also think they have access to tools that are generally used by institutional investors to mitigate equity risk. The landscape here is therefore also becoming friendlier towards strategies that perhaps would be considered quite exotic for the retail space if you go to other parts of Europe.

We are on the Avanza (retail) platform. So far, it's a minor allocation, but our offering is there and we are starting to get some questions from these types of investors as well.

Gunnar Wiljander: We have been marketing to the Nordic investor base – so Sweden, Finland, Norway and Denmark – for a long time. We were quite successful in Sweden, for obvious reasons, and also in Finland. In Norway a bit and Denmark the fewest.

Nordkinn is also operating in Norway and is therefore a well-known house there, so you may feel about that differently. *But I do believe that Sweden and Finland really stand out globally in a particular way, which is that compared to most countries – maybe with the exception of the US and Switzerland – hedge funds are in fact quite popular, and secondly they don't have a bad reputation. Here, hedge funds are widely used among institutions with Finland being number one for a long time where institutional investors had been using hedge funds for long periods with very substantial allocations. We are talking about 5% to 10% in hedge funds when continental Europe had 0 or 0.5%, which is a meaningless allocation, you might as well not do it at all.*



We see the same in Sweden. When I look at our current and our historic investor base, you see a broad spectrum institutions but also people, for example politicians, ex-politicians, political parties, labor unions across the scope except maybe the ultra left wing. So you can see that we are not talking about the usual suspects here when it comes to who invests in hedge fund and who doesn't. Isn't it interesting to notice how **hedge funds are accepted here in Sweden**, and there is not a bad word about them?

Carl Rydin: I very much agree with those points. What I find interesting though is that from a media narrative, here in the Nordic region, more so than in the US for example, it's the private equity firms that have really been hit hard in the media.

Gunnar Wiljander: Well, for obvious reasons. They have been very constructive to avoid paying tax.

Carl Rydin: That could be one reason. In addition, they are often early investors in certain structural or regulatory changes. For example, you saw a lot of private equity firms getting involved with public services and ending up owning some of the largest companies providing care for the elderly, health and schooling in Sweden. So, I just wanted to point out that in Sweden it's more the private equity firms which are the ones that have been hit in the media narrative.



Per Ivarsson: Gunnar, your comments and Nektar's experience with the Nordic investor base are extremely interesting. I think the relatively broad acceptance of hedge funds and managed futures in Sweden and Finland is based in the **strong engineering tradition** in both countries. Traditionally, if you look at Swedish CEOs, they are usually engineers whereas if you go to the rest of Europe, even tech companies are run by accountants or lawyers.

My theory is that an engineering background helps when it comes to number crunching and understanding quantitative strategies.

Gunnar Wiljander: It's a good theory.

Erik Orving: I agree with the Per here, and it is evident when you look at how large institutional investors in Sweden run their investment portfolios. The engineering mindset comes into play in a variety of ways, both in preference and understanding of quantitative investment strategies, but also in asset allocation and in terms of alpha-beta separation.

Matthias Knab

The popular alpha-beta separation is a quite quantitative procedure, however when you look at the hedge fund returns of these institutional investors, it often hasn't been good, and they could be disappointed from that perspective. But equally, there are still hedge funds out there that compound five to ten percent per year but they don't make it in those institutions' universe because of the strict alpha-beta separation.

And subsequently the investor may make a decision like, *"Okay, we are going to stop investing in hedge funds and pile more money into real estate and private equity and other illiquid alternatives,"* which in the end can create a whole new set of risks. On the other side, in your equity exposure, in general you understand the risks.

For me it's interesting to **compare Sweden to Finland** from that perspective, I see a big difference there. Finnish investors typically had gone after the best hedge funds in the world through the use of consultants or through their own network, whereas in Sweden, I have sometimes heard the criticism that you don't tend to see any top hedge funds in the bigger pension funds' portfolios apart from maybe Bridgewater and things like that.

Erik Eidolf: We should also point out that similar to the hedge fund industry in general being somewhat opaque and heterogeneous, the same characteristics also apply to the Nordic investor community. Investors across the Nordic markets are heterogeneous, each sub-market has its own segmentation of institutional investors, with large differences in terms of size, how and to which extent hedge funds are used in their portfolios, and so on. This requires deeper understanding of each investor.

I also think that the way hedge funds are marketed today is much different from say 15-20 years ago. Back then, we argued why you should invest in hedge funds while we today instead seek to be pedagogical about what we do, and then leave it up to the investor to decide if it fits into their portfolio or not.

When looking at our own investor base, we can conclude that many see us as a "tightly risk-managed hedge fund" and subsequently use Nordkinn as the stable component in a portfolio of hedge funds. Alternatively, many rely on our low correlation profile and use us as substitute/complement to long-only bonds. We avoid influencing how our investors fit and use us into their allocations, but instead put all efforts on being pedagogical about what we do. Therefore, we are diligent on equal treatment and on being consistent in all communication.



Carl Rydin: That's a good point, however despite all the differences between the individual funds and strategies, it seems like we are also seeing **more correlations within the hedge fund industry**, especially on the long/short equity side. Today, it seems the most contrarian approach to investing is simply being a fundamental long-term value investor. It sounds counterintuitive but when it comes down to it, so many investors and allocators are short-term oriented whether they want to or not.

It seems that investors like us – value investors by heart – have fallen a bit out of favor. Equities which have been considered expensive have – until recently – become even more expensive. If we look at the more illiquid investment alternatives such as real estate or private equity, those funds have a capital base that's



locked in for five or more years. It's a better situation to deliver returns over time, and I believe that goes for a public equity standpoint as well, particularly in the small cap space, we encourage our investors to take the long-term side given the short-term volatility that we see.

The reality is that we are not able and should not be required to compete on the short-term alpha generation from month to month, or quarter to quarter. Our approach to investing requires us to hold on to our investments until the catalyst or value enhancement has occurred. We have many good examples of when this has worked out and it typically takes three to five years. Similar to the alternative strategies I mentioned which benefit from locked up capital, we also feel that our long-term investment ideas definitely deliver value over time, and that's something we aim to communicate very clearly to our investors in explaining to them what we actually do in our investments and what makes our investments successful in the end. So we typically develop a plan where we invest and engage with a company with the aim to see a fundamental change to unlock value maybe three or five years ahead. In order to do this, you need a very understanding investor base.

Achim Karle: I fully agree with your points that it is of utmost importance to understand your investor or user base. It is the same in our case as an exchange, we always keen to provide the best exchange tradable derivatives products and functionalities for our clients.

We just recently conducted a big client consultation event series here in the Nordics. Therefore we have been to Denmark, Norway, Sweden, Finland as all these countries are thought leaders or sort of front runners in terms of **ESG requirements and implementation**. We also understood that client demands today is driven towards ESG more than ever before.

We know that today's standards adopted in northern countries are very high in terms of ESG. Furthermore demand will emerge driven on the one side from the regulators, and on the other side from the environmental changes we all can experience. Looking at the weather, the summer 2018 was a sort of outlier, the unusual weather patterns are continuing now into fall with one heat record after the other. We've measured the hottest daily October temperature this year in Germany as well in Sweden, and so in a way everybody now is feeling something has changed and that there might be something wrong or going into the wrong direction.

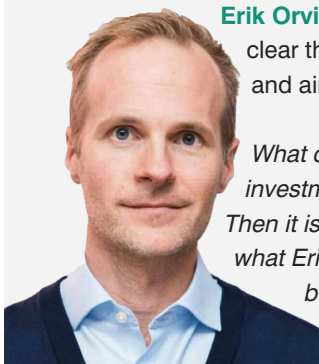
What we figured out with this consultation is that ESG is indeed the big topic, demand will be, is increasing steady and that it is therefore important to have well defined, standardized products that help investors to create value and even enhance performance of investments using ESG compliant, financial products.

So we as an exchange we see a large potential here, and I was wondering how you from the hedge fund or alternative investment side are looking at ESG and what you may already be doing?



Erik Orving:

I agree that there is a renewed interest in ESG in the Nordics, particularly in Sweden. It was a hot topic already ten years ago, but as of lately it has been a key decision parameter for investors. In Sweden, we discuss ESG in most of our meetings.

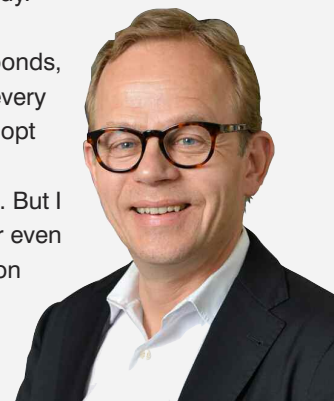


Erik Orving: It's about how we invest. Coming back to the conversations we are having now, it's, however, clear that everyone wants different things in ESG. Each investor has his or her own guidelines, preferences and aims, and so it is difficult to please everyone.

What could be a solution here? I think that fund managers, like ourselves, need to set our own responsible investment policy, which suits the overall investment strategy and maximizes the return from ESG-analysis. Then it is up to the fund manager to explain it to the investor and through this find common ground. Similar to what Erik from Nordkinn said about educating investors on exactly what you do in your strategy, I think it will become very important to do the same with regards to ESG.

Gunnar Wiljander: We have been around for quite some time and we started to get questions on ESG roughly ten years ago, as you said. At that time, the discussion was primarily driven by a group of investors that have been quite keen on hedge funds for a long time – the Swedish foundations. They start to require some sort of screening of your portfolios a long time ago to be invested with you. There has been a company in Sweden called Ethix which is now called ISS Ethix that has been screening funds and hedge funds for many years. So this has been done for quite some time already.

I have to add that this is easy for if you trade the risk-free space like we do. We trade government bonds, risk-free rates and currencies. It's very hard to be unethical in that space and so you tend to pass every screening. But if you invest in companies, corporate bonds, equities, then you will actually have to opt out of certain things. While we opt out of things automatically, we might not trade Kazakhstan or whatever, just to bring up a name – not for ethical reasons but because it's not tradable and illiquid. But I agree that demands are coming from various places now, perhaps more for political correctness or even greenwashing – people want to sell products, and ESG is the new thing that helps doing that. But on the other hand there has been a genuine interest from many large investors for a very long time.



Erik Eidolf: We believe that sustainability, similar to e.g. themes such as how to optimally respond to regulation, appropriate disclosure, etc, can be powerful tools to influence us in improving how we run our business. Therefore, ultimately, key is for us as a firm to figure out how ESG fits into our business and, just as Erik from Bodenholm said, how does it translates for us specifically.



At Nordkinn we decided to commence from our investors' perspective. Around two years ago we assigned an **"Investor Ombudsman"** as an independent board member having the specific purpose to represent and protect the interests of all of our investors. We have now 67 institutional investors in Nordkinn, and if we were to line them up based on to which degree they are believers in ESG, I think you would get an approximate picture mirroring that of the whole market space.

To secure that our work within sustainability remains genuine and close to our DNA, we get inspiration by keeping an eye on our **ESG skeptical investors** in particular. If the skeptics can relate to our efforts, we are probably on the right path. For this reason we commenced by implementing the “the Investor Ombudsman” concept, which undoubtedly is in the interests of all our investors.

We have since added two perspectives; how we invest and our role in the financial system. With regards to ESG implementation in how we invest, in sum, we take responsibility of how we use our balance sheet to influence. Within our role in the financial system and society as a whole, we are active members and strong advocates for the UN PRI and the SBAI (Standards Board for Alternative Investments). But in each step in our process to implement sustainability, we must never lose sight on making all efforts close to our business.

Per Ivarsson: I agree with the statement that as a fund manager you need to take an active stance, because there is not one solution that fits all. You have to be very clear about ESG and then communicate it, just as you communicate the rest of your strategy. Some investors won't like it, and others will.

But for us, as we ultimately invest in futures, it's an even more difficult question. For example, Canadian equity index futures include uranium mining companies. Would you kick that index out? While this is an ongoing discussion, we have to be very clear about things already now. In fact, we did our first study in 2009, an internal 40-page internal paper. Back in those days, it was even more unclear regarding futures. In the derivatives space, back then, we interviewed some of the foremost experts in the ESG space, and they all gave us different answers...



Gunnar Wiljander:

I have question to you Per. How about the soft commodities space, so things like agricultural derivatives?

Per Ivarsson: In Sweden many institutions must opt out of soft commodities because of regulation. Usually, they say that they would like to have the exposure but are not able to. We argue instead that it's better to have an efficient price formation of any commodity, which is exactly what the futures markets offer. For example, it is better to have efficient price formation of oil that reflects cost, supply/demand, and so on instead of opaque markets that can be more easily manipulated.



There is an interesting precedent in the US. There used to be a futures trading in onions in the 1940's and the early 1950's, but the contract was very volatile. So, the government shut down the trading of onion futures. But studies done since then actually find that the volatility is often even higher because of the **inefficient price formation**. *What's important to notice is that the futures trading didn't increase volatility, it just made the price fluctuations very transparent. I think the same holds for any commodities.*

Achim Karle: We talked about the lack of a standardized approach to ESG, and this is exactly what we see as well. Right now, there are no standardized ESG products on the market, and each investor has like a different standard as the awareness and perspective can be very different.

As exchange, one of our aims of course is to bundle liquidity, so if we come up with products, they need to be standard products like a plain vanilla future tradable on exchange, also to lower the cost of trading. What we heard from investors and pensions is that the cost of trading and investment into ESG is relatively high, and sometimes of course comes with a reduction in performance because you exclude some companies.

For example, when it comes to military sector, there are very successful and profitable companies in that sector right now. However, if you exclude them, this performance, their profits are missing out in comparison to the benchmark as an example.

So, how can you define a benchmark, which is ESG compliant and meets the standards for most of the clients? We aim for a best in class approach here. Eurex already has some very strong benchmark futures such as the Euro STOXX50 and now the Euro STOXX600. As a side note, we do see people moving from 50 into the 600 space, and of course the Euro STOXX600 is more diverse and also provides, for example a certain exposure towards South Europe, so investors are moving from the 50 and 600 because of the diversification and exposure.

Now, if you now want to establish a **liquid ESG product**, of course we take this benchmark in account, clean it and create an ESG version of it. Sounds easy but actually it's not at all that easy. We have to apply different philosophies – but what should the product be like. Should it be based on just exclusions or do we take more SRI weightings in? Should we take data from ESG rating firms?

What we try to achieve and what the result of our market consultation was, is that we really should create a product, which is most tradable for all types of perspectives and investment strategies.

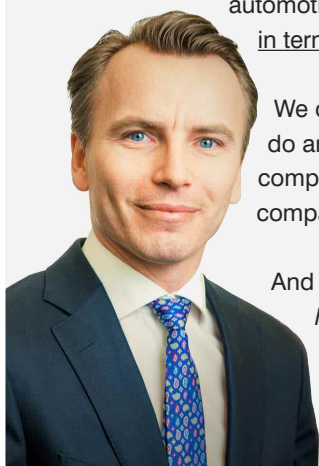
At the end, there won't be the single solution, though it could be just a simple exclusion list, or a best in class approach future without the creation of tail risk, with a small tracking error and smooth correlation towards the benchmark, and so a product which is tradable for everybody and everyone needs.



Carl Rydin: I would imagine that a lot of companies will end up being thrown back and forth from the dirt into the good. Then next time, back again. I mean, we're seeing some banks in the Nordic region which – from an ESG perspective – looked great a month ago and now they don't. You can see the same with some US tech/social media companies or certain German automotive companies. From that perspective I would then also think an ESG index could fluctuate quite a bit in terms of its constituents.

We obviously take ESG seriously when you promise your investors that there are certain things that we do and research when we invest in companies. So we have decided to exclude certain companies completely. We have not decided to eliminate shorting those sectors, so we are still allowed to short a company that we might consider being sort of unethical or which wouldn't fit an ESG profile.

And then on top of that, if you take the G within ESG, *we actually like to get involved in a company that has poor governance because those companies often trade at a discount to its true value. We believe that even as a minority shareholder we can improve and influence the corporate governance positively.*



Part of our investor presentation material illustrates how we have been involved with a company lacking proper governance oversight, and where the market cap was way below the intrinsic value of the company. We then got involved and all shareholders benefitted once this issue was identified and later addressed. In other words, following a constructive approach to improve a company's competitive position. That's the biggest misconception with shareholder activism.

Achim Karle: From our client consultations we also found that, there are kind of **two mindsets**, one being: "Okay, I know this company is not so well developed in their ESG standard, but we keep on investing in it, in order to have our stake in the company and to influence them to shift in the right direction."

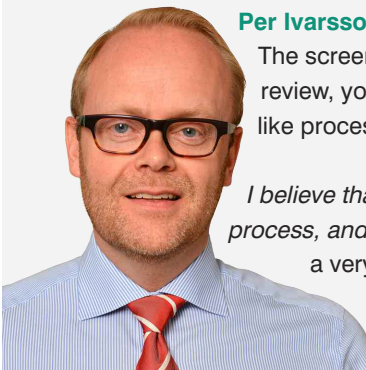
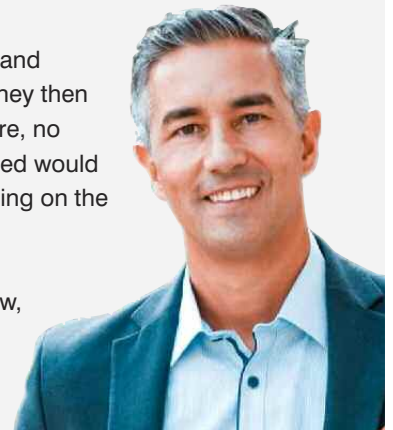
And then there is the other mindset, which is, "Oh no, we don't want to invest at all in non-compliant ESG firms, so we pull our investment from those companies to show them, 'Hey guys, you're doing wrong. When you change behavior we will be back, or you don't change and we're not back.'"

Then, as often in life, things that appear to be obvious on the first look can turn out being very different when you look from another angle. Let me give you an example.

We met an asset manager who had investments in banks in Israel. Then the Palestine conflict started to boil up again and they saw in the media what was going on there, they started to pull the money from their investments in Israeli banks. They said, "We can't stay invested with you guys because there's something going wrong there. It's not ESG compliant, so we want to sell our holdings."

After that, the Israelis actually called back the investors and persuaded them to come to Israel and actually see what the banks are doing there in the Palestine strip. Being there on the ground, they then figured out that without those Israeli banks, there would not be any cash / financial infrastructure, no small loans, there would be no ATMs. All these things an economy and the ordinary people need would be gone if the banks were not there. Therefore, they then actually saw what the banks were doing on the ground was good, and there was not any talk about selling after that.

Here you go again with all the problems around negative screening. In addition, as you all know, there is usually costs involved in assessing such a situation.



Per Ivarsson: I think there are several challenges when you outsource the ESG screening to other parties. The screening is only valid on the day it was issued. It's like a restaurant review. If you read a 2-year old review, you don't know if the restaurant is still good or not. It may be better to have a sort of Trip Advisor-like process where the ESG-score is constantly updated by your peers.

I believe that ESG and having timely information needs to be treated just like another factor in your process, and you can't rely on some one-time stamp that someone else gave at some point. ESG has to be a very active and integrated part of the screening and selection side.

Gunnar Wiljander: Having had investors, including some big Swedish insurance companies, that want to apply an ESG process for many years now, I can share that we have regularly received questions on what our stance on things like nuclear weapons. I think if you trade single corporates, that is an easier field because you can then either take the activist approach or opt out. But if you trade the risk-free space, it's hard to do something really meaningful.

I also want to address window dressing here. Is someone trading green bonds? We offer our investors monthly liquidity with four days' notice, so we you are not going to touch green bonds for liquidity reasons. So, green bonds might fit a buy and hold investor but not a liquid hedge fund.

Oil is another big topic. Let me explain. We trade a lot of inflation. There's one component in that which is very volatile, and that's energy. So if you want to put on an inflation relative value trade, you might want to hedge out the energy components by adding shorts in oil, gasoline and natural gas et cetera. That's another trick.

Like any other manager, we often get the question, "What is your view on oil?" We then say, "Well, we short it, and sometimes we are long." That's because **for us oil is part of an inflation trade**. We trade it because it represents inflation. If there would be no oil in inflation indexes, then we wouldn't have that problem. But we cannot really do that.

Another thing is equities. We hedge the risk-on tilt very often in the portfolios even though we don't trade equities. A relative value portfolio can have an equity risk tilt without having a direct equity exposure. So, we would sell EuroSTOXX or S&P 500 futures against it and the hedge has to be liquid. So why not take out the unethical components of your hedge? Well, the hedge has to be liquid. So, therefore your new ESG futures, Achim, can be very interesting. If they are liquid, we might as well trade them as well.

And then another question we sometimes get is, "What's your view on nuclear weapons?" Well, we trade government bonds and currencies, what is our approach then? We invest long and short in US dollars, Pound Sterling, euro, Chinese renminbi, Indian rupee, Israeli shekel sometimes, and those countries all have nuclear weapons. If you have an approach not to buy the government bonds, then you can't invest in those countries at all! As soon as you buy a US dollar, you lend money to the government of the US, and that should then also exclude any other US asset such as real estate, equities, what have you. And so we believe that the approaches that can be adopted in the risk free space are very limited, though.



Matthias Knab

When you talk about green bonds, are they as illiquid as you are saying?

Gunnar Wiljander:

Well too illiquid for our mandate

Achim Karle:

The key word is obviously liquidity. That is what everybody is looking for. So you need a product which is liquid because as the demand is also very substantial...

Gunnar Wiljander:

That's why you use futures for that!

Achim Karle: Exactly, this is a field where you use futures. From the exchange side, we need the market makers also do their work. We would never introduce a future without having at least three market makers behind the product. So, in addition, we started to approach some of the market makers in order to persuade them to act as liquidity provider for new ESG futures. We asked what they think of the new products and if they would like to perform as liquidity provider, and they told us, "Hey, that's a good idea, we are happy to support!"



Moreover, as those products are set up and linked to an existing benchmark future, which market makers already active in, it's easy for them to adopt and quote for the new product as well. So, liquidity will be the key driver and we will ensure enough liquidity in this new product space.

I see a really bright future with those products and that demand will rise, not just because there is already demand for from Scandinavia and Continental Europe but also because the European Commission is setting up new regulations, so also from the political side more and more investors will be directed into ESG and Low Carbon investment space.

Erik Eidolf: If we step back and reflect what's different now compared to say five years ago, one of the first things coming to mind is the existence of the **2030 Agenda for Sustainable Development**, adopted in 2015 by the UN member states. It defines 17 Sustainable Development Goals or SDGs to be achieved by 2030. The key catalyst calling for action here is its clear deadline. As the 2030 Agenda increasingly is being adopted by the large asset owners, I think we as a hedge fund community can take on a very important role, given our absolute return focus and being active managers. Applied correctly, and with the robustness of the financial system in mind, the often shorter term investment horizon of hedge funds are vital in adding liquidity and thereby efficiency to the markets.

Locally, we have now a topical issue of money laundering incidents within some of the major banks. Money laundering is arguably one of the biggest threats against an efficient and sustainable financial system. By implementing e.g. governance as a theme, these banks can be pushed to get their act together. Being active managers, hedge funds act differently than the traditional "buy-and-hold" asset owners, which allows hedge funds broadly to be used as an integral part of the solution rather than a threat to the 2030 Agenda. At the UN PRI level, we are currently creating a **"guideline for ESG implementation" for hedge funds**, which we hope will be constructive in moving this forward.



Matthias Knab

We talked about that there is no single standard definition about what is green or ESG. I read in an article that just in Germany alone there are 19 different certifications and labels for green funds or investment products.

Carl Rydin:

Who decides on those certifications?

Matthias Knab

It's some association or different groups.

Erik Orving mentioned that some players are against shorting stocks for ESG reasons, because even shorting means providing liquidity to a stock. I mean, this is a completely philosophical discussion. You could also argue that shorting is something like a leveraged sell on a stock. But, I understand that people may have a different opinions, and this just shows again how many things that need to be thought through and agreed on.

I believe Erik from Bodenholm made an excellent point that at least for now, we need to go ahead, define our own agenda and be clear about it and communicate it. I think this is an excellent and proactive approach.

Achim Karle:

The picture is changing, everywhere. We can also see this with the **2018 Nobel Memorial Prize in Economic Sciences** that went to Paul Romer, William Nordhaus for integrating climate change and technological innovations into long-run macroeconomic analysis. The paradigms are changing slowly and everywhere, and I can foresee much more demand and more products going forward.

Matthias Knab

Let's look at outlook and future opportunities in your space or strategies.

Per Ivarsson: The good thing about being in the managed futures space is that we have no opinion about any perceived true values or over- or underpriced assets. But, looking at the broader trends within our industry, we see an increased interest in Europe, and Sweden, towards finding **risk mitigation of the equity exposure**. I think this recent interest was sparked by CalSTRS in 2017 when they implemented explicit equity risk mitigation strategies for their portfolio with large allocations to CTAs and some long-term bonds and global macro mandates.



That move appears to have started several waves of interest, especially in Europe where the larger pension funds look at risk mitigation as well to see how this can fit into their strategies. So, the investors are trying to broaden the scope of their investments with the aim to get a more robust portfolio over time. I think that's a good thing. In addition, there is also a tendency for investors to be less sensitive towards short-term performance and apply a long-term view which I think is quite interesting and hopeful.

Carl Rydin: One trend I wanted to comment on is that especially in the Nordic region the larger private equity firms appear not to have a particularly difficult time raising capital. We are therefore seeing a lot of dry powder from the private equity firms, and obviously that means competing for potential targets in the private market space becomes more difficult and valuations going up.

Maybe a result of that, or for whatever reason, we are also seeing some of the private equity firms in the Nordic region increasing their mandates and actually allowing themselves to invest in the public markets. There's some big names in Stockholm here that's done this for a while or starting recently.



Matthias Knab

How specifically do they invest in the public markets?

Carl Rydin: Well, for example you're seeing EQT recently acquired Zeres Capital, took over their portfolio and brought that team over; Triton has a designated public markets team. Altor within their mandate are allowed to take minority stakes in public companies, they have done so in certain cases below 30 percent which means they do not have to do a mandatory offer for all shares.

We are seeing that across this private equity space and from the way they look at it and how they research companies, also on the buyout side, is that *taking a sort of five plus year stance and trying to change the company for the better is also very possible to do in the public space*. That's something we are seeing more and more. A lot of the investors we speak to like that approach. It's definitely a phenomenon that has developed and accelerated in the last few years especially because I think the private market space on the equity buyout side is getting quite crowded and as a consequence we are seeing now more of them getting involved as minority shareholders in publicly traded companies.

This also links back to my earlier comments about the shareholder-friendly environment in the Nordic region that allows them to be minority shareholders yet also control part of Board seats and being able to implement change.



Many allocators commit capital to private equity strategies with long lock-ups. If part of this capital is then deployed in the public markets there is clearly an advantage having this locked up capital. Compared to many public funds that are being as liquid as traded daily, it's harder to run a long-term investment strategy without knowing for sure that the capital you are deploying is also equally as long-term. At the end of the day, when explaining our 3-5 year investment approach, the long-term oriented investors we talk to do actually prefer somewhat lumpy superior long-term annual returns versus steady but mediocre returns. That's how we look at investing and where we think a long-term capital commitment makes sense.

Erik Orving: Bodenholm is spending a lot of their time outside of the Nordics on conglomerates that are deconglomerating and spin-offs from other companies. We look at these opportunities on both sides of the pond.

Generally speaking the trend is in our favor as we observe more and more opportunities coming to the market, with Europe also now waking up to the concept of deconglomerating. Siemens, Continental, Thyssenkrupp and Daimler for example have announced spin offs. In Sweden we see large industrial companies Atlas Copco and Autoliv spinning of divisions.

Every year we review 15-20 spin-off situations, and with a relatively concentrated portfolio we don't need to run after all of them, we just need to find 2-3 really potent ones every year. Besides that, we typically monitor 7-8 opportunities in conglomerates that have announced **deconglomeration strategies**.



Carl Rydin: Typically, when a conglomerate spins something out, they hand it out to the shareholders, and you would then become a shareholder of both companies. I wonder, do you typically get involved post spinoff or do you try to get involved early or anticipate the spinoff?

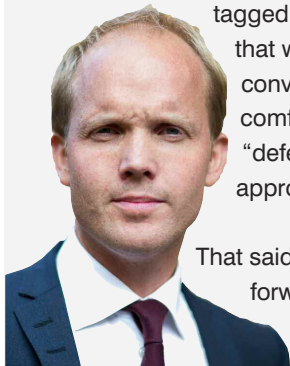
Erik Orving: We look at companies once they have announced they will do a spin-off. We can then decide to invest before the spin-off happens or to wait and buy after the spin-off is completed. Statistics show that companies usually outperform from the day of announcement into the spin-off date and the companies also tend to outperform post the spin-off date. For us, it depends on if the sum-of-the-part valuation is attractive ahead of the spin-off date or if we want to buy one part, i.e. the RemainCo or SpinCo.

Erik Eidolf: When it comes to Nordkinn, we are strong believers in the Swedish saying that “the shoemaker should make shoes”. For us this simply means that our sole focus should be on what we know and do best: Everything from our return objectives to our investment strategy is built “bottom-up” from the skill-sets and experiences of our investment team.

Like most other hedge funds that operate in the liquid space, we need to be transparent in our reporting, including how we perform every single month. The benefit of that is that we on an ongoing basis can express an absolute return, agnostic to market beta, lowly correlated and so forth, but with the obvious caveat (!) that we always need to perform. As we are unable to “control” our returns, we instead rely on a structured investment process with clear portfolio sub-mandates to bring discipline to our consumption of risk.

We specifically deploy a “game plan / tagging concept” where every single position has a game plan, which is tagged with a clear stop-loss and performance target. Doing this perpetually, looking back over the 64 months that we have been running our fund, we see a clear asymmetry between losses and gains. As we are convinced that the residual of this asymmetry explains our close to zero correlated absolute returns, we are comfortable with the risk/returns expectations that our investors have on us, as long as we keep “defending” the asymmetry by continued focus on disciplined risk consumption based upon our specific approach.

That said, we also must stay attentive to the ever changing prerequisites and nuances of the markets. Going forward, central banks are now gradually moving away from excessive monetary accommodation, which



we believe will alter e.g. the volatility pattern of the markets. Generally, higher vol is a potential source for generation of additional alpha, assuming that we are on the “right side” of the volatility, which again calls for being disciplined on how we consume risk.

Gunnar Wiljander: We are a global macro and fixed income relative value hedge fund and I also believe we are approaching interesting times, at least in our space. Perhaps not the initial phase of the unorthodox monetary policies but the recent few years have been very challenging to trade from a macro perspective. Keeping crisis level monetary policy across the big global economies and Sweden amid an economic boom has been somewhat of a mystery to a lot of people. So until recently, the result has been low volatility in rates and fixed income and asset prices going up across the board which has been a fantastic ride. *But you cannot buy risky assets if you want to be uncorrelated to just those assets.*

Therefore, the uncorrelated space has been difficult. Now we are in 2018 and looking back assets have done enormously well. However, what seems to happen is that when investors read your disclaimers saying that past performance is no indication of future performance, they seem to read it differently, and so when they look at the portfolios today some tend to assume that the past performance is a strong indication of future performance. So, if you do a nine-year lookback on the S&P 500, it's up some 350 percent since 2009 which is amazing, with a Sharpe of 1.5 or so, and we see the same here in the Nordics with OMX, I think. Global equities are also up 250% with a Sharpe above 1. I don't think this has ever happened in history and, of course, it looks fantastic. So equities have a very strong following to be long, if that something you want to have.

If you don't want to be in equities, you could try to generate equity like returns by doing it on the illiquid side. So when you look at the alternative bucket of institutional investors, you see the move away from hedge funds into other alternative investment because you want to generate returns. If you are an endowment or a foundation, you want to pay your coupons to schools, give grants to researchers and retirement funds need to pay pensions, et cetera. So you want your six to nine percent coupon every year to keep doing what you do. And that's hard when rates are 0.5% or 1.5%.

We have seen investors moving money from us into other alternatives such as private equity, real estate, structured credits, global credits, private debt and direct lending. But if you think about those strategies or asset classes, that is mostly beta with a high lack of transparency, a lack of liquidity, mixed with leverage. It's very hard to beat a commercial real estate portfolio on a five-year lookback basis when massive leverage has been applied amazingly well. You look like a genius. I mean, that the model to make billions, and indeed there are a lot of billionaires that are active in this.

But, as I said, I think we will be seeing pretty interesting times now when global monetary policies are contracting. The US have deferred clearly out of this and are selling 50 yards of government bonds per month now compared to buying similar amounts a few years ago. There's a rate of return – you almost have positive real rates of return on the short-term, so cash is an alternative. The other big central banks also want to get out of this. Bank of Japan have pegged the ten-year bond to a 10 basis points plus minus a tight range. There's no volatility. They want to get out of this. So when this reverses, I think we have a fantastic and interesting opportunity to make money in what we do.

I'm on the same side here as Eric, we didn't start do anything new in what we do. I mean, we didn't start buying real estate because real estate goes up. We try to figure out where rates and currencies are going and do fixed income arbitrage. If central banks put the wet blanket over rates and keep volatility a zero, there's not much you can do. But now I believe we'll have an interesting time going forward. Crashes are normally good for hedge funds because – of course, depending on the strategy – they tend to stand out from the most obvious trade which is just to buy S&P 500 and sit on it and make a lot of money.



Per Ivarsson: I don't know if anyone else here was at the macro economic forum here in Stockholm last week organized by a large, London-based, research house.

The topic of the event was what could cause the next global crisis, and I had assumed that this year they would be even more alarmed, but it was actually quite the opposite.

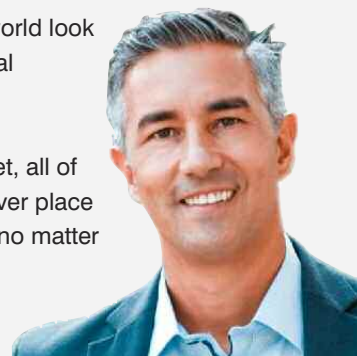


They come every year, and last year they were quite alarmistic, talking about the knife's edge that federal banks must balance. If they raise rates too quickly, it might trigger a crash. If they raise too slow, markets risk to overheat and a potential crash would even more dramatic. So, last year, there seemed to be a lot of dark clouds in the sky. Interestingly, this year, the speakers were less worried. The general stance was like, "OK well, you have the trade wars, but frankly it doesn't really affect more than a fraction of global trade!", and the story was the same for many different scenarios, and none of it was really alarming. The conclusion was that a lot of different scenarios would have to coincide for a real crisis to develop. In fact this shift in sentiment makes me more worried. When a crisis comes like a flash out of the clear sky is it becomes really serious.

Achim Karle: We spoke a bit about opportunities, outlook, but let us also address a major threat to the markets called **Brexit**. I mean, even our chancellor in Germany who usually communicates calmly, "Don't worry; we will take care of this. Its fine, it's going to be good," issues unheard statements such as, "Oh, we will see if it's going to be good."

Brexit is still a major threat. What happens if we will have a no-deal, a hard Brexit? How will the world look like past Brexit? These are really scenarios, which I think nobody really understands, and financial markets may suffer from market disruptions.

Right now, many banks are preparing fallback scenarios for a no deal Brexit, and, let us not forget, all of this costs a lot of money as well. Even if the press talks about Frankfurt, Paris or Milan or whichever place emerging as a "winner" of Brexit, the truth is that everybody is going to lose on a no deal Brexit, no matter what.



Matthias Knab Italy is another big potential blow up.



Gunnar Wiljander: If you look at where Italian rates are now, there's no way that their budget deficit will be two and a half. It's rather going to be three, three and a half, so that's interesting.

But also, Achim, talking about winners, I think Deutsche Boerse Group could be among the winners when it comes to the clearing business in Europe. So from one side you may as well looking forward to a hard Brexit. As we know, global interest rates swaps are currently cleared by LCH and most active clients that trade a lot such as hedge funds or some long-only investors that use swaps clear those products

because it's a very efficient way of doing business. All that business is currently on LCH and it is unclear whether you can clear on LCH in a hard Brexit. Some of that liquidity will move mostly likely to Eurex. We as well as other traders and market makers are following where the liquidity is. If liquidity is somewhere else, you will move there. I think most traders are quite agnostic about which clearing house they use. It's hard to say where Deutsche Boerse Group is more credit worthy than LCH or CME or ICE, et cetera.

Achim Karle:

I agree that from that side there is a big opportunity for Deutsche Boerse Group with the Brexit in terms of developing further growth in clearing business.

But despite this fact, looking at the bigger picture, a no deal - a hard Brexit, when the UK will potentially be losing all pass porting rights, then all of the vehicles will be settled by cash on one specific point of time. I think this is a major risk people need to look at as well.

Gunnar Wiljander: *I think all hedge fund managers, at least if they have a substantial business, have to look at Brexit. We have operations in London, Singapore and Stockholm and have PMs at those locations – we have to look at this. From my perspective, it can be done, also a hard Brexit. I think the markets, the banks and the clearing houses, all are preparing for it in various degrees. I would not think that March 29th 2019 arrives and you just fall out of bed. Everyone is preparing for a hard Brexit right now and setting up everything you need to do, and then if you need to do, you just fall over.*

It's sad for the Brits though. JP Morgan is building a trading floor in Paris regardless. I think with 1000 seats or so. Goldman Sachs are moving substantial part of the business to Frankfurt. RBS now called NatWest is setting up substantial part of their business in Amsterdam. Regardless of hard or soft Brexit, the financial industry in London, which is a big or probably the largest tax payer in the UK, is moving out.



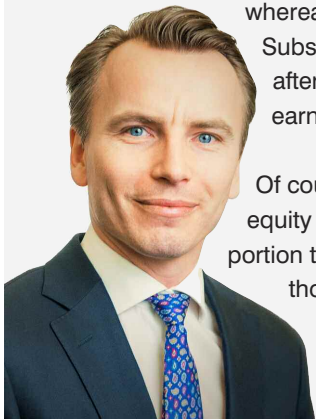
Per Ivarsson:

One can't help wondering, as we have just finished adapting to AIFMD, MiFID, GDPR requirements and now we have Brexit. What's going to happen when Brexit is a fact and we've all adapted to it? Will we see a broad scale discharge of work force in the financial sector? Will this trigger a recession? Or can we perhaps trust that there will be some other new regulation coming that will keep us busy?

Carl Rydin: I don't have a lot to add on the macro side, so let me share some thoughts about where we are right now in our long book. Given that we are most likely moving towards the later innings of the cycle and with rates still low from a historical standpoint, I would characterize some of our companies as having a kind of **"self-help" component** where they have a potential to change its earnings-profile independent of macro factors. That could include effects that Erik from Bodenholm was mentioning – spinning out maybe a division that lacks synergies with the rest of the company. Or, say the company has made a fairly large acquisition recently where acquirer has historically been very strong in services or after-market sales whereas the acquired company has a large installed base but been lacking on the service side.

Subsequently, there can be an attractive potential in bringing that new company in and developing the aftermarket sales equally well. The point is that it's very much around the company itself building out its earnings profile organically rather than relying on say a certain external macro theme.

Of course, there is obviously cyclical involvement in many of these names. If there is a quite a substantial equity downturn, our long portfolio will be hit, but on the other side we are also sitting on a larger cash portion today than we have ever had, so then we would be ready to act as well. We would certainly add to those companies that we have already done research on if there is an opportunity buy them at lower levels.



Gunnar Wiljander: What is your current net exposure?

Carl Rydin: Currently we are around 40%. So, we are still quite long biased. On the short side we have certain names we have identified, and we also have on top some short positions in index futures.

While our long book is more directed towards small caps, our short book has the more liquid, larger companies. So, there is a certain difference between the long and short book in terms of market cap, but that's for obvious reasons. It's much tougher shorting the smaller names because we need that liquidity and some shares are also hard to borrow. We are seeing at the moment that some of our high conviction shorts are getting more expensive to borrow. So, it is important to be early in those particular names.



Erik Eidolf: We believe, on the back of central banks now commencing the withdrawal of monetary accommodation, that *bond yields over the medium term are structurally set to increase. The issue is however that the increase in rates will be a bumpy path. This calls for disciplined risk taking, on position by position basis where the scaling in and out of each position requires a highly active approach.*



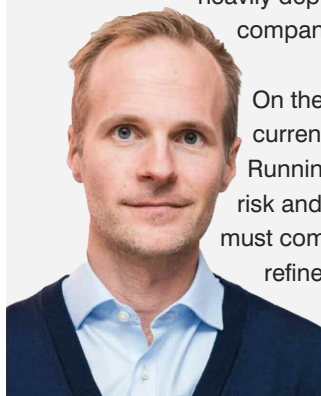
Gunnar Wiljander: More technically, it's hard to beat forward rates too. That means rates would have to rise quite fast, otherwise you lose carry.

It's similar to when you buy an option on something and then the market goes too slowly and you burn all your options time value.

It's trickier to trade in an up rate up environment than down for some reason or another. Which is interesting because if you're a rates guy or a foreign exchange guy, you're not the long guy, you don't care. You buy and sell new and used stuff and are not a long only investor. Most macro traders tend to have a quite bearish or skeptical view on everything. So, it would be easy, but it's not that easy actually to trade a bear market at all.



Erik Orving: We are bottom-up investors and we don't want macro calls to steer our exposure and/or investment strategy, but like everyone here around the table we are quite clear on the fact that we are at the end of a very long economic cycle, and that a recession soon is knocking on the door. Consequently, we see bad risk/reward in cyclical companies whose growth is heavily dependent on the economic cycle and we have made sure that we have limited exposure to cyclical companies in our long book.



On the short side, we see increasing take-out risk in many names, cheap financing, hot M&A trends and currency moves making certain markets cheaper than others. This is something we monitor diligently. Running a short book based on individual stocks and not index hedges, **M&A-risk** is probably your biggest risk and biggest potential detractor to performance. If a short is taken out, you lose a lot of money, and you must come up with a lot of winners to make up for your losses in that one name. Over the years we have refined our risk management processes to minimize the number of take outs in our short book and the results have become much better.

Gunnar Wiljander:

So technically, do you try to counter that with your long bias to some extent? You are right, shorting equities is for a number of reasons more risky than having longs.

Erik Orving:

Not directly, however we have smaller and more positions, and a stricter stop-loss process for the short book.

Carl Rydin: I think we have a similar view there. What may be different is that on the long side, we also like to find **compounders** in addition to some of our sort of more complex positions where if you do a some-of-the-parts valuation you find the value is much higher compared to what the stock is currently trading at. But with those compounders, if you invest in a quality name at a good valuation, you can be invested for long periods and just compound over years, and that position obviously grows as a percentage of the overall portfolio.

On the short side, once you are right and maybe the stock gets cut in half and you make money, your position also gets cut in half. So, you are either adding to it, because you have such a high conviction, or otherwise the position becomes smaller part of the portfolio, you really need to add new names on the short book as your right, so to speak, which makes it a constant process of finding new shorts to add.



Gunnar Wiljander: I don't know about private investors because that is not our business – although we have a lot of them, but in aggregate they are like half a percent of our capital – however what I would still like to add is that I believe *investors in general, particularly institutions after this run, will find themselves in situation where they have way more risk than they think they have.*

Most investors will probably start with a diversified portfolio that may include a barbell strategy which might be a technical term for having a spread between two different risks. This means you have a lot of risk on in one part of the portfolio, in private equity or something like that. That part is leveraged long essentially with a lack of liquidity and transparency. And, of course, it looks wonderful because you don't have to look at the volatility everyday. So from a number crunching perspective that is a fantastic product. And then you also have some of the de-risk components such as government bonds or hedge funds. Both fixed income and equities in combination have performed wonderfully. This is called a risk parity strategy in technical terms.



But it could equally be the case that in a sell-off scenario both asset classes actually sell-off simultaneously. So, there's no diversification really between fixed income and equities at this stage, you could argue. And I think the institutions which have cut a lot of the de-risk strategies in their portfolios could end up in a corner. So, when the markets turn, because all markets turn at some time – it doesn't have to be today or tomorrow, it could be next year or two years from now – I believe investors will realize they have a lot more risks than they actually think they have. I think we will see very interesting times in which it will also be very good to be a hedge fund manager.



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Contact

Matthias Knab
Founder
Opalesque Ltd.
www.opalesque.com
Email: knab@opalesque.com
Tel: +49-89-2351-3055
Mobile: +49-170-189-0077

