

PROTEAN™

DECEMBER 2021 • PARTNER LETTER

Dear partners,

What a difference a year makes. The rationale for starting Protean Capital was to pool capital in a lightly regulated Family Office setting, and manage it the only way I know: with institutional information access and execution, a versatile and patient approach and a tilt towards small- and midcap. A truly opportunistic net long approach with an eye to preserving capital via hedging and selective shorts. Albeit a way too short period to draw any certain conclusions, the initial few months has seen encouraging performance, with positive returns both on the long and short side as well as acceptable volatility.

December has been both eventful and quite honestly a bit boring. The month's performance has oscillated around zero since we decided to unwind all positions at the beginning of the month. We enter 2022 with 100% cash and nothing more. Boring. Now, the eventful bit: since inception in August we have received several approaches to manage additional external capital. As regulatory demands (and operating cost) increase exponentially when you need authorization by the FSA, we were reluctant to engage. By the end of November, however, and with Carl Gustafsson joining, we reached critical mass as a few Family Offices, high-net-worth individuals and finance professionals committed meaningful locked-up capital.

A regulated investment vehicle demands a significant administrative infrastructure, why there is a certain threshold that needs clearing before it becomes a realistic option. But here we are! This is the reason we unwound the portfolio in December – we're getting ready to shortly start with brand new clothes on! As readers of earlier Partner Letters will remember, I am critical of size and asset gathering in the finance industry, arguing maximized fees risk being prioritized at the expense of returns, leaving investors worse off. I do believe, though, there is a Goldilocks-interval for a small hedge fund somewhere between 1,5 - 2,5bn SEK. At that asset-size, you collect the benefits of being a meaningful counterpart in the market, with better access to deals, company executives, sell-side service, infrastructure service providers etc., while keeping small enough to capitalize on less liquid investment opportunities and being able to allocate meaningful amounts to your best ideas (they're only so many in any given year, remember?). We want to run an investment business first, not a fee collecting business (but we do of course want to cover our cost and get paid if we outperform).

Taking the leap from family office to regulated hedge fund is an intense and interesting exercise. I'm chuffed Carl Gustafsson is on board, since starting a fund is NOT a one-man exercise! We have recruited a professional Board of Directors, which is ultimately responsible for operations and regulatory compliance and therefore must be compiled of

PROTEAN™

DECEMBER 2021 • PARTNER LETTER

competent individuals. We have authored an application to the Swedish FSA, the administrative equivalent to completing an Iron Man Triathlon as it comes with no less than 25 company-specific policies attached (and counting). We have signed a lease for office space, registered trademarks, procured web site administration, counterparties, prime broker, compliance officer, risk management, IT-service, internal and external auditors.

Our overarching goal when processing all these necessities has been to use the best providers in the market, with cost as a distant second priority. Having worked at several large banks myself, sometimes in a managerial position, I know all too well the risks involved in not having competent advice and sound structures in place from day one. If there's one type of risk not worth taking it's the ones lurking in legal grey zones – doing everything by the book is simply a question of keeping your licence to operate, and therefore we have aimed for best-in-class when putting both the team, legal structure, and operational set-up together. The question we're currently grappling with is the investor base: we have some room left to reach a comfortable size for a start-up fund and are therefore keen to add a few investors. Hedge funds are often closed to retail investors since a) for some reason hedge funds are considered "complex" (au contraire: I consider our fund simpler) b) it's not ideal to have substantial outflows at inopportune times. You want to be able to buy when everyone else is selling, not the other way round, and retail investors are generally perceived as more prone to doing just this. I don't know if I agree with that prejudice, hasn't retail dip-buying become a national sport in the past decade?

In the institutional world of hedge funds, it is generally frowned upon to have a retail investor base, since the fear is "when they all sell they leave the fund (and therefore the patient investors) with the most illiquid assets, which then is an added risk to institutional investors". While this is a reasonable objection, there are instances where institutional investors have been no better. I believe this is an exaggerated fear. As a business owner, I think it's far more important to have a diversified investor base, where not all individual investors risk thinking the same thing at the same time. Just like listed equities, funds get the investors they deserve over time. If we can generate 10-15% returns consistently over an extended period regardless of market climate (a.k.a. our goal), we will create a durable business with patient and loyal investors, who will cut us some slack during the inevitable periods of underperformance, who understand the cost of giving away some upside to offer protection on the downside and who appreciate to invest alongside with managers who eat their own cooking.

Although we're humble and realize there's probably some way to go, and some track-record that needs generating, we certainly intend to hard

PROTEAN™

DECEMBER 2021 • PARTNER LETTER

close the fund for additional deposits if and when we reach a relatively modest amount of assets under management. Returns come first. The question is how we get there, how do we attract investors who share our time horizon and vision for how to generate acceptable risk-adjusted returns? Do we allow retail investors to participate from day one? Do we stick with only institutional investors? Do we put a minimum subscription threshold in place to reduce the potential flows (50k, 100k, 500k SEK)? Do we restrict withdrawals to once a quarter or yearly? Do we only allow subscriptions via one designated distribution partner, or do we go for distribution via popular online brokerages? Here we need help: what do you, dear reader of the Partner Letter, think of all this? Would you consider investing? What more would you like to know? What else should we be doing? Since we don't believe in paying for marketing, or discussing our holdings publicly to any great extent, we will likely remain an underground fund, with investors finding us, rather than us finding investors – which suits our patient approach just fine. Like a broken record: focus is on investing, not on asset gathering! If you find our approach interesting, do get in touch and let us know your thoughts!

Pontus.dackmo@proteancapital.se

carl.gustafsson@proteancapital.se

On a personal note: this is a very exciting time. It's certainly with a good dollop of humility and trepidation me and Carl take on the challenge of both running our own business and investing other people's money according to a strategy we have devised ourselves. Earlier funds we have managed have been "products" of bigger asset managers, where you must follow the formula for that particular fund management company and invest according to certain criteria.

Not so at Protean: we have a versatile and curious approach, and our limited size allows us to be nimble. Little did I know when I authored my thesis in Financial Economics at Umeå University in 2002, based on Kahneman & Twersky's ideas that cognitive biases are observable in market prices, that I one day would be launching a fund myself. Nor that I would be able to put up a reasonable amount to fund the operations and be a significant founding investor in the fund.

I'm grateful to a handful of mentors that have enabled me to develop – if not a skillset, then at least – a keen interest in investing: my first boss in the broking business, David Feinburg who first believed in my sales skills and taught me that a Swede too could write reasonable Queen's English. Johan Roth at Nordea who have been a great supporter through the past 20 years. John Hernander and team at Nordea Asset Management for teaching me diligence and patience when investing. And last but not least Peter Gyllenhammar, managing to mix fun and seriousness is a great skill,

particularly if it's paired with an investment mind that keeps churning out ideas. Thank you, Peter, for being an enabler and believing in me and Carl. Thanks also to the first investors in the fund, taking the plunge with us without a public track-record. We hope we won't disappoint. We're excited with the new developments and grateful for the faith put in our process and strategy by a handful of professional allocators. 2022 will see the launch of our fund, and we can't wait to get started. The future Partner Letters will be under a new brand.

What we're thinking about • IPO-mania As the year draws to a close, one remarkable feature of 2021 is the phenomenal flurry of new companies that came to the Scandinavian markets in the past 12 months. I asked one of the ECM desks for an overview: back came a list of no less than 225 Nordic IPO's executed during the year. When there's demand, supply will follow. I have worked 15 years in the IPO sausage factory and never thought I'd see the day return when "having a good relationship with the ECM-desk" (euphemism for "being a well-paying client") would come back in vogue, but the rise of "anchor investing" – where a handful of supposedly quality institutions take the majority of a new issue – is just that. The benefit of size for the institutions over private investors. I don't really have an opinion here, it is what it is, and it's a free market. In an IPO the investment banks are incentivised several ways: paid by the seller once, paid by the buyers in an ongoing business relationship, and evaluated by potential corporate clients in after-market performance of the deals. Given how many new issues are under water, one can wonder who this system really satisfies? Part of me think we should return to when investment banks acted as proper underwriters, committing own funds to new issues. The quality threshold would rise and a reasonable issue price should come higher up the priority list as the advisor would be forced to satisfy more stake-holders or suffer direct monetary consequences. Maybe I'm just old. • Is boring better? Despite numerous IPO face plants, indices climbed significantly during the year. It indeed is interesting times. One chart that has made the rounds is how the broad indices would have had far less illustrious performance had the five-six best constituents (basically FAANG) been excluded. I'm in two minds about what to make of that chart; either you can make the argument that the valuation bubble in expectation stocks and high-multiple growth stocks is deflating "under the surface", since many of those stocks indeed have had a rough time 2021. Or, as my non-scientific suspicion would have it; I think this might be fairly true for any year – the brunt of an index' performance is likely to come from a few high-flying constituents (this is actually a rational argument for owning index ETFs: you don't risk losing out on a big winner). I suppose many aspiring stockpickers with concentrated portfolios have learned this lesson in 2021: sometimes boring is better. • Short the dogs? There's statistics for everything in Sweden. Even dog ownership. And the 2nd derivative is turning negative

following a substantial corona-induced acceleration in previous years. The proprietor of “Hundstallet”, a local dog shelter in Stockholm, said in a recent interview they’re seeing “increased pressure, no doubt” from regular families wanting to relieve themselves of their corona-dog when the dog friendly work-from-home regiments started to be rolled back. Scouring the local online classified ads also reveals similar stories, and I quote: “It’s time to leave the puppy to someone with more time. Due to changed working hours the dog needs someone with time to exercise and stimulate. Food for 3 days included.” That last sentence got to me, reminiscent of Hemingway’s “For sale: baby shoes, never worn”. Sad indeed. However, all companies associated with the pet-boom are enjoying eye-watering multiples, implicitly assuming continued super-strong growth and flawless execution for years to come. Planting a seed here, maybe there’s a trade to be made on the short side soon? • Is ESG investing a market inefficiency? The investing literature is littered with suggestions that the best buyers and sellers to take the other side of are the “non-economic ones”. Simply a market actor with a less-than-rational approach to investing, with the assumption that rational means a profit maximizing homo economicus. Now, there’s certainly an argument to be had about the limitations to free markets and how some externalities are captured (or not) without intervention, but suffice to say that strict ESG-investing at least comes close to being irrational, from a profit maximizing perspective. My personal criticism to this thematic castle in the sand is that the labels put on “ESG-funds” are too watered down and imprecise that it rarely captures anything. Do you support human rights? Do you think the climate is important? Do you not invest in companies that violate international treaties? If yes, Voilà you’re ESG! An example: “our fund that invests in European equities have decided to divest all oil and gas producing companies”. *pats oneself on back* Cue reality: Europe goes on to consume oil and gas. In fact, more! The world consumed 4% more oil and gas 2021 compared to 2019. Despite electrification. Despite your ESG-fund. The one consequence (maybe) was that the European oil and gas companies faced a fraction higher capital cost, making investments more expensive, reducing their relative competitive position vs other oil producers. And who are the other oil producers, likely to take market shares in Europe going forward? Are they in politically stable democracies? With efficient and safe operations? With accountability and remuneration tied to sustainability policies? No they’re not... By deploying naïve, short-sighted, nice-sounding soundbite investment policies, I fear we’re tilting the scales in favour of rogue states and less accountable actors. Naturally, in an ideal world, we’d be further down the road reducing our oil dependency, and I do hope we get there. But let’s not kid ourselves that it’s going to be either easy or cheap. Fuel poverty is on the way to become a more common concept, and it’s going to be driven by higher prices. Are we ready for it? Does society accept it? • Bond-proxy unwind I suppose few know that the first animated cartoon



DECEMBER 2021 • PARTNER LETTER

featuring Wile E Coyote and the Road Runner appeared in 1949 and had the futuristic-sounding title “Fast and Furry-ous”? Every now and then, Mr Coyote’s futile attempts at capturing the Road Runner sees him running off a cliff, pausing for a few moments, frozen still in mid-air, breaking the fourth wall looking into the proverbial camera at the audience, with nothing but empty space below. This is where I suspect some of the bond-proxy darlings are positioned right now. Because should interest rates normalise (a big if, arguably, but nonetheless a clear and present danger considering the current inflation impulse), a bond proxy stock is nothing less than a high multiple stock with low growth. And nothing but air below. Food for thought.

Pontus Dackmo
Investment Manager
Protean Capital Management AB