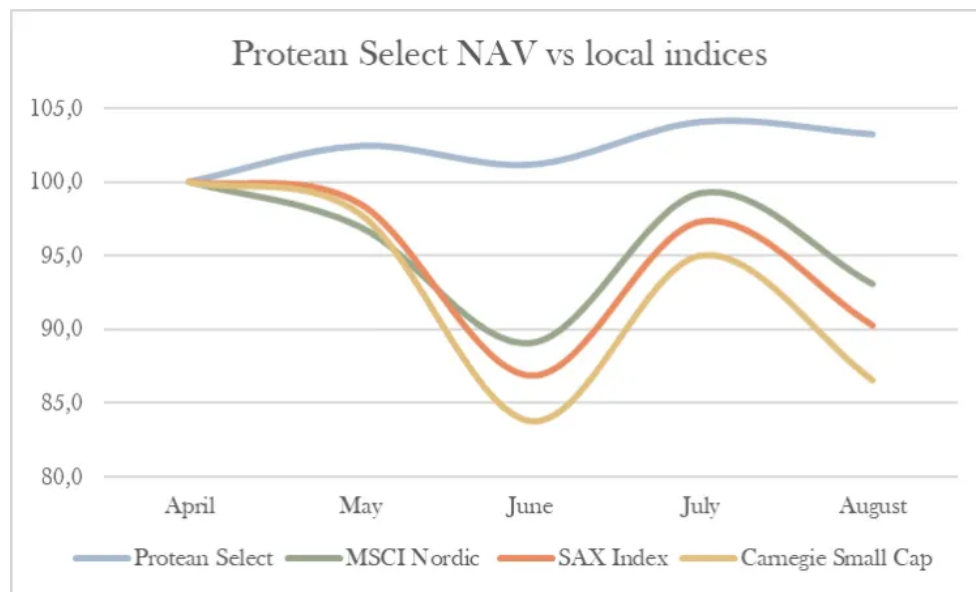


PROTEAN™

AUGUST 2022 • PARTNER LETTER

Dear Partners,

Protean Select returned -0,8% in August. Most indices saw rather significant decline of between -6% and -9% for the month. Since our start, at the beginning of May, the fund has returned 3,2%. In the same period, various Nordic indices (MSCI, SAX, OMXPI) are down between -7% and -13,5%. It's a short time, but so far, we're delivering according to plan.



Notable contributors to the performance in August have particularly been our short positions in various indices, in addition to long positions in UPM Kymmene, Equinor, and Tryg. Since the fund reports in SEK and does not hedge currency exposures, we have had a positive contribution from holdings in EUR, NOK and DKK due to the weaker SEK. Detractors have mostly been found on the long side, where Crayon in Norway account for most of the negative performance.

We enter September with a continued lower net exposure to the market than we think will be the long-term average for our strategy (approximately 30% net long, but 20% adjusted for our position in Swedish Match). Given we are a net long strategy we will correlate with the market. It is simply a fact of life. In a stylized scenario, being 20% net long means the fund increases 2% if the market goes up by 10%, and the mirror opposite in a negative scenario.

Although we are satisfied to have reasonably protected the fund's capital, despite the positive net exposure in a falling market, let's not kid ourselves: we would have loved to post a positive number on the bottom line, and are very annoyed at being down in August. A month is however



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an arbitrary period: just because performance is measured every 30 days does not mean we optimize for monthly returns! Much of these short-term decimals are noise. The big picture is we remain cautious and try to strike a balance between optimism and downside protection. We are selectively adding positions in great value small caps and hope to be rewarded eventually.

What is Protean Select?

Before considering an investment in Protean Select, please read the fund prospectus and the Key Investor Information Document (KIID). As you are hopefully aware, past performance does not guarantee future performance. The value of the fund may rise as well as fall and there is no guarantee you will recover your original investment.

It deserves repeating we have launched the fund to manage our own (little) money in an institutional setting. It's simply the only way we know how to invest. We have significant skin in the game, which means we wear the funds' P&L on our sleeves. All day. Every day. Our incentives are therefore doubly aligned with our investors. It reflects on our positioning and work ethic: we hate losing money, but we don't have a business (or a livelihood) if we don't generate returns.

It also means Protean Select is an unusual fund. Funds are often "products", where buzzwords are piled to incite asset growth. You are buying an exposure (sector, theme, style) and you as an investor, therefore, need to think about changing allocations between products every now and then. We don't think that way. Or work that way. This is our sole vehicle for investing, and we rely on being able to change when the market changes (or preferably right before). We cannot afford, literally and metaphorically, to underperform and blame "our style is out of fashion right now" – we are trying hard to be an all-weather fund.

So far, we've done all right, but the real test will be when a new paradigm emerges. Will we be able and willing to change? The one tenet we keep repeating is this: the real money is made being long; pessimists don't build skyscrapers. Therefore, we remain stubbornly net long despite heightened uncertainty. We're not overconfident enough to believe we will pick the bottom when it occurs. But, to paraphrase Buffett's 2020 shareholder letter:

"Me and Carl remain unable to promise results. We can and do pledge to treat you as partners."

What's around the corner

Our near-term outlook remains largely unchanged. We are concerned the consumer has yet to feel the full force of the pinch in the purse stemming

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from inflation, energy prices, and interest rates. This is a well-rehearsed theme by now, but that doesn't mean it is not likely. Sometimes consensus is right. The one thing that has surprised us in this bear market is the resilience of the retail investor. Recent statistics show retail customers of Nordnet/Avanza have been net buyers of equities every month for the past 8 months. Impressive. The question is for how long we will remain surprised (and impressed)? We see a non-zero risk of accelerated selling, not least in retail favorites, once disposable incomes start shrinking noticeably.

Would you, as but one example, consider buying a new sauna when skyrocketing electricity prices are front-page news on a daily basis? There are lots of nice-to-haves that will fall down the priority list in the second half of the year.

The tortoise and the hare

Aesop's classical fable of the overconfident hare, ridiculing the slow-moving tortoise, only to be beaten in a race because of his arrogance (taking a nap half-way), can be interpreted in two different ways: is the learning that "overconfidence leads to the hare's downfall", or is the learning that "the dogged persistence of the tortoise is what wins the race"? Whichever it is, it's applicable to our thinking at Protean: while we are confident in our abilities, we are also acutely aware of our shortcomings and the risks involved with trying to predict the future. Therefore, we strongly prefer to "hasten slowly", avoiding draw-downs as best we can, and keeping a lookout for stock-specific opportunities where we can have an edge.

There's a special charm to being mediocre. But only if you are consistently mediocre. It's with the fable as it is with funds – there will always be a shining star in any given year. Someone who nailed a sizeable position in a screamer, or someone with a big bearish bet who timed a bear market. But with big bets come big risks – you can go from hero to zero in no time. If you are reliably mediocre and capable of generating moderate returns even in a bear market, you won't be a rock star, but you will likely, over a long enough time horizon, beat the returns of a more volatile, risk-prone manager.

This is also the paradox of running a small investment fund: if your ambition is to be BIG and make meaningful money on fees, you need to swing for the fences and take outsized risks to have an eye-popping short-term track record. Mediocre returns simply won't generate the attention you need to raise significant assets (therefore underperforming hedge funds that are below their high-water mark, and thus unable to raise assets, often close). Luckily, Protean does not want to be big. We are happy to compound our little capital (although, in all honesty, we would

like a bit more assets). The fund industry is funny this way: concentrated risky funds that do manage to put up a few big numbers are rewarded with massive inflows, but when they inevitably hit a rough patch, it is open hunting season criticizing the strategy and the manager (even though it was obvious from the get-go that concentration works both ways).

The mediocre, prudent but consistent manager is not generally liked – and by the time it is obvious in the track record they are capable of outperforming, they're old and ready to retire... Remember this, kids: draw-downs are kryptonite for compound interest.

I'm not trying to argue it is easy – it is not – but portfolio construction is not an exact science, and I believe it is as much qualitative as it is quantitative. The handy-work of analyzing end-markets, fund flows, sentiment, owner-stats, positioning, balance sheets, cash-flow statements and management body-language does not fit with a CAP-M approach to portfolio optimization. I think it is about knowing what you own, being aware and on top of the inherent risks, and, crucially, how you size your bets and hedge them when appropriate.

Right now, with the world in flux, we're more than happy being a tortoise.

What we're thinking and reading

- Building in public

The fund's assets have grown to nearly SEK 450 million, and we are part grateful for the trust, and part astonished we've come this far. We started with 300m SEK. We keep building towards the target of 1bn SEK where we will be more comfortable running a sustainable business. At 2bn SEK we will close the fund not to dilute performance.

A big part running a fund is to ensure you keep the license to operate: there are layers upon layers of regulations, policies and stakeholders that peer over our shoulder, to ensure we do not paint outside the lines of the permissible. Operational excellence is important.

- Diesel

Something's going on in the diesel market in Europe and I'm not sure I like it. First, demand in Europe has been very robust as of late, much due to the ongoing industrial substitution from NatGas to (the so far cheaper) diesel. Inventories are at multi-decade lows; crack spreads are at highs. Second, this is despite the ban on Russian diesel not being due for implementation until December (which will kick a rather serious spanner in the works, as Russian diesel has excellent cold properties, as opposed to most other grades).

As a response, US exports of diesel to Europe are so high there is a fear of domestic US shortage. The Minister for Energy in the US wrote a letter to the heads of the large refiners in the US last week, threatening them with “federal action” unless they focused on increasing US sales. Reading transcripts from the refiners, it seems clear the US will be unable and unwilling to come to the rescue. When there’s a shortage looming, price will be the reaction channel to sort the issue. Protean Select has positions on that implicitly express this view (at the moment of writing). There is one large-cap company in Scandinavia manufacturing diesel, but not from fossil fuels. Hence, when diesel prices go up, their margins expand *ceteris paribus*.

- Cynics are stupid (and make less money)

In trying to make it through the much heralded “The Matter With Things” by Dr McGilchrist (honestly, the book makes my head hurt). This passage from chapter 26 stuck with me despite the brain fog induced by the heavy language and topic:

“Cynicism appears to be a coping strategy by the cognitively less gifted to avoid being duped by others. Less competent individuals are more likely to be cynical across the board.”

Now that’s a pretty interesting statement. I find it rings true. This is not just McGilchrist guesswork, the statement is based on actual research – where on formal testing, people with high levels of cynicism have repeatedly been found to be less intelligent, and have lower educational levels. Since inherent intelligence and education help you detect and avoid deceit, it indirectly contributes to a more positive view of human nature and a greater level of trust. He goes on to cite several studies on trust, showing how people typically earn more if they are willing to trust strangers, and that cynical individuals earn lower incomes due to ineptitude for cooperation. If you want to be financially successful, don’t be a cynic.

Pontus Dackmo

CEO and Investment Manager

Protean Funds Scandinavia AB

Disclaimer: Before considering an investment in Protean Select, please refer to our prospectus and KIID-material. Investments in a fund can both increase and decrease in value. Full return of capital is not guaranteed.