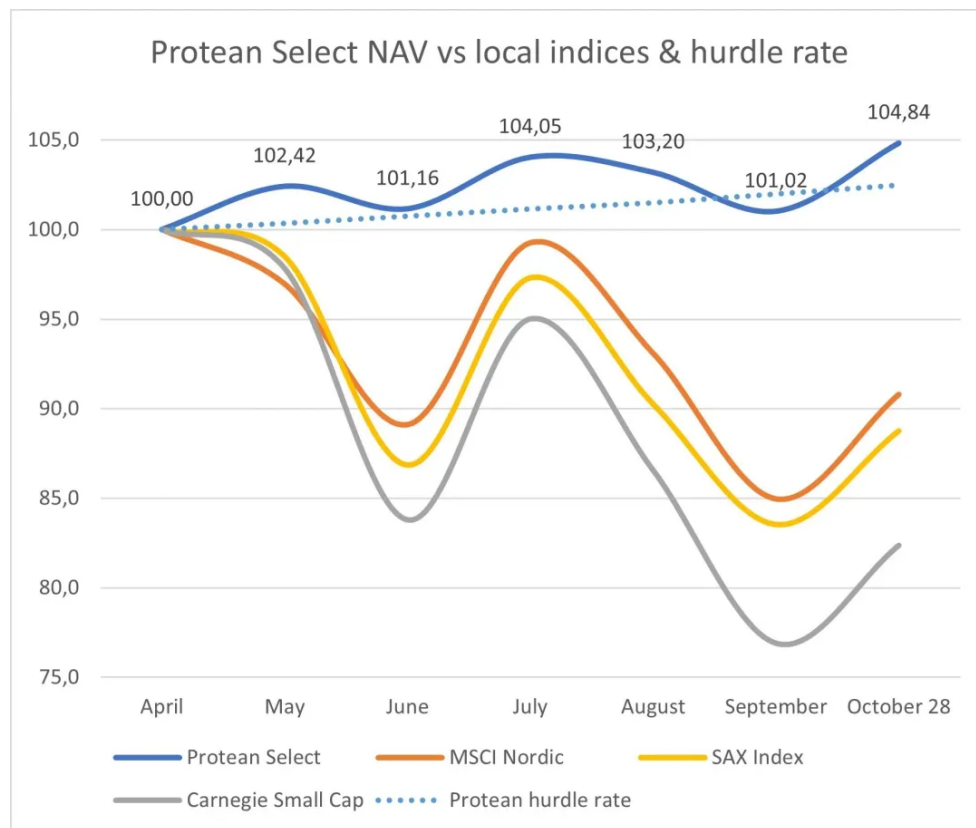


Dear Partners,

Protean Select returned 3,78% in October. The markets advanced between 6-7% for the month, depending on index chosen. Since our start, at the beginning of May, the fund has returned +4,84%. In the same period, various Nordic indices (MSCI, SAX, CSRX) are down between -10% and -18%. Our hurdle rate for the period is roughly 2,5%.



*We illustrate our performance showing a few indices as reference. Note we do not compare ourselves to an index, we aim to have positive returns regardless of market. But no return is created in a vacuum, and a net-long strategy will correlate. Our hurdle-rate is 5,5% annualized (4% + 90-day Swedish T-bills, currently 1,5%).

Notable contributors to the performance in October came predominantly from long positions. Nordea, Alleima and Skanska contributed nicely. Detractors have mostly been found in the hedging portfolio, with index-futures and swap-baskets of various kinds.

We are pleased to participate on the upside despite a low market exposure, after months of focusing on protecting the downside. We



OCTOBER 2022 • PARTNER LETTER

believe it offers an early proof we can and will be adaptive.

We enter November with a lower net exposure to the market than we think will be the long-term average for our strategy. After running October with a net exposure averaging 30%, we are only marginally higher at time of writing.

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.

Revenge of the Nation State

““There are decades where nothing happens, and there are weeks where decades happen.” ”

The quote above is attributed to Vladimir Lenin, who no doubt would have found it easier to navigate a hostile 2022 than, say, a globalizing 2005. We are in the midst of an unpleasant revival to standard-format 20th century geopolitics. What complicates matters is that the oscillation of classic ingredients of realpolitik - imperial ambitions, great-power conflicts, fights over resources, nuclear proliferation - have intersected with the emergence of historically new ones like climate change, pandemics, demographics, and migration (tempting to add energy crisis, but that's not really a new one). As onion on the salmon (as the Swedish saying goes. 'To round things off' would be a reasonable translation) comes a United States with a remarkable break-down in social and institutional cohesion, exemplified by a swath of parliamentarians refusing to accept an election result and indeed a storming of Capitolum.

One can be excused for being a tad disillusioned.

As a custodian of our investor's (and, indeed, our own) capital, we take the job of analyzing the world, and applying the conclusions in our portfolio construction, very seriously. Therefore, we need to be aware not only of the weather but also the climate. Stock exchange moves over any 3-6-month period is weather. Bigger picture tectonic shifts take years, and are harder to call, but have an order of magnitude bigger impact. This is climate.

Heightened uncertainty, and, as we wrote about in last month's Partner Letter, the needs further down Maslow's famous pyramid coming back into fashion, after decades of plenty and safety, trigger feelings of fear. The consequence is predictable: calls for safety. And what can be safer than making sure you are self-reliant? Cue a massive wave of "prepping" handbooks, crank-powered FM-radios, first-aid kits, and flashlights (heck,

I can even name a nick-nack retailer in Sweden that saw a Q2 boost from prepping).

This is first level stuff. Individuals and families. A bread winner provides for the near and dear. Easy to bulk up on tinned goods and kerosine stoves.

The second level is the nation state. Politicians of all colors have their sentiment tentacles far down the depth of society and will pick up on, and promote, whatever new feeling comes into fashion. In a world craving safety, this means you promise protection. From everything. Go Big State! In short: you go French.

Dirigisme, s'il vous plaît

Emmanuel Macron has for years talked about a “strategic autonomy”. Not being (too) dependent on foreigners for critical inputs. As The Economist last week highlighted in its Bagehot column, the French minister for agriculture is also minister for “food sovereignty”, just as its minister for finance is for “industrial sovereignty”. The dirigisme apparent in France is also gaining ground in other industrialized countries. In Sweden, with a long history of corporativism, my bet would be we're only a few years from seeing increased governmental activity in arenas that for now are reserved for private enterprises (railway, power transmission, schools come to mind, but perhaps even telecom?). On a greater scale, the support for policies limiting state subsidies to certain industries appears waning. The EU is also putting together a “Green border tax” aimed at levelling the playing field for companies arbitraging different environmental policies.

These things matter. They matter for industries. They matter even more for individual companies. Politics is making a BIG comeback. We (Protean) paid very close attention when the new Swedish government published their document outlining what policies the disparate parties had agreed upon. We made a handful of (small but) successful trades on the back of it, including shorting offshore wind developers that suddenly risked having to carry the cost of under-water network build-out (prohibitively expensive), and the potential dilution of mandatory renewables blend-in from 2024, causing concerns for renewable fuel manufacturers. We also sat up when the Norwegian government decided to unveil a sweeping new natural resources tax on salmon farmers, so aggressively constructed it triggered a substantial underperformance in the listed names. Our read of the situation is that the reaction from the industry – pulling basically all Norwegian growth investments, threatening job-losses – has sown the seeds of moderation. It appears likely the proposal will be adjusted to a lower tax-rate, as indicated by recent press quotes from leading domestic politicians. We are **modestly long salmon farmers** in Norway at time of writing. With current earnings power, the stocks are

cheap, plus the option of a friendlier final tax implementation, making it an interesting asymmetric risk/reward situation. It's not going to get worse. And prices should get a boost from lower future supply, raising contract prices.

As politicians scramble for solutions that increase (perceived?) safety, we are going back to basics. Energy, raw materials, food stuffs, transportation, supply chains – there are few companies not at risk of seeing sticky-fingered politicians getting involved in their business dynamics in the name of national security. To make matters worse, in today's globally interconnected world, it's not only your own politicians you need to worry about. If your company is listed in one hegemonic bloc but has most profits or suppliers or customers in another part of the world, you are very much subject to the whims of multiple random stakeholders.

Given how the playing-field is structured right now, and the direction of travel with authoritarian strongmen consolidating power across globe (Xi, Modri, Putin, Bolsanaro, Trump, Orban, the list goes on), our possible dynamic outcomes just multiplied. And not in a good way.

Just look at what's going on with the semiconductor industry – a truly global and enormously specialized industry – in the wake of drastic US sanctions on Chinese manufacturers of advanced chips. You think this won't impact literally ever advanced chip-user in the world? One way or another it will. Q3 reports from companies around the world show that the weather remains tolerable, but underneath the surface the climate is changing.

Qui bono

Politics are not 100% negative for equities. Take the **Scandinavian banking-sector** and its deep involvement in the Baltic states. Yes, some shady (Russian) characters have been allowed to slip through the money-laundering cracks. In turn triggering far-reaching investigations by several authorities, including the mighty US Department of Justice. The magnitude of potential fines are of sizes that are almost existential, and the uncertainty has been a wet blanket on some stocks for quite some time. But. Here's where politics come in. In a geopolitical perspective our take is: breaking the backbone of banking and financial services in three NATO-states on the Russian border, would **NOT** be in the best interest of Western institutions and safety. Hence, fines will only ever be "manageable" because the alternative could spell political and social instability paired with risks of unwanted re-orientation. We quickly added some **Danske Bank** on the announcement of further clarity on the legal situation. There's every chance it keeps closing the ESG-gap to peers over the coming months.

A similar train of thought can be employed when it comes to Nokia and particularly **Ericsson**. Although ERIC is an ESG train-wreck, it is also a critical high-level infrastructure provider on a global scale. Crucially, they are also NOT Huawei. Our judgement, from this viewpoint, is that potential fines in any or all investigations are likely to be... let's call it... lenient. We have recently added some Ericsson to the portfolio as we deem the risks overblown and would be very surprised if Johan Forsell and team at main owner Investor AB don't see it fit to do a complete overhaul soon.

One big thought we're toying with is that companies exposed to super-long supply chains, spanning the entire globe, with trade lanes across the seven seas, are particularly vulnerable in this macroeconomic backdrop. We are, as an example, short **AP Moller Maersk** on increasing political risks, de-globalization and increased risk-premia (it's only part of the thesis, however: earnings, poor capital allocation, competitive pressures, weak alliances, poor industry discipline potentially coming back, all add to the story).

Politics matter. It will matter more in the years ahead. We are paying attention.

What's around the corner

No bottom has ever felt like a bottom. In bear market volatility, where fierce rips on short covering, and brutal dumps on bad data/events, are par for the course, the only thing we can be sure of is uncertainty. Therefore, when the market advances from a recent low – there's no way in real time to assess its bottom-plausibility.

Thinking about stylized “bottoms” one needs to remember it's a process rather than event. It does not at all follow that a panic precedes the low point in markets. I find it more plausible to assume it is found somewhere when panic has been replaced by apathy. Who cares about stocks anymore – they just go down! That's the sentiment of a bottom. Not “THIS is the dip that should be bought!”.

Referencing the earlier comment on climate vs weather, it's easy to get caught up in near termism when your day is overflowing with company reports focusing on quarters rather than years. We humans have an interesting tendency to overvalue things that happened recently and undervalue things that happened some distance away. We are just not very good pairing magnitudes with time-lapse (Kahneman & Tversky calls this recency bias).

Example: new regulations/tariffs/something completely changes the dynamics in a global market, a niche company dependent on a particular product in this market looks set to see a materially smaller business in the years ahead. The stock sells down 10-15% on the political news, but

trades right back to where it started two weeks later on “a solid quarterly report”. We see this all the time.

The weather remains ok, but the climate is changing.

What we're thinking and reading

- Building in public

It won't make a difference to our investors, but on November 1st the management of Protean Select was formally delegated to Protean Funds Scandinavia AB. During a transition period we have been employed by Wahlstedt & Sageryd as portfolio managers. This is part of our timeline of starting the fund, as the administrative hurdles are material. We have now evolved into our final form, as my Pokémon-playing kids would describe it.

The fund starts November a hair's breadth from half a billion SEK in assets. We are grateful and humbled by the trust put in our process and strategy by our investors. Thank you.

- The not so Swedish Match

We have held a big position in Swedish Match and are satisfied PMI were forced to raise their bid for the company. Our analysis and outsized positioning were correct. Over the past six months the fund has benefitted significantly from the position as it stubbornly trended upwards with zero correlation to a falling market.

However, we have now printed the Serenity Prayer and posted it on the office wall.

“Lord, Grant me the serenity to accept the things I cannot change, the courage to change the things I can and the wisdom to know the difference.”

PMI raised the bid exactly the level where it remains uncertain whether it will go through. Kudos to them and their investment bankers. Odds are however they will get away with underpaying for SWMA. And there is very little Protean can do about that, regardless of how annoyed we are. In just a few days we will know more about the outcome.

Following the final bid, the risk/reward changed materially. The take-over rules are very clear PMI cannot again raise its (measly) bid, and it is unlikely a rival bidder emerges this late. This means the upside is capped at 116 SEK. Only 1,8% away from where the stock closed on Friday the 29th of October. On the other hand, there is a non-zero chance PMI will

choose to walk away if they cannot secure enough acceptances. In that case the downside is material, to say somewhere in the 80-90 SEK range. To us, this means SWMA ahead of the bid closing is an asymmetric risk skewed to the downside.

In the spirit of housekeeping with scarce mental energy we have chosen not to participate. We have sold our shares in Swedish Match. Had we owned a big enough stake to feel responsibility for SWMA's future, and the ability to influence the outcome, the situation would be vastly different. Instead, we turn our small size to an advantage. And continue to hope the bid fails so we again can become shareholders.

- Dispersion is our friend

A stockpicking ambition welcomes a market where stocks actually move in different directions on the same day. When macro takes center stage, and all correlations break down (stocks are either all up 3% or down 3%), it's plain boring.

Not so in the past few weeks of Scandinavian reporting season. We've seen multiple stocks drop 20% plus on earnings reports that did not change the long-term fundamental value of the company by nearly that magnitude.

As a consequence we now find ourselves re-invigorated in the small and mid-cap part of our portfolio. We have added positions in several unfairly treated quality companies over the past weeks: star capital allocator and acquirer **Royal Unibrew**, well-run and solid IT-consultant **KnowIT**, Finnish consultant **Sitowise** and contract manufacturer **Nolato**. All acquired at multiples and prices that would've been almost unthinkable only a few weeks or months back.

The one that takes the price, however, is the facility management company **Coor**. We have been involved in Coor on the long side before and we know it well. Coming into Q3 reporting, however, there was a number of factors that could lead to disappointment vs rather high expectation. We held a moderate short position in the stock over the numbers. Long story short: they missed. The magnitude of the drop, however, beat our expectations. With the stock down 20% on the day, but the reason for the miss of a largely transient nature, and long-term earnings power unchanged, we not only covered our short position, but went long. This is us being small. And protean. Fingers crossed it works out.

Pontus Dackmo
CEO and Investment Manager
Protean Funds Scandinavia AB