



DECEMBER 2023 • PARTNER LETTER

Dear Partners,

Protean Select returned 3.3% in December. That is +4.3% YTD and +13.5% since inception. This takes us above our previous highest NAV. Pleasingly, it means 100% of our investors have made money, regardless of when the investment was made. Much happy with that.

Rusta, our short position in EUR/SEK, longs in Hexagon and Ambea, were top contributors.

On the negative side were our Small-cap Hedges, longs in Raysearch and Promimic.

Protean Small Cap returned 10.4% in its seventh month (following +12% in November!) and is now +11.9% since its inception in July. The benchmark Carnegie Nordic Small Cap Index was up 7.8% in December. After seven months, the fund is ahead of its benchmark by 6.5%-points.

Rusta, Byggbakta and Fasadgruppen were top contributors.

RaySearch, Lundbeck and MEKO the biggest detractors.

The combined assets in our two strategies is approximately 1.45bn SEK.

We are very pleased with the launch of the small cap fund. True to our core belief that funds die when they become too big (i.e. has less-than-optimal performance), both funds are subject to closing well before this becomes an issue (2bn and 4bn SEK, respectively).

Thank you for being an investor with Protean. We salute you!

Team Protean Funds

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# What happened in December (and 2023)

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DECEMBER 2023 • WRITTEN BY PONTUS DACKMO

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| December                        | 2023-11-30 | 2023-12-29 |       |
|---------------------------------|------------|------------|-------|
| MSCI Nordic Total Return (SEK)  | 590,7      | 624,1      | 5,7%  |
| OMX ALL (SAX)                   | 834,4      | 902,9      | 8,2%  |
| OMX30                           | 2 232,5    | 2 396,1    | 7,3%  |
| Carnegie Nordic Small Cap Index | 731,2      | 788,310    | 7,8%  |
| Protean Select NAV              | 109,9      | 113,530    | 3,3%  |
| Protean Small Cap NAV           | 101,4      | 111,920    | 10,4% |

## Revenge of the mediocre

Ahh, year-end. Time to wade knee-deep in summaries of the madness just passed and one confident prediction after another about the hare-brained schemes about to play out in the next twelve months. Basking in the warm glow of hindsight bias (“I knew all along this was going to happen”) and overconfidence (“This year I will be right!”), the annual nonsense fountain of “2024 Investment Outlooks” and media summaries, is a sight to behold. It seems a rudimentary feature of humanity that we cannot accept being terrible at predictions. Particularly about the future.

There is a vast body of scientific evidence in support of this statement: we are simply rubbish forecasters. There is no hiding that, in the words of the great James Montier, “in the face of uncertainty, we will cling to any irrelevant number as support. Little wonder, then, that investors continue to rely on forecasts.”

Picking two arbitrary measuring points, exactly one year apart, can yield some interesting results. Behold, as but one example, the difference between the January 1st 10-year US treasury yield and the December 31st

level: 0.00%. For all the upheavals and huffing about rates during the year, when all was said and done – nothing. No change.

## Noise cancelling

The investing world is riddled with noise. There are too many players in this game that profit from activity. The business model of brokers and advisors relies on fees per transaction; hence, you need to transact for them to be paid. Media outlets and research publications need you to buy what they are selling – the more dramatic the headline conclusion, the more likely you are to pick it up and pay for it. No wonder the old joke “Economists have predicted 11 of the last 2 recessions”.

We believe the big money in investing is made by owning smaller companies that grow big, while protecting the portfolio from oversized draw-downs. Just looking at our best contributors for 2023, or since inception for that matter, proves our point: Alleima, Cargotec and RaySearch are companies we have held since day one of the fund. Big moves take time. During that time there will be noise.

The air we breathe contains about 78% nitrogen. Yet, impressively, our lungs ignore this. This is how we think about noise in the investment arena: we breathe it in... and exhale it right back out. This is a stylized scenario, however, because more often than not it is darn tricky to tell investment nitrogen from oxygen, or noise from signal. Some investment proposals carry all the markings of a great case but still end up with you looking like a clown (or how about our “tactically owning a 2% trading position in Embracer because a, b and c, only to see it drop 40% in a day”- kind of clown?). Hindsight is 20-20.

Oh, do you remember that banking crisis we had for about two weeks in the US? That was fun but lasted about a week. Or the production problems at a Novo Nordisk sub-supplier that triggered a 10% pull-back for the stock, but ultimately was just a small bump in the road that stretches much longer. There was a ton of font-size 42 headlines during the year that all turned into nothingburgers over a few weeks.

## The meek shall inherit the earth

2023 was the revenge of the mediocre. Taylor Swift is a perfect illustration. She's the biggest artist in a generation, but an average singer, the songs are bland muzak, she can't dance to save her life and has about the same stage charisma as a cactus. It's the low-risk choice for the masses. As uncontroversial and wholesome as motherhood and apple pie. Yet, my wife has of course bought tickets for the concert in Stockholm in May and I'm reluctantly looking forward to joining. A lukewarm footbath is still a footbath.

It was also the revenge of the interest rate. Seldom has such an ephemeral social construct been the subject of so much debate as rates were during 2023. Let's just call the period from the GFC to the end of the pandemic what it was: an anomaly. Let's simply assume we will have an average, mediocre economy, and interest rate for a while. The financial world isn't facing Armageddon, like in 2008, nor are we all convinced there's a risk we're going extinct like in mid-2020. Let's worry about average things. Small things. Non-existential things. Boring things. Like the business cycle. Like whether there will be a 25 or 50bps cut in rates. Like whether a company will beat or miss its earnings estimates.

Let 2024 be the year of mediocrity, where the meek (interpreted as humble and patient) at least get a glimpse of that heavenly bliss.

Please?

## No complacency

The previous paragraph is certainly not to say we are complacent. We are breathing the same alarming headlines as everybody else. That ripping sound in the background, as an example, appears to be the slow tearing of the Western democratic social fabric, slowly built since the Enlightenment. The triad of China, Russia, and Iran appear unusually co-ordinated in a historical context. De-globalization threatens to complicate not only supply chains and world trade but entire continents reliant on imported goods for product and capital goods to sustain themselves. Add to this the frog-in-water process of climate change, and the waves of immigration in its wake. There is no shortage of things to worry about.

One of the few things we can know for sure about 2024, is that it will have its fair share of blow-ups in the portfolio. You see, running a fund is not unlike spending a week at a charter hotel in the mediterranean chock-full with toddlers: it's nice and plenty of joyful shrieks, but you just know there eventually will be turds in the pool. We are at least mentally prepared.

Much have been written about how 2024 is an election year for a majority of the world's population. Firstly, that fact alone is a reason to celebrate. It's too easy to imagine a parallel universe where autocracy is the norm. Secondly, there is a tendency to exaggerate the impact of politics on markets, particularly in the short- to medium term. There will be a gargantuan amount of noise produced, not least on social media, on politics and elections in 2024. If there is one prediction we are comfortable about making for 2024: it will be a mental challenge to exhale that particular breed of toxic nitrogen.



DECEMBER 2023 • PARTNER LETTER

## Putting returns in context

Returning a little over 4% in 2023 isn't great when the hurdle rate is 8% and most indices were up double digits in the same period. However, we do not optimize for yearly performance – it is a too short period to draw any reasonable conclusions. It is paramount to recognize we manage Protean Select with substantially lower risk than the overall market. Using standard deviation as a proxy, we have been running somewhere between one-third to a quarter of the market's risk level. This dampens the swings in the portfolio, on the upside as well as downside.

Since inception, 20 months ago, Protean Select has outperformed the NHX Equities Index (50-odd equity-focused Nordic hedge funds) by more than 10%. It is a similar amount ahead of the MSCI Nordic Small Cap Index. We are however trailing the large-cap index by a handful of percent as this segment of the market has had particularly strong performance, and we are overweight smaller capitalization stocks.

We are pleased that, with the closing of 2023, we are again back at an all-time high net asset value (NAV). This means everyone who has invested with us – at any time – has a positive return on their investment.

## Mission impossible

Our goal is participating in the upside while protecting the downside. This goal, apart from being the Holy Grail of Investing, is close to impossible, and will during periods translate to mediocre returns. Particularly when equity markets stage a snap 10%+ rally in two months, triggering FOMO and us all forgetting markets tend to constantly exert the maximum amount of pain to the maximum number of people – both up and down.

Fortunes quickly made can equally quickly be lost. As Paul Tudor Jones described it:

“Defense is ten times more important than offense. The wealth you have can be so ephemeral; you have to be very focused on the downside at all times.

When you have a good position, it will take care of itself. Where you need to be focused is where you're losing money, and that's when people don't want to look: “My account is going down. I don't even want to open it.” “

I like to pretend this is us. Every day we focus on the things that are not working. It's exhausting. We probably pay 10x more attention to things not working in the portfolio, than to those behaving like expected, both on the long and short side.

## Mind the risk

Coming back to context, the charm, and the curse of running a long-short portfolio is that returns are inevitably compared to overall markets. Therefore, you look like an idiot when underperforming strong rallies, but is merely doing your job when protecting the downside during a big draw-down. There's just one attention-stealing number most pay attention to: what's the YTD return? Adding insult to injury, when some hedge fund peer posts a strong return-figure for a random period, you look particularly bad in comparison.

Often, there is little attention paid to the difference in risk. What level of risk was required to generate those returns? If you are running 90% net long, 230% gross, with 15% of the portfolio in a small-cap stock that happened to do well, it is not the same as generating that return with 130% gross, 30% net and a well-diversified portfolio. It just isn't. We tip our hat to concentrated big headline returns and a high net portfolio, but that's just not how we run money. We focus on the downside. We prefer a diversified portfolio. We wouldn't enjoy the 40% draw-down when that aggressive strategy inevitably backfires.

There is reason professional allocators focus on historical "maximum draw-downs" (absolute loss) and how long it takes a fund to recover previous such losses: it shows the attention paid to the downside.

What really impresses us is consistent positive returns with small and short periods of absolute losses.

Reasonable returns, with reasonable risk, over an unreasonably long period – that's what absolute investing is about.



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# Protean Select

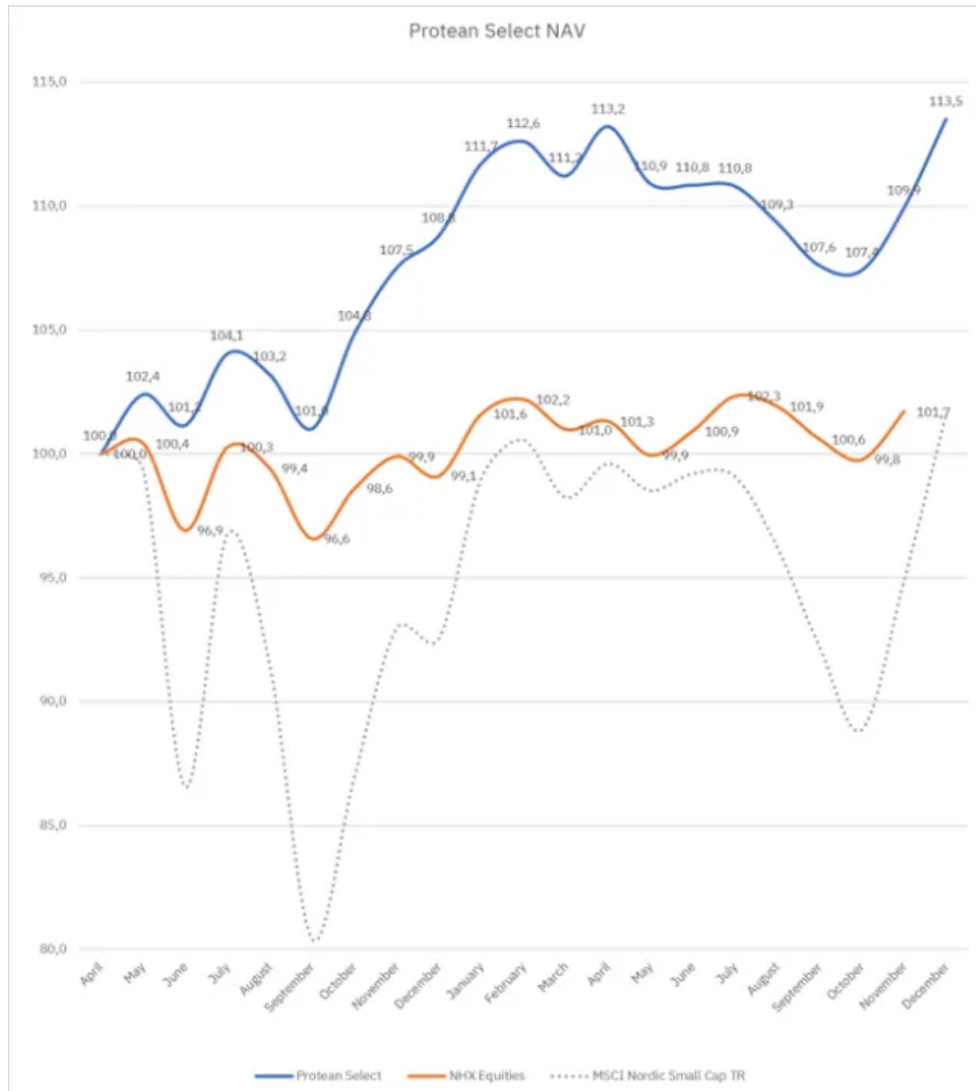
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# PROTEAN™

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\*We illustrate our performance by showing a comparison with the NHX Equities index. This is an index constructed from the performance of 54 Nordic hedge funds focusing on equity strategies. NHX is published after our Partner Letter, so updates with one-month lag in the chart above. We aim to have positive returns regardless of the market, but no return is created in a vacuum, and a net-long strategy will correlate. Our hurdle rate is >8% annualized (4% + 90-day Swedish T-bills). All figures are net of fees.

**+3.3% return in December means we close the year at a tolerable +4.3% return. Not great, not disaster. Tolerable.**

Stand-out performer of the month was recently IPO'd discount retail chain Rusta. We subscribed for shares in the IPO, seeing it had several features that suit this environment well: no debt, a low-risk non-cyclical business model with a long track record, and a strong main owner with

skin in the game. Rusta came to the market at the worst possible time, which meant few investors did the work or felt compelled to invest. Naturally, it then is exactly the time to invest. After appreciating 50%+ in a matter of months – and a stonker of a quarterly report – the absolute valuation upside has diminished, but we note there remain many domestic funds missing from the shareholder list, as well as index funds, which will hold a hand under the stock.

Our second-best performer was our short position in EUR/SEK. A few months ago, we decided to hedge our Finnish and Danish currency exposures, seeing the SEK had weakened substantially in a short period. Although the gain was substantial in December, note it is offset almost completely by FX losses on our non-Swedish holdings. We optimise for performance in SEK.

In third place comes our (rather big) trading-position in Hexagon. After a turbulent period in the wake of a short-seller report and management changes, the stock has recovered – which was our case all along. The short seller report raised a handful of reasonable objections to governance structures and the optics of current and former managers co-investing in a private vehicle adjacent to Hexagon's core areas. Hexagon's response has been to overhaul its board, issue new policies and increase disclosures. A decent set of numbers and an ok CMD later, the market appears willing to move on, and the stock has started to catch up with both sector colleagues and the general market.

On the negative side we mostly find market hedges. Despite scaling back index future and basket shorts, and upping the net exposure gradually throughout December, our small cap short basket managed to cost us -1.2% for the month, with another -0.4% thrown in from index hedges and put options.

Other detractors were smaller: -0.2% from our big position in RaySearch, which took a breather after a strong run and a similar negative contribution from our holding in micro-cap Promimic. Both are cases we believe have a long runway, why we accept and anticipate short term volatility.

The fund's full year return of just above 4% might not be much to brag about, but we take comfort in having generated it with substantially less risk than the general market. It is also satisfying to print a new ATH net asset value, as it means all investors have now made money, regardless of when investing in the fund. Assuming you haven't sold during the draw-down naturally, but why would you do that if you have invested with a three-year horizon like ourselves?



DECEMBER 2023 • PARTNER LETTER

We enter 2024 with our usual meek stance. Had to google “meek” – it can mean both humble and patient. Perfect! We are currently running the net exposure in an interval between 30-40%, and a gross of about 115%. This is relatively cautious but in line with our average exposure since inception. Our biggest positions Telia, UPM and Cargotec are all around 3,5%-weights in the portfolio, while our biggest shorts (banks and other stupidly valued things) are between 2-2,5% positions. We continue to run an overweight exposure to small caps, and there remains a number of holdings in the fund that we have held since day one.

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# Protean Small Cap

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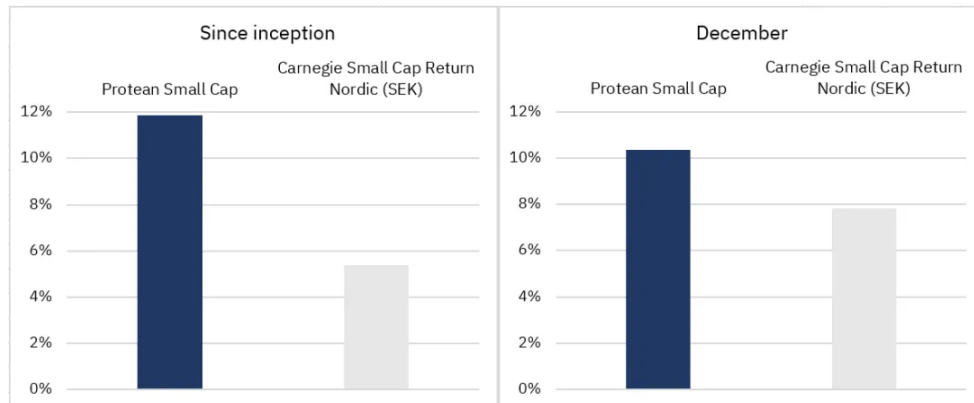
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December was a strong month for Protean Small Cap. We close the month at +10.4%, meaning that performance since inception in June lands at +11.9%. In doing so we closed 2.5% ahead of our CSXRN (SEK) benchmark for the month, and 6.5% ahead since start. Since the intra-month trough for the fund in October, it has gained 27%, highlighting the volatility in small caps as an asset class.

Rusta was our best contributor. Byggfakta and Fasadgruppen also performed strongly in December, as interest rates fell. Byggfakta has been perceived as a proxy on the outlook for the Swedish construction sector, and that fueled its recovery. The business is more stable, more diverse in both terms of geography and drivers, than the share price would indicate. However, Fasadgruppen really is a proxy on the Swedish real estate sector, and we increased our position (while selling our final stakes in Balder and Pandox) during December as the underlying long-term prospects improved indirectly via lower long-term rates.

Ossdsign surprised positively with a positive trading update early in the month. It has been a holding in the fund since inception and has become a strong contributor as the market gradually has realized the long-term opportunity that lies in the Catalyst product.

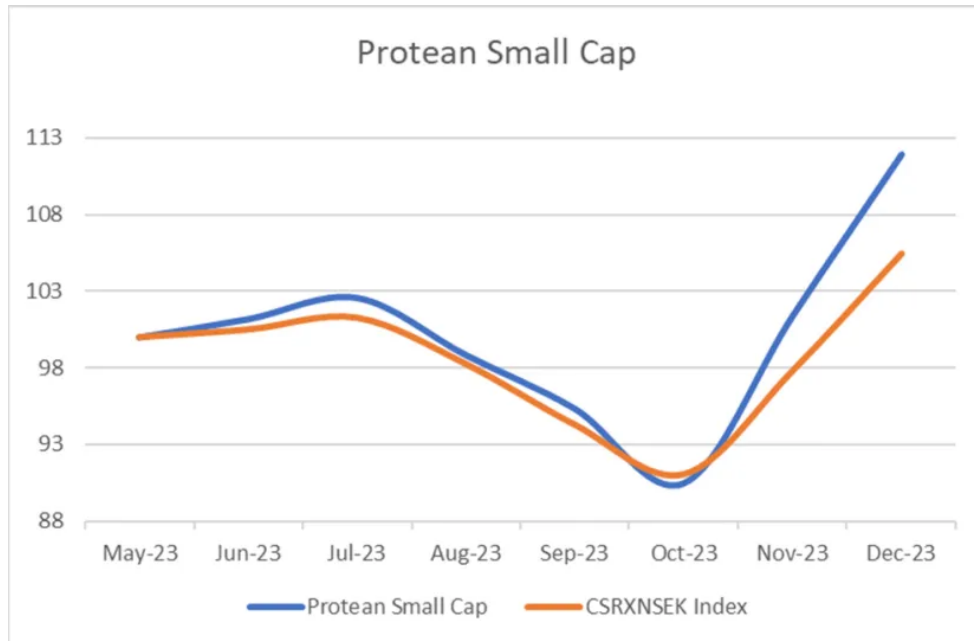
Detractors include Raysearch and Lundbeck, as well as Meko.



We've added Stockmann to the portfolio. This Finnish company has not been on our radar for a couple of years as it has been plagued by its legacy department store business which has been loss-making. There are still losses in that business, but they appear to be contained. This situation has meant that the progress for its Lindex business has gone unnoticed by many.

Lindex is a well-known Swedish fashion retailer with focus on women's and children's clothing. It appears to be a very well-run business: gross margins are at 65% and EBIT margins have improved greatly during the last years, now almost at 15%. It has fully pivoted to an omnichannel model, with its physical footprint (500 stores, of which 99% are profitable) are supplemented by online sales. Lindex is currently making c. 90 MEUR in EBIT per year, a number that we believe will grow. This can be compared to the Stockmann enterprise value of ca. 430 MEUR (adjusted for leases).

In a recent strategic update, Stockmann announced that it is contemplating to change its corporate name to Lindex, which feels like a sensible move: if you have a business line that makes up >100% of profits, focus on that. In our eyes, the next step would be to seek a dual listing in Sweden. This would create the foundation for a valuation more in-line with peers, which would yield a considerable upside.



### What does the small cap portfolio look like?

As we enter 2024 the portfolio holds 48 names, with market caps ranging from 96bn (SOBI) to 205 MSEK (we have 10 bps position in Swedish affiliate Tradedoubler, where liquidity has been elusive) with an average market cap of SEK14bn. Our biggest holding is the Finnish industrial Cargotec with a weight of 3.8%. We slice the portfolio in four buckets:

- **Larger names:** These are more liquid names, where we see specific catalysts over the coming months. The most recently added name to this bucket has been the Swedish defense company Saab which we added in November as we considered the 2024 sales outlook to be underestimated.
- **Small and Mid-Caps with longer horizon:** The bulk of the portfolio lies in this bucket. It holds a combination of 'steady as she goes' type of compounders such as the forgotten Danish conglomerate Schouw, or more idiosyncratic cases such as Raysearch.
- **Small caps with large potential:** These are very volatile cases, where some have done well for us (Ossdesign and Devyser in particular) while others have certainly not (RTX and Modulight).
- **Tactical situations:** We believe that the market yields opportunities every day. There are mispricings every day based on overreaction to the broker reports, index reshufflings and just plain exaggerated price action on negative news. We are not believers in the efficient market hypothesis. If there's a 20-dollar bill on the street we will pick it up, and it would end up in this bucket.

# Building in public – The second year of Protean Funds Scandinavia AB

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Doubled staff.

More than doubled assets under management.

Launched a small cap long-only fund (that beat benchmark by 6,5% over its first 7 months!).

Was right slightly more often than wrong.

Survived and recovered a 5% draw-down.

Welcomed our first international institutional investor.

Moved to a bigger office (25 square meters vs 17 square meters).

Office still resembles a cupboard. Only a slightly bigger one.

Had fun.

Was curious.

Had boring. Was frustrated.

Met 100's of company managements and analysts.

Had disasters.



DECEMBER 2023 • PARTNER LETTER

Had successes.

Spent exactly zero dollars on marketing.

Participated in a handful of podcasts and interviews.

Started paying ourselves a modest salary.

Paid a ton of money for IT-infrastructure.

Implemented an external PMS/OMS-system.

Times thinking about quitting: 0.

Days being annoyed with poorly performing stocks in the portfolio: 365.

### The monthly reminder

We optimise for performance, not for convenience, size, or marketing.

You can withdraw money only quarterly (monthly in Small Cap).

We will tell you very little about our holdings.

Our strategy is tricky to describe as we aim to be versatile.

A hedge fund can lose money even if markets are up.

We charge a performance fee if we do well.

You do not get a discount if you have a larger sum to invest.

We do not have a long track record.

Thank you for being an investor.

Pontus Dackmo

CEO & Investment Manager

Protean Funds Scandinavia AB