



From left to right: Björn Suurwee, Deputy CEO and Portfolio Manager, Thomas Pohjanen, CEO and Portfolio Manager – Excalibur Asset Management

Skills Honed and Perfected in and by the Markets

By Eugeniu Guzun – HedgeNordic

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Swedish hedge fund Excalibur Fixed Income has one of the lowest recorded maximum drawdowns in the Nordic hedge fund universe despite being one of its longest-running members. The fixed-income macro fund has experienced only two years of low single-digit losses, while delivering an annualized return of 4.8 percent – the high end of its 4-5 percent target return band – since launching in April of 2001. The ability to generate this return with limited downside risk in fixed-income markets is a “mastery that cannot be taught in even the best business schools,” according to founder Thomas Pohjanen.

The past three years and the beginning of 2023 saw Excalibur Fixed Income enjoy some of its best streaks of performance that bring back memories from its first 12-15 lucrative years. The Excalibur team has rejoiced the more volatile and uncertain market conditions characterized by rapid, abrupt changes and reversals. With an annualized return of seven percent in the past three years, Thomas Pohjanen and his team managed to anticipate central bank decisions and capitalize on opportunities arising

from diverging expectations within highly liquid and safe money market- and related credit instruments. “Our performance in the past three years reflects more macroeconomic uncertainty and the absolute mainstay of all our investments in very safe credit-worthy instruments,” explains Pohjanen.

According to Pohjanen, pure alpha is not about harvesting market risk premia by hoarding up on huge credit risk and magnifying that exposure using leverage. “Pure alpha to me is more about trying to understand the market, its implicit expectations, how markets will evolve over time, and how to position the portfolio in anticipation of central banks moving from neutral to hawkish, or from hawkish to neutral, or neutral to dovish,” elaborates the founder and co-portfolio manager of Excalibur Fixed Income. “This is not impossible to do, we have proven that over the years.”

One key observation, that has become more pronounced in recent years, Pohjanen has made over his more than 20 years of running Excalibur Fixed Income is that investors and fellow fund managers

“tend to stay too long with the messaging of central banks.” According to Pohjanen, “it is correct to listen to what the central banks are telling you most of the time. But when markets are heading towards turning points, you have to release yourself from what central banks tell you.” Central banks, more often than not, want to be sure with a margin of safety that they are making the correct move before taking action.

A SNAPSHOT OF THE PAST THREE YEARS

The starting point of a more fertile environment for Excalibur Fixed Income was “the unfortunate onslaught of COVID-19 hitting our societies and financial markets in early 2020,” recalls Pohjanen. “We were of the opinion that the great health crisis that hit globally would be met at all cost by both fiscal and monetary authorities, to prevent it from also turning into a financial crisis,” explains the founder of Excalibur Asset Management. “We expected that the taps would be open and sure enough they were.” Pohjanen and his co-portfolio

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manager Björn Suurwee positioned the portfolio for lower interest rates, easier monetary conditions and more quantitative easing, expecting spreads to compress in all sorts of instruments versus risk-free rates. “Sure enough that happened.”

At the turn between the years 2020 and 2021, there was still uncertainty and negativity around economic growth prospects. Pohjanen and his team, however, were starting to have a change of heart following the successful development of COVID-19 vaccines. “We felt that the great speed at which medical companies were delivering vaccines would change the picture completely,” recalls Pohjanen. As soon as the U.K. started vaccinating people at the turn of the year and early 2021, we thought “this was the seed of a different year.” Central banks, however, “were not signaling anything else than continued easy monetary policy.”

Soon inflation started picking up in the United States due to different disturbances to the world economy such as supply chain issues and chip shortages. Pohjanen started preparing Excalibur Fixed Income for a different turn of events. When Fed members started sounding the alarm about inflation picking up during the summer of 2021, the Stockholm-based team at Excalibur started adding positions set to benefit from higher inflation and interest rates in the United States. “We started turning from a long duration view in some parts of the portfolio to short duration,” says Pohjanen. “We implemented strategies to pick up returns from rising interest rates.”

Inflationary pressures soon started showing signs across Europe, and the Nordic region as well. Riksbank’s preferred measure of tracking inflation breached the two percent level in August 2022 and rose steadily over the subsequent months. “Markets were still expecting that the Swedish central bank would hold interest rates steady up until the outbreak of Russia’s war in Ukraine,” recalls Pohjanen. “The Riksbank’s chief said the bank was going to hold interest rates steady at zero all the way through 2024 and many participants surely believed them,” he continues. “We were building short positions well in advance of February 2022, expecting the central bank to have to turn their message around and this was important in 2022 for the return.”

Pohjanen believes one can predict central bank decisions well in advance and build positions to benefit from them. “If you are a student of the same data central bankers look at and they are slaves on the same data wagon as the rest of us, then you are able to predict advance turning points in monetary policy strategy,” argues Pohjanen. “This has been a recurring theme over the years. One can discern what will be in the next set of events, when the central bank will turn their message.”

With Excalibur Fixed Income focusing on three different markets – the U.S., Eurozone and Swedish fixed-income markets, the team running the fund tends to find attractive opportunities to exploit at any given time. “These three markets tend to move a bit out of sync, so it’s possible to construct trading strategies that can benefit from a certain market being ahead of others,” says Pohjanen. “You can build, for instance, long-duration strategies in one part of a market and offset some of that risk with an opposite trade in a different market that is not quite as advanced in the business cycle.”

DOWNSIDE PROTECTION THROUGH IMMUNIZATION STRATEGIES

Excalibur Fixed Income has recorded one of the lowest drawdowns in the entire Nordic universe, experiencing only two down years of low single-digit losses (1.5 percent in 2018 and 1.7 percent in 2015). “These figures tell you more about how we run our risk book than words can say,” once said Pohjanen. “When we are going into a position, we always have pre-determined immunization strategies,” explains the portfolio manager.

“If the market moves significantly against you, we have immunization strategies that we do put in place to minimize downside because something is happening that we had not expected and had not foreseen,” says Pohjanen. Another observation that has helped Pohjanen minimize losses over the years was to be more careful when a certain market belief or conviction becomes too well entrenched, i.e. many market participants had bought into a certain theme. You want to be more careful if too many investors are on the same train.

To capitalize on a given conviction or theme, Pohjanen also seeks to build a position with a “hockey stick” return profile. “We try to build portions of the portfolio using options. If we are wrong on the direction itself, which is more seldom, timing is devilishly hard,” says Pohjanen. “You just don’t know if this will happen this quarter or the next quarter. It’s a matter of limiting the downside while being exposed to your conviction.”

The ability to build a portfolio with a “hockey stick” return profile coupled with limited downside risk “is a mastery that cannot be taught in even the best business schools,” reckons Pohjanen. “It has to be honed and perfected by being in the markets,” he emphasizes. “This is a business where it’s good to be getting some gray hairs simply because you have seen overreactions, you have seen turbulences, you have seen the psychology of market behavior.”