April Partner Letter

Cognitive Birthday Dissonance

Dear Partners,

Protean Small Cap continued its strong performance and returned 2.2% in April. That is 1.1% ahead of the CSXRN (SEK) benchmark index for the month. Performance since inception in June 2023 stands at +28%, **outperforming the index by 13% in eleven months**. Notable is the quality of return: the portfolio is diversified; no single position has at any time been larger than 4.5%.

Top contributors were **Kemira**, **Cargotec**, **Netel**, **Nolato** and **Sedana.** Notable detractors **CINT**, **Elanders,** and **Lindex.**

Protean Select posted -0.2% return for the month. That's +4.3% YTD and 18.4+% since inception two years ago (Happy birthday us!). The realized volatility in the strategy remains below 7%, which can be interpreted as about a third of the risk of the overall market.

Top contributors were **Cargotec** (again), **Alfa Laval** (again) and **Netel**. Notable detractors were **Lindex**, **DSV,** and **short index futures** position.

This month's letter elaborates on what we think is going on, the cognitive dissonance with optimistic macro and pessimistic global geopolitics, and a happy birthday to us as the Protean Select fund turns two years old!

Thank you for being an investor!

//Team Protean

What's going on?

The Scandinavian earnings season for Q1 was unusually concentrated to the last week of April. On Thursday the 25th no less than 173 companies reported in one single day. That's almost a fifth of our investable universe. No wonder stocks move in near-random fashion during reporting days, given how nobody can digest and draw any meaningful conclusion from all relevant reports in the time given.

Gauging expectations and positioning is possible only on reporting days. Analysts trip over each other to reference "the most updated consensus" and position their ratings, opinions and estimates around the average of all visible opinions. But reporting day is when invisible opinions are revealed – the opinions of those that ultimately set the price: investors. Naturally, some of the expectations can be gleaned from how a stock has traded into the announcement. If a stock has been strong into numbers, it comes as no surprise that expectations are likely elevated.

This is the trick of earnings season if one is in the game of trying to trade it: find situations where your conviction is at odds with the consensus (i.e. how the stock has been trading, combined with what analysts and other investors are saying). It's easier said than done, however, because it is almost by definition the names you are comfortable with that are likely to blow up. We rarely (if ever) take quarterly report bets in single stocks; it is too hard and too stochastic. We rather buy or sell overreactions (or under-reactions) to reports when the facts are out in the open. It carries less smack of speculation and more of investing.

Investing in a multi-year thesis can also be a frustrating exercise during reporting season. If we own a stock with a view something will gradually happen in the coming 1-2-3 years, drawdowns in a single quarter because this or that number missed expectations in a random three-month period, are a source of nothing but annoyance. This quarter had its fair share of noise-driven earnings misses in companies where we have a view on the longer-term case. Take our big position in **Lindex**, or starting-position in **Vitrolife** or long-held **Elanders**. All down big on the month, for various reasons, but none that change our long-term case. This is the type of volatility a long-term investor needs to stomach. Like the founder of Four Seasons said: *Excellence is the capacity to take pain*. Short-term underperformance is painful, even if marginal. Let's hope we're not fooling ourselves this patience is an indication of excellence.

On an index level, April doesn't look all that dramatic: large-cap indices are up low single digits, while small-cap indices are down low single digits. In Sweden, the spread between the OMX30 and the most widely followed small cap index was about 2,5% for the month, largely driven by a roughly 7% negative return from the real estate sector, which is no less than 20% of the index. All in all, despite all the single stock volatility, things were relatively calm on the surface.

Cognitive dissonance

The overarching picture of markets and the world we're grappling with can best be described as one of cognitive dissonance. This is the term used when one holds two conflicting beliefs. It was coined by a researcher following a cult that believed the world was going to end and observed how the members coped with the world not ending. Hint: they instead believed the world didn't end thanks to the faithfulness of the cult members. How convenient. This zeitgeist was aptly captured by Viking Global CEO **Andreas Halvorsen** when speaking at an event arranged by Norges Bank recently (and I'm butchering the quote here for effect):

"There is a general consensus that the economy is fine. [...] At the same time, there is a consensus that geopolitically we're in for a hard landing. [...] These two outcomes cannot coexist. [...] the probability is that the world of investors attached to the benign economic environment is too high."

Half a century of globalization has built intricate interdependencies across the world. Aptly exemplified by the impact on global supply chains from ever-so-short disruptions of shipping lanes, or indeed the bullwhip inventory effect from COVID-19. Given the outsized impacts on returns global events can have, we as money managers need to be macro-aware even if our edge comes from being local and fundamental. This, too, is an effect of us managing our own money in our funds. We don't hide behind single stock narratives, we shoulder the allocator responsibility. When the big picture is unusually blurry, with several geopolitical hotspots simmering, global macro – as evidenced recently by violent rates and FX movements (USD/JPY!) – in a period of heightened volatility, paired with equity markets posting strong returns, there's something that doesn't add up.

We are therefore not in a position where we feel comfortable going out on a limb by adding much in terms of risk from length in the book. This is why the hedge fund remains in the 30's on beta-adjusted net exposure, and why we have implemented a tail risk hedge via an index put-spread. We hate losing money. So, we try hard not to. Sometimes this means sacrificing some of the upside. So be it.

Positioning a Nordic-focused hedge fund with an eye to global macro is not something we put on the front page of the product description. We instead pride ourselves that returns over time should come from owning idiosyncratic bottom-up fundamental cases in small- and midcaps. But that doesn't mean we can afford to be complacent when it comes to protecting from draw-down risks stemming from global macro acting up.

Happy birthday! Protean Select turns 2 years

The closing of April means the Protean Select hedge fund has survived and prospered for a full two years. It's been a journey! We are glad to have generated a reasonable 18% return, with low risk, in a period characterized by big upheavals and change. We are also somewhat frustrated since we feel we could have done a lot better. I guess that's a feature, not a bug, of money management that you will always have a (big) proportion of decisions being plain wrong. We're still learning.

In the past two years we have had several stocks perform exceptionally well. Some deserve an honourable mention: **Cargotec**, which we have held since day one, is up by >75% (and still cheap!). **Raysearch**, another very early name in the fund, has more than doubled. **Byggfakta**, a sad story for a long time, was ultimately bought out and generated a healthy 50% return for us. **Swedish Match** (RIP) was bid for only two weeks after the launch of the fund, and we fought hard to keep it listed in Sweden. Given we built the position up to 12% of the fund, it generated a good return when the bid was raised. **Novo Nordisk** has been a staple in the fund since day one and has helped a lot (we still own it!). Being adaptive and active does not mean we cannot be long-term.

Our biggest loser has been **Embracer**, as we sat through the one-day 40% drop with a 1.5% position. We underestimated the structural headwinds in the gaming industry and the added complexity from high indebtedness and overestimated the strategic acumen and business building genius of CEO and Founder Lars Wingefors. We also have a small position in Finnish **Modulight** that has remained since day one, despite the stock falling 63%. It's a *memento mori* in the portfolio (that still could work, mind).

Our stated target return is intentionally vague, as a long-biased hedge fund will always correlate somewhat with the overall markets. What we have stated is we focus both on return AND risk. Will we beat the market? Sometimes. Will we do it over the long term? Empirical evidence suggests this is very unlikely, but that's not keeping us from trying. Our hurdle rate is approximately 8% per annum. It is calculated thinking the average net exposure of the fund would be 50%. So far, the average has been closer to 30%, reflecting our more cautious view. This lower net makes performance generation more difficult. It is pleasing that we, despite the lower risk than anticipated, have managed to outperform our tough benchmark.

We launched Protean Select on May 2, 2022. The same day interest rates in Sweden broke 0% from below for the first time in many years. The same day we saw a 7% flash crash on the OMX. It was only weeks ahead of a 20% draw-down in small-cap indices. We are proud to have navigated this treacherous beginning.

We believe we are on the way to proving our concept of reasonable returns with reasonable risk works.

The strategy manages approximately 1.2bn SEK and will close for additional deposits at 2bn SEK.

May 3, 2024

Protean Funds is a proud sponsor of Bergsjö IF

If you squint really hard, you can see the Protean Funds logo on the new shirts of the Bergsjö IF youth team.

Almost three years ago when we first started this project, we thought about sponsorship and marketing. Do we want to do it? Do we do like everyone else and print our logo on expensive golf balls and t-shirts? Or do we want to make a difference and support something that actually matters?
We asked our social media what societal problem was perceived as both most acute and also what one realistically, as a corporation, could do about it. A consensus emerged that integration is an issue, and that youth sports is a worthy cause to support.

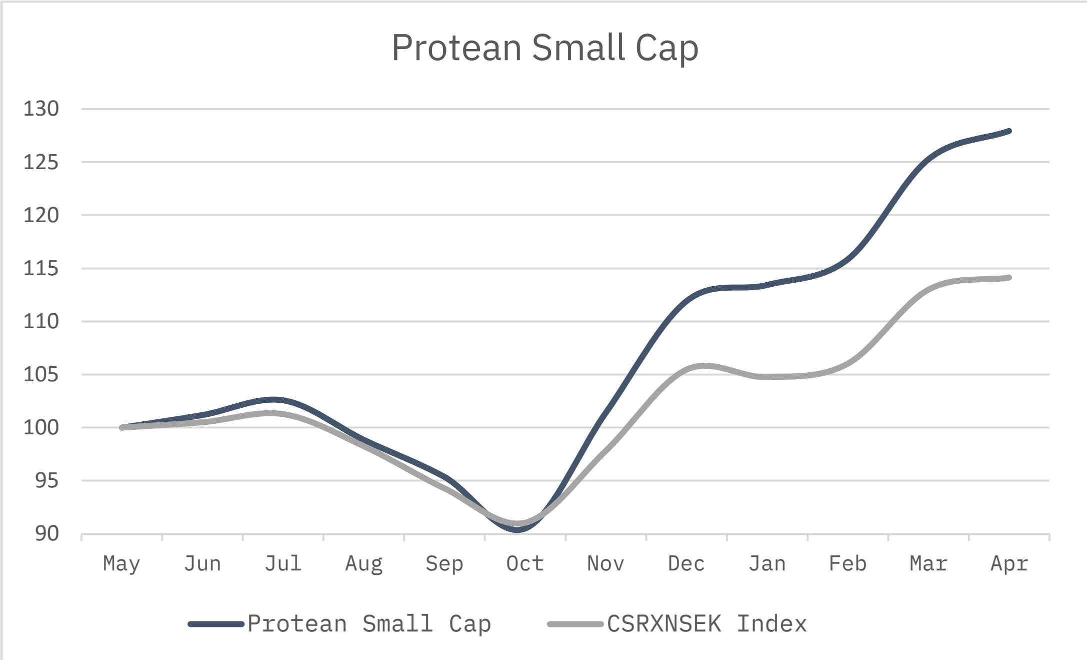
When looking for a suitable club, we were pointed to Bersgsjö IF, a small football club in a challenged urban area in Gothenburg. The club has been run by local heroes Kurt and Billy for the past 40 years, engaging several youth teams in training and match play. The club is a prime example of the positive impact small, local clubs can have on an otherwise unforgiving environment. We have committed to sponsor Bergsjö IF with a cash stipend, for them to use as they see fit. According to the regular reports we receive, our contribution (small, in the grand scheme of things) has helped the club stay afloat, and even expand the number teams in training, upgrade the equipment and with our encouragement they have started working on recruiting a girls team for the first time in the area.

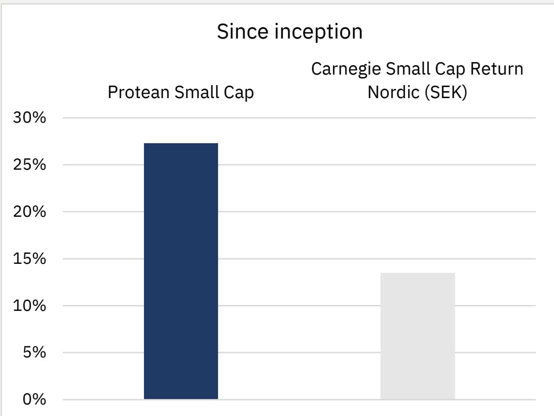
We wish and hope more small companies can be inspired to do similar things. It’s rewarding to try and help, in whatever little way one can. To use some of the marketing budget for something meaningful, rather than buying logo-candy and pens, is a no-brainer.

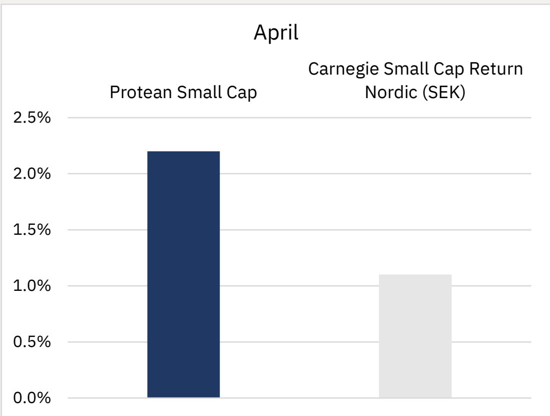
Protean Small Cap – Carl's update for April

April was a strong month for Protean Small Cap, both in absolute and relative terms.

We close the month at +2.1%, meaning that performance since inception in June last year lands at +27.3%. In doing so we closed 1.1% ahead of our CSXRN (SEK) benchmark for the month, and 13.8% ahead since start.







Top contributors were **Kemira**, **Cargotec**, **Netel**, **Nolato** and **Sedana.** Notable detractors **CINT**, **Elanders** and **Lindex.**

Finnish specialty chemical maker **Kemira** reported better than expected numbers for the quarter, and the share performed strongly in the wake of this. The share remains attractively valued despite a >25 per cent gain since we initiated the position when the Finnish state ownership entity Solidium sold their position in a placing. With an improving pulp cycle, declining input cost and better than expected pricing power, we anticipate an earnings upgrade later this year.

Cargotec delivered outstanding results for the first quarter, beating expectations by more than 25 per cent on EBIT. Sorry for this: but we told you so - repeatedly. We been banging the on table about this underrated Finnish industrial for quite some time, and we start to feel vindicated. However, when you have a three-fold transformation story such as Cargotec, where we see a) estimates being too conservative and b) the earnings multiple is too low and c) the spin-off of Kalmar will further underscore this, the most important thing is: keep owning the stock.

CINT remains a volatile story, where the Media Measurement arm continues to make good strides, signing customers such as **Netflix** during the quarter. The Marketplace business remains under pressure, however, as certain customers have insourced their business. Media Measurement looks to grow by 35-40% organically also in 2024, and remains the key point in our investment case.

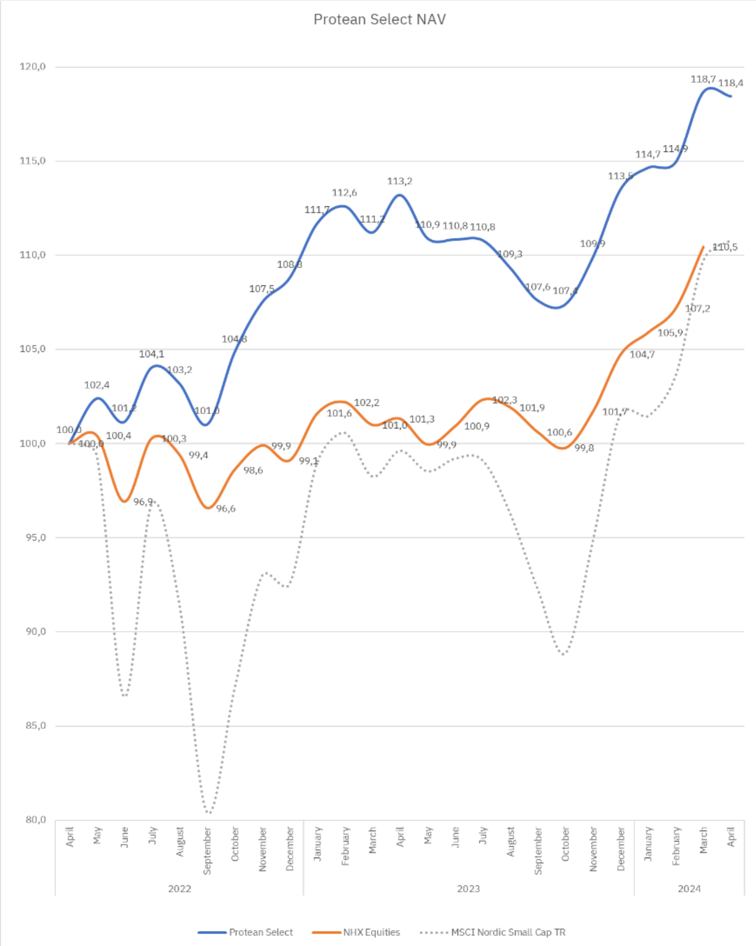
The portfolio remains diversified, with roughly 45 names with no one position above 4.5%.

The ten biggest positions in Protean Small Cap as we enter April are:

Cargotec	4.5%
Devyser	4.0%
Acast	3.9%
Kemira	3.7%
Ambea	3.6%
Raysearch	3.6%
Nolato	3.3%
Rejlers	3.0%
Netel	3.0%
Fagerhult	2.9%

May 3, 2024

Protean Select – Pontus' update for April



**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.*

Protean Select posted -0.2% return in April. That's +4.3% YTD and +18.4% since inception two years ago. The realized volatility in the strategy keeps hovering below 7%, which gives a feel for how much risk we take to generate this return. It is approximately a third of the realized volatility of the market.

We exit April with approximately 38% beta-adjusted net long exposure, and 125% gross exposure. In the high end of the interval we have been getting used to for the past two years. The portfolio remains well diversified, with the biggest position accounting for less than 4% of the portfolio.

Best contributors were **Cargotec**, **Alfa Laval,** and **Netel**. All on the long side.
Detractors were **Lindex** and **DSV** longs, and **short index** futures.

On the last day of April **Svitzer A/S**, the tugboat company, was spun out of AP Moller Maersk. Why? Nobody knows. Nobody wants it. Owners of Maersk are, apart from the family that controls the majority of capital and votes, mostly global large-cap investors. Now they're sat with 2 shares in Svitzer for every 1 share they own in Maersk. There is likely a significant flow-back in the coming weeks, typical of spin-off situations throughout history. As chronicled by **Joel Greenblatt** in the book "*You can be a stock market genius*", spin-offs are often opportunities to pick up small businesses that are ignored, under-analyzed, and now able to run their capital allocation without concern of up-streaming to the mother or other conglomerate concerns. In short, theoretically, the flow-back could create a buying opportunity.

We think Svitzer is an exception. We think it's the opposite. We think one should rid oneself of involuntary exposure to a low-return, capital-intense, low-growth, poor cash-flow, highly indebted, cost-pressured, semi-poorly managed business. At the current market price, the headline EBITDA multiple might appear low (which it should be) but the FCF yield and dividend yield are only a smidgeon above what you get from putting your money in the bank. It should be double that, meaning the equity is worth half. Best case.

We have recently taken a position in Finnish/Swedish utility company **Fortum**, seeing an emerging story not dissimilar to our thesis in Boliden from last month's Partner Letter. The long-term demand outlook for electricity generation in the Nordics is benign. Particularly for baseload power like hydro and nuclear. With increasing intermittent renewables in the generation mix, nuclear and hydro can extract a premium via optimization payments. This is what happened in Q1 at Fortum: the payments received for helping balance the grid-enabled a significantly higher achieved electricity price. The market appears to think this is transient. We think not. Listening to the COO of **Svenska Kraftnät** (the authority responsible for Sweden's system for electricity) they warn about the "billions" it is costing in payments to generators to balance the system. This is not fading away. Yet 65% of analysts are neutral or negative. This is a consensus meh-stock. A good starting point.

With the stock trading at 12x PE, an 8% dividend yield, and a balance sheet in pristine shape (0.3x ND/EBITDA vs a 2x "target"), the risks appear priced in but little of the upside. Neither is anyone paying any attention to the replacement value of the existing assets exploding upwards. This value is nowhere on the balance sheet. That it's now 10x more expensive to build a nuclear reactor, or politically impossible to build a new hydro plant, is not reflected in book values.

Add to this the allure of AI – a half-hare-brained idea, but one that has given the US utility stocks their mojo back – with the thesis that the roll-out of AI capacity drives substantial electricity demand. There is data suggesting data centers consumed 2.5% of US electricity production in 2022 but is projected to use 20% by 2030. We are already seeing utilities in the US pausing data center connections, and in Chicago power demand is forecast to jump 900%, requiring the output of 4 new nuclear reactors.... Scandinavia is, thanks to its temperature and access to low-CO2 electricity, a preferred place for the world's tech giants to build data center capacity. Who knows about that, but even without AI changing the world it seems clear power markets are destined to tighten and stay tight, particularly for hydro and nuclear. As Yoda would have put it: Good for Fortum, that is.

The monthly reminder

We optimize 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