October 2, 2023

Disclaimer: Before considering an investment in any of Protean's funds, 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.

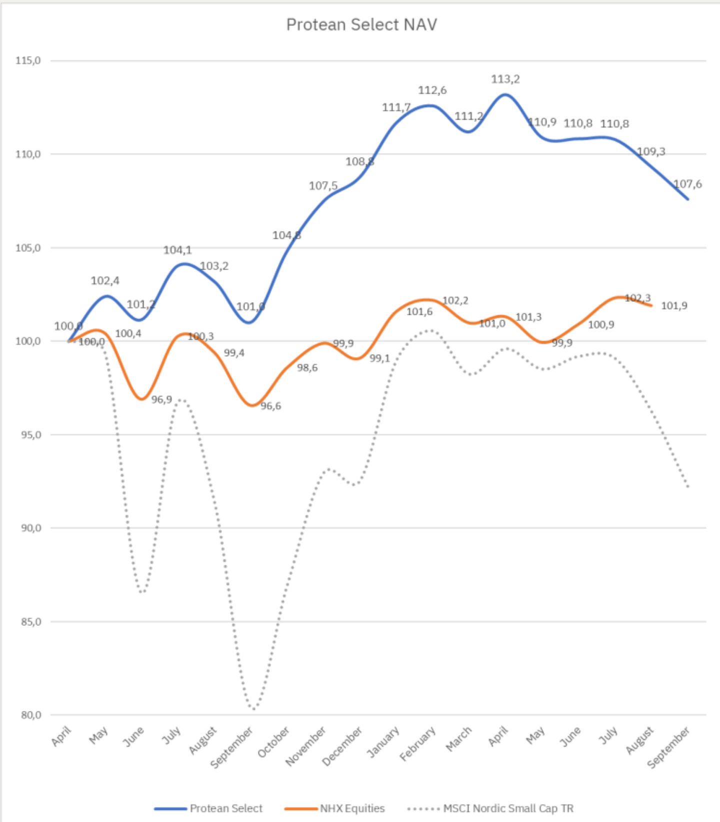
September Partner Letter

Get Rich Quick

Dear partners,

Protean Select returned -1.6% in September. The year-to-date return is now -1.1%. Since our start, 17 months ago, the fund has returned +7.6%.

Protean Small Cap returned -3.5% in September. After four months, the fund is 1.1% points ahead of its Carnegie Nordic Small Cap-benchmark. Thank you for being an investor.



**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 performance figures are net of fees.*

TLDR

- **Protean Select** returned -1.6% for the month, -1.1% YTD and +7.6% since inception.
- On a rolling 12-month basis, the fund has returned 6.5%.
- Our short position in a basket of **Swedish small caps**, the short **EUR/SEK,** and long position in **Alleima** were top contributors.
- On the negative side we find our long positions in EUR-denominated **Cargotec, Metso** and **Scanfil** were the biggest detractors.

- **Protean Small Cap** returned -3.5% in its fourth month.
- The benchmark Carnegie Nordic Small Cap Index was down 4% in September.
- **Alleima, Truecaller** and **Ossdsign** were top contributors.
- **ES Energy Save**, **Netel** and **Cargotec** were the biggest detractors.
- After four months in existence, the fund is **ahead of its benchmark index by 1.1%-points**.

- The combined assets in our two strategies is approximately **850m SEK**.
- Our net exposure to equities in Protean Select is currently 24%, our gross exposure 112%.
- The portfolio **remains diversified**. No long position is bigger than 4%, and no single short position is bigger than 1.5%.

Overall, which might sound paradoxical, this did not feel like a bad month (although it wasn't great). Yes, our positioning has been too optimistic in the past few months, but we see some very encouraging signs on a single stock level, and the underperformers were mostly small positions. We are confident we are on the right track with the composition of the portfolio and look forward to the quarters and years ahead.

What happened in September

September	2023-08-31	2023-09-29	
MSCI Nordic Total Return (SEK)	563,0	569,3	1,1%
MSCI Nordic Small Cap (SEK)	767,1	755,9	-1,5%
OMX ALL (SAX)	812,6	795,4	-2,1%
OMX30	2 184,7	2 155,5	-1,3%
Carnegie Swedish Small Cap Index	1 188,5	1 142,5	-3,9%
Carnegie Nordic Small Cap Index	734,4	704,7	-4,0%
Protean Select NAV	109,3	107,6	-1,5%
Protean Small Cap NAV	98,9	95,4	-3,5%

We have experienced a few months of negative performance. The reason is that we a while back decided to raise the net exposure in the Select fund and increase the allocation to small caps. This was **too early**, which, in investing means **plain wrong**.

Our reasoning was that inflation would roll-over as comparators grew easier, annualising the extreme energy prices, component shortages and freight rates. This would, in turn, lead to a narrative change from "*the fastest interest rate hike cycle in history, something's gonna break!*" to "*peak interest rates, when's the cuts*?". Paired with pockets of very attractive valuations and negative overall positioning, we anticipated positive performance from our holdings.

Now, inflation does appear to be rolling over, but the consequence for markets has so far not been what we anticipated. Instead, we got "*Oops! Disposable incomes are under severe pressure and the duration of high interest rates looks to be extended as job markets remain strong*!". This has continued to put pressure on multiples across a variety of industries. The short positions in consumer discretionary we mentioned in a previous monthly letter have paid off handsomely (**Electrolux**, **Husqvarna**, **Thule**, **Nokian Tyres** etc), but were insufficiently sized to make up for the beta-induced losses in the diversified long portfolio.

We have re-assessed; we have re-shuffled. We again run a lower net and have reduced some of the illiquidity in the fund, but we continue to find what we believe is ample opportunity. Sadly, there's no hiding that when you enter a month with 43% positive net exposure and overweight small caps, and indices end down this way, negative return will be the result.

As we have repeatedly warned, there will be periods of poor performance. It's both mathematically and practically inevitable. This appears to be one of them. All we can do is assure you that we remain convinced we have the processes, structures, and incentives in place to keep working hard, turning over rocks, digging for data points, and acting on our convictions.

We manage the funds with a three-year perspective. We think the biggest returns over time are made being net long smaller companies. Shorter periods can (and will) therefore be volatile. It takes time for a fundamental thesis in a stock to play out. Sometimes years. We take comfort in that, since our start, the fund continues to outperform most comparable funds, as well as both large-cap and small-cap indices in the Nordics.

Whilst it's not fun to print a few months of negative returns, we paid the price for our optimism and net positive exposure. The balancing act of protecting the downside, while being ready to capitalize on the upside, comes at a cost when markets head south.

If you're looking to get rich quick, we are not the optimal custodians of your capital. If you are looking for reasonable returns, with reasonable risk, then, perhaps, there's a conversation to be had.

Protean Select – update for September

The Select fund returned -1.57% for the month. While unsatisfactory when you aim for absolute positive performance, it was more a result of positioning than any single blow-up in the portfolio. The individual stocks have largely played out as anticipated, but we did not foresee the magnitude of the overall market weakness.

For a few months, we have taken the precaution of hedging the currency risk in the portfolio. As the SEK has printed all-time lows vs. the EUR (and therefore the pegged DKK), we postulated there was almost nobody left to turn negative to the Swedish Krona.

When sentiment is extremely one-sided, it often pays to look in the other direction.

Since hedging via currency futures is a relatively cheap and straightforward process, we took a bigger position (150m SEK) to offset all the FX risk in the portfolio. This paid off in September, as the SEK finally strengthened materially. The EURSEK hedge contributed 0.5% to the fund. Note, however, that the effect on the fund is rather an avoidance of an FX loss, from the positions in equities listed in Finland and Denmark, than an outright gain. The net effect is near zero, as can be seen from the negative contribution from our Finnish holdings.

Our basket of Swedish small caps, which we short to hedge part of the market risk, had a terrible month, which perversely means it was a top-three contributor to returns.

Considering recent events, we have re-assessed our overall market view and decided we were too early to pivot to a more positive stance. We continue to fine-tune the exposures in the fund and have returned to a decidedly more conservative positioning, but remain net long and slightly less, but still, overweight small caps.

As the Small Cap Fund below, we added a position in **Ossdsign** in September.

October 2, 2023

Protean Small Cap – Carl's update for September

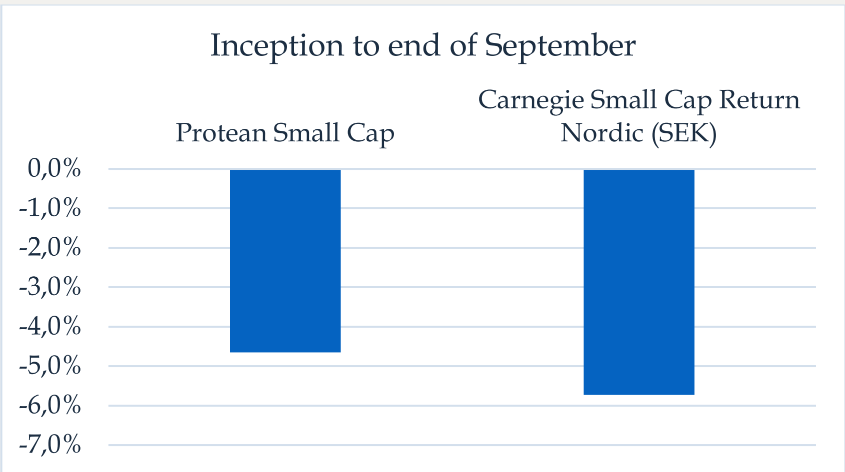
Alleima was our best contributor, for the second month running. It's now less cheap, still without 'something actually happening'. One of our losers for the month, **Cargotec** (again!) remains in the same 'cheap-without-catalyst' camp. We are waiting for a revaluation. Patience. When we think we are right, we have a lot of patience. Sometimes too much. Still, it is encouraging that the spin-off dynamics will come into play for Cargotec during 2024.

Ossdsign was our third best contributor. The saying 'If it looks like a duck, walks like a duck and quacks like a duck, it's a duck" comes to mind. Just replace "duck" with "**Bonesupport"** and you pretty much see our investment thesis. Having been a small position in Small Cap since inception, we added to the position when the company announced a strategic reorientation in late September, to become fully focussed on the rapidly growing Catalyst franchise, as well as raising SEK150m to further support the ongoing hyper-growth.

It's awful for many small caps in the Nordics right now. Liquidity is being blamed as the main culprit for the poor performance, but in many cases, valuation has simply been too high. Implicitly saying the risk premium too low. However, as is often the case, overshooting turns into undershooting and this has led to a situation where we see a plethora of exciting situations when we think about 'normalized earnings with a normalized multiple in a three-year perspective'.

We've suffered from being too early in a few of these situations during September. From experience we know how quickly the dynamics in a depressed stock can change if the fundamental analysis is correct. And lack of liquidity works on the upside too.

A new name added to the fund during September is the Danish pharma company **Lundbeck**, which gradually is getting more recognition for its progress in diversifying the earnings base. The stock is cheap (that word again!) but has momentum in terms of earnings and pipeline development.



Get Rich Quick

Investing is a constant fight between short-term change and medium-term transformations. Managing the ever-shifting horizons, expectations, valuations, and what's already priced into shares versus what isn't. This is what we do. We're (relatively) comfortable doing it.

But what makes us uneasy is when the long-term landscape undergoes frequent changes. It's an exhausting endeavour to probe the great global questions that never seem to have concrete answers. There's no end to the facts to chase or leads to follow, and you might end up with a feeling your head is too small to contain all the intricacies. It also makes your head hurt and you throw *The Economist* in the bin unopened.

Yet, this is the canvas we have chosen to paint. Without a comprehensive worldview, especially in times of heightened flux, we are clueless. The portfolio/canvas must be a bottom-up <u>and</u> top-down expression of our worldview.

We take our role as custodians of the wealth of others seriously, and in contrast to straightforward allocation products like "Small caps" or "Swedish Equities" we mind the absolute downside. This makes having a view of the world and directions of markets a must. In an ever-intertwined global market, with most companies exposed to sprawling global supply chains and world market prices, there is nowhere to hide. It might not be an outright edge to mind the macro, but it is table stakes to consider it. With great effort.

Stream of consciousness

The experience of reading something written in the style "stream of consciousness" is akin to glimpsing someone's unfiltered thought process. Free associations. Random facts. Narratives shift. Think of stream of consciousness luminaries like *Tolstoy, Beckett, Kerouac, Plath*, and *Morrison* (or *Lundell*, to take a familiar Swedish example).

Today, trying to keep up with the evolving outlook, share prices, and markets, feels much like this. We are in a perpetual stream of consciousness world. Data points accumulate, we absorb them, weigh them, balance them, and try to piece them together. Suddenly, a significant new piece demands attention, or an old one disappears.

In recent months, our mental stream has been crowded with diverse thoughts:

- Years of policy excess post-COVID and the GFC.
- Borrowing from the future with artificially low interest rates.
- Is endless growth sustainable, or are environmentalists onto something?
- Escalating costs of resource extraction, stoking inflation.
- The debate over money's price and existence in an era of money printing.
- Resurgent inflation, fuelled by demographic shifts and China's evolving challenges.

- Questions about central bank independence in the face of accelerating interest rates.
- Shrinking disposable incomes, with savings as a fading lifeline.
- A spending spree or an upcoming cautious approach to vacations and travel?
- The ebbing of supply chain disruptions.
- Inventory corrections, their acceleration, and an impending reversal?
- The fastest hiking cycle in history, but with an impact coming with a significant lag?
- Markets grappling with deflating multiples.
- The past 30 years have seen multiple structurally deflating forces, which are now turning into inflationary forces.

All these thoughts are valid, common knowledge, and yet they linger: Are they fully priced into current share values? Shouldn't they be? And yet, are they really?

If unemployment surges, what then?

Historical parallels offer some comfort, but history is a social science, not an exact one. We can't replicate results, and unprecedented events are, well, constant.

Things that have never happened before, happen all the time

The prevailing axiom, “markets inevitably recover”, has been the bedrock of investor assumptions. But what if it's time to challenge this? Is there still too much optimism? Are we all self-congratulatory BuffettMungers, clinging to outdated beliefs despite demographic and climate shifts?

Is this creeping doubt that “**what if there really is a storm ahead of us**?” a reasonable thought?

Navigating the short term versus the long term, it's a constant conundrum. Is the market a voting machine or a weighing machine? Positioning matters in the short term, but what's the long-term outlook?

It’s popular to claim to be investing in “mega trends”, but what do you do when the prevailing mega trend is “falling disposable income”?

Populistic backlash

ESG, once lauded, faces a backlash. Politicians shift their stance, seeking to appease voters by easing climate policies. During September we held short positions in wind developers **Orsted** and **OX2**, plus turbine manufacturer **Vestas**. Rising costs and public resistance cast doubts on the near-term attractiveness of renewable energy investments.

The term "ESG" emerged from policy failures, a market response to climate concerns. Valuations surged, driven by the belief in doing good, while policy remained stagnant. Can this disparity last?

The inertia of global climate policy reveals democracy's flaw: changing leaders every few years allows for easy reversals. Populism and nationalism thrive on simplistic solutions to complex problems.

Go long, go short, or go fishing

Plotting the path of our fractured and fragmented World in the coming years is a major intellectual challenge, considering there is a non-zero number of disastrous outcomes. The soft-landing narrative appears to have a both short and narrow runway to aim for. This heightened uncertainty is why we structured the Select fund as a long/short product – to have the opportunity to preserve capital in periods like these.

You will likely not read or hear about many fund managers openly admitting to being uncertain. After all, why trust a fund manager with your savings if they don't appear dead sure about what they're doing?! Perhaps it is like the infamous **Jesse Livermore** quipped:

"There is a time to go long, a time to go short, and a time to go fishing."

Like we argued in a partner letter a few months back: when markets are like this there is nothing brilliant to do. What we mean is there's no grand strategy, no hail Mary pass, no levered long or ultra short positioning that will help us Get Rich Quick.

The consequence is we keep at the lower end of our net long positioning range, with continued diversified exposures, trying to strike a balance between single-stock opportunities on the long or short side, while keeping a close eye on the preservation of capital.

We sincerely hope there will be a time – soon – when long-term changes stabilise, and we will be comfortable adding more length to the portfolio.

For the time being, we're fishing.

Sentiment tuning fork

Notably a rather unusual song has spent the past three weeks in the no 1 position on the US Billboard list. "Rich men north of Richmond" by Oliver Anthony is a rough production, a solo singer/guitar tune that debuted top of the list only days after going viral on YouTube.

Why is it interesting? Because it contains a lot of typically right-wing talking points such as low wages, food poverty, high taxes, critique of central government and social welfare. From a Nordic perspective, what made us take notice, are the lines:

And the obese milkin' welfare
Well, God, if you're five-foot-three and you're three-hundred pounds
Taxes ought not to pay for your bags of Fudge Rounds

Shall we consider it an everyman's op-ed in the ongoing debate of obesity medication, on how and if the government should subsidize Wegovy and Ozempic?

Politics aside, it's actually a pretty good song.

High-water, Mark

The fee structure dynamics of a hedge fund works in both directions. To charge a performance fee, the fund needs to be both above its previously highest level (this is what is called a high-water mark). To be below the high-water mark is called “being in a draw-down”.

Regulation has become stricter in recent years, as many hedge funds were only hedging in name and not in reality, being disguised long-funds with hedge fund fees. When the tide went out and markets went down, these funds went down with them. This is why funds started in the past, say, 5-10 years often have a hurdle rate on top of the high-water mark. We are such a fund. Our hurdle is a combination of the Swedish risk-free rate (STIBOR) and a 4% absolute return target. As the STIBOR is now 4%+, our hurdle rate is therefore 8%+.

Since our fund crystallises fees every month, it also means the absolute hurdle is added every month by one 12th of 8%, or approximately 0.7%.

The high-water mark for Protean Select was reached in March, and we have had a few so-so months (as has the market, in fairness), which means we’re a bit below said mark. Since March, the steady beat of 0.7% has been added to the performance fee hurdle, on top of the high-water mark.

It’s a tough target to beat, generating 8%+ with net long exposure when markets are going down or sideways. But it’s a fair target. And the flip side for our investors is that this high-water mark is collective – it means that any new investments will be treated *pari passu* with the fund. New investments will not be subject to a performance fee until we have generated 8% returns, as things stand right now.

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.

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