June 1, 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.

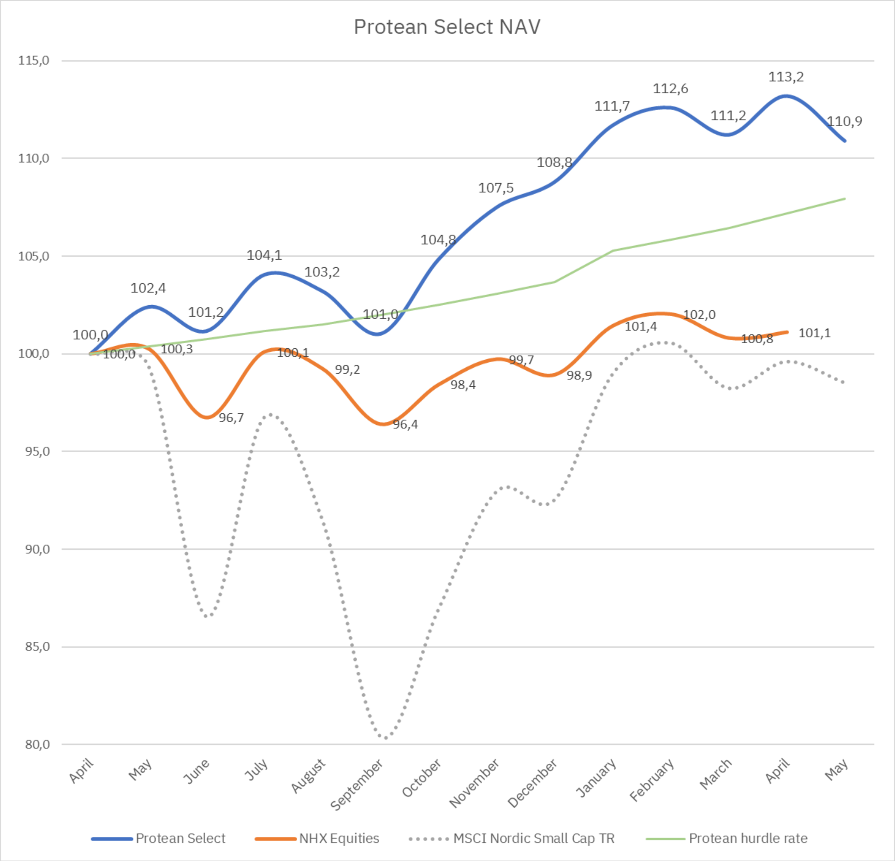
Link to all Partner Letters

May Partner Letter

Skitmånad. It happens.

Dear partners,

Protean Select returned -2% in a displeasing May. The year-to-date return is now +1.9%. Since our start, 13 months ago, the fund has returned +10.9% (with substantially lower risk than the general market). 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. We also, for reference, add our hurdle rate and a Nordic Small Cap index, expressed in SEK. We do not compare ourselves to an index. We aim to have positive returns regardless of the market. No return is created in a vacuum, and a net-long strategy will correlate. Our hurdle rate is 7.3% annualized (4% + 90-day Swedish T-bills). All performance figures are net of fees.*

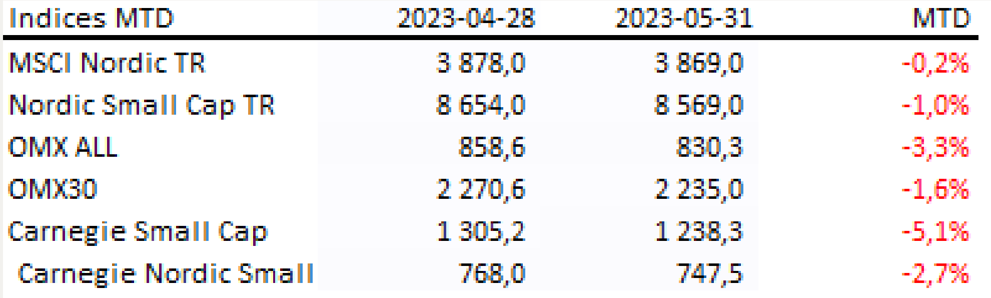
June 1, 2023

TLDR (too long; didn't-read version)

- **May**: Protean Select returned -2%. YTD +1.9%, since inception +10.9%.
- **Storskogen, Promimic and Metso** were top contributors.
- **Embracer** was our biggest detractor. Its 40%+ fall in one day alone cost us nearly -1% on our trading position.
- We start June with **800m SEK in AuM** in Protean Select, and **60m SEK** in Protean Small Cap.
- Our net exposure to equities is currently 25%, our gross exposure 120%.
- The portfolio **remains diversified**. No long position is bigger than 3.5%, and no single short position is bigger than 1.5%.

- Our second fund, long only **Protean Small Cap,** launched on the 1st of June 2023. It offers a more volatile – but potentially higher return – alternative to Protean Select and is managed with the same versatile mindset.

What happened in May?



Indices MTD	2023-04-28	2023-05-31	MTD
MSCI Nordic TR	3 878,0	3 869,0	-0,2%
Nordic Small Cap TR	8 654,0	8 569,0	-1,0%
OMX ALL	858,6	830,3	-3,3%
OMX30	2 270,6	2 235,0	-1,6%
Carnegie Small Cap	1 305,2	1 238,3	-5,1%
Carnegie Nordic Small	768,0	747,5	-2,7%

This was a frustrating month for us. In Swedish it was a classic skitmånad (you can figure it out). The dispersion among indices, and the striking difference between small-cap and large-cap stock performance that has characterized this year, continued in May. On some days, our small and mid-cap sub-strategy resembled the Titanic violinist who stubbornly kept playing despite the ship going down (but ultimately went down with the ship too).

As the AI hype started sweeping markets, more and more semi-desperate attempts by corporates and brokers alike, to associate a narrative with the trend, and several equities indeed overshooting substantially on a weak relation with the concept. We have put on small positions to express our mild skepticism (whilst nodding at Soros and acknowledging **bubbles-in-forming are powerful things)**.

Managing money for the long term when staring at screens every day is a mental challenge and an obvious dichotomy. But it's a necessary dichotomy because the long term is made up of a long line of short terms. May was a frustrating month because we can point to a relatively **small number of decisions that caused the drawdown** in the fund. The fund performance was still largely in line to slightly better than general indices for the month. No disaster, but certainly not where we want to be, even monthly. We fight for every hundredth of a percentage point of return, which is why it's annoying to have a month where we don't feel we've done well. In a longer-term perspective, a single month's performance – arguably an arbitrary measurement period – does not matter a whole lot. But it matters to us. And, obviously, we acknowledge it matters to you.

We remind ourselves (and you) that our process is designed to capture multi-year winners and to provide capital protection during periods of substantial market corrections. Unfortunately, it is a built-in feature that the rare multi-bagger beasts will have rough patches along the way. As you may know, there are several stocks we have held since starting the fund 13 months ago. We anticipate holding them for years longer if they continue to develop well fundamentally. There's no quantitative way of making a judgment between selling on an anticipated short-term hiccup or absorbing the pain of temporary underperformance. Investing is an art, not a science. We hope and think we can make above 50% correct decisions in similar situations – but offer no guarantee. The only thing Protean offers is this: insurance. Insurance that, since we're invested ourselves 100% alongside our investors, and have not optimized profits in the fund company (we have a high hurdle rate, an adaptive strategy, a voluntary size constraint), we keep doing our utmost to create returns for the long term. For ourselves. And for you.

Our performance should be measured in years rather than months and the key to long-term performance is Stay In the Game, which comes at the cost of not participating in short-term rallies. This is why we only allow quarterly redemptions. It is why we cap the fund at 200m USD. It is why we stubbornly keep some of our small cap long-term holdings.

Current positioning

We are uncomfortable with the current market setup. Something's not right. Things are fraying at the ends. The excesses of the ZIRP-era are slowly bleeding out of the system, yet we're not far off Covid-highs on index levels. While some stocks are trading at multi-year low valuations, others are busy printing all-time-high multiples. There are islands of complacency and pockets of despair. Both can’t be right.

Swedish mortgage volumes shrunk in April. Let that sink in. They declined by 5bn SEK. That’s a lot. That’s disposable income or savings converted to reduced indebtedness. Of course, it’s going to have an impact. High-frequency trucking data suggests a continued slowdown in trade volumes and overcapacity. Things are undoubtedly slowing. The feeling is we’ve done a false start – the forward-looking equity market participants have tried to look around the corner and seen a normalization 6-12 months out. The question we ask is whether that normalization is a mirage. What’s normal these days anyway?

We remain cautiously positioned, with a well-diversified portfolio and low net and gross exposure. If things play out as we fear in the coming year, we aim to minimize the downside. If we’re wrong – fingers crossed – we will participate in the upside to some extent, given our stubborn positive net exposure.

What went well in May

The avid reader of our Partner Letters will remember we in an earlier issue argued disdained stocks could be bargains. We exemplified with our position in the hated, highly levered, failed IPO, roll-up story **Storskogen**. The Q1 report continued to build on the trends seen already in Q4, with more focus on cash flows and pruning the portfolio, rather than aggressively acquiring everything everywhere, triggering a substantial rally. Storskogen contributed 0,5% to the fund in May.

We were recently introduced to tiny Gothenburg-based medtech company **Promimic** by one of our sell-side friends. It's important to have friends. If you don't have size (i.e. being a large payer to a brokerage house), you can try to compensate by being a nice guy. Take the calls. Respond to emails. Take meetings. Do small favors. Give timely feedback. Promimic is a case in point. Had we not had friends, picked the phone up, taken the meeting, we wouldn't have heard about it. We certainly wouldn't have found a block of shares at SEK 16 (it closed May at 27). And we would not have almost 80% return on the position in a little over a month. Thanks to our sell-side friends!

Promimic is a promising little company that for almost 20 years have developed a nano-surface for implants that enable better osse-integration and fewer infections. They have partnerships and products already in the market, and the Q1 report showed the first ever cash-flow break-even quarter since its founding. The growth outlook is benign and there are no regulatory hurdles or commercialization issues to overcome (which is often the case with small-cap medtech companies). Furthermore, we are fans of the management team, who communicate in a clear and honest fashion and have substantial experience in the segment. Our small position in Promimic contributed .55% to the fund in May.

What went pear shaped in May

Without a shadow of a doubt, the biggest detractor in May was our 2% position in Swedish gaming conglomerate **Embracer**. Our assessment was that the recent success of the Dead Island 2 game, paired with a 25% drop over 10 days post the profit warning, provided a positive risk/reward over the reporting day. In hindsight it's easy to say "We should have acted differently! Why were we not short?". However, scrutinizing our rationale, and the data available at the time, I'm not sure we would, given similar circumstances. We should (obviously, in hindsight) have put more weight on the fact that the guided "transformative deal" had already been pushed out in time, suggesting a higher risk it might not materialize at all. And perhaps the sizing of the position was too aggressive relative to our conviction. We should have realized that a miss and a canceled deal would provide an expectations re-set and management trust event that made the risk/reward unattractive. We refrain from having opinions about the long-term prospects, or strategy, of the company. We simply note that we thought the risk/reward was positive over the event. Risk won as the deal fell through. Which sucks. We were wrong, egg on our face.

It is the flip side of taking uncomfortable positions: sometimes the downside materializes. In Storskogen, a similar type of situation, we were rewarded. On occasion, it's "uncomfortable" for a reason, and only ends up as a slap in the face and a reverse pay-out.

One can't help but speculate how different the Embracer trade outcome could have been, had the deal materialized, and focus shifted to the recent successful AAA-game launch, with a material short base…

We have traded Embracer successfully both on the long and short side in the past year. It's been a frequent name in the tactical/trading book, acknowledging both the volatility and the tricky business model risks. The 40% drop in the stock on the 24th of May, and the 1% loss the fund suffered from the holding in May, takes us to break even in Embracer isolated since the launch of the fund. Which also sucks.

What we’re thinking

Everything to everyone.

We invest the way we believe yields the best risk-adjusted returns. With an ever-changing market, we try to adapt. This means we do not offer a product that can be easily defined. We are not market neutral. We are not long biased. But we can be. On occasion. Our difficult pitch is the price we pay for optimizing performance over asset gathering. It’s uncomfortable and weird in a stale industry focused on marketing and labels. But that’s fine. If you don’t like it, or don’t understand what we try to achieve, that’s ok. We’re not for you. And that’s fine too.

“**I want a fund manager who puts their money where their mouth is**”

The headline is from an article published in The Times on the 27th of May. Here’s a couple of quotes: *There is much emphasis in the fund world on performance numbers and the biggest holdings in a portfolio — what are the fees, asset allocation and how much money is invested? These are all important questions, but not at the expense of this one: does the fund manager invest too? […] Managers should be shouting from the rooftops if they invest. What better advert could they ever supply for their own fund?”*

That we have skin in the game is an important feature of the entire project. We profit alongside our investors when things go well, and we suffer to an equal (bigger?) extent during the inevitable periods when things are not going all that well.

In the spirit of openness and accountability we decided to share the actual amount we (Pontus and Carl) have invested together in our funds: **over 50m SEK**. This accounts for nearly 100% of our investable assets (some fractions are tied up in old pension schemes that can’t be moved, annoyingly, and a few unlisted investments). On top of this comes assets from our extended families, friends, and business associates.

With this backdrop, as you can imagine, we pay a lot of attention to the fund. We have very strong incentives both to do well, and – equally important – not to do too badly (we will inevitably do badly occasionally, like this month).

Debt ceiling euphoria?

Rarely is the phenomenon of our limited mental bandwidth so observable as in financial markets. In the past weeks I've seen more index-level reactions to headlines regarding the US debt ceiling extension than one can shake a stick at. Does it matter? Is it a made-up risk? Is it worth spending time on? No, yes, no. Taking a step back, bickering over a raised debt ceiling (put in place, once upon a time, to instill some budgetary discipline – clearly not working as intended) is simply a reflection of debts continuing to build. As interest rates continue to rise, higher debt will become increasingly difficult to service. Hence, fundamentally, an agreement on a higher debt ceiling should be interpreted as nothing else but another exercise of kicking the can down the road. In line with expectations. With the caveat that expectations on US politics were low to start with.

The next leg to the US debt ceiling debate will be where the liquidity, to buy the tsunami of new government debt that an extension triggers, will come from. Equities?

Generative AI – singularity or the latest fad?

As with all technological breakthroughs, generative AI holds the promise of a Brave New World. Suddenly, as the green pasture of a newfangled technology grips our imagination, there's no end to the possibilities for profit for companies even remotely exposed to the latest fad. Imagine our surprise when Atlas Copco, with single-digit percentage exposure to equipment for vacuum generation in semiconductor factories, gained X billion SEK in market capitalization in a matter of days.

Call us boring, but we've seen this movie before. Every technological breakthrough, big or small, that grips our minds, follows a traditional S-curve of varying length and magnitude.

We can imagine any number of industries that might be impacted by simplified creation of generic content (edtech, affiliates, consultants, media), but are they benefitting from higher productivity, leading to improved profitability and growth, or are they in the process of being genuinely disrupted? Too soon to call, but we're watching the space.

Swedish contract manufacturers

There's been a bull case (and associated rationalizations as to why that is) in Swedish contract manufacturing companies in recent years. Growth has accelerated, multiples have expanded, companies have been on acquisition sprees. Suddenly there's an entire cluster of rather reasonable market caps in the space: NOTE, AQ Group, Nolato, Hanza etc etc.

A big part of the narrative of these companies is how UNIQUE they are in their various approaches. "We stay close to our clients and help with product development", "We are far more efficient", "we're not swing capacity, we're a PARTNER" and so on.

How about this observation: could it be none of the above rationalizations? Could it simply be that Sweden has become **a low-cost country**? Protean is currently invested in one of the contract manufacturers (and short another).

The monthly reminder

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

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

We 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.

Pontus Dackmo
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