PORTFOLIO REPORT

EQUITY PERFORMANCE

HCM
HANDELS CAPITAL MANAGEMENT

March 2020

THE STUDENT UNION

CEO Comments

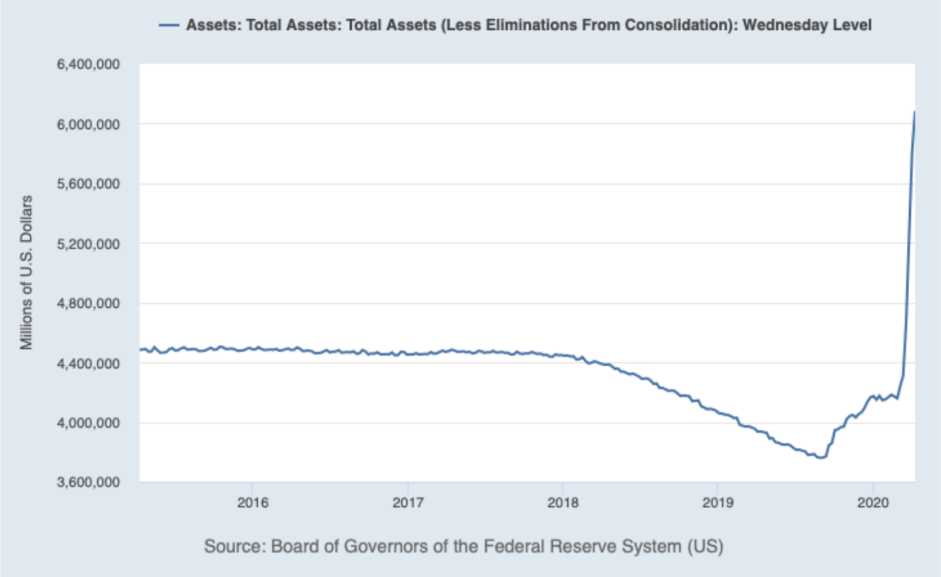
The end of march marks the end of the first quarter of 2020. This quarter has not been easy for most investors. As we noted in our end of the year report, valuations were high going into this year. This has caused a deeper, more rapid, decline of markets as the economy came to a halt due to the corona virus. During the first quarter, the MSCI Europe fell by 21 percent. By investing style, small cap and REITs has performed the worst, both falling about 30 percent. Growth-style investing suffered the least, with a decline of 15 percent.

The equity portfolio of Handels Capital Management declined by 11 percent during the first quarter. Hence, the portfolio has outperformed the OMXSGI by 7 percent for the quarter.

The perfect storm of failed negotiations between OPEC and Russia and a global demand shock led to the oil price falling by more than 60 percent. Furthermore, the decline of oil caused a spillover effect to the NOK, which traded as low as 0.85 SEK in March.

We don't need to wait for the traditional economic data to appreciate the scale of the hit to the economy. As the world is trying to contain the corona virus by lockdown, the economy has stopped. For example, car sales in China fell about 80% in February. Data from the restaurant booking app Opentable show that bookings are down close to 100% in nearly every country that they operate in. In one week in March, over three million people signed up for jobless benefits in the US, more than four times the previous record since 1967. Clearly, this is not just a normal recession, but a sudden shock to the economy that is unprecedented among developed economies in the post-war period.

An unprecedented shock requires an unprecedented policy response. And that is what we have seen. Central bankers have thrown everything they can at the problem, cutting rates to their lower bound and restarting and expanding asset purchase programs. The Fed's commitment to purchase as many government bonds as necessary is a substantial step, which should enable it to keep government borrowing costs low, despite the massive fiscal stimulus that is required to deal with the economic consequences of the virus. The Fed's corporate credit program should also prove a significant support for investment grade corporate bonds.



Most encouraging has been the policy response from the likes of the UK and Germany where governments have committed to pay a significant proportion of workers' wages during the shutdown to enable companies not to lay off staff despite the dramatic hit to sales.

In the US, a very substantial fiscal stimulus package has been agreed, worth about 10% of GDP, which will include some grants to small businesses. The package also provides government backing for credit to be provided by the Federal Reserve to investment grade companies. This should ensure that large investment grade companies don't fail in the near term.

The depth and duration of this recession will depend on the extent to which governments fill in the gaps in their current fiscal responses, supported by the central banks, to ensure that unemployment and bankruptcies, of otherwise solid businesses, are prevented.

Erik Cassel
Chief Executive Officer – 2020-03-12

Asset Manager's Comments

COVID-19 caught both EU and US flat-footed. The market had priced the virus-attack in Wuhan as a non-event, making historical comparisons with e.g. Swine Flu, MERS and Ebola. The market underestimated the tail risk with a pandemic and its disastrous consequences. Some people claim that the pandemic is a Black Swan, it was something unexpected. But if the Black Swan supporters had read the book, they would have known that such a global pandemic is explicitly presented as a white swan; something that would eventually take place with great certainty. Bill Gates presented this White Swan in a widely available TED talk in 2015: The next outbreak? We're not ready.

Fun fact: A tail-risk hedge fund advised by Nassim Taleb returned 3,600% in March. A portfolio that invested 97% in S&P500 and 3% in Universa's fund would have been unscathed in March. Pretty impressive method of risk mitigation, even if the returns come sporadically.

For this month, our equities outperformed the benchmark by 2.3 ppt with a monthly return of -10.5% vs. -12.8%. Weak in absolute terms but OK in relative terms.

Extra focus this month has been on making sure that our equities have strong enough balance sheets. Today, ~35% of HCM's equities has net cash. Our other holdings have a NIBD leverage around ~1x EBITDA, except Billerud at 1,9x. We view Billeruds leverage to be fair since their new paper machine KM7 likely will produce a great chunk of FCF in the coming years. They have cash enough to withstand debt repayments for at least 3 years. On top of that, they withdraw their extra dividend of 900 SEKm to strengthen their balance sheet. This reduces their NIBD by 15%, everything else equal.

Luckily, we were able to sell a stake in our high-yield fund before the Swedish credit market took a turn. This liquidity was later used to add to our holding in SBB, which took an unreasonably large hit in it's share price. The company has a strong financial position with an ICR of 3 and LTV of 41%, and Fitch who affirms a BBB- investment grade rating early in April.

The whole portfolio returned -6,40% in March, which was in-line with our benchmark that returned -6,41% for the month. Global Bonds returned a negative -4,3% compared to our benchmark which was up 2,6%. Alternative Investments had a strong relative month, returning a negative return of -1,7% compared to Barclays Hedge Fund Index which preliminary was down -7,9%.

Risk

From time to time I'll expand on some of my thoughts here. Sometimes it's pleasant to write down the ideas in order to "think clearly".Let's talk shortly about one of the most important things, risk. My own perception of risk* is not about a stock's beta or volatility as theoretical financial literature often suggests. Instead, I view it as making poor bets where time will create a permanent loss of capital. Let me try to explain it with a figure.

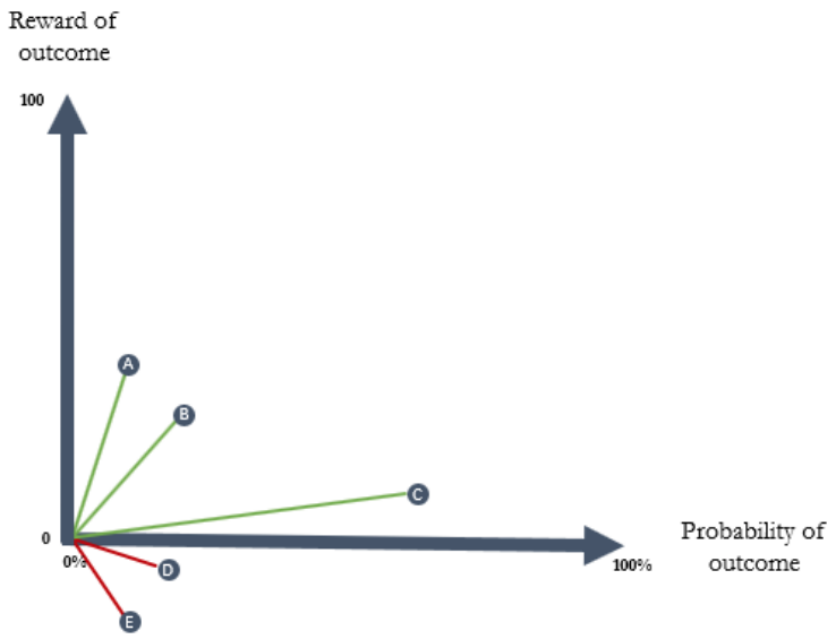


***Figure 1:** Various scenarios of a company results in different rewards, both positive and negative.*

Risk is about the certainty of future cashflows. There will never be a straight 100% probability outcome of a company. A company's future cashflow can consist of many various scenarios, were different probabilities is applied to each outcome. Origo in the figure is the current value (EV) of a company.

Because origo is the current EV, the price you pay is the single most important factor for making good investments over time.

We take a theoretical example of Company X. The company has 5 estimated outcomes (A-E) for the coming 10 years. Each outcome has an applied probability and a theoretical NPV of the cashflows.

- Scenario A - They experience a heavy regulatory tailwind which creates a synthetic monopoly and therefore doubling the long-term margins.
- Scenario B - Their greatest competitor breaks the covenants due to COVID-19 and goes bankrupt. This creates a powerful supply shock that Company X benefits from.
- Scenario C - The duration of the growth in cashflows is greater than the market anticipates.
- Scenario D - One of the newly launched products (which the market had high hopes for) turned out as a bust. Revised estimates of the cashflow.
- Scenario E - Their cash cow becomes disrupted by a new technical solution. It becomes hard to finance future organic CAPEX which should drive growth.

The most important thing is that you have a positive expected value that exceeds (with your required return) the current EV. Margin of safety included. If each of your estimated scenarios sums up to a value of e.g. +30% vs. today's value, you should swing the bat. And if it's an even greater pitch – swing it harder.

The edge is to find enough bets of this kind. Given time, the math will do it's work.

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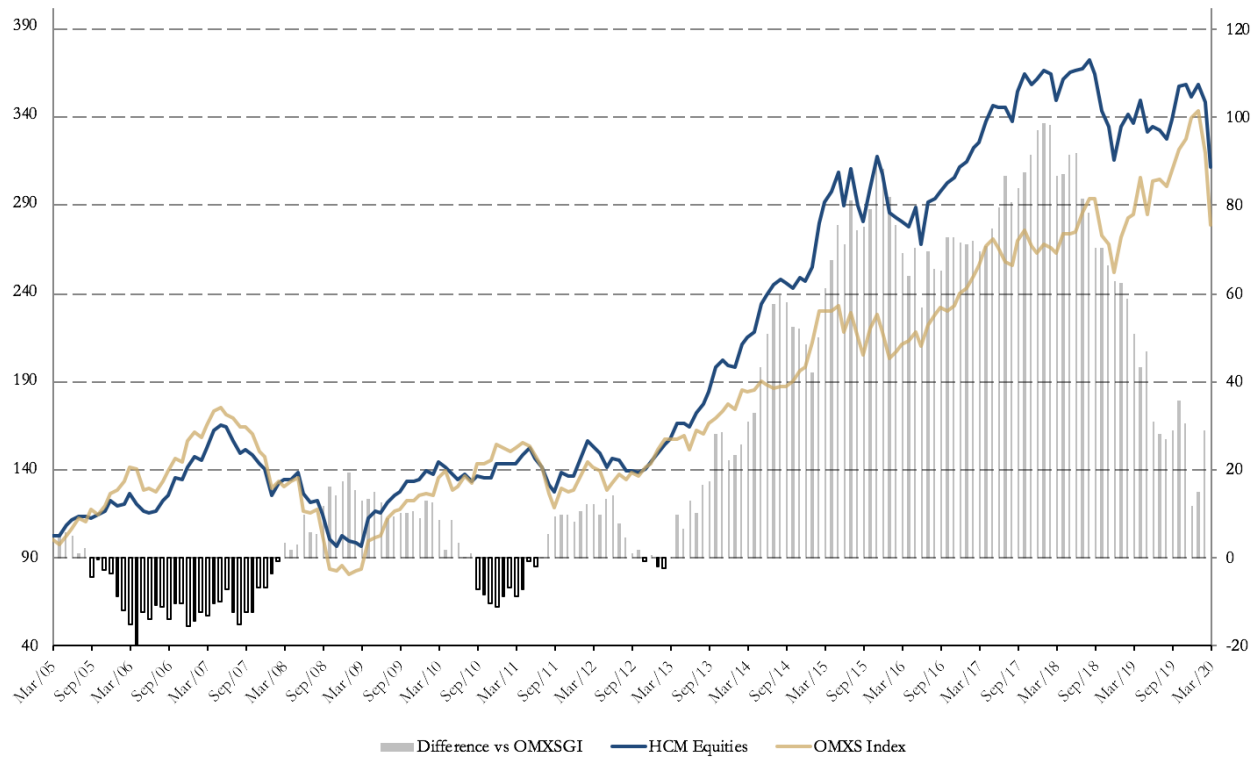
Sincerely,Filip Helmroth
Asset Manager - 2020-03-14

*Not strictly HCM's view.

HCM Equities Performance



Return & Risk	HCM Equities	Benchmark
Last Month	-10,53%	-12,86%
Year To Date	-11,18%	-17,96%
Last Twelve Months	-7,25%	-2,34%
Since Start (March 2005)	210,25%	177,02%
Average Yearly Return	7,80%	6,99%
Months Active	181	181
Number of Positive Months	104	113
Number of Negative Months	77	68
Annualized Std. Dev. Last 12m	14,54%	20,06%
Sharpe Ratio Last 12m	-0,62	-0,21
Benchmark Correlation Last 12m	0,86	

Best Performers	1 Month
ChemoMetec	4,6%
Microsoft	0,4%
Balco	0,0%
Worst Performers	**1 Month**
Loomis	-39,3%
Catella	-35,5%
SBB	-29,6%

Currency Exposure	Weight
SEK	82,5%
USD	6,6%
NOK	3,9%
DKK	6,9%

HCM Portfolio Performance