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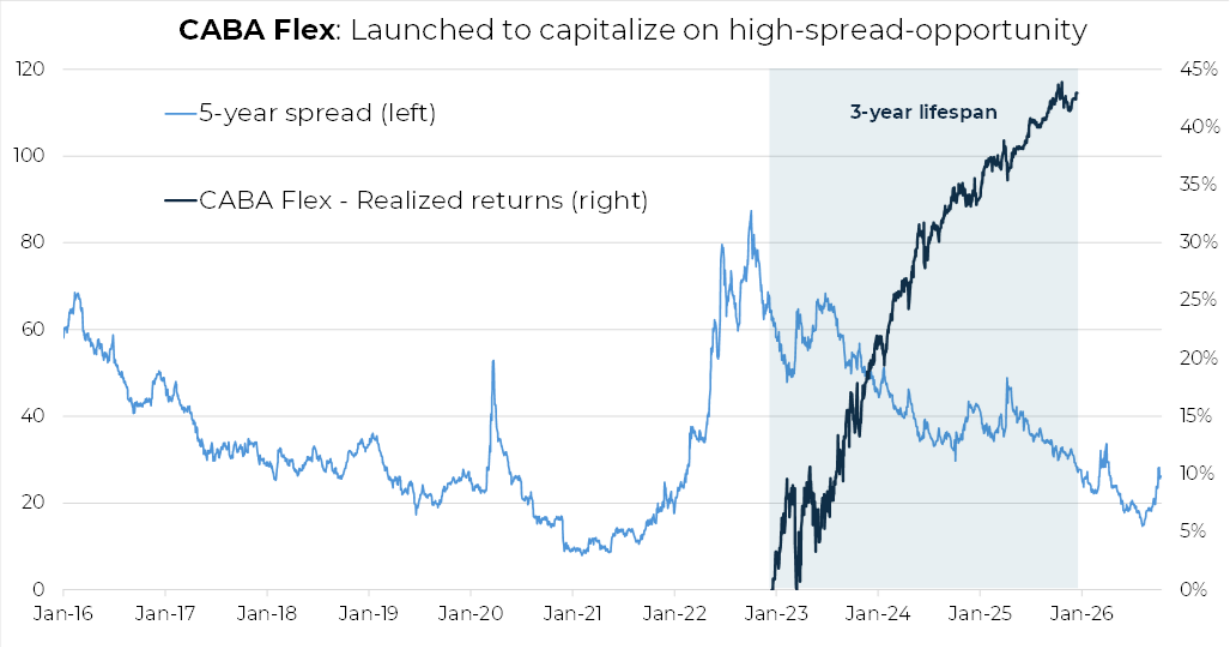
CABA Flex: Buying the Spread When It Pays

In December 2022, with the 5-year Scandinavian covered-bond spread at roughly twice its 2016–21 average, CABA Capital launched a new maturity fund, CABA Flex, to take advantage of the widening. The three-year fund subsequently returned about 43% (12.6% a year) with an annualised volatility of 11.0%.

THE OPPORTUNITY

The spread - the extra yield AAA-rated Scandinavian covered bonds pay over government bonds and swaps - was about 10bp in early 2021. In 2022 the combined shocks to the market from energy, geopolitics and high inflation had pushed the spread to almost 90bp. Calculations on carry and roll down showed that the likely net return over a three- year period would be near 37%, and the fund was launched in December 2022.



Source: Nordea, CABA Capital. Past performance does not predict future returns.

HOW THE FUND CAPTURED IT

CABA Flex bought 5y covered bonds and sold 5y government bonds to lock in the spread and eliminate the interest rate risk. Returns were generated from the spread and pull-to-par, not from interest-rate moves. Leverage scaled up the spread to provide an attractive return while the fixed three-year lifespan ensured a declining risk profile as the bonds moved closer to maturity. CABA Flex was Hedgeweek's Newcomer of the Year 2024.

WHY IT MATTERS FOR FAMILY OFFICES

- **Timing can be captured.** CABA has since launched CABA Flex 2, 3 and 4 creating a series of three-year funds. Each Flex vintage locks in the spread on offer at launch, so investors can commit when spreads are wide, as in 2022.
- **No market call needed.** Duration was hedged, so the return came from the spread, not from a view on rates or equities.
- **A defined horizon.** A three-year life, with risk falling as the bonds near par, fits portfolios planned around known liquidity needs.

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