

ARE WE A HEDGE FUND?

003: Letters from the desk of the CIO.

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To:

[Public / SAIL website / CIO letter]

From:

Johnny Brom, SAIL Founder and CIO

Dear All,

This past weekend, my wife and I dug up and replanted our front garden. It's the kind of work that requires many cups of coffee and leaves ample time to daydream. Somewhere between planting the 18th and 19th shrub in our hedgerow (*Prunus lusitanica*, though I am aware you didn't ask), I found myself pondering whether SAIL is actually a hedge fund - and I don't mean because of the fee structure. I will explain...

But first, a (very) quick bit of admin to start. I am shifting from issuing an 'Annual Letter' to sending out shorter, but more frequent ones (something to zip through in a mid-morning coffee break). This is much more in line with my own free-flowing communication style and is better suited to providing the sort of 'under-the-hood' insights into our current thinking. These will not be marketing pieces or performance explainers — for that you should look at what we do, not what we say — the objective will purely be to give you something to consider. Writing thoughts down is equally helpful for me (giving is receiving after all).

So... returning to my current 'hedge fund' contemplation. Let me unpack my thought. My starting point was considering that hedge funds (at least historically) use a diverse investment strategy to generate returns for investors regardless of market direction. That last bit is important when the market is being driven by strong, one-sided trends.

In the past years, but even more so in 2025 and now 2026, the market has looked more and more like an interesting '*reflexivity*'¹ conundrum. Market participants are aware of their ability to influence the market and are actively influencing it beyond the fundamentals of any underlying asset. What I mean is that outside of the general irrationality of life right now, 'the market' is thinking quite rationally in the sense that: (1) it is a relevant political actor (and can thus influence non-market outcomes, e.g. actions a political leader(s) might take, for its own betterment); and (2) that, as long as the market keeps swaying along to the music, the music will keep playing, i.e. you create your own outcome (spoiler: the music has to eventually stop).² So the main themes keep on prevailing – irrespective of any indicators to the contrary.

That said, there has recently been reason to stop and ponder for a moment on two themes which have dominated the media and discussions with investors: Artificial Intelligence ("AI") and Private Credit ("PC") in 2025, which have both amplified in 2026. So much of the global capex spend is going to AI and AI-related activities. Mere months ago, it started to feel like data centres are life and that nothing else matters. Large A-rated companies are spending many billions - and that means they need a lot of capital – and smaller companies are also spending proportionately as much or more. Private markets managers are keen to oblige (they have had the money to deploy) and given the strong free-cash flow position of these companies (at least the leading ones), PC is well suited to fund this massive investment cycle. The narrative fits. Names like Apollo, Ares and Blue Owl have become much more mainstream in a short period of time.

I imagine the GPs running these PCs have done their homework on their borrowers, but if you think about what is being financed and then how the AI race is likely to end up — in that '*winner (singular) will take all*' — I do find the risk-reward trade for PC an interesting conundrum. The latest Oaktree quarterly memo³ speaks about a "*new era of dispersion in financial assets*", and JP Morgan is warning about the widening gap between the winners and losers. However, most PC managers remain active in the AI/Software space, continuing to fill the funding gap.

Part of the reason for PC's rapid growth is, of course, the diminished roles of banks in lending to the middle-market. But another reason is the fit of this asset class in the portfolios of institutional asset allocators. Unlike private equity, PC has strong cash yields, the downside protection is significantly higher, and the capital charge for institutional investors (e.g. insurance) is typically lower. It makes a lot of sense as an asset class.

The PC market is roughly USD 2 trillion in early 2026, and has been growing rapidly, with the US being approximately 70% of the entire asset class. Europe is most of the remaining market. Direct Lending is the main mechanism, and PE sponsor-backed acquisition financing is the main model underpinning

¹ As per George Soros's *The Alchemy of Finance* (1987). The central thesis of the book (first published in 1987) was that market participants do not passively observe and react to economic fundamentals, rather they actively shape them. In other words, there is a two-way feedback loop between how people think about markets and the reality that those markets reflect. Soros called this "*reflexivity*". This stands in opposition to Eugene Fama's Efficient Market Hypothesis which holds that prices accurately reflect all available information.

² Reminds me again of Chuck Prince, former CEO of Citigroup, famously stating in 2007 that "*as long as the music is playing, you've got to get up and dance.*"

³ Oaktree Credit Quarterly, Q4 2025

PC. Within that, most of the growth that PC has financed has been in the AI / software space (because that is where most of the recent growth in the US has been). This is not unexpected. However, if you are an asset allocator and you are looking through market exposure, sector exposure, and asset class exposure, you are likely to find that you are taking a rather concentrated risk on very few markets and very few themes.

It is perhaps an uncomfortably recognition that for all of the expert portfolio metrics being applied, institutional portfolios are still heavily exposed to the current day major trends, and in this age of tech euphoria and yet more racy financial innovations (how many times over was First Brands levered?), you could ask yourself: are we missing something? Why are we ultimately exposed to so few markets, and - even more concerning - to the singular themes that those markets are selling. Pause to consider whether it really makes sense that one's total portfolio exposure is so long US... So long acquisition-related AI growth... and that even when asset class diversification is sought... it all kinda ends up back there (e.g. via PC as well)?

Institutional investors predominantly have long investment horizons and therefore absolutely should be investing in such revolutionary themes as AI. But does it not make sense to hedge that moonshot approach, 'push out the efficient frontier' so to speak, by adding in different portfolio assets, in different markets and sectors, that are not as influenced by the current day headline themes?

This is how we are thinking right now at SAIL. While the world is fixating on the 'generational disruption' that is AI, and the possible fall of the latest financial wizardry that is PC, we are unwavering in our strategy of financing 'tangible things', like food systems, agriculture and sustainable fuels, and we are doing it far-away from the current frothy exuberance in markets like Ecuador, the Netherlands, Vietnam, and Brazil. Our perspective is that while the world is indeed experiencing AI-driven disruption, the boom-and-bust cycle of innovation will inevitably run its course (even if the horizon has been dramatically extended by the money printing press). What will remain constant is that we also need to eat, - that we need to stay warm, and - that, ultimately, we need the externalities (like nature) to survive.

At SAIL, we are generalists focused on the real economy and the sustainability of core industries that are fundamental, in that humans cannot easily do without them. We could do without a computer but not food.

You could call this hedging through investment in defensive industries (although I like to think of them simply as sustainable industries). The best companies within these industries are antifragile: they strengthen from a cleanout; they are survivors. More and more, we see this approach as a hedge for asset allocators who are over-exposed to the ever increasing concentration of global markets. Financing the non-US, non-sponsored global credit market and focusing on defensive core industries provides a juxtaposition in the portfolio of an asset allocator. It isn't inherently better than the current exposure; but it is different, with much lower correlation and contagion risk is significantly lower; so, in effect... a hedge. It makes theoretical sense to consider it. The issue...is access. Access to portfolio assets.

Then there is second type of hedging — related to the intrinsic value of nature itself. The investors that we are talking to typically have a view on nature and climate. The view generally boils down to the fact that long-term investors (especially those managing funds for pensioners or insurance holders) recognise that we need to do something about protecting nature on our planet and that climate change is having a negative impact on our world which needs to be addressed. Broadly speaking we are talking about a strategy towards Net Zero (climate emissions) potentially, and then looking at the exposures in a current portfolio in the context of their impact on this planet and how we can bring it back to be within the confines of what the planet can handle. We can all (except perhaps Messrs Musk

and Bezos) recognise that there is only one planet inhabitable for humans, and we are using up its resources beyond what it can regenerate at the moment.

But how does one go about unlocking this hedge. Well... you could spend a pretty penny on consultants to conduct a theoretical study on your portfolio's impact. Indeed, there are many scientists conducting very complicated research to figure out portfolio exposure to nature risks. We know them and this is important work. But I believe that we should keep it as simple as we can when it comes to actually investing. A 'back of the matchbox' analysis is infinitely more powerful in this case. Ultimately, we don't need to count the number of species of butterflies in a hectare of Amazonian rainforest to conclude that that hectare of this planet is extremely rich in biodiversity, and thus of high value to the planet.

The CIO of a large asset allocator might look at a nature impact study and learn that the portfolio would be suitable if there were 1.5 earths available. But how exactly is that helpful in identifying how to close the gap and make it suitable in the context of the single inhabitable planet that we have? The risk-return profile is not up for discussion; we agree that it cannot be compromised. At the same time, the concentrated markets that are currently drawing global investment are not giving much exposure to the kinds of investments that would allow institutional asset allocators to shift their portfolios back within global planetary constraints. Such investments are often not obviously in scope. Yet, if you can bring them into scope, and readily invest in them, then you are responsibly hedging your bets. Hedging against the speedtrain of technological advancement that isn't counting the vast hectares, let alone the butterflies. Implementing the hedge that nature is going to be important in the long-term seems like a smart idea (and – quite frankly - an obvious one).

The question is access.

If you look into fundamental global industries, and you consider providing credit to sponsorless corporates in these industries, and their supporting supply chains, you are pushing out your portfolio diversification, reducing correlation and contagion risk, and can generate not only idiosyncratic alpha but certainly also portfolio level alpha. Next... we overlay the second type of hedge which is that if those same target corporates participate in the supply chains linked to nature (and this list is longer than first appears) and we finance the participants who are willing to disrupt current practices by growing sustainably... then we can build an antifragile portfolio exposure. These companies are the ones who take the longer-term view that they can grow while protecting nature, and sequestering carbon, and that approach to growth actually drives their business resilience and thus, in the long-run, their market share. All of this improves downside protection (which is everything to a credit manager). Then, I believe, you have a very interesting double-hedge in your asset allocation mix, and you can sleep a little better in these uncertain times.

At SAIL, we are not 'financing nature'. We don't practice alchemy using biodiversity credits or voluntary carbon credits (on this front I can't help but think of the 'holistic healer' who turns George purple in one of my personal favourite Seinfeld episodes ⁴). We finance companies that are strong, growing, and generating free-cash flow. Companies that operate in environments where nature is prevalent and particularly valuable for the world. Companies that recognise the need to protect nature in order to drive their own long-term resilience. They commit to a plan to take the right actions with respect to nature. That plan helps them (market access, physical risk mitigation, long-term resilience) and it helps

⁴ Seinfeld, "[The Heart Attack](#)" (Season 2, Episode 8).

us and our LPs (financial performance). This shift is important to understand; then it just becomes direct lending to (mainly sponsorless) corporates. Credit is after all, an ancient pastime.

The question of addressable market often comes up from the discerning listener. It is actually a rather curious case. 50% of global production is highly or moderately reliant on nature⁵ according to the World Economic Forum, which is roughly USD 60 trillion of GDP. And of course, 100% of humans are dependent on nature.

To focus for a moment on one industry, Food and Agriculture - where SAIL started with its first fund in 2017. This is a USD 13 trillion industry. Purely for production purposes the industry needs about USD 700 billion of capex per annum; to transform this huge industry into more sustainable (including protecting and regenerating nature) production it needs an extra USD 500-700 billion per annum⁶. These numbers are big enough for a small but ambitious outfit like SAIL to consider interesting. Inside that pool we can identify and finance the gems. We can create blueprints for industry transformation. And most importantly for our LPs, we can provide access to the valuable portfolio assets that we have uncovered from all corners of the globe.

I spoke to a rates trader the other day, who made the case for why we should be in equity right now. Back of the envelope... half the companies on the S&P 500 will go to zero and maybe half will do 10x...that is the power of this AI disruption he says. *IF* that is the case you need to buy the market and not lend to it, because your net performance and risk is much better with the purely equity exposure then.

It was an interesting thesis. I do agree with the winners-and-losers theme, as we discussed earlier. But even if there is only a small chance of this kind of disruption happening; shouldn't you be thinking about placing some other bets too. The hedge fund industry will sell you many ideas – all much more eloquently than me. But I like financing the protection of that food we take for granted on our plate. I like the idea of real economy exposure through a simple, clean financing product like a senior, secured loan. I like the idea of turning nature into – not yet another 'financial innovation' (read: *'someone-is-taking-advantage-of-you'*) product, but rather an enhancer of a company's durability and long-term strength. That kind of hedge fund, I would be happy to nail SAIL's colours to the mast of. Just like the one recently planted in my front garden, the hedging-work requires commitment and a willingness to continuously take the time to tend to it.

Something to consider in 2026, when you are feeling a bit uncertain about your asset allocation at a time of feeling a bit uncertain about everything.

Yours Sincerely,

Johnny Brom

Founder and Chief Investment Officer

⁵ World Economic Forum paper in collaboration with PWC, 'Nature Risk Rising', January 2020.

⁶ SAIL internal analysis, coupled with FAO reports, including 'The Triple Gap in Finance for Agrifood Systems.'