Future Trends Equity Fund

Q1 2024 Commentary

Fund Manager

Alex Gunz

Investment Objective

The Fund aims to deliver consistent and sustainable long-term returns by investing in a concentrated portfolio of global equities.

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Opinions expressed whether in general or in both on the performance of individual investments and in a wider economic context represent the views of the contributor at the time of preparation.

The Heptagon Future Trends Fund saw a 3.2% gain in the first quarter of 2024. While this return was behind the move in our benchmark, the MSCI World Index, we understand the reasons for this. More importantly, since global equities bottomed in late October last year, we have been pleased to have captured almost all the market's upside despite owning none of the US mega-cap stocks that have been responsible for driving the market over this period. Our whole philosophy is about offering investors *a different kind of future*. Since inception in 2016, there has been no change in our investment process: our approach is multi-thematic, supported by top-down and bottom-up fundamental analysis.

A different kind of future

The question we have asked ourselves and found ourselves being asked most regularly recently is *"what kind of future would you rather own?"* We do not deny the strength or the quality of the business models that comprise the largest businesses in the S&P 500 and MSCI World Indices. Our concern is more that we believe that very little scope for disappointment is embedded in (earnings) expectations for these businesses, while concentration levels are extremely elevated.

The 10-largest businesses in the MSCI World comprise 23% of the Index. For the S&P 500, the equivalent figure for the top-10 is more than 30%, the highest it has ever been (per Bloomberg). By contrast, **within the Future Trends, our ten leading businesses comprise more than 50% of the Fund**. This is high conviction investing.

Importantly, there is also **zero overlap between our largest holdings and those in the MSCI World Index**. The latter is dominated by mega-cap tech companies. Sure, Eli Lilly (number-eight in the Index) operates in a similar space – obesity treatment – to Novo Nordisk (number-three in the Future Trends Fund), but there the overlap ends. Further, we have owned Novo Nordisk since the inception of the Future Trends Fund rather than having added it more recently.

Past performance is no guide to future performance, and the value of investments and income from them can fall as well as rise

MSCI World Index Top – 10 constituents and weights

Microsoft	4.6%
Apple	4.5%
NVIDIA	3.1%
Alphabet	3.0%
amazon	2.6%
Meta	1.7%
Berkshire Hathaway Inc.	1.0%
Lilly	0.9%
BROADCOM	0.9%
TESLA	0.8%
	Top – 10: 23.0%

Heptagon Future Trends Fund Top – 10 constituents and weights

ASML	6.1%
mastercard	6.1%
novo nordisk	6.0%
QUANTA	5.6%
INTUITIVE SURGICAL	5.5%
PROLOGIS	5.3%
paloalto networks	5.2%
EQUINIX	5.0%
xylem	4.9%
CHENIERE	4.8%
	Top – 10: 54.4%

Source: MSCI, Heptagon Capital as of 29/03/24 for Future Trends; 29/02/24 for MSCI World.

A review of the top-10 holdings of the Future Trends Fund shows that we invest in a broad range of themes including alternative energy (Cheniere), automation (Intuitive), cyber (Palo Alto), data (ASML, Equinix), obesity (Novo), payments (Mastercard), smart grids (Quanta), warehouses (Prologis) and water (Xylem). We have listed these themes alphabetically to avoid bias, but it should be evident that **Future Trends is a truly pan-thematic portfolio**.

We believe that a pan-thematic approach is the correct one for several reasons. First, the common-sense angle of not putting all our thematic eggs in one metaphorical basket – **there are benefits in diversification**. Next, we believe that as multiple future trends overlap, they can become mutually reinforcing, creating a virtuous circle effect. Related to this, we have argued consistently in our work that *technology is only an enabler*, a means to an end rather than an end in itself.

There is also the useful lesson of history. While we are all aware that past performance is no guide to the future, things can still rhyme. What we do know is that **the leaders from each era have had a much small market weight a decade later**. This phenomenon has repeated itself from the 1970s US blue chips through to dotcom darlings of the Internet bubble via both the global oil majors of the 1980s and the Japanese financials of the 1990s. It *may* be little different with the perceived AI beneficiaries of today. Invariably, investors *over-estimate* the benefits of new technologies in the near-term, even if they under-estimate them over the longer-term. Several data points we have seen suggest that the progression of AI is beginning to follow the classic Gartner 'hype cycle.' If we are at a peak of inflated expectations currently, then a trough of disillusionment could conceivably follow.

By contrast, what excites us about the trends in which we invest is that **we are still in an early innings of deployment**. Furthermore, by virtue of being pan-thematic in our approach, **we see multiple runways ahead**. Take the Novo Nordisk opportunity. Just 2% of people globally with obesity are currently treated, while no more than 15% of those with diabetes are in control of their illness. There is a similar runway for Mastercard – the only other business apart from Novo that has been in the Fund since inception. Despite the ubiquity of contactless payment options in London (where your Fund Manager lives), globally, *by volume*, only 25% of all payments have been digitalised. Such an opportunity should allow Mastercard to continue growing its top-line at a double-digit rate going into the 2030s. These are just two examples from a lengthy list.

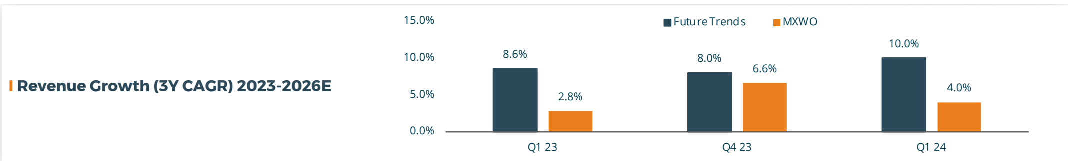
Factor	Global Penetration	Future Trends Exposure
Digital payment volumes	~25%	mastercard
Corporate workloads in the cloud	~20%	EQUINIX
Retail purchases made online	~20%	PROLOGIS
Renewables share of energy industry	~15%	First Solar.
Operations performed with minimally invasive surgery	~10%	INTUITIVE SURGICAL
Diabetes and obesity sufferers currently treated	<10%	novo nordisk
Non-meat-based global protein consumption	<5%	MOWI
AI spend as a % of total software spend	~1%	ASML
Human genomes sequenced	<1%	ThermoFisher SCIENTIFIC

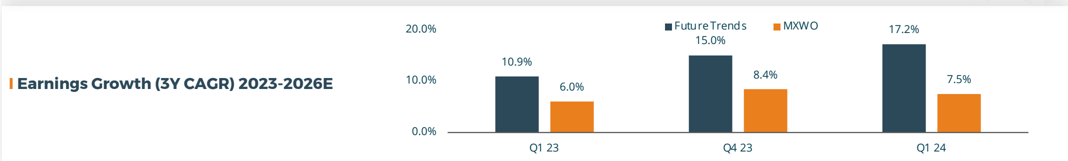
The illustrations above highlight certain key businesses that may be represented in the strategy and are not intended to depict the entire investment universe.

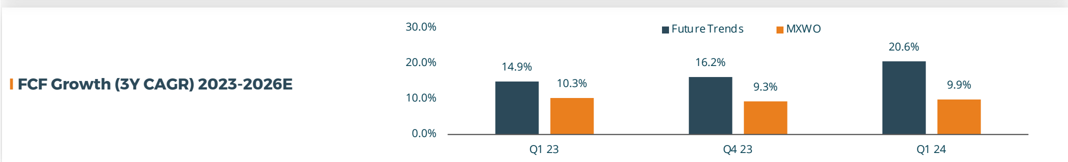
Our conviction in these thematic opportunities and the businesses we own to gain exposure to them is reinforced through our ongoing interaction with them. During the past quarter, we travelled to Denmark to attend Novo Nordisk's biennial Capital Markets Day. We were also in California last month where we got to meet with Visa, Mastercard's closest peer (we last met Mastercard in New York in September). Overall, **we met 15 of the 22 businesses in which we are currently invested in the past quarter**, in a combination of London, Denmark and the US. In addition, we also attended Wind Europe, the industry's largest conference, in Bilbao. Much of this activity is recorded in our weekly Blog.

The qualitative analysis we have consistently done is supported by detailed quantitative analysis too. Every business in which we invest must pass a strict set of criteria that have remained unchanged since day-one of the Fund. We build and maintain financial models for all the businesses within our investment universe and write internal briefing notes. These are available on request.

When we consider prospects for our businesses from a bottom-up perspective, it is evident that **prospects for the Fund have improved both relative to a quarter and a year ago**. This is inevitably a combination of better organic prospects for our businesses (which have benefited from earnings upgrades) as well as portfolio changes (discussed below). Importantly, the outlook for the Fund's businesses' now look better than previously, but also the differential between the Fund – we use a weighted average of the businesses we own – and the MSCI World Index has continued to improve, in our favour.







*Sources: MSCI, Bloomberg, Heptagon Capital. *Weighted average for the Fund. **MSCI World NR USD.*

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The businesses owned within the Future Trends Fund should experience **revenue, earnings and free cashflow growth rates more than double that of the MSCI World Index**, on a three-year compound annual growth rate basis. Such growth (combined with the balance sheet health of our businesses) means that the businesses we own trade at a premium to the MSCI World Index on a forward P/E basis (34.5x versus 18.6x), but we see this as justified, given prospects. In addition, our average business is currently 27.0% undervalued on a long-term, discounted free cashflow basis. To our minds, it is clear what kind of future we would like to own.

Portfolio changes in Q1

The first quarter was an active one for the Future Trends Fund. **We added three new businesses to the Fund and also exited from three businesses**. We made one additional change to the Fund at the end of the quarter, which we will disclose in due course. Low turnover has been a consistent approach since the inception of the Fund, but we have to both recognise when businesses change and, separately, be opportunistic. Much of the turnover was also influenced by our ongoing interaction with management teams.

Most notably, **we now have over 8% of the Fund allocated to the theme of cybersecurity via two holdings (Palo Alto Networks at 5.2%, and Darktrace at 3.6%)**. Investors may recall that we have consistently stated that *data have no value unless secured, stored and analysed*. The Fund has previously had exposure to the cyber theme through the ownership of Sophos, Avast and Darktrace. We sold the latter in August 2022 when it received an unsolicited take-over approach from private equity group, Thoma Bravo, which ultimately did not result in a bid. Since then, we have sought opportunities to regain exposure to the space. Further, we believe that the importance of the cyber theme has only *increased* given the speed with which AI is developing.

In our comprehensive analysis of the universe of cyber businesses we concluded that **Palo Alto Networks has both the strongest overall franchise and the most consistent track record of execution**. We initiated dialogue with the business in summer 2022 and have tracked progress since. Its latest Capital Markets Day (September 2023) and results presentation (February 2024) set out a clear vision for the future and established medium-term targets that we believe are achievable. The pullback in the share price in February allowed us to increase our position. Our confidence was reinforced by meeting with Palo Alto management at their Santa Clare HQ in March.

In terms of Darktrace, we clearly knew the business well and used price weakness at the start of the year to re-enter the business at *almost exactly the same price* as our initial February 2022 purchase. In the time from our exit to re-entry, we have noted improvements in corporate governance and evidence of operational execution (with both guidance and estimates continuing to move up). Throughout the past two years we have been in consistent dialogue with Darktrace management and met with them twice (once virtually and once in-person) during the past quarter.

Separately, **we initiated a ~2.5% position in Match Group**. With its portfolio of 40+ brands, Match is the market leader in online dating apps globally. Tinder, its prize asset, has a ~16% share of the overall market. We see online dating as a trend being in an early innings of development and consistent with the thematic work we have done in terms of both **more time spent online** and **the case for platform businesses**. Match is an asset-light, high margin, cash-generative business (35% operating margin, 70% FCF conversion). We believe that the business should see upside from better management and more strategic focus going forward. Match has committed to hosting an Investor Day later in 2024, which we believe should provide enhanced visibility into its positioning.

Our positions in the above businesses were funded through **a full sell in our positions in Aptiv, Chegg and Zebra Technologies**. Of this trio, Zebra was the least controversial. We believe that Zebra retains a strong franchise in automation and logistics but have other exposure to this theme via Prologis and GXO, businesses in which we have higher conviction. Over the period we owned Zebra (from 2018), we made a ~28% return on our initial investment.

While we believe that Aptiv has a strong franchise in terms of both hardware and software solutions for the auto industry, we are increasingly of the opinion that the electric/ autonomous vehicle theme will take longer than previously assumed to develop. We also worry about the potential risk of commoditisation within Aptiv's markets. For Chegg, despite having seen a major decline in the share price from peak and despite having met with senior management at their California HQ in March, we do not have sufficient confidence or visibility in future prospects for the business to justify continuing as an investor.

Most importantly, **we have developed clear learnings from having been investors in Aptiv and Chegg that will influence our investment approach going forward**. In short, our conclusion is to avoid owning auto businesses or direct-to-consumer business models. Our general preference has always been for – and has been reinforced in – secular investment stories with strong thematic tailwinds. We also favour B2B businesses or B2B2C platforms (such as Mastercard or Airbnb) since network effects are stronger and the opportunity costs of switching are higher. No investment process should ever remain static. There is always scope for improvement.

Conclusion

It is hard not to be optimistic about prospects for the Future Trends Fund, particularly given the fact that its NAV at the end of March stands 12.5% below its all-time high (recorded in September 2021). We are pleased to have captured almost all of the market's upside since its October 2023 trough despite having underperformed in Q1.

Our whole philosophy is about offering investors *a different kind of future* – a multi-thematic world view via a concentrated Fund with high (90%+) active share and strong sustainability credentials. When we look bottom-up at the financial outlook for the businesses we own, the metrics have *improved* relative to the start of the year, giving us confidence in our process. **The runway ahead for the businesses we own is significant**.

Thank you for your ongoing interest in and support for the Future Trends Fund.

Alex Gunz, Fund Manager
April 2024

Appendix 1: Q1 leaders and laggards –

The Future Trends Fund gained 3.2% during the first quarter of 2024, which compares to an 8.9% return for the MSCI World. Although disappointing, we understand the reasons behind the underperformance (not owning US mega-caps) and have exited from two of our main laggards (Aptiv and Chegg), leaving the Fund better positioned for the future.

Dispersion between our leaders and laggards is inevitable, given the multi-thematic approach adopted by the Fund. Based on businesses *owned throughout the quarter*, there was 43 points between our best- and worst-performing businesses.

ASML topped the table with a 30.9% gain. We have regularly asserted that *the future can't happen without ASML*, and the business demonstrated a robust order book (over two times higher than consensus had been assuming) and confident outlook at the time of its January results. Demand for its machines – that make semiconductor chips – is only heading one way at present, supported by interest in AI. **Novo Nordisk** (26.2% higher) was the Fund's second-best performer, driven by ongoing demand for its obesity and diabetes solutions. March's Investor Day also increased investor confidence in its positioning.

At the other end of the spectrum, **GXO Logistics** was 12.1% lower in Q1 and **Vestas** down 9.9% relative to the end of 2023. Both businesses demonstrated solid results, but investors remain currently uncertain about future growth trajectories. We met with the CFO of GXO in London and with Vestas in Denmark and derive continued confidence in the positioning of the two businesses.

Chegg closed the quarter down 36.4% (and was 32.1% lower in the time we held it) but was the Fund's smallest position throughout the period. The shares have continued to trade lower in subsequent to our sell decision. Aptiv is a similar story, with the shares ending the quarter down 12.1% and below where we exited. By contrast, **in the short period of**

time we have owned Darktrace, it has returned 24.8% to the Fund. Our position in Match Group is roughly flat, and we are currently down on Palo Alto. Investing, of course, is for the long-term.

Appendix 2: A reminder of the Future Trends investment case

What makes the Future Trends Fund different:

- Pan-thematic and concentrated: exposure to 13 different themes via a 22-stock portfolio.
- Diversification: No mega-cap tech ("Magnificent Seven") exposure.
- High conviction: 90%+ active share; 50%+ in top-10.
- Discipline: No loss-making businesses.
- Proprietary research approach: database of 80+ thematic white papers dating to 2011 complemented by strict bottom-up stock selection.
- Sustainability: Article 8, AA rating from MSCI, quarterly sustainability reports available.

Active risk management is embedded within the strategy:

- 100% long-only equity strategy with no use of derivatives, hedging or options.
- Exclusion of controversial sectors.
- Position sizing determined by conviction and market capitalisation of businesses.
- Low turnover of ~25% per annum and long holding periods.
- Regular intra-portfolio rebalancing (with a typical approach to add on share price weakness).
- Concentrated portfolio allows for constant monitoring.
- Highly liquid portfolio: 100% of the Fund could be liquidated in less than one trading day.

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SFDR

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