Heptagon Kettle Hill US L/S Equity Fund

Q4 2024 Commentary

Portfolio Management

Andrew Kurita

Investment Objective

The Fund aims to achieve long-term capital growth through investing primarily in US small-capitalization stocks. The Fund's Sub-Investment Manager, Kettle Hill Capital Management, is a long/short equity fund manager, established by Andrew Kurita in 2003 and is in New York, USA.

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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 Kettle Hill US L/S Equity Fund** (the "Fund") is a sub-fund of Heptagon Fund ICAV which is an open-ended umbrella type investment vehicle authorised pursuant to UCITS regulations. Heptagon Capital Limited ("Heptagon") is the Investment Manager and Kettle Hill Capital Management, LLC ("Kettle Hill") is the Sub-Investment Manager, meaning Kettle Hill exercises discretionary investment authority over the Fund.

The Fund was launched on October 5, 2017, and had AUM of USD 77m as of December 31, 2024. Since its launch until the end of Q4 2024, the Fund has returned 5.6% (I USD share class) on an annualised basis compared to 4.1% for the HFRX Equity Hedge Index. During the final quarter of 2024, the Fund returned 2.1% (I USD share class) compared to 0.3% for the HFRX Equity Hedge Index.

For the quarter ended December 31, 2024, Kettle Hill Partners, LP had a gain of 2.2%, net of all fees. Longs contributed 2.2%, and shorts subtracted 0.1%. For the year ended December 31, 2024, Kettle Hill Partners, LP had a gain of 10.1%, net of all fees. Longs contributed 12.0%, and shorts subtracted 1.8%. Ending exposure was 80% gross and 70% net, 75% gross long and -5% gross short, resulting in a long/short ratio of 14.8:1.

The views expressed represent the opinions of Kettle Hill, as of 31st December 2024, are not intended as a forecast or guarantee of future results and are subject to change without notice.

2024 Review

We are pleased with our returns for 2024. We certainly don't think it was an easy year for investors as there were many abrupt shifts in risk appetite. We believe we traded reasonably effectively around market volatility and dislocations that occurred in small-cap stocks. Consumer stocks were the biggest contributors to our performance, and we made money on both longs and shorts in that sector. Our outlook was cautious at the start of the year but, based on our ongoing analysis, we pivoted to a bullish consumer stance in the third quarter. Software stocks were the biggest detractor from performance, with losses coming primarily during the second quarter earnings season.

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

In early November, Trump's win seemed to be anticipated by the market, yet it still resulted in wild speculation, short covering, and a massive rally once the election results were announced. Many stocks perceived to be policy losers in a Trump administration were sold off. We believe we were able to sort through the noise and identify some situations where there were possible overreactions. For example, many retail stocks sold off because investors were concerned that Trump would implement 60% tariffs on goods imported from China, however, some of these retailers had already shifted their supply chains away from China due to Covid-related disruptions. We took advantage of the volatility and added to our favorite stocks where we thought we could disprove the potential trade-war bear case.

In December, there was a substantial sell-off as the Fed's Chairman Jerome Powell unexpectedly delivered hawkish comments. Overall, we think we navigated 2024 reasonably well due to our research and tactical positioning.

4Q24 Winners and Losers

Best-Performing Long—RH (RH)
RH is a leading retail and luxury lifestyle brand operating primarily in the home furnishings market. Our primary research and channel checks had us excited about their new product launch. In 2024, sales of million-dollar homes surged, and CEO Gary Friedman, who has historically traded RH well, purchased stock in the open market. The company exceeded earnings expectations and provided strong guidance. As the stock neared our long-term price target, we decided to reduce our exposure.

Worst-Performing Long—Wynn Resorts, Limited (WYNN)
WYNN owns, operates and develops hotels and casino resorts in Las Vegas, Boston, Macau, China and the UAE. In September, prior to the start of the quarter, we held a position in WYNN as the stock rebounded from what we thought were oversold levels. This was driven by a surge of investor enthusiasm for stocks deemed to benefit from anticipated Chinese economic stimulus programs. The decline of the stock in 4Q24 was a result of investor disappointment about the magnitude of the stimulus and toxic US-Chinese relations.

We believe that WYNN is far more than a Chinese meme stock. In our view, the management team is excellent, and we think they are the best operators in the gaming industry. Their new project in the UAE, facing little competition, has the potential to exceed estimates. Macau is expected to be only 25% of the company's earnings, so our thesis is that the stock often incorrectly trades on Chinese macro news. Nevertheless, we believe Macau can exceed estimates as growth returns to that market.

In November, billionaire Tilman Fertitta increased his stake in the company from 6.0% to 9.9%We believe this is a clear signal of undervaluation and could indicate additional business catalysts in the future. As the company continues to grow and diversify its business, we believe the stock will be revalued upward. We continue to maintain a position.

Best-Performing Short—American Eagle Outfitters, Inc. (AEO)
AEO retails men's and women's casual apparel, footwear, outerwear and accessories under the American Eagle and Aerie brands. Our store checks uncovered fashion misses and increased levels of discounting. Insiders were selling stock. We believed the company was facing decelerating business trends that their peers were not experiencing. We shorted the stock and covered for a profit after the company missed earnings.

Worst-Performing Short—Reddit, Inc. (RDDT)
RDDT operates a social media platform of topic-based communities. Cautious commentary from the company regarding a deceleration in the rate of revenue growth in 4Q24 compelled us to short RDDT. Weeks later, the company beat the quarter and guided to accelerating revenue growth. We adhered to our risk-management guidelines and covered the short for a loss.

Investment Outlook

Similar to the start of 2024, we believe the Fed is once again overstating the risk of inflation as we enter 2025. We don't think that the Consumer Price Index (CPI) running at 3% is a major concern. With the Federal Funds Rate at around 4.25%, we believe it should not exceed the current inflation level of 3%. Conversations with companies reveal no significant inflation risks. Supply chain disruptions from Covid seem to have been resolved and labor appears to be readily available with little upward pressure on wages. Executives we spoke with saw high levels of inflation coming before the Fed did, they also saw it declining before the Fed did. We find no evidence of accelerating inflation.

Fed Chair Powell may be hedging his bets, waiting to see what President Trump will propose. We believe his policies will be less inflationary than feared. Deportations are likely to focus on criminals, alleviating potential labor concerns. Initial tariff announcements are likely to be the starting point of negotiations and could come in lower than feared. Ultimately, we think President Trump views the stock market as his report card, so any negative reactions to policy trial balloons are likely to be followed by softening of the message. We believe progress in AI applications will become more evident in the next 12-18 months, potentially leading to deflationary effects. Successful implementation of DOGE policies may also contribute to deflation.

There are potential benefits of a Trump presidency for stocks in our universe. An increase in M&A activity could result in more buyouts of our longs, as we typically use discounted cash flow analysis to target investing in companies that are trading below our estimate of private market valuation. We'd like to think that fewer of our shorts will be acquired, as we believe they are trading above our estimate of private market valuation, but we'll be aware of that risk and take appropriate measures as necessary. Deregulation has the potential to increase economic growth, nevertheless, we'll stay cautious, alert and calm and will try to use volatility to our advantage.

This more sanguine view versus market consensus encouraged us to tactically increase exposure by covering shorts and increasing longs as we entered 2025. As stock prices have stabilized on tame inflation data, we've reduced some of our long exposure and don't think we have a significant reason for a large market bet in either direction at this time.

Whilst we think the overall market is fairly valued, we also think there are potential dislocations in stocks that fundamental analysis can exploit. We are all aware of the many reasons why the price discovery mechanism in most stocks could be broken. Some factors that could be influencing the price distortions in the market include; passive investments gained at the expense of active management, the "Magnificent 7" stocks gaining share, quants, trend followers and even active managers who seem to have increased their reliance on factor-based trading strategies, etc.

Increasingly, we believe individual stock prices are becoming disconnected from fundamental trends as a result of money flow with non-fundamental motivations. We think trends in active management are also creating opportunities for our style of investing as we believe the pendulum has swung too far. We think that fundamental-oriented investors with 12-to-18-month investment horizons can find more asymmetric risk-reward opportunities, and thus, have the potential to generate alpha due to the valuation dislocation of the average stock. We strongly believe that this is what we are seeing in the opportunity set in the market and in our current portfolio. On the long side, we like gaming, REITs, semiconductors and airlines. We're short market-share losers in industrial, consumer and internet advertising.

Operational Update

There were no changes to personnel in the quarter and no material changes to the overall business.

Conclusion

Thank you for your investment in Kettle Hill. We remain fully committed to generating alpha and continuing to develop the capabilities of our firm.

Sincerely,
Heptagon Capital and Kettle Hill Management

Annualized Total Returns as of 31st December 2024, net of fees

	Q4 24	YTD	1-Year	3-Year	5-Year	10-Year
Kettle Hill Partners, LP	2.1%	10.1%	10.1%	6.7%	9.4%	6.4%
HFRX Equity Hedge Index	0.3%	7.8%	7.8%	3.7%	5.5%	3.5%

Source: Kettle Hill, Morningstar

Kettle Hill manages the Irish regulated Heptagon Kettle Hill US L/S Equity UCITS Fund according to the same investment principals, philosophy and execution of approach as it manages Kettle Hill Partners, LP, a Delaware Limited Partnership available for U.S. accredited investors that launched in June 2003. However, it should be noted that due to different regulation, fees, taxes, charges, and other expenses there can be variances between the investment returns demonstrated by each portfolio. Kettle Hill Partners, LP performance is provided in the table above to show a longer track record for the underlying strategy.

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Important Information

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Risk Warnings

The Fund is subject to special risk considerations including geographic concentration risk, portfolio concentration risk and operational risk. The investment return and principal value of an investment will fluctuate so that the investor's shares, when redeemed, may be worth more or less than their original cost. Any investor should consider the investment objectives, risks and charges and expenses of the fund carefully before investing. Where an investment is denominated in a currency other than the investor's currency, changes in rates of exchange may have an adverse effect on the value, price of, or income derived from the investment.

SFDR

The Fund takes sustainability risks into account within the investment process, and this is disclosed in accordance with Article 6 requirements of the Sustainable Finance Disclosure Regulation ('SFDR') in the Fund's Prospectus. However, the Fund does not have as its objective sustainable investment and does not promote environmental or social characteristics for the purposes of the SFDR. Sustainability risks may occur in a manner that is not anticipated by the Sub-Investment Manager, there may be a sudden, material negative impact on the value of an investment and hence the returns of the Fund. As a result of the assessment of the impact of sustainability risks on the returns of the Fund, the Sub-Investment Manager aims to identified that the Fund may be exposed to sustainability risks and will aim to mitigate those risks.

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For all definitions of the financial terms used within this document, please refer to the glossary on our website: https://www.heptagon-capital.com/glossary

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