

Future Trends Equity Fund

Q3 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.

Contact

Heptagon Capital

63 Brook Street, Mayfair,
London W1K 4HS

Tel: +44 20 7070 1800

email london@heptagon-capital.com

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 3.6% gain in the third quarter of 2024, putting the Fund up over 10.0% on a year-to-date basis. In the context of 11.1% annualised returns since inception and with one quarter of 2024 remaining, we should be pleased with this outcome. However, the Fund has underperformed its MSCI World Index benchmark, with mega-cap tech businesses (to which the Fund has no exposure) continuing to have an outsized impact on driving market returns. When we look forward, we are highly optimistic on prospects for the Fund when viewed from both a top-down and bottom-up perspective.

A turning tide

The last three years have been brutal for many actively managed equity strategies, Future Trends included. In the period from 1 October 2021 through to 30 September 2024, annualised returns for the Fund were flat (or up 0.04%) compared to a ~9% annual gain for the MSCI World. This does not make for pretty reading.

Sure, we can point to data that show **fewer than one-third of actively managed US equity strategies have outperformed year-to-date**. The metric is similar on a three-year time horizon too (per Bloomberg). Given that the US now comprises over 70% of the MSCI World Index, we can assume this is a fair proxy for the returns that global managers have delivered too.

Nonetheless, what is important to us are the three following considerations, the first two of which are interlinked:

- 1: **we understand why the Fund has underperformed;**
- 2: **there has been no style drift** – we have stuck to our investment process throughout; and
- 3: **we believe that September 2024 marks a critical turning point** in our favour.

In terms of the first two points, remember that **Future Trends has consistently had an active share of over 95%**. The whole philosophy of the Fund is premised on high conviction investing, hence why the top ten names within the Fund comprise over 50% of the portfolio. Contrast this with the MSCI World Index

(our benchmark), where the ten largest constituents account for less than 25% of the Index. Position number ten in the MSCI World Index is Berkshire Hathaway, at a 0.8% weighting. Keysight Technologies, the tenth largest holding in the Future Trends Fund, carries a 4.6% weighting.

Furthermore, as regular readers will be aware, **the Fund has had no exposure to the Magnificent Seven mega-cap tech names** over the course of the recent rally. We do not dispute per se the quality of many of these business models. Rather, our concern relates to valuation levels and the weight of passive money that has flowed into these businesses. As a veteran of the dotcom boom (where your Fund Manager worked as a sell-side analyst covering telecoms operators), elevated expectations can easily lead to easy disappointment and rapid reassessments. The ‘darlings’ of every generation have historically found their market capitalisations *lower* a decade later. History may rhyme.

Looking ahead, we believe that the set up for Future Trends is compelling. The fundamentals for our businesses remain as robust as ever. **Our bottom-up, weighted aggregate estimates for the businesses in the Future Trends have improved relative to the start of the year.** The Fund should see its businesses deliver compound annual revenue growth almost double the rate of the MSCI World (and well ahead of global GDP) over the next three years. Crucially, they are also translating this top-line performance into significant free cashflow generation. Compare the three-year CAGR for the Fund to that of the MSCI World: 18.6% versus 11.9% (MSCI World data courtesy of Bloomberg).

We also think that **the macro backdrop does matter.** While it is well understood that past performance is no guide to the future, we are encouraged by the fact that **the Fund has historically performed particularly well in lower inflation and interest rate environments.** With the Fed having embarked on a rate-cutting cycle from a position of strength (see our latest macro commentary [here](#)), we believe that this environment could be attractive for strategies such as Future Trends.

As the table below shows, from the inception of the Future Trends Fund in January 2016 through to its peak NAV in September 2021, the strategy delivered over 19% annualised returns, well ahead of both its benchmark and its Morningstar peer group of global large-cap growth equity funds. Over the subsequent three-year period, there was an abrupt reversal of this trend, which coincided with two factors: rapidly rising inflation and a corresponding interest rate response, combined with a highly concentrated mania in a select number of perceived AI beneficiary stocks.

Annualised returns for Future Trends

| | Dates | Future Trends | FT direct peer average* | Morningstar peer average** | MSCI World Index TR | FT alpha vs MSCI World | Factors |
|------------------------------|-------------------|---------------|-------------------------|----------------------------|---------------------|------------------------|---|
| Inception to Peak NAV | Jan-16 - Sept 21 | 18.8% | NA | 16.4% | 15.3% | 3.5% | Low inflation and interest rates/ no AI and mega-cap tech mania |
| Peak NAV to Today | Sept 21 - Sept 24 | -1.7% | -3.2% | 0.9% | 7.2% | -8.9% | Rising inflation and interest rates/ AI and mega-cap tech mania |
| Going forward... | | | | | | | Falling inflation and interest rates/ waning AI and mega-cap tech mania |

* Simple average from direct peer group of thematic funds comprising: Allianz Thematic, Baillie Gifford Worldwide Positive Change Fund, Heptagon Future Trends Equity Fund, M&G Global Themes Fund, Pictet – Global Megatrend Selection, Robeco Global Consumer Trends. Note, only two of this above list (Pictet and Robeco) had launched in January 2016.

** Morningstar category in which Future Trends is placed is Global Large Cap Growth Equity. Future Trends is an all-cap strategy, but this provides a proxy for analysis over a longer time period. Morningstar performance rounded to month-ends for periods.

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

Going forward, we believe that both these trends could reverse, providing **a supportive backdrop to the Future Trends Fund**. While we do not wish to dwell too extensively on the macro, a weaker US Dollar (the corollary of lower interest rates) should also be beneficial, given that the majority of the Fund’s businesses are US-listed *and* global in nature. Thematic investing has been out of fashion for the last three years (as the data in the above table show), but we believe now constitutes an attractive entry point.

I The future looks bright...

The conviction in the trends in which we are invested only continues to grow. This view is reinforced by our **ongoing proprietary thematic work and corporate interactions**. A [business trip to the US](#) in mid-August served as a timely reminder of how grid infrastructure needs to be upgraded in order to support growing data demands, particularly in light of the AI gold rush. The Fund has been an investor in Quanta Services since June 2023. We met with the full management team of Quanta while in New York. We also initiated a position over the past quarter in EMCOR, another business that has exposure to the electrification theme (more details on this follow in Appendix one of the report).

We [published our 88th dedicated theme piece, on cybersecurity](#), in September. Cyber-attacks could cost the world \$9tr in 2024, equivalent to a third of US GDP or more than 25 times Apple’s last reported revenues. No surprise then that spend on cyber needs to increase, particularly in the context of AI having given attackers (and defenders) a new set of tools. We believe that cyber businesses which have embraced the logic of platformisation look best-placed, hence why Palo Alto Networks is in a top-five position in the Future Trends Fund.

Elsewhere, [we travelled to Norway](#) to spend two days with MOWI. This provided privileged access to understand the whole salmon value chain, from feed to processing. The business remains highly differentiated versus its peers in its proprietary approach to salmon development (post-smolt) and technology (smart farming and smart factories), hence why the Future Trends Fund has been an investor in MOWI since 2018.

This trip and many of our other work over the period is captured in the [Future Trends Blog](#). We published 13 pieces over the quarter. Other highlights from the past quarter included [visiting Mastercard’s London experience centre](#) and attending the [Big Data LDN trade show](#). **We also met with 22 companies over the quarter** including many of our portfolio holdings. We spent time with ARM’s CEO in London and management of GXO Logistics and Xylem in the US, among others.

... and is supported by valuation metrics

Given the long runways that the businesses in which we are invested have, we believe that a focus on free cashflow is the most logical way to value our businesses. Nonetheless, given the multi-thematic nature of the Fund, we have consistently counselled against relying on one single metric. The key headline for us: **our businesses are, on average, ~30% undervalued on a long-term discounted free cashflow basis and are cheaper now than at peak valuation**, as the table below shows.

| | 3Y Growth CAGRs | | Valuation metrics | | |
|---------------------------------------|-----------------|---------------|-------------------|--------------|---------------|
| | Revenue | FCF | P/E (x) | FCF yield | DCF upside |
| Future Trends (12/23) | 8.0% | 16.2% | 26.4 | 3.4% | 28.9% |
| Future Trends (09/24) | 9.2% | 18.6% | 30.9 | 2.8% | 29.6% |
| Future Trends peak valuation | | | 34.8 | 2.7% | 18.2% |
| Future Trends discount vs peak | | | -11.2% | 0.1pp | 11.4pp |
| MSCI World (09/24) | 5.1% | 11.9% | 20.9 | 2.9% | - |
| vs Future Trends | -4.1pp | -6.7pp | -47.8% | 0.1pp | - |

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

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

Begin with growth. As we discussed earlier, **our businesses are forecast to grow faster than the MSCI World Index over the next three years**, on our estimates. Our forecasts have also *improved* relative to the start of the year, in terms of both the outlook for revenues and for free cashflow generation. The table below also shows how far ahead our current forecasts stand versus the MSCI World (by over 4pp on a revenue basis and almost 7pp when considering free cashflow).

These superior prospects help explain **why Future Trends trades at a premium relative to the MSCI World Index on a forward P/E basis**. The fact that the average business in the Future Trends Fund carries net debt/EBITDA of 0.8x, versus 1.6x for the MSCI World Index average may also explain the premium. Interestingly, on a free cashflow yield basis, the metric for the Future Trends Fund is markedly closer to that of the MSCI World (2.8% vs 2.9%), even if it has fallen since the start of the year. On a discounted free cashflow basis, the potential upside relative to the start of the year is consistent.

I Conclusion: reasons for optimism

We believe that valuation metrics provide *additional* support for the Future Trends investment case, when viewed on both an absolute and relative basis. Take a step back. Thematic investing has been out of fashion for the last three years, but we believe that the tide is now turning. A more supportive macro backdrop should act as a bolster for the strategy. Most crucially, we have stuck to fundamentals throughout the life of the Fund. Our strategy has always been pan-thematic and concentrated, driven by both top-down and bottom-up considerations.

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

Alex Gunz, Fund Manager

October 2024

I Appendix 1: Q3 portfolio changes

During the quarter **we initiated a 3.0% position in EMCOR Group**. Founded in 1994 and headquartered in Connecticut, EMCOR is a \$20bn leading speciality contractor active in the US and the UK. The business is involved in the installation, operation, maintenance and management of complex critical infrastructure projects such as data centres, warehouses, hospitals and other manufacturing facilities.

EMCOR is exposed to multiple future trends including [electrification and grid upgrades](#), [sustainable buildings](#), [digitalisation](#), and [artificial intelligence](#) all electrical and mechanical systems are seeing increased content, complexity and sophistication, which plays to EMCOR's strengths. EMCOR has developed a strong execution track record, which has translated into ~40% annualised returns over the last five years. We believe its scale and decentralised business model (over 40,000 employees situated in more than 400 locations) combined with a best-in-class safety track record have allowed it to continue to win business and gain market share.

With a \$9.0bn last reported backlog (equivalent to over 60% of consensus revenues for 2024), EMCOR has good forward visibility. The business has raised its financial guidance twice so far in 2024. Improved project mix and scale efficiencies could see margins increase further, in our view. EMCOR runs an efficient business model, targeting at least 100% cash conversion over the cycle. The business currently trades on just 20.6x forward P/E with a 5.0% free cashflow yield and offer 20% upside potential on our discounted free cashflow model.

We initiated contact with EMCOR during the summer and management has shown great flexibility in making itself available and sharing information. **Adding EMCOR to the Fund helps grow thematic diversification as well as improve valuation and sustainability metrics**. MSCI awards EMCOR and AA rating.

Our EMCOR position was funded through reducing weights in a number of other businesses in the Future Trends Fund. Since investing in late August, **EMCOR has already generated a 15.9% weighted return for the Fund** (based on average purchase price). It ended the quarter at a 3.5% position in the Fund.

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

I Appendix 2: Q3 leaders and laggards -

The Future Trends Fund gained 3.6% during the third quarter of 2024, which compares to a 6.4% return for the MSCI World Index. Interestingly, half of the businesses the Fund owned throughout the quarter outperformed the benchmark, while EMCOR also contributed positively during the period in which the Fund was invested.

It is therefore legitimate to ask why the Fund underperformed in the quarter. The answer is simple: **our two biggest weighted positions at the end of the second quarter were our two worst performers in the third quarter**. This was an unprecedented occurrence for the Fund, and we believe these moves should reverse.

During Q3, **ASML closed down 22.7% and Novo Nordisk traded 21.8% lower**. These two businesses respectively contributed negative 158 basis points and minus 136 points respectively over the third quarter. **Despite these drawdowns, our conviction in the two businesses remains unchanged**. Indeed, after a 16.1% drop in the Novo share price in September (ASML fell 'only' 9% over the month), we used weakness at month-end to *increase* our weighting in the stock by around 50 basis points.

For context, **ASML has generated an absolute return of 462% since we first invested in the business in July 2017, while Novo has returned 312%**. We have owned this latter business since the Fund's inception (along with Mastercard, which has returned 440%). Some of the underperformance at both ASML and Novo in Q3 can simply be attributed to profit-taking given prior strong performance.

At a stock-specific level, ASML has suffered from concerns over a potentially more restrictive regulatory environment which may impact the business selling its (advanced) machinery into China, currently its largest end-market. Further, ASML's guidance for the quarter ahead was below consensus, triggering some downgrades to consensus expectations. We remain positive on the case for the business given not only its longer-term positioning (we have said many times that 'the future can't happen without ASML' owing to the importance of its unique machinery in the data ecosystem) but also since the business will provide an update on its positioning in November. Its biannual Capital Markets Day will also likely lay out new medium-term financial guidance. We will be attending.

Similar to ASML, Novo Nordisk shares traded lower on the day of its second quarter results, owing to a mixed performance and financial guide. There is no doubt about the strength of the company's positioning in our mind, given its leading drug franchise and the fact that a very small percentage of those suffering from either diabetes or obesity are currently treated. Novo, however, has had to contend with elevated expectations amidst a context of supply shortages for its key drug (Wegovy), signs of new entrants assessing the market and a potentially more restrictive pricing environment in the US. After the move in the share price, these expectations are now better discounted in our view, while the upside from new treatment areas such as Alzheimer's (see our work on the topic [here](#)) is not fully appreciated.

At the opposite end of the spectrum, **we were pleased to see Match Group record a 24.6% gain over the quarter and Quanta Services close the period 17.3% higher**. While Match is a relatively small weighting in the Fund, Quanta closed the quarter as the Fund's largest position.

Match benefited from several factors including improving fundamentals (stabilising user trends at its core Tinder franchise), an announced cost-cutting plan, the involvement of another activist investor and a planned Capital Markets Day before year-end. Trading on less than 20 times Bloomberg consensus earnings, very little upside potential is discounted in our view.

For Quanta, we discussed previously why electrification is a theme that we believe will only grow in importance. The business announced a very strong beat-and-raise quarter of results in August and reported a record order backlog of over \$31bn. Having spent time with senior management recently, our confidence in this business is undiminished.

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

I Important Information

Past performance is not an indication or guarantee of future performance and no representation or warranty is made regarding future performance. This communication is for information purposes only. It is not an invitation or inducement to engage in investment activity.

The document is provided for information purposes only and does not constitute investment advice or any recommendation to buy or sell or otherwise transact in any investments.

The contents of this document are based upon sources of information which Heptagon Capital believes to be reliable. However, except to the extent required by applicable law or regulations, no guarantee, warranty or representation (express or implied) is given as to the accuracy or completeness of this document or its contents and, Heptagon Capital, its affiliate companies and its members, officers, employees, agents and advisors do not accept any liability or responsibility in respect of the information or any views expressed herein. 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. Where this document provides forward-looking statements which are based on relevant reports, current opinions, expectations and projections, actual results could differ materially from those anticipated in such statements. All opinions and estimates included in the document are subject to change without notice and Heptagon Capital is under no obligation to update or revise information contained in the document. Furthermore, Heptagon Capital disclaims any liability for any loss, damage, costs or expenses (including direct, indirect, special and consequential) howsoever arising which any person may suffer or incur as a result of viewing or utilising any information included in this document.

The document is protected by copyright. The use of any trademarks and logos displayed in the document without Heptagon Capital's prior written consent is strictly prohibited. Information in the document must not be published or redistributed without Heptagon Capital's prior written consent.

Heptagon Capital Limited has issued this communication as investment manager for Heptagon Fund ICAV, and is licensed to conduct investment services by the Malta Financial Services Authority. Heptagon Capital LLP, acting as Distributor, is authorised and regulated in the UK by the Financial Conduct Authority.

I 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.

I SFDR

This Fund has been classified as an Article 8 for the purposes of the EU's Sustainable Finance Disclosure Regulation ('SFDR'). The Fund promotes environmental and/or social characteristics but does not have sustainable investment as its primary objective. It might invest partially in assets that have a sustainable objective, for instance assets that are qualified as sustainable according to EU classifications but does not place significantly higher importance on the environmental objective of each underlying investment. Please see [Prospectus](#) for further information on the Funds environmental and/or social characteristics and relevant sustainability risks and principal adverse impacts which may impact the Fund's performance.

I Disclaimers

Source: MSCI. The MSCI information may only be used for your internal use, may not be reproduced or disseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages. (www.msci.com)

The Global Industry Classification Standard (“GICS”) was developed by and is the exclusive property and a service mark of MSCI Inc. (“MSCI”) and S&P Global Market Intelligence (“S&P”) and is licensed for use by Heptagon Fund ICAV. Neither MSCI, S&P, nor any other party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any of such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

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>

Heptagon Capital, 63 Brook Street, Mayfair,
London W1K 4HS
Tel: +44 20 7070 1800
(FRN 403304)

Authorised & Regulated by the Financial Conduct
Authority in the UK
12 Endeavour Square, London

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