European Focus Equity Fund

Market commentary and attribution analysis as of 31st December 2023

Portfolio Management

Christian Diebitsch

Investment Objective

The Fund aims to deliver long-term capital appreciation by investing in European equities. The Fund employs a high conviction, bottom-up, low turnover, research driven strategy with a focus on companies that exhibit sustainable long- term growth.

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.

Performance and executive summary

2023 was a decent year for the Heptagon European Focus Equity Fund. The Portfolio advanced by +14.5% in absolute terms to a NAV of €199.1839 but it fell short of the benchmark MSCI Europe Net (EUR) index which rose by +15.8% in comparison (-138bps relative performance). Closer analysis shows that the Portfolio outperformed the benchmark index in three out of four quarters. The Fund's 1H23 performance was strong – both in absolute terms and relative to the market – but 3Q23 saw a temporary reversal back to deep-value sectors (primarily Energy) which dominated the market in 2022 and which the strategy does not invest in. Indeed, 3Q23 was also the only quarter last year which registered negative returns for the broader market as well as for the Portfolio. The tide turned again in 4Q23 when the Fund registered a healthy absolute performance and an outperformance against the benchmark index.

2023 was all about inflation

Inflation and inflation expectations dictated financial market conditions in 2023. The economic backdrop in 1H23 was characterised by a sharp fall in headline inflation, which for Central Banks must be regarded as *'low-hanging-fruit'* in their battle to bring down price increases, but the jobs market remained strong throughout 1H23. At the same time, the Fed, the ECB and the BoE jointly proclaimed they would not embark on interest rate cuts to be made too early. Consequently, in 3Q23 the penny finally dropped for the investment community that interest rates were indeed likely to stay *'higher-for-longer'* and this epiphany prompted a sharp increase in long bond yields with the effect that the yield curve flattened albeit at a higher level. The immediate impact on equity markets was a sudden affiliation to deep-value stocks.

The reemergence of deep-value bias…

The value-driven rally in 3Q23 was further unpinned by the joint 'OPEC+' (Saudi Arabia and Russia) statement that the organisation would cut oil production by some 1m barrels per day. In other words, consensus swiftly adopted the similar view

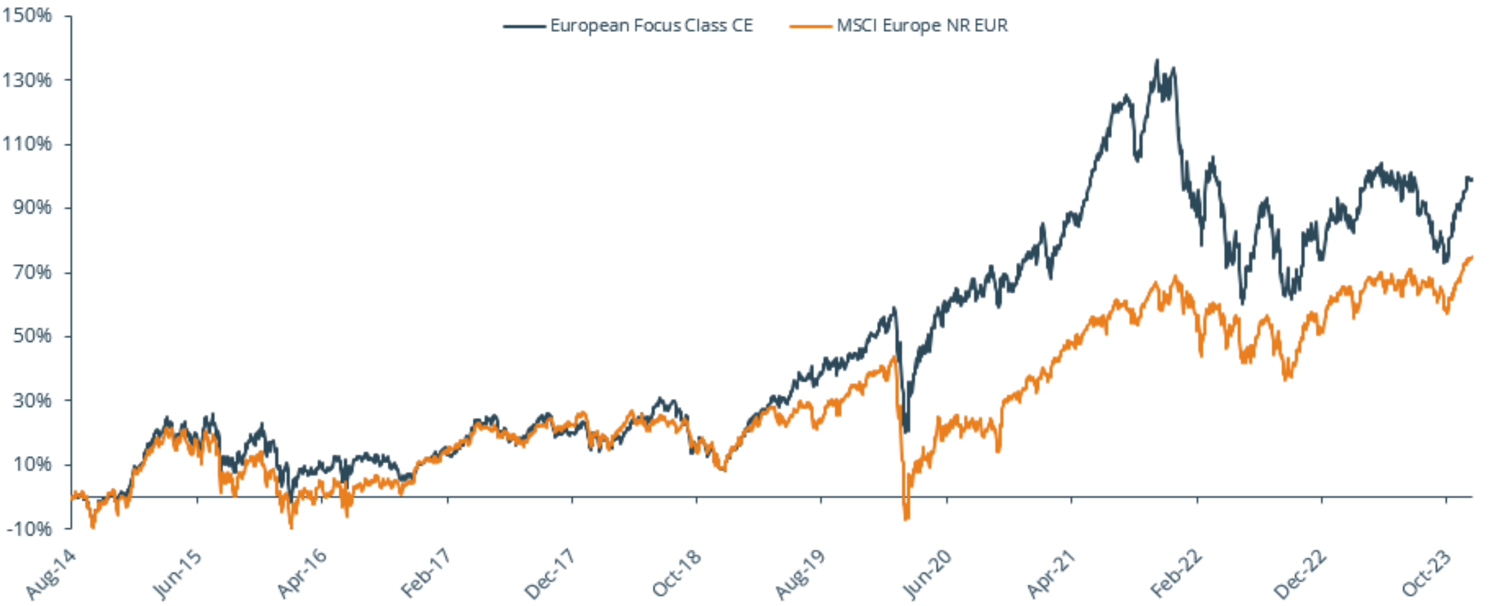
Past performance is no guide to future performance, and the value of investments and income from them can fall as well as rise

which came to characterise 2022 when the belief was that bond yields were to continue to be elevated alongside already high energy costs.

...appears to have been short-lived.

Just as quickly as the deep-value rally emerged in the equity markets, it vanished. What first triggered the swift reversal was the US jobs data for September (published on Friday 6th Oct). The three key US employment metrics - job-creation, unemployment and wage growth - showed coherent softening and these data points preceded lower core-inflation data, which strips out volatile housing and energy costs and therefore quickly investors readopted their view from 1H23 that core inflation was about to peak and/or would soon start to decline.

The European Focus CE share class performance since inception on 26 August 2014



**From Fund launch 26/08/2014*
Source: FactSet Research Systems

Analysed in isolation, 3Q23 saw the performance of most Western stock markets moderate compared to the prior quarters in 2023. While Europe registered profit-taking in 3Q23, the US showed modest gains, but these gains were confined to a narrow cluster of sectors, such as Technology (primarily AI-driven stocks) and Energy. Due to the lack of 'bell-weather AI-stocks' in Europe, investors' attention swung to income-generating sectors, such as Energy, Real Estate and Financials (see table below). Based on equities' price action at that time, we construe that: *(i)* there was still a high degree of uncertainty regarding the macroeconomic outlook and *(ii)* in a post-QE era when bond yields were higher, they now offered a meaningful substitute to equities.

Another plausible reason for the performance divergence of US vs. European equities in 3Q23...

When analysing the divergence in the positive vs. the negative returns between the US and the European equity markets in 3Q23, not only do we believe the US stocks benefitted from a higher proportion of technology-exposed stocks, but also because of how swiftly the Fed responded in the face of escalating inflation compared with the tardiness of the ECB and the BoE.

...and that appears to have made a big difference.

At the time of writing, based on the latest commentary from the Fed Chairman, Jerome Powell, following the FOMC meeting (13th Dec), it appears as if the Bank has conducted its last interest rate increase during this rate hike cycle. Meanwhile, the Heads of the ECB and the BoE are much less clear as to if/ how and when interest rates are likely to be cut in Europe.

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

Where are we in the economic and the stock market cycles?

From a macroeconomic standpoint, the current business cycle appears somewhat inscrutable. A group of market commentators convincingly argue that global economics are at the end of the business cycle while another group argue equally well that global economics are showing similar signs with those that are present at the beginning of a recovery. Analysing different clusters of stocks and their price action often gives meaningful insight regarding the appetite or aversion to risk. When looking at defensive vs. growth (as well as recovery-driven) sectors in 2023, it is quite clear that defensive industries (such as Consumer Staples) were out-of-favour as they underperformed the benchmark index in all four quarters. The other side of the spectrum is that more cyclically exposed Industrials outperformed the benchmark in three-out-of-four quarters. Against this backdrop, we construe that macroeconomics (and thus equity markets) are more likely to be at the beginning of an upturn than the other way around.

The table below sets out the quarterly investment returns of the key European industry sectors, the benchmark MSCI Europe index as well as the performance-ranking of European Focus. We draw the following conclusions from the below table:

- Technology and growth-like stocks represented the best-performing cluster of stocks in 1H23 and in 2023, but they uniformly performed poorly in 3Q23.
- Interest-rate sensitive and cyclical recovery sectors, such as Industrials and Financials, were the second best-performing clusters of stocks in 2023.
- Income-exposed sectors, such as Real-estate and Utility stocks, performed well in 2H23 when core inflations started to show signs of falling.
- The Energy sector only outperformed the benchmark index in 3Q23 (and by a wide margin), but this sector was at or near the bottom of the European sector league table in three out of four quarters in 2023.

Sector performance of the MSCI Europe NR (EUR) index and European Focus in 9M23

Sector	1Q23	Sector	2Q23	Sector	1H23	Sector	3Q23	Sector	9M23	Sector	4Q23	Sector	2023
Technology	20.4%	Technology	4.3%	Technology	25.5%	Energy	13.7%	Technology	12.2%	Real estate	22.6%	Technology	33.1%
Cons disc	19.3%	Finance	2.8%	Cons disc	21.7%	Real estate	7.9%	Industrials	10.3%	Technology	18.6%	Industrials	24.7%
Comm serv	15.1%	**Euro Focus**	**2.5%**	**Euro Focus**	**15.6%**	Finance	2.0%	Finance	9.1%	Industrials	13.1%	Real estate	17.7%
Euro Focus	**12.8%**	Industrials	2.4%	Industrials	15.2%	Healthcare	1.1%	**MSCI Europe**	**8.8%**	**Euro Focus**	**10.6%**	Finance	16.5%
Industrials	12.5%	**MSCI Europe**	**2.3%**	**MSCI Europe**	**11.1%**	Comm serv	0.1%	Energy	8.7%	Materials	9.9%	**MSCI Europe**	**15.8%**
MSCI Europe	**8.6%**	Healthcare	2.3%	Utilities	8.8%	Materials	-0.6%	Cons disc	7.8%	Utilities	9.9%	Euro Focus	14.5%
Utilities	7.5%	Cons disc	2.0%	Finance	6.9%	**MSCI Europe**	**-2.1%**	Healthcare	6.9%	Finance	6.8%	Cons disc	13.4%
Cons stapl	6.0%	Utilities	1.2%	Comm serv	6.7%	Industrials	-4.3%	Comm serv	6.8%	**MSCI Europe**	**6.4%**	Comm serv	10.9%
Finance	4.0%	Energy	-1.9%	Healthcare	5.7%	Cons stapl	-5.1%	**Euro Focus**	**3.5%**	Cons disc	5.3%	Healthcare	9.6%
Healthcare	3.4%	Cons stapl	-2.0%	Cons stapl	3.8%	Utilities	-8.4%	Utilities	-0.3%	Comm serv	3.8%	Materials	8.3%
Materials	2.6%	Materials	-3.4%	Materials	-1.0%	**Euro Focus**	**-10.5%**	Cons stapl	-1.5%	Cons stapl	0.5%	Healthcare	6.4%
Energy	-2.6%	Real estate	-3.9%	Energy	-4.4%	Technology	-10.6%	Materials	-1.5%	Healthcare	-0.4%	Energy	4.5%
Real estate	-7.4%	Comm serv	-7.3%	Real estate	-11.0%	Cons disc	-11.5%	Real estate	-3.9%	Energy	-3.9%	Cons stapl	-1.0%

Source: Bloomberg

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

Possible key drivers for equities in 2024

We believe inflation and inflation-expectations (i.e. bond yields) will continue to be the key foundation to how investors will build their Portfolios in 2024. We also believe that the Fed will continue to set the broader framework for financial market conditions. Against this backdrop, the Fed Chairman some time ago clearly stated three criteria for the Bank to start easing monetary policy and to our knowledge they have not changed:

- Prices of core goods need to keep falling.
- Housing inflation needs to follow private rent indices lower.
- Inflation for ex-housing core services needs to fall decisively.

At the time of writing, US core CPI was running at 3.9% Y/Y in Dec (down from 4.0% Y/Y in Nov), but this level is still considerably higher than the Fed's overarching objectives of: *(i)* bringing inflation down to its 2% target; *(ii)* to restore price stability while at the same time *(iii)* achieve maximum employment.

Looking ahead – a likely return to *'traditional normal'*

Background

Economic cycles tend to look different while in the midst of them, but in our experience – given time – most of the peculiarities that relate to a specific cycle tend to mould into the bigger picture and that cycle turns out to be broadly the same as previous cycles.

The most visible 'difference' this time around is arguably that economies never faced periods when Central Banks actively pursued Quantitative Easing (QE). Analysed in a longer-term perspective, in the aftermath of the subprime-crisis (2008-10), Central Banks were actively manipulating the long-end of the yield curve in order to stimulate employment and capital investment. This is contrary to the conventional monetary policy in the past when Central Banks concentrated on curtailing consumption by raising short interest rates and thus let the long end of the curve take care of itself. It now seems likely that the QE-impact on these economies will need to be offset by an opposite strategy, i.e. Quantitative Tightening (QT).

Having embarked on the QE-trail – and possibly continued on this path for too long since inflation was dormant – governments (aka Central Banks) had little choice but to continue to stimulate underlying economies once the pandemic set in. Ultimately, inevitable constraints to supply-chains emerged when economies reopened since households had accumulated considerable saving during the lockdowns and had cash to spend. The economic effect was that inflation emerged and instead of turning out to be *'transitory'* once supply-chain issues were cleared, price pressures turned out to be much more structural. Hence, Central Banks are now in the unenviable position that they will need to apply restrictive monetary policies in order to bring price pressures lower.

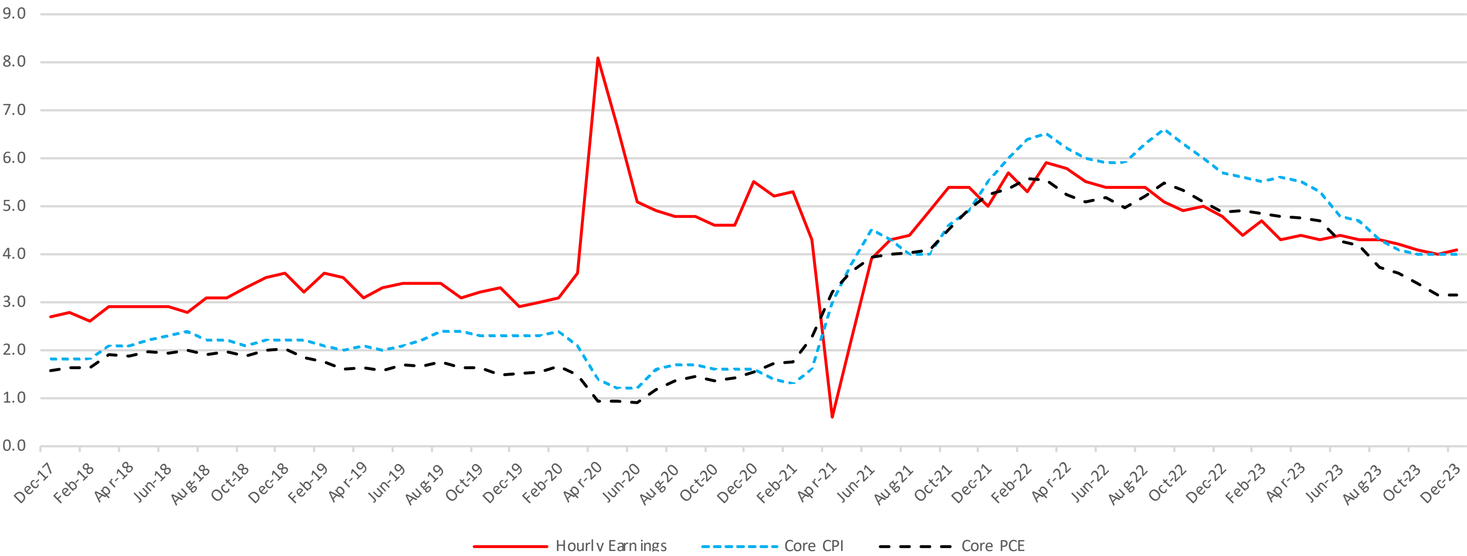
The current situation

We would argue that there is no preset level of interest rates that is required to bring down inflation. However, in our opinion the Fed is (as usual) way ahead of its Central Banking peers by having assessed underlying economic conditions correctly. Chairman Jerome Powell was the first Head of a Central Bank to abandon the word *'transitory'* and instead changed the Bank's narrative to what level of interest rates should be considered *'restrictive'*. With hindsight we construe that the Fed got it broadly correct.

Looking at the trajectory of inflation, US interest rates have been in restrictive territory for some time. This was noticeable as headline inflation dropped from a peak of 9.1% in Jun-22 to 3.0% in Jun-23 (US monthly CPI registered 12 consecutive declines in headline inflation). The second and current part of Central Banks' inflation-fight is to combat underlying price pressures, i.e. *'core inflation'* (which strips out volatile food and energy costs). Until recently, core inflation remained stubbornly high primarily due to a strong jobs market. However, since 4Q23 core inflation appears to be buckling as: *(i)* monthly job creation is decreasing and *(ii)* 'Hourly Earnings' (wage growth) appears to be levelling off and/or has started to fall.

As the Fed is committed to bring inflation and inflation expectations down to its self-imposed target of 2%, we believe the Bank will not start to cut the Fed Funds rate until annual Hourly Earnings (i.e. wage growth) is consistently below core inflation (see chart below).

Hourly earnings vs. core inflation (core CPI and core PCE)



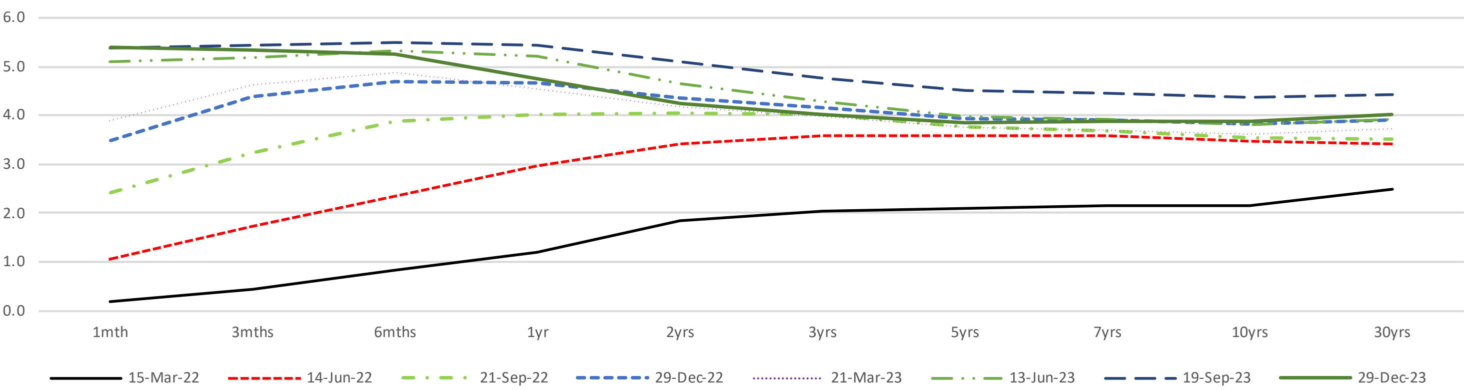
Source: Bloomberg

The timing of the reversal of the tightening cycle is anyone's guess, but our research shows that an average Fed rate hike cycle lasts 10 quarters (i.e. 2.5 years). Over that period, the Bank typically eradicates 80% of headline CPI. Since the Fed's first interest rate hike in the current cycle was made in Mar-22 – if history is a guide – the current trajectory should last until Sep-24. While we do not believe the Fed will continuously raise interest rates considering the five *'hawkish pauses'* since Jun-Dec-23, we believe the first rate cut will still be some time off. Furthermore, since US peak CPI reached 9.1% in Jun-22, it follows that the Fed should be able to reduce inflation to around 1.8% over this rate hike cycle (i.e. compliant with the Bank's self-imposed 2% target) if history is a guide.

A probable outlook

Experience shows that once the 'inflation-genie' has slipped out of the bottle, it is extremely difficult to prop it back in again. We believe this implies that Central Banks will struggle to get back to pre-pandemic levels of around 0.5-2%. However, we note that extremely long-term inflation and 10-year bond yield data for the US economy going back to the 1820s (excluding periods of wars, such as the Civil War 1861-65, WW1 1914-18 and WW2 1939-45), CPI has tended to be around the 4% level. This is similar to where the US 10-year bond yield has traded over the same timeline. In other words, over extremely long periods the US 10-year bond yield appears to have been a proxy for headline inflation.

US yield curves at key dates since the Fed's first interest rate hike in Mar-22



Source: Bloomberg and Heptagon

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

As the US yield curve graph above shows, the curve inverted in 4Q22, implying a slowdown in demand. At the time of writing and according to the US futures market, investors anticipate US interest rates to peak within the next three months. This assumption is roughly the same compared with the consensus view about a year ago.

Assessment of economic momentum

The first table below sets out annual top-down GDP growth expectations for 2023-25 for some of the world's largest economic areas. The table shows that economic momentum slowed down in 2022 as societies felt the adverse impact following Central Banks' interest rate hikes. In our view, economic momentum regained strength in 2023 (bar the Eurozone) for two main reasons: *(i)* there is a lag between the effect of higher interest rates and a buoyant jobs market which meant that wages and salaries continued to rise and; *(ii)* supply-chain constraints abated at the same time as consumption recovered, bolstered by household savings that were accumulated during the pandemic period.

The table below shows that all economic areas are expected to continue to see lower economic activity in 2024 – possibly because: *(i)* inflation has remained higher-for-longer; *(ii)* pandemic-related household savings have been partly depleted and *(iii)* households have had to rein in their spending. However, as the global economy is likely to advance going into 2025, economic activity should gradually regain momentum during the course of 2024.

Consensus annual GDP growth forecasts for the US and other leading economic regions

% change	2021	2022	2023e	2024e	2025e
USA	5.8%	1.9%	2.4%	1.3%	1.7%
Eurozone	5.9%	3.4%	0.5%	0.6%	1.5%
China	8.4%	3.0%	5.2%	4.5%	4.3%
Japan	2.7%	1.0%	2.0%	0.8%	1.0%
Average	**5.7%**	**2.3%**	**2.5%**	**1.8%**	**2.1%**

Source: Bloomberg as at 01/01/2024

The table below is decomposed for the years 2023 and 2024 where the GDP growth expectations show rolling four-quarter averages for each period when they were noted starting from Jan-23. Hence, the table is an illustration of GDP growth expectations for each year on an ongoing basis.

% change	23e (Jan-23)	23e (Apr-23)	23e (Jul-23)	23e (Oct-23)	23e (Dec-23)	24e (Apr-23)	24e (Jul-23)	24e (Oct-23)	24e (Dec-23)
USA	0.3%	1.1%	1.3%	2.1%	2.4%	0.7%	0.6%	0.9%	1.4%
Eurozone	-0.1%	0.6%	0.7%	0.6%	0.5%	1.1%	1.2%	0.8%	0.5%
China	4.8%	5.4%	5.6%	5.0%	5.2%	5.1%	4.7%	4.5%	4.5%
Japan	1.3%	1.0%	1.3%	1.9%	1.7%	1.2%	1.1%	1.0%	0.7%
Average	**1.6%**	**2.0%**	**2.2%**	**2.4%**	**2.4%**	**2.0%**	**1.9%**	**1.8%**	**1.8%**

Source: Bloomberg as at 01/01/2024

The table shows that consensus GDP growth expectations for 2023 were at their trough in Jan-23, but as the year progressed, expectations improved. In other words, reality did not turn out to be as bad as economists' initial expectations.

Consensus expectations for 2024 show a different profile as growth projections have accelerated during 2H23 for the US while for Europe they have moved in the opposite direction. Meanwhile, expectations for economic activity in China and Japan in 2024 have been broadly unchanged during 2H23.

We also note that the profile of consensus expectations during 2H23 have moulded into a more conventional profile which stems from the fact that the US tends to lead the global economy back to prosperity. This is compatible with our opinion that the US is a consumer-driven economy while Europe and Asia are export-dependent. Hence, once the

US economy starts to recover, Europe and Asia will export themselves back to prosperity. This contrasts with what we considered to be an unusual recovery pattern until Jul-23 when consensus expected Eurozone GDP growth for 2024 to be higher than that of the US.

The power of compounding

We first introduced the below table in 2021. It illustrates the benefits of compounding. The top-part of the table depicts how sales, EBITDA and EBIT growth have developed and are expected to progress for European Focus and for Europe (the MSCI index) during 2020-25e, according to Bloomberg's consensus estimates.

The lower part of the table illustrates how these growth rates impact sales and profits based on current consensus prospects. We have anchored the numbers to 2019, i.e. the year before the pandemic set in. The table clearly shows the benefit of not *'giving up'* sales or profits during periods of economic weakness by achieving a much larger base from which to continue to generate fortunes.

Projection of sales and profit growth of European Focus and MSCI Europe index

HEFEF	FY19	FY20	FY21	FY22	FY23e	FY24e	FY25e	MSCI	FY19	FY20	FY21	FY22	FY23e	FY24e	FY25e
Sales		2.2%	20.9%	13.2%	10.6%	7.2%	9.0%	Sales		-14.1%	4.1%	24.4%	-1.2%	2.3%	2.8%
EBITDA		5.0%	31.3%	16.9%	10.7%	12.6%	13.8%	EBITDA		-23.9%	32.6%	23.4%	2.6%	3.2%	6.2%
EBIT		4.8%	61.6%	22.1%	21.1%	14.6%	17.0%	EBIT		-39.8%	82.9%	26.2%	18.3%	4.7%	6.3%

HEFEF	FY19	FY20	FY21	FY22	FY23e	FY24e	FY25e	MSCI	FY19	FY20	FY21	FY22	FY23e	FY24e	FY25e
Sales	100	102.2	123.6	139.9	154.7	165.9	180.8	Sales	100	85.9	89.4	111.2	109.9	112.4	115.6
EBITDA	100	105.0	137.8	161.1	178.3	200.7	228.5	EBITDA	100	76.1	100.9	124.5	127.7	131.8	140.0
EBIT	100	104.8	169.4	206.8	250.4	287.0	335.8	EBIT	100	60.2	110.1	138.9	164.3	172.0	182.8

Source: Bloomberg dated 06/10/2023

The above tables are based on the Portfolio weightings as at year-end 2023. For prior years, the year-end weightings have been used to look at how the Portfolio was structured at that time. Based on Bloomberg's consensus forecasts, European Focus and the MSCI Europe index are expected to show the following:

- **Sales:** European Focus is expected to grow its sales by +10.6% in FY23 compared with a -1.2% sales decline of the MSCI Europe index. For FY24, European Focus is expected to grow its sales by +7.2% compared with only +2.3% of the MSCI Europe index. We are also introducing the FY25 expected growth rates, which for European Focus shows an acceleration to +9.0% revenue growth vs. only +2.8% of the MSCI Europe index.
- **EBITDA:** European Focus is expected to grow its EBITDA by +10.7% in FY23 compared with only +2.6% of the MSCI Europe index. For FY24, European Focus is expected to show EBITDA growth at +12.6% compared to only +3.2% of the MSCI Europe index and further to +13.8% in FY25 compared to only +6.2% of the MSCI Europe index.
- **EBIT:** European Focus is expected to grow its EBIT by +21.1% in FY23 compared with +18.3% of the MSCI Europe index. For FY24, European Focus is expected to grow its EBITDA by +14.6% compared to only +4.7% of the MSCI Europe index and further to +17.0% in FY25 compared to +6.3% of the MSCI Europe index.

Analysing how the revenue profiles of European Focus and the MSCI Europe index have progressed since pre-pandemic levels by using 2019 as the base year clearly illustrates the importance of not *'giving up'* sales (and profits) and thus benefit from compounding.

- **Sales:** European Focus' 'revenue base' is expected to stand at 154.7 at the end of FY23, i.e. nearly +55% ahead of its pre-pandemic level in 2019, while the MSCI Europe index is only expected to be 109.9, i.e. less than 10% higher than its pre-pandemic level. This is further amplified in FY24 when European Focus is expected to have a revenue base around 66% higher than its pre-pandemic level, which compares with only +12% of the MSCI Europe index.

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

Further in FY25, European Focus' revenue base is expected to be nearly 81% higher than its pre-pandemic level, which compares with only +16% of the MSCI Europe index.

- **EBITDA:** European Focus' EBITDA base is expected to stand at 178.3 at the end of FY23, i.e. 78% ahead of its pre-pandemic level in 2019 while the MSCI Europe index is only expected to be +28% higher than its pre-pandemic level. This is further amplified in FY24 when European Focus is expected to have an EBITDA base 101% higher than its pre-pandemic level, which compares with less than +32% of the MSCI Europe index. Further in FY25, European Focus' EBITDA base is expected to be 128% higher than its pre-pandemic level, which compares with only +40% of the MSCI Europe index.
- **EBIT:** European Focus' EBIT base is expected to stand at 250.4 at the end of FY23, i.e. 150% ahead of its pre-pandemic level in 2019, while the MSCI Europe index is only expected to be +64% higher than its pre-pandemic level. This is further amplified in FY24 when European Focus is expected to have an EBIT base that is 187% higher than its pre-pandemic level, which compares with only +72% of the MSCI Europe index. Further in FY25, European Focus' EBIT base is expected to be 236% higher than its pre-pandemic level, which compares with only +83% of the MSCI Europe index.

If these growth trajectories were to continue into the future - which we construe is a broadly fair assumption given that the average year of foundation for a Portfolio company was 1932 - compounding should be further amplified. Over time, this should be a strong underpinning of the valuation premium of European Focus against the MSCI Europe index.

ESG considerations

European Focus is classified as an '**Article 8 Fund**', which means that the Fund promotes – among other characteristics – environmental and social factors in businesses in which investments are made follow good governance practices. Against this backdrop, ESG as a concept has always been integrated part of the investment philosophy of European Focus. This stance is based on the belief that *'doing well and doing good is mutually dependent'* for businesses to be successful in the long-term. In other words, the strategy does not believe that it is good business to cut corners in any of the 'ESG-verticals' given potential repercussions – be it financial risk – such as becoming liable to fines and other damages, reputational issues etc. To facilitate this approach, European Focus has an exclusion list which restricts the strategy from investing in businesses that are generally regarded as harmful to society (fossil-fuel, nuclear, weapons, tobacco, adult entertainment and gambling).

As investors and companies are continuously re-assessing various aspects of ESG, we note that all our Portfolio companies in one way or another have aligned part of their managers' remuneration packages to measurable ESG targets. We estimate that such ESG-related targets affect individual managers' variable compensation by up to 20% depending on industry and company.

Having gone through our Portfolio companies' 2022 annual and SRI reports, we note that businesses have made great progress in improving CO_2 emissions, waste, water etc Y/Y. While companies' ESG-disclosures stepped up in 2019, the pandemic naturally caused a severe disruption to how companies could improve going forward.

Given a few years since the pandemic, we have noted the following pattern by most companies: CO2 emissions, waste, water etc. fell sharply in 2020 due to the pandemic-instilled lockdowns which had a significant effect on business volumes for most of our Portfolio companies. In 2021, however, most businesses focused on recovering lost revenues and profits from the prior year and consequently, environmental metrics (CO2 emissions, waste, water and proportion of energy-sourcing from renewables) saw a sharp increase. This contrasts with the corresponding readings for 2022, which showed real improvement – both in terms of the reduction of CO2 emissions, waste, water and proportion of energy-sourcing from renewables in absolute terms – but also in terms of disclosure.

Risks and uncertainties

- **Indebtedness:** more countries are starting to feel the pain from higher borrowing costs. According to the S&P and the IIF (Institute of International Finance), global indebtedness has reached some $300tn, equivalent to around 350% of global GDP. Traditionally, economists considered countries' debt-to-GDP ratios in the 70-80% range as manageable, but once they reach levels in excess of 100%, debt-servicing starts to compromise countries' fiscal flexibility and ability to invest. As global interest rates may stay higher-for-longer, existing debt levels could pose an increasing problem to many economies (and companies).

- **Inflation and bond yields:** headline inflation has substantially declined in most of the world's leading economies. At the time of writing, it appears as if core inflation is also on a downward trajectory. If wage growth remains elevated, however, Central Banks are unlikely to start cutting their steering rates, which implies that economies could be set for a hard landing.

- **Putin's war with Ukraine and the Israeli/Gaza conflict:** we still see a risk (albeit gradually smaller) that Putin ramps up his war-efforts by deploying nuclear tactical weapons. After nearly two years of fighting, we are inclined to believe that Putin's failed attempt to occupy Ukraine has turned into a *'road to nowhere'*. Against this backdrop, we note similarities between the ongoing Russian/Ukraine War and the 'Soviet/Afghan War' in 1979-89. Once the US stepped up its efforts to supply equipment (in that case 'Stinger' missiles which were used against Soviet attack-helicopters), the Soviet Union's war efforts eventually faded with the result that the country pulled back. In addition, the recent conflict between Israel and Palestine in the Gaza Bank could become longer-than-expected and also spread across other parts of the Middle Eastern region (which currently appears to be the case).

- **Other geopolitical issues:** China's real-estate-infused credit crisis continues to brew in the background following the defaults of the real-estate giants, such as Evergrande and Country Garden, that now appear to have an impact on domestic consumption. Moreover, although China's seemingly close relationship with Russia is worrying from a geopolitical angle, we believe that China's ultimate aspirations are more closely aligned with its economic interests, and this should make the US and the EU Beijing's preferred trading partners for investment and capital allocation. However, China is yet to condemn Vladimir Putin for invading Ukraine. Given the strong worldwide opinion against Russia – and the severe sanctions against this country – it is likely that China is running a higher reputational risk by not taking a clearer stance against Putin's war efforts.

Attribution analysis for 2023

2023 was a decent period for the Heptagon European Focus Equity Fund in absolute terms, but the Fund underperformed the benchmark index. Over the past year, the Portfolio generated a gain of +14.5% vs. +15.8% of the MSCI Europe NR (EUR) index, reflecting an -138bps underperformance vs. the benchmark index. Closer analysis shows that although European Focus outperformed the benchmark in three out of four quarters in 2023, there was a weak relative performance in 3Q23 (-843bps vs. the benchmark), when the Energy sector (which the Fund does not invest in) had a stellar performance (+13.7% vs. -2.1% of the benchmark).

In the below attribution analysis for 2023, the performance of each stock has been converted to EUR from its local currency. Each stock's EUR-denominated performance should be compared with the benchmark index, MSCI Europe NR (EUR), which advanced by advanced by +15.8% over the same period.

Contributors

Novo Nordisk (NOVOB DC)

NOVOB (Denmark: +48.5% and 8.6% exposure), the world's largest manufacturer of insulin and anti-obesity drugs, was not only the second best-performing stock in the Portfolio in 2023 but also the best performer in 2022 (+27.6% vs. -9.5% of the benchmark index). During 3Q23, NOVOB de-throned LVMH to become Europe's largest company by market capitalisation on the back of a multitude of positive write-ups relating to the top-selling anti-obesity drug, Ozempic, where the underlying fundamentals appear to be truly amazing. The key points for healthcare authorities and society in general to consider are: *(i)* obesity should be regarded as a chronic and relapsing disease; *(ii)* the market value of obesity drugs is expected to reach some $200bn within the next decade; *(iii)* according to the WHO more than 1bn people globally are currently suffering from obesity and this number is expected to double by 2035 due to sedentary lifestyles and rising availability of processed food; *(iv)* the World Obesity Federation expects the economic cost of obesity to reach around 3% by 2035.

Putting these market drivers into context; NOVOB's FY23 sales are expected to reach around $35bn, of which circa $5bn relates to obesity drugs (circa 15% to the total). This implies that there is an approximate 40 times upside in market potential for obesity drugs to NOVOB. A few additional attributes also entice us for the year ahead and beyond as regards NOVOB. *First*, the company will ramp-up production of Ozempic in 2024 in order to meet demand. *Secondly*, Ozempic will be rolled out in several European countries. *Thirdly*, NOVOB has also set its sight also on the prevention of obesity by better understanding the underlying causes of weight gain. NOVOB is scheduled to release 4Q23 results on 31st Jan; we have no reason to believe that this report and the FY24 guidance will be anything but solid.

Adidas (ADS GY)

ADS (Germany: +44.5% and 4.8% exposure), the world's #2 biggest manufacturer of sports-shoes after Nike, was the second best-performing stock in the Portfolio in 2023. This strong advance is a sharp contrast with 2022, when the ADS share was a consistent underperformer due to: *(i)* the widespread Chinese lockdowns that led to lower sales volumes; *(ii)* the acrimonious and costly split-up with Kanye West and the *Yeezy* brand and; *(iii)* poor communication that ultimately led to the ousting of the CEO, Kasper Rorsted. However, since the arrival of Puma's former CEO, Bjørn Gulden, in 2023 investor-sentiment to the ADS share has completely U-turned. Moreover, since Gulden's arrival at ADS, there has been a noticeable improvement to the company's communication and a possible improvement to the company's corporate culture.

Following a few pre-announcements, such as the 2Q23 results (3rd Aug) and the 3Q23 results (8th Nov) ADS' official quarterly reports turned out to be *'non-events'* in 2H23. The main reason for the better-than-expected profitability relates to successful online sell-outs of the legacy Yeezy stock, which management initially thought would be a drag to the financial performance. Over-and-above this, ADS has signed several strategic contracts with a range of athletes and teams across multiple sports. For example, Manchester United, started to wear Adidas' kit in 2023 and so did Lionel Messi, who recently signed up with Inter Miami CF; the Heptathlon star, Anna Hall, became part of the *'Adidas family'* as well as the Indian Cricket Team. At the 3Q23 webcast, ADS commented that during the Cricket 50/50 World Cup in India, some 500,000 Indian cricket jerseys were sold. Moreover, several individual basketball stars (Damian Lillard, James Harden, Derrick Rose, Trae Young and more) have signed contracts with Adidas. ADS' next reporting event will be the 4Q23 results on 6th Mar; we have little doubt that there will be more positive announcements as momentum of the business currently seems to be strong and we also note that there is likely to be another *'Yeezy sellout'* in 2024.

Atlas Copco (ATCOA SS)

ATCOA (Sweden: +41.3% and 6.8% exposure), the world-leading manufacturer of compressor technique, vacuum pumps and ancillary equipment was the third best-performing stock in the Portfolio in 2023. While the company's 4Q22 set of results (26th Jan) fell short of market expectations as the important Vacuum Technique division (16% of sales and 14% of EBIT) recorded a -22% LfL fall in the order intake primarily caused by weakness in the APAC region, management continued to guide for a continuation of current business volumes. However, the 1Q23 results (27th April) were well ahead of market expectations and CEO, Mats Rahmström, commented that this was: *'Primarily due to several significant orders and strong project-related business as the order intake increased more than expected and reached a new record level'*. Moreover, orders for industrial compressors (ATCOA's core expertise) increased as demand for gas and process compressors was *'extraordinary'* (this type of machinery is used in manufacturing, such as for automotive and EV production). Although the 2Q23 set of results (19th July) was ahead of market expectations, order intake in the investor-sensitive Vacuum Technique division showed a -28% LfL Y/Y decline and investors duly took a negative view to the report. ATCOA's fortunes again turned for the better in 3Q23 (25th Oct) as profitability was ahead of market expectations. Management commented that the order intake was strong for large-sized compressors, but order intake (again) weakened for vacuum-pumps. Nonetheless, the market took an overall positive view to the report and consensus projections were raised for FY23 and for future years. ATCOA's 4Q23 set of results are due on 25th Jan.

Straumann (STMN SW)

STMN (Switzerland: +36.8% and 4.9% exposure), the focused and global leader in dental implants and ancillary orthodontal materials, was the fourth best-performing stock in the Portfolio in 2023. This strong performance reflects a sharp contrast with 2022 when STMN was one of the weakest performers in the Fund. We note that over-and-above falling bond yields, very little has changed in terms of STMN's fundamental outlook in 2023. Although the company's FY22 set of results (21st Feb) fell slightly short of highly set market expectations, investors remained sanguine as management commented that profitability during 2H22 had been impaired by capacity-expansions, enhancements in digitalisation as well as staff hirings (i.e. all investments were aimed at growing the business). The 1Q23 revenue statement (3rd May) was ahead of consensus projections. While STMN's total LfL sales growth reached only 3.4% in 1Q23 due to the lockdown in China in Jan-Feb, management commented that excluding China, the LfL sales growth in the APAC region would have been +9.5% in 1Q23 (vs. the official LfL growth of -23.5% in APAC). The 1H23 results statement (15th Aug) was ahead of market expectations. The key highlight in the report related to the APAC region where LfL growth reached +23.1% in 2Q23 given pent-up demand in China. However, management commented that by Sep-Oct, the Chinese demand-spike should come to an end and STMN would have a clearer idea of what the underlying demand would be. Nonetheless, STMN maintained the guidance (*'LfL revenue growth in the high single-digit range and EBIT margin of around 25%…'*). The 3Q23 revenues statement (31st Oct) was again ahead of market expectations as the bright spot continued to be the APAC region where LfL growth reached +26.8% in 3Q23. The Chinese orthodontics market was extremely volatile in 2023 exacerbated by the fact that the country started to purchase medical equipment through VBP (Volume Based Procurement). Such bulk-buying is likely to have boosted volumes (possibly by some 20-30%) in 2023, but at the same time, prices are likely to have fallen by some -40% to -50%. STMN will publish its FY23 set of results on 27th Feb.

ASML (ASML NA)

ASML (the Netherlands: +35.3% and 6.0% exposure), the world's leading supplier of semi-conductor manufacturing equipment, was the fifth best-performing stock in the Portfolio in 2023. The ASML share registered a very strong performance in 1H23 (+31.1% vs +11.1% of the benchmark) – partly underpinned by Nvidia's *'blow-out'* numbers (24th May) and the company's remarks that the demand-driven boom for AI-chipsets should last for several years. However, as value-driven sectors became in vogue with investors, the stock had a weak performance in 3Q23 (-15.7% vs. -2.1% of the benchmark) despite no material change in the company's underlying fundamentals. ASML's 2Q23 results (19th Jul) were ahead of highly set market expectations, but as management issued an unusual cautionary statement: *'The timing, shape and slope of the recovery is causing some short-term concern with customers…'* the stock saw some profit-taking. ASML's 3Q23 set of results (18th Oct) was broadly in line with market expectations. While sales fell slightly short of consensus, all profit-metrics were ahead. Nonetheless, the market took a negative view to the numbers as order bookings fell sharply by in 3Q23 (-72%), but we noted that the output and shipments of high profit-margin EUV machinery increased by +48% and ASML's overall machinery shipments increased by +36% (all comparisons in 3Q23 year-over-year). ASML will release 4Q23 results on 24th Jan.

Detractors

Zalando (ZAL GY)

ZAL (Germany: -35.2% and 1.8% exposure), Europe's largest online fashion retailer, was the worst-performing stock in the Portfolio in 2023. After a roaring performance during the pandemic period and the first seven months of 2021, the ZAL share has been a drag for two main reasons. *First*, technology and other growth-like stocks suffered in the early part of that year because of higher bond yields. *Secondly*, consumer confidence in Germany was particularly hard-hit following Vladimir Putin's invasion of Ukraine. ZAL remains the smallest position in European Focus, and we are reluctant to part ways with this business since the fundamental shift towards online European retailing is still arguably in its infancy. Our initial purchase of ZAL (Jun-17) was around €41 per share. At the end of 2023, the ZAL share was priced at around €21.5 (close to -48% below

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

our initial purchase price and down from an all-time high of €104.65 on 7th Jul-21). ZAL's LfL sales CAGR was close to 20% until Putin's invasion of Ukraine in Feb-22 and EBITDA compounded by around 16% annually over the same timeline. The business is thus now more than 2x bigger in terms of sales and EBITDA while the balance sheet is net cash positive. ZAL's market shares across Continental Europe are considerably larger and its product suite is substantially broader partly due to the *'Partner Program'* where third party retailers can link up with ZAL and receive a wide range of online and logistics support. Moreover, ZAL's product offering now includes cosmetics, which we believe is well-suited for online-trading due to consumers' repetitive purchasing pattern of such products. In the cosmetics field, ZAL has a close cooperation with the cosmetics retail-giant, Sephora (fully owned by LVMH). ZAL's 3Q23 results (2nd Nov) reflected a mixed bag as management did a good job in improving profitability by holding fulfilment and marketing expenses at bay. Although it looks as if the consumer environment in the DACH region further deteriorated in 4Q23, we still expect a slight improvement in LfL sales growth due to easier base numbers for comparison. Moreover, we believe management will guide for a gradual improvement in trading conditions FY24. ZAL's 4Q23 set of results is due on 13th Mar.

Tomra (TOM NO)

TOM (Norway: -30.3% and 3.9% exposure), the world's leading provider of recycling and sorting equipment for beverage bottles and cans, was the second weakest-performing stock in the Portfolio in 2023. In our opinion, TOM's main competitive edge does not relate to its machinery – so called 'RVMs' (Reverse Vending Machines) – but in how to implement deposit-systems for beverage bottles and cans in different jurisdictions and how they should be optimally funded generally by incentivising consumers to return empty bottles and cans. In a nutshell, TOM acts as a consultant by guiding countries how to best implement deposit systems. Given today's environmental constraints relating to recycling of glass/plastic bottles and cans – we continue to be confounded by the poor performance of the stock price. While we understand investors' disappointment relating to the weak performance of the Food division (33% of sales and 22% of EBIT in FY22), the key driver for the stock is the much more important core division, Collection (50% of sales and 54% of EBIT), which should continue to be the main engine for the business in the years to come.

TOM's order backlog is currently near an all-time high and so is the order intake. While we are cognisant that the company's business volumes tend to be somewhat irregular and can often appear to be 'lumpy', we believe there are two other reasons for the poor performance of the stock. *First*, communication between the TOM and the market is somewhat sketchy as the CEO and the CFO have often come across as too cagey by having downplayed the cost and timing of prior supply-chain bottlenecks. This suggests that confidence in management has been dented. In addition, we note that other Environmental stocks in the *'renewable energy field'*, like Danish Vestas (VWS DC), Orsted (ORSTED DC) and Nordex Group (NDX1 GR) also saw their stocks perform poorly during most of 2023. Against this backdrop, we construe that there is a higher degree of sector-correlation amongst Environmental stocks than previously believed. TOM's next set of results is the 4Q23 statement, which is due on 15th Feb. While our expectations for the quarter are modest, we believe management will give guidance for a recovery in FY24.

Lonza (LONN SW)

LONN (Switzerland: -22.1% and 2.9% exposure), one of the world's leading CDMOs (Contract Development Manufacturing Organisations) has seen a sudden and sharp fall from grace. The LONN share was the third weakest performer in the Portfolio in 2023. Following the successful JV with Moderna (MRNA US) in respect of Covid-19 vaccines during the pandemic, which saw the LONN share peak some 121% higher (at CHF784.60 on 6th Sep-21) vs. its year-end 2023 price, not much appears to have gone the company's way. The stock was performing nicely during 1H23 (+17.8% vs +11.1% of the benchmark), but a series of mishaps occurred in 2H23. With hindsight, LONN's misfortunes started following the release of the 1H23 statement (21st Jul), which fell short of market expectations. Two main reasons were to blame. *First*, there was a degree of under-utilization in early-stage biotechnology services (caused by higher funding costs). *Secondly*, there was lower demand for nutraceutical capsules (due to a weaker consumer environment). Against this backdrop, management cut the FY23 sales guidance from *'high single-digit' to 'mid-to-high single-digit'* LfL growth as well as the core EBITDA margin guidance from '30-31%' to '28-29%'. To add insult to injury, LONN issued a statement (18th Sep) that CEO, Pierre-Alain Ruffieux, would leave the company

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

by mutual agreement and this announcement naturally raised investor concerns about the company's medium-term outlook. Around the same time, there was also a communiqué that LONN and Moderna would discontinue its JV, which was established in 1H20, as demand for Covid-19 vaccines was waning. Consequently, LONN swiftly organised an Investor Day (17th Oct) to clarify some of the key issues. In our opinion, the main takeaways from LONN's Investor Day, is that the medium-term (2024-28) annual LfL sales growth rate should be in the 11-13% range and core EBITDA margin in the range of 32-34% (FY22: 32.1%). In the short term, however, LONN's main predicament is that its growth rate is expected to temporarily come to a halt in FY24 as the company will receive a termination fee from Moderna in 2023 (around CHF200m, or around 3% of the projected FY23 revenues).

While our current exposure to LONN is under review, we believe LONN's underlying business is solid. Switzerland has traditionally fostered world-leading businesses where the requirement for *'precision'* in a wider sense is highly critical (such as in the weaving-machinery industry, watchmaking, medical-technology etc). Against this backdrop, we cannot see why LONN – as a reputable international CDMO – would be an exception. LONN will publish FY23 results on 26th Jan. While we have low expectations for a meaningful improvement of LONN's underlying business, we are hopeful that management will be a bit more granular regarding current trading conditions.

Diageo (DGE LN)

DGE (UK: -20.1% and 4.0% exposure), the world's largest distiller and with possibly the widest range of well-renowned brand names under its umbrella (such as Johnnie Walker, Gordon's, Tanqueray, Smirnoff and Captain Morgan and many more), was the fourth weakest-performing stock in the Portfolio in 2023. We believe few factors are to blame. While the 1H22/23 set of results (26th Jan) was ahead of market expectations reflecting continuous LfL revenue recovery in North America and organic sales recoveries in most other regions, management commented that the 2H22/23 period (Jan-Jun) would face more difficult base numbers for comparison and a potential consumer-driven slowdown. Management's concerns were confirmed with the FY22/23 set of results (1st Aug) which fell short of market expectations due to a slowdown in volume growth in 2H22/23. We also note that following the passing of Sir Ivan Menezes, the recently appointed CEO, Debra Ann Crew (ex-Head of North America) did not come across particularly well during the webcast as she hid behind clichés like: *'We feel good about...'* when the company's sequential growth rate sharply decelerated, and inventory levels increased. In addition, management guided for *'more of the same'* in FY23/24; reflecting LfL sales growth in the 5-7% range and LfL EBIT growth of 6-9%, which is likely to be back-end loaded to 2H23/24 (i.e. Jan-Jun-24). To add insult to injury, DGE's new CEO was forced to issue an embarrassing profit-warning (10th Nov) relating to weakness in the LATAM business. Since this happened less than a week before DGE's scheduled investor day in New York City (15th Nov), investors were more interested in hearing about what management's short-term action-plan is to restore profitability than the company's long-term strategic agenda. DGE's 1H23/24 set of results is due on 30th Jan.

Nestlé (NESN SW)

NESN (Switzerland: -3.0% and 4.0% exposure), the world's largest food manufacturer, was the fifth weakest-performing stock in the Fund in 2023. While NESN's FY22 set of results (16th Feb) fell slightly short of market expectations, the 1Q23 sales report (25th Apr) was ahead of consensus. NESN's 1H23 set of results (6th Jul) were *'in-line-to-slightly-better'* than market expectations; while revenues were slightly lower due to volume losses which were fully offset by price hikes, all profit metrics beat consensus. Moreover, management slightly raised the FY23 guidance to 7-8% LfL sales growth (from 6-8% LfL sales growth). The 3Q23 sales report (19th Oct) fell short of market expectations. Pricing continued to be the main driver to top-line growth and management made several remarks that volume growth would end up in positive territory in FY23. Nonetheless, the market took a negative view to the report partly due to the fact that NESN's long-standing CFO, Francois-Xavier Roger, will leave the Group by 1st Jun-24. NESN has appointed Anna Manz, who is currently the CFO of the London Stock Exchange (LSEG LN), as Roger's successor. In the YTD, we construe that the lack of investor interest in the NESN share is not immediately company-specific but more likely related to the defensive characteristics and the Consumer Staples sector, which is currently out-of-favour. As highlighted earlier in this report, the Consumer Staples sector was the only European industry group to register negative returns in 2023 (-1.0% vs. +15.8% of the benchmark). NESN will publish FY23 results on 22nd Feb.

European Focus Portfolio changes

The '5/10/40' UCITS rule states that: *(i)* positions over 5% cannot have an aggregate weighting which exceeds 40% and *(ii)* an individual position cannot have a weighting which exceeds 10%. As trades of less than 1% are too small to have any meaningful impact on the Fund's performance, we generally only comment on trades exceeding this level.

In total, we have made 9 active changes to the Portfolio during 2023 (2022: 4 changes) of ±1% or more, of which 3 changes were made in 4Q23 (4Q22: 2).

- We added to the Swedish capital goods company, **Atlas Copco** (from 4.0% to 5.0%), on 26st Jan and 1st Feb: while the 4Q22 set of results fell short of market expectations as the important Vacuum Technique division (FY22: 16% of sales and 14% of EBIT) recorded a -22% LfL fall in the order intake (primarily because of weakness in the APAC region), management continued to guide for a continuation of current business volumes. The Atlas Copco share closed -6.0% lower (MSPE +0.4%) on the day of the 4Q22 release. However, since the 4Q22 report, consensus FY23 and FY24 sales estimates were slightly raised while the corresponding EBIT were marginally cut.

- We added to the French cosmetics group, **L'Oréal** (from 4.3% to 5.3%), on 10th Feb: the FY22 set of results (published after the market closure on 9th Feb), was ahead of highly set market expectations. The numbers reflected sequential continued strong of LfL sales growth 8.1% in 4Q22 (3Q22: 9.1%; 2Q22: 13.4% and 1Q22: 13.5%) implying that for the second year running OR generated double-digit LfL growth. From a category point of view, Active Cosmetics (FY22: 14% of sales and 15% of EBIT) continued to outperform the other divisions. It was also pleasing to note that L'Oréal Luxe (FY22: 39% of sales and 39% of EBIT) showed sequential acceleration in 4Q22 LfL growth (but se suspect it was partly boosted by easier base numbers for comparison). When the L'Oréal opened for trading on the following day, it opened slightly higher (MSPE -0.7%). During the session, the stock traded in a volatile fashion, and it closed -0.8% lower (MSPE -0.8%). Since the FY22 statement, consensus sales estimates for L'Oréal were slightly raised while the corresponding EBIT changes were broadly neutral.

- We divested the French food and pharma-testing group, **Eurofins Scientific** (from 2.4% to 0.0%), on 6th Mar: the FY22 set of results (1st Mar) fell short of market expectations. In our view, there were several issues with the report which was overly complicated with several restatements that made it opaque. More important, management cut its key metric *'Adjusted EBITDA'* guidance for FY23 as the company is unlikely to gain any additional Covid-related business which has tremendously benefited the group over the past 2-3 years. We also got the impression that Eurofins will transition into different type of growth momentum where more of the new business will be generated from the organic build-up of new laboratories, which should cap top-line growth but should eventually increase the company's profit-margin. The market took the FY22 report badly with the Eurofins share closing -12.1% lower (MSPE -0.7%) on the day of the announcement. Following the 'normal' bounce back during the ensuing days, we parted ways with the holdings which has been held in the Portfolio since April 2016. During the time we were invested in Eurofins Scientific, the position generated a total return of +99% vs. +64% of the MSCI Europe benchmark index.

- We added to the German sports-shoe manufacturer, **Adidas** (from 2.4% to 3.6%) on 13th and on 14th Mar. The 4Q22 report (8th Mar) fell slightly short of lowly set market expectations. However, the actual results statement had already been pre-announced by the new CEO, Bjørn Gulden (ex-Puma), who took charge of Adidas in Jan-23. At that time of the pre-announcement (aka profit-warning on 9th Feb), Gulden took the opportunity to *'kitchen-sink'* expectations for the company by essentially writing off what used to be the highly successful *Yeezy* brand after the acrimonious split-up with Kanye West. The Adidas share opened lower on the day of the 4Q22 announcement, and the stock traded in a down-trodden fashion until management's customary webcast when it regained its poise to close higher after Gulden vowed to not leave ADS until the EBIT margin had reached *'at least 10%'* (FY22: 3.0%). Following the 4Q22 report, consensus sales estimates for Adidas in FY23 and FY24 were left essentially unchanged but the corresponding changes to EBIT showed upgrades of some +50% and +1% respectively.

- We initiated a position in the British professional recruitment specialist, **Page Group** (from 0.0% to 1.5%), on 31st Aug: although Page has been in our investment universe for several years, we have never previously been invested in the business. The stock was on our watchlist for a few quarters as these secular-cyclical stocks normally display excellent bounce backs once the underlying business conditions and/or LfL growth rates improve. Page typically generates net fees in the range of £250-270m per quarter. Due to *'talent shortage'*, net fees have up extremely well but the quarterly LfL growth rates have still fallen sequentially for six consecutive periods; while they are likely to continue to be on a downward trajectory (perhaps) for another 1-2 quarters, come 2024, LfL growth should start to recover due to much easier base numbers for comparison. Once such a reversal in the trend line has been established, these stocks tend to appreciate in the range of 80-120%. It is our aim to continue to add to this position during 4Q23 and possibly into 2024. Page published its 3Q23 trading statement (11th Oct), which was in line with our projections. The company's next reporting date is the 4Q23 trading statement on 15th Jan-24.

- We divested **SGS** (from 2.8% to 0.0%) on 6th Sep: this position has been part of European Focus since Aug-19. The rationale for the divestment of this fine and well-managed company is that a multitude of international companies are either voluntarily (or involuntarily) taking a more distant view towards China. Although SGS does not sell directly into the Chinese market, many of its international customers have used the SGS' TIC (Testing/Inspection/Certification) services for exports out of China. Since many of these customers are now either relocating (or at least re-assessing) their need for using China as a manufacturing-hub, we believe SGS' medium-term fundamentals have deteriorated. Following the divestment of SGS, European Focus no longer has any 'TIC exposure' as we sold SGS' British peer, **Intertek**, in Aug-22 and for different reasons, we also divested **Eurofins Scientific** in Mar-23 (see above comment).

- We added to the British professional recruitment specialist, **Page Group** (from 1.7% to 4.1%) during 11th Oct to 6th Nov. An encouraging trading statement from the much smaller British peer of Page Group (Robert Walters Plc) a day prior to that of Page prompted us to continue to add to this recent investment. Although Page Group's quarterly net fee LfL growth rate has deteriorated for each of the three consecutive quarters in 2023 (similar with other recruitment companies and as mentioned earlier), we anticipate a sharp bounce-back once the company enters 2024 due to easy base numbers for comparison. From a qualitative point of view (and we believe equally important), during Page's 3Q23 webcast (11th Oct), management commented that while business conditions in most geographies remained suppressed, it looked as if US trading had started picking up – particularly in the technology sector on the US West Coast. Traditionally, such remarks have proven to be a good nod to entry points into recruitment stocks.

- We divested the Dutch payment provider, **Adyen** (from 1.7% to 0.0%) during 9th to 15th Nov. Following a dreadful set of 1H23 results (17th Aug) on which we commented in the 9M23 attribution analysis, the Adyen share was by far the worst performer in the Portfolio and in our Investment Universe during 3Q23 (-55.5% vs. -9.8% of the benchmark). Following the 1H23 set of results, we suspect that along with a multitude of other investors, we lost confidence in Adyen's management team and more to the point – how Adyen's management interacted and communicated with the investment community following the 1H23 set of results. In our case, it took the company six weeks to grant us a private meeting with one of the representatives from the Investor Relations (IR) Team. When we eventually got in contact with the Adyen's IR representative, the person had minimal relevant experience. Failing to get any meaningful information from the IR Team, we decided to delay our exit until a sudden (and we suspect enforced) decision to organise an investor-day in San Francisco on 9th Nov was announced. While not having been a successful investment for the Portfolio, this decision proved to be correct as our exit price of Adyen was some 49% higher compared with the closing price prior to the Investor Day (€695.7). The strategy of European Focus is to invest in high-quality companies in the widest sense. In our view, part of this modus operandi is to have a continuous dialogue with the management teams in the Portfolio companies. Clearly, access to management has to be an essential part of this strategy as well as for any business to act as a good steward and be a solid corporate citizen. Following Adyen's behaviour to ignore our request for a meeting for more than a month (despite several attempts on our part to engage with the company) and ultimately offer us an inexperienced IR representative, we have also eliminated Adyen from our Investment Universe.

- We initiated a position in the British professional recruitment specialist, **Hays** (from 0.0% to 2.5%), on 14th Dec. Following the Fed's last FOMC meeting in 2023 (13th Dec) and Chairman Jerome Powell's acknowledgement that the Bank is likely to have conducted enough interest rate increases during this rate hike cycle, we adopted a much more positive view towards (secular) cyclical recovery stocks. Consequently, we acquired a position in Hays. We have owned Hays in the past, but as this stock has been lagging other professional recruitment stocks (such as Page Group, Robert Walters and Robert Half International), we believe it is only logical that it will mean-revert it if the correct financial markets conditions are set in motion, such as at the time of our purchase of the share. Hays next report will be the 1H23/24 set of result which is due on 22nd Feb.

Christian Diebitsch, Fund Manager, Heptagon Capital

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.

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.

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

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.

Authorised & Regulated by the Financial Conduct Authority (FRN: 403304)

Disclaimers

Source: MSCI. The MSCI information may only be used for your internal use, may not be reproduced or redisseminated 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