HEPTAGON Capital

Listed Private Assets: Monthly commentary

January 2021

The Strategy returned +1% during January, outperforming Global Equities which corrected –1%.

Our portfolio managed to produce a positive return despite a correction in most listed equity markets in January, reinforcing our views that cross-asset correlations are returning to some sort of normality. Overall, we expect our portfolio to have low correlations to traditional equity indices (0.4 to 0.6 over a full cycle) and as such, it was pleasing to see this put to the test in January.

The ultra-low rate environment that has prevailed in markets over the past few years has created a frenzy in growth and tech-related stocks around the globe, particularly in the US. We find it hard to deny today that there exists a significant feedback loop between the loose, unconventional monetary policies implemented around the world and asset price inflation in growth equities. If one thinks of growth stocks as "long-duration assets", given that investors tend to discount that growth over very long time periods, the discount rate used by many investors is strongly influenced by the overall yield and rate environment. As such, the remarkable outperformance of growth as a factor against pretty much all other styles of investing can be in part attributed to the behaviour of the Federal Reserve and other major central banks over the past 10 years. It is our view that this self-re-enforcing mechanism, which has created asset inflation as opposed to "real world inflation", is at the source of many of the issues impacting active management, the rise in inequalities and populism. It can also be argued that it has now created epic bubbles in parts of the market.

Given the above, it is not surprising that value, real estate and infrastructure have struggled to keep up with the performance of other listed assets. However, the shift towards the use of fiscal stimulus is, in our view, a game-changer and has the potential to reverse the imbalances created by monetary policy alone. We have seen evidence of this over the past few months and that is why we feel comfortable with our portfolio going forward: it is relatively much cheaper than the growth-oriented parts of the market and will benefit from this change in leadership.

Logistic assets were the main drivers of performance in January with both Tritax Big Box and Tritax Eurobox delivering a +10% total return for the month. Continued interest in this space, particularly from large institutional players, has supported valuations and asset prices over the past few months. A combination of strong rent collections and solid rental income growth has helped our two holdings get to the top of the league in terms of long-term REITs performance. Their ability to increase shareholder value through large scale development capabilities will be a key driver of returns going forward.

Within Real Estate, we continue our drive to rotate out of names which are trading at a premium into discounted opportunities. We took profit on our position in Primary Health Properties, which has been a strong long-term performer in our portfolio but has been trading at a very high premium for a while. The proceeds helped us to start building a position in the PRS REIT, a London listed company focussing on the family home segment. This is an area that we have had an interest in for some time given the structural undersupply of newly built homes in the UK. We always try to find long term secular trends underpinning our positions and as such, PRS fits many of our selection criteria. The lack of supply of new homes, particularly in the affordable segment, has only increased as a result of the pandemic. One of PRS' key advantages is its deep and long-term relationship with both housebuilders and government authorities. The UK government's home agency is the third-largest shareholder in the REIT with a 6% stake. The government has, over the past few years, made it a priority to address the chronic shortages of new housing as well as the decline in affordability. Additionally, the UK's Private Rented Sector is highly fragmented with the majority of assets owned by buy-to-let investors with very little ownership from professional/institutional investors. The company's strong relationship with housebuilders is key to sourcing new assets; it has already delivered in excess of 3,000 homes and the company is on track to deliver 5,000 new homes by early 2021. We purchased this holding on a 15% discount and with a current dividend yield of 5% per annum.

Within Private Debt, our speciality lender VPC also produced solid performance for January with a 10% total return. This holding has demonstrated strong resilience since the start of the COVID-19 pandemic and despite the lockdowns. As investors started pricing a significant ramp-up in credit defaults following the abrupt drop in growth witnessed in March, this holding went to a 45% discount. This was understandable given the lack of visibility and potential impact to the underlying borrowers of VSL lending platforms, however, the firm's structuring and underwriting proved to be resilient and defensive. Each investment is typically structured with a guarantee and a blanket lien over the underlying loans as well as a 'first loss' cushion provided by the lenders, protecting VSL's capital in the event of defaults. Additionally, both monetary and fiscal interventions managed to put a line in the sand, so to speak, and managed to avoid a dramatic pick-up in default rates. We will be looking to add to this position opportunistically over the months to come.

Finally, after a very quiet period for new issues, there have been 4 new IPOs announced in our space over the past 4 weeks. We will be meeting with 2 of these managers to explore these new opportunities. The need for capital to decarbonise our economies should mean that the opportunity set and pipeline for many specialist managers in this space will grow over time and as such, offer plenty of opportunities for us to get exposure to this long term secular trend.

We continue to believe that each segment of our portfolio should generate solid returns in the current environment and we are finding pockets of opportunities in real estate in particular. As with any crisis, new, less-levered capital structures will emerge, which should create interesting long-term investments across many assets.

Kind regards,

Arnaud Gandon, Portfolio Manager

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Heptagon Capital LLP, 63 Brook Street, Mayfair, London W1K 4HS
tel +44 20 7070 1800
fax +44 20 7070 1881
email london@heptagon-capital.com

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