HEPTAGON Capital

Listed Private Assets: Quarterly Commentary

Q4 2020

Our Strategy returned +8.7% for the fourth quarter of 2020, the most remarkable year, bringing the year to date total return to +5%.

We have often contended that the next crisis is unlikely to be like the previous one and rarely comes with any warnings. As I was writing this commentary to reflect on 2019 only a year ago, if anyone had told me that the world would see a global pandemic, rolling lockdowns and a successful attempt to storm the Capitol in Washington following the US presidential election, I would most probably have dismissed them instantly. Well, here we are, almost a year later, and the streets are deserted, restaurants are still closed and the Democrats are pushing for a second impeachment of Donald Trump; something that has never happened before. So much has happened in 2020 and in such a short space of time, from the despair and unimaginable suffering resulting from the virus and its impact, to the light and hope offered by the vaccines.

In many ways, financial markets have followed a similar pattern this year, from despair to euphoria in a matter of months. What took almost a year to be implemented during the GFC, took a matter of weeks this time around as Central Banks and Governments alike stepped in to support economies and markets. The magnitude and the speed of these interventions were on a scale never seen before and proved very successful at drawing the proverbial line in the sand for global asset markets.

Both the fiscal and monetary stimuli have been very effective at propping up asset markets but maybe less so at supporting the real economy, further driving the gap between financial markets and economic growth. Have markets got ahead of themselves or will economies catch up to what is currently been priced across many asset classes? Only time will tell, but by making sure that we do not overpay for the businesses we own, which is a core part of our approach, we should be able to successfully navigate both scenarios.

Furthermore, in our view, having a good balance between growth and value factors (long and short duration assets) will be key to steering our asset allocation in the medium term, given the volatility in US treasury yields. The US yield curve steepened dramatically during the last quarter of 2020, mostly in anticipation of Biden's proposed policies. Should this trend carry on, a change of leadership in the equity markets is possible, away from the FANGs and the technology complex, towards Financials, Energy, Real Assets and "old economy" stocks. As such, our portfolio's exposure to REITS and Infrastructure (roughly 50% exposure combined) should provide a solid source of returns should such a scenario unfold.

It has long been our view that there is no such thing as being able to time the market, let alone factor exposure. That is why one of the key developments of 2020 for the Listed Private Asset strategy was to find longer duration, growth assets within the Private Equity and Venture Capital sectors in order to balance our overall exposure. In that way, we do not have to make the "right factor call" but rather to find companies that match our desired selection criteria. We look to **back high-quality management teams**, that are (preferably) **operating in niche strategies**, and try **to avoid overpaying** for them.

The last quarter of 2020 marks a return to form for listed Hedge Funds with Pershing Square and Third Point leading the way.

Both investment companies produced outsized returns with +28% and +24% respectively. Third Point's Daniel Loeb continued to steer its fund to further recover from a very difficult first quarter, where the listed vehicle lost -20%. Driving the equity portfolio's gains were a series of well-timed entries into new positions since the market bottom, including in Alibaba and JD.com, Amazon, and Disney; as well as by bounce backs in several core positions including S&P Global and Prudential. The firm spent a considerable amount of time and resources trying to estimate how quickly and credibly progress was being made on potential vaccines. Their research informed their decision to keep re-investing in the equity book as news of an effective vaccine would support many of their investments.

This momentum for Third Point offshore enabled the share price to rally strongly and, as such, a significant narrowing of the company's discount to net asset value, from -30% in mid-April to about -17% at the year-end. The fluctuation in the discount of this investment company since its inception in 2007 provides yet another example of the opportunities to access talent with a margin of safety offered by this niche sector.

Our exposure to the two largest US Agency Mortgage Backed Securities REITS also delivered outstanding total returns in Q4 2020.

Annaly Capital and AGNC Investment Corp returned +22% and +15% respectively, as spreads continued to tighten in this credit sector, following the large dislocation witnessed in Q1. We bought these two positions in June and July, taking the view that these are well-managed REITs with plenty of experience in navigating through volatile times as both were operating during the GFC in 2008. Additionally, the Federal Reserve was very quick at initiating direct purchases of AMBS paper in the market in order to provide liquidity and restore calm into this sector, which is perceived as critical to a functioning US Real Estate market. We purchased both companies in June and July on a respective dividend yield of 14% for Annaly and 12% for AGNC Investment Corp. Both have ample cash buffers on their balance sheet and plenty of liquidity to support their dividend. They are also enjoying ultra-low funding costs for their leverage, allowing for relatively high margins. Additionally, having shrunk the size of their balance sheets dramatically following the Q1 correction, both companies now have room to invest and expand on the opportunities in the market, while providing a rare and significant source of income.

From zero to hero, our holding in IP Group saw the most significant discount narrowing during Q4 as its net asset value rose.

What a difference a year makes in the life of some companies, IP Group went from being a company making the headlines for all the wrong reasons (mostly because its largest shareholder was Woodford Asset Management) to creating remarkable shareholder value through a sale and announced joint venture on two of its underlying life science portfolio companies. As with many intellectual property companies (or Venture Capital firms), improvement in net asset value tends to be rather lumpy, based on a clear catalyst for its portfolio companies. We are pleased to have added to this holding in May, on a significant discount to net asset value (-45%); since then the company's discount has narrowed to about -5% at the end of 2020.

Renewable operators in both wind and solar continue to be the laggard in Q4 and produce mediocre returns for the full year.

Our owners/operators of renewable assets produced total returns of about +2% on aggregate for the year, a return below their stated levels of dividend yield (at around 5% to 6%). These companies entered the crisis with relatively high premiums and were impacted by the gradual decline in energy prices witnessed in the past few years, culminating in a complete collapse in the first quarter of this year. Despite the recent growth in renewable power production globally, electricity prices are still very much correlated with the price of hydrocarbons (at least for now) and as such any significant decline in energy prices is likely to have an impact on long term electricity price forecasts. This is very much what happened this year; our portfolio companies in this sector rely on long term price forecasters for modelling their revenues and future cash flows. A sharp reduction in these forecasts caused most companies in the sector to review long term electricity prices in their models, forcing them to adjust future net asset values downwards.

As energy prices recover, we should expect these long term prices to bottom over time and we continue to view this sector as attractive despite the prevailing premiums given the secure level of income provided by their long term contracted cash flows, especially in a market environment where income has become a very scarce resource.

Looking forward to 2021, we feel that many real assets that have not fully participated to the rally witnessed in the second half of 2020 have a chance to catch up. Real Estate, in particular, is one asset class that will, in our view, create some interesting opportunities when the vaccines start to have an impact on infection rate and life can return to some sort of normality. Some of the very large European REITS focussed on "brick and mortar" retail, as well as offices, are trading on very significant discounts. We will undoubtedly see restructuration's, right issues and other corporate actions that may provide an attractive entry point in many of these names. In the meantime, we will continue to look for discounted investment opportunities, while balancing the need for liquidity and income for our strategy.

We would like to thank our holders for their support during what has been the most challenging year.

Kind regards,

Arnaud Gandon, Portfolio Manager

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SFDR

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

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