HEPTAGON Capital

Driehaus US Micro Cap Equity Fund

Q3 2021 Commentary

Fund Manager

Jeff James

Investment Objective

The investment objective of the Fund is to achieve long-term capital growth. The Fund's Sub-Investment Manager, Driehaus Capital Management LLC, is a privately-held boutique asset management firm located in Chicago, USA.

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The **Driehaus US Micro Cap Equity Fund** (the "Fund") is a sub-fund of Heptagon Fund ICAV which is an open-ended umbrella type investment vehicle authorised pursuant to UCITS regulations. Heptagon Capital Limited ("Heptagon") is the Investment Manager and Driehaus Capital Management LLC ("Driehaus") is the Sub-Investment Manager meaning Driehaus exercises discretionary investment authority over the Fund. The Fund was launched on 7th December 2016 and had AUM of USD 872m as of 30th September 2021. During the third quarter of 2021, the Fund outperformed its benchmark, the Russell Micro Cap Growth Index TR (the "Index"), returning -3.9% (I USD share class) compared to -9.1% for the Index.

Market Overview

The September quarter was a down period for the U.S. equity market as the number of headwinds and concerns expanded, causing economic growth to slow and equity multiples to contract slightly. While the largest capitalization stocks outperformed, helping the S&P 500 to eke out a tiny gain of 0.6%, the rest of the market struggled as size was an important driver of returns. Larger cap stocks outperformed mid caps, which outperformed small caps, which outperformed micro caps. Value also managed to outperform growth during the period.

The micro and small cap indices have now consolidated in a sideways fashion since the spring of this year and are off approximately ten percent from their highs earlier this year. The S&P 500, which reached new price highs throughout the quarter, has now declined about five percent from its recent early September high.

The equity market is typically weak during the August to October period, but multiple fundamental concerns have also pressured equities with the Delta variant the most prominent having caused another major wave of new COVID cases. As a result, many parts of the U.S. brought back mask policies and other social distancing restrictions. While most of new cases are among the unvaccinated population, especially in terms of severe disease, this wave certainly impacted the economic momentum that had been accelerating during the first half of 2021. Economic (GDP) growth slowed as consumer travel and leisure spending decelerated, supply chains continued to be severely impacted, labor markets remained extremely stressed and the return to office policies for many companies were delayed.

Inflation, interest rates and monetary policy were also a major focus for equity investors. Despite Fed Chair Jerome Powell's "transitory" description of inflation, the elevated price levels are proving to be stubborn as supply chains and labor markets continue to be impacted by COVID. The extreme, widespread shortages and extended lead times across most industries and the lack of visibility regarding a return to normal for most supply chains is something that has not been witnessed before. The same can be said of the labor markets. The number of open or unfilled jobs (over 11 million) is a record and far exceeds the number of job applicants seeking work (roughly 8 million). Nearly every industry is having a difficult time finding workers. Many believed that as the extended and generous unemployment benefits ended in early September and as schools reopened, workers would return but this process is also proving to be slower than most expected. This is putting additional upward pressure on wages and overall inflation. The supply chain and labor issues are holding back the potential for economic growth and have reduced consensus economic growth assumptions for the second half of this year. Supply chains and labor markets should normalize over time, especially if this Delta wave is the last significant one. As these supply side issues slowly normalize, their recovery will be a tailwind for economic growth. Interest rates, which appear to have bottomed in early August, are rising again and may continue to do so. Increasing rates, within reason, and upward sloping yield curves can be positive signs of economic growth but the pace of the increase in rates (and inflation) and the potential pressure on monetary policy are risks that will need to be monitored carefully.

There are numerous other risks. These include: the U.S. debt ceiling, Fed tapering and eventual tightening, the re-appointment of Fed Chair Jerome Powell, the passage and the size of the infrastructure bill, rising crude oil prices, tension between China and Taiwan, Evergrande and the over-levered China real estate sector and future potential COVID variants.

Positively, the demand side of the economic equation remains robust. Pent up demand, low inventories, rising incomes, record net worth and the new economic cycle are all driving very strong demand. At the same time, the lack of product, rising prices and extended lead times could impact demand and overall economic potential. Still, we expect demand to remain strong enough as the supply chains and labor market slowly recover over the next several quarters.

Stock and sector leadership continues to be rotational. Cyclicals led in the first half of 2021 fueled by the reopening of the economy. Then as yields fell and Delta cases rose in the September quarter, many WFH (work from home) stocks performed better and many cyclical stocks in the consumer discretionary and industrials sectors lagged. As Delta variant cases peaked in early September and are now steadily declining, many "reopening" cyclicals are beginning to benefit.

Our overall sanguine view is supported by our conviction that the economy is still early in its recovery. Given the COVID-induced recession ended last year, we are just entering the second year of this expansion and historically the last five U.S. economic cycles have lasted five to ten years. No two cycles are the same, but this expansion is off to a stronger start despite many of the unprecedented aspects of this one.

Corporate earnings remain robust and have made new highs, as equities have pulled back from their highs earlier this year. Together, higher earnings and lower stock prices have created more attractive valuations and have set up an attractive dynamic as the market looks ahead towards the year end and into 2022. As the market digests the current macro uncertainties, we are finding many appealing opportunities both among cyclicals as well as secular growth companies.

Performance Review

For the September quarter, the Driehaus US Micro Cap Equity Fund outperformed its benchmark. The Fund fell -3.9%, while the Russell Microcap Growth Index declined a sharp -9.1%. The Fund also outperformed the small cap indices, such as the Russell 2000 which declined -4.4% and the Russell 2000 Growth which pulled back -5.7%, but it did trail the S&P 500 which gained 0.6%.

The relative outperformance versus the Russell Micro Cap Growth Index was driven by the portfolio's strong performance in several sectors including healthcare, technology, and consumer staples.

The market's stock and sector leadership continue to be very rotational. While cyclical and reopening stocks performed best in the first half of the year, within the portfolio secular growth parts of technology and healthcare performed well as Delta cases rose and economic growth slowed in the September quarter.

The portfolio from a bottom-up basis continues to experience strong earnings reports with robust positive surprises, estimate revisions and bullish fundamental outlooks. It also benefitted from good balance and diversification across the various growth categories (secular, cyclical, consistent, recovery) which boosted outperformance.

By sector, the following sectors saw positive absolute returns for the quarter (in order of magnitude): consumer staples, energy, technology, and financials. As the market declined, several sectors experienced negative absolute returns, including consumer discretionary, communication services, materials, industrials, and healthcare. The positive relative returns for the quarter were primarily from (in order of magnitude): healthcare, technology, and consumer staples, while consumer discretionary and communication services detracted on a relative basis.

Healthcare

Healthcare outperformed as the sector contributed 282 basis points on a relative basis. The portfolio's holdings were down just 2% versus a decline of 11% for the index's healthcare holdings. Several biotech holdings performed well as there was increased optimism on their clinical pipelines and some holdings reported strong clinical trial data.

IPO activity within the group remains strong with many companies coming public during the quarter. The level of innovation we see in healthcare is exciting. Biotech/therapeutics, molecular diagnostics and med-tech all stand to benefit strongly looking forward as these companies improve the standard of care and provide better outcomes for patients.

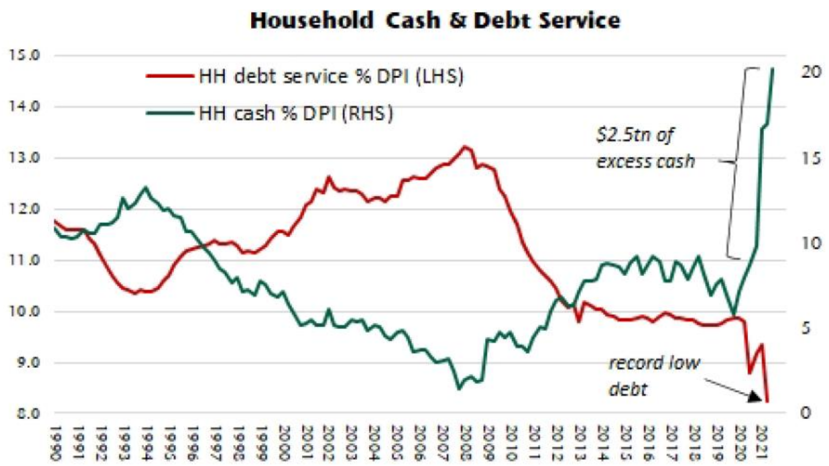
Technology

Technology outperformed while contributing 198 basis points on a relative basis. It continues to see strong fundamental trends in most of its sub-industries. IT service stocks remain strong. Software recovered after a choppy first half. The performance of our semiconductor holdings was also strong while semi capital equipment holdings were mixed. Telco equipment holdings continue to perform well as the outlook for rural broadband spending is robust.

Consumer Discretionary and Staples

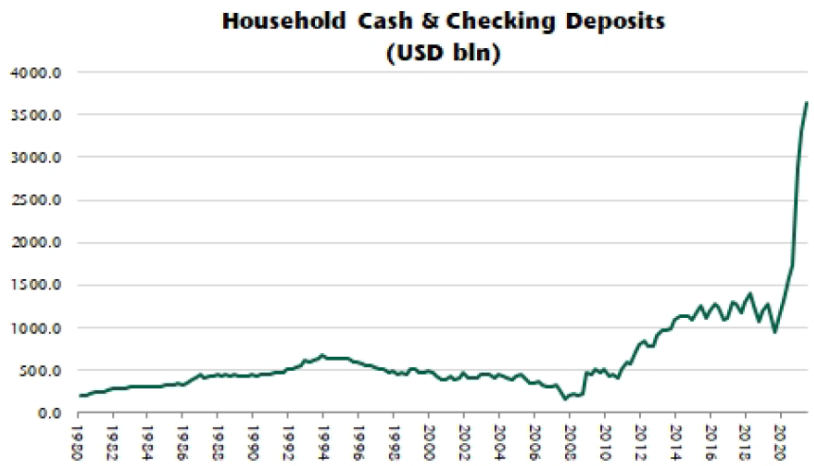
The consumer discretionary sector holdings, which saw strength in the first half of the year, had broad weakness in the September quarter as the Delta-related cases soared. Supply chain, reduced stimulus benefits and labor issues were also sources of the sector's weakness. As a result, and as attractive opportunities developed in other sectors, we reduced our weighting in consumer discretionary from 21.2% to 16.7% during the quarter. As the Delta cases are now falling and most are vaccinated, we do expect the sector to recover. Supply chain issues will linger but they may be discounted in some situations. As the economy continues to grow and labor markets normalize, we expect the very high savings rates and massive pent-up demand to continue to drive solid consumer spending. We remain impressed with robust financial strength of the U.S. consumer as wages, net worth and overall household balance sheets are the strongest we have ever seen. As the consumer is such a core segment of the aggregate U.S. economy, we highlight the strength of the consumer's financial position in Exhibits 1-3.

Exhibit 1: Household Cash & Debt Service



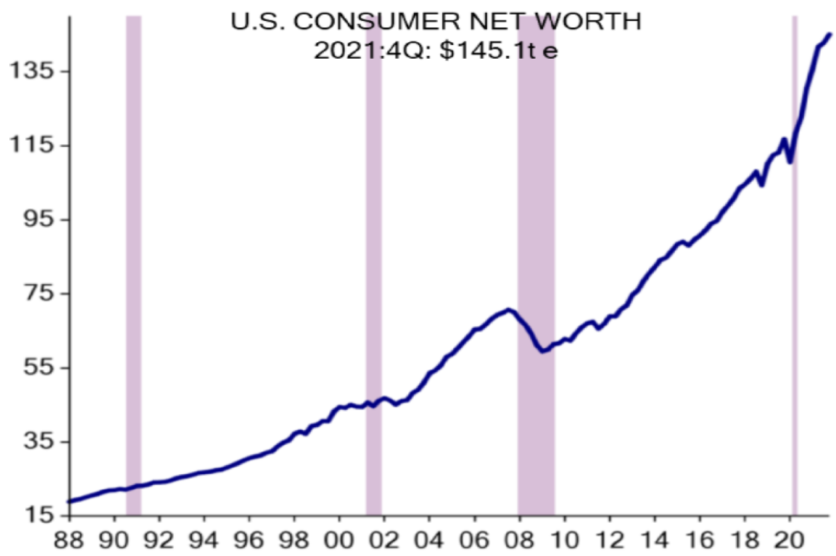
Source: Haver, JEF Economics

Exhibit 2: Household Cash & Checking Deposits (USD bn)



Source: Haver, JEF Economics

Exhibit 3: US Consumer Net Worth



Source: Evercore ISI

Consumer staples also added nicely to outperformance as an energy drink producer and a skin products company performed strongly.

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

Outlook & Positioning

The outlook for the economy and earnings remains positive as there are multiple drivers supporting this economic expansion. We believe the level of earnings will continue to make new highs. The overall direction of equities will follow the path of earnings as the economic expansion continues. That said, multiple factors are causing stocks to churn sideways. The Delta variant has slowed economic growth over the past few months. The severe stress in supply chains and the labor market don't have recent precedent. Inflation remains elevated and is the highest in years and various political and geopolitical concerns are depressing investor sentiment. Overall, though as the supply side issues slowly improve and we potentially move to a post-pandemic period, the U.S. expansion could prove to be self-sustaining.

The mRNA based COVID-19 vaccines are working very well and appear to provide good protection especially against severe disease. The percentage of adult Americans who are vaccinated is over seventy percent. Delta cases are now in decline after peaking in September and the risk of an additional major COVID wave is low, but naturally unpredictable.

Smaller cap valuations are attractive on a relative basis versus large caps looking at the past four decades. Earnings growth rates for smaller companies are much stronger than large caps. Micro and small caps generally perform well for years from the beginning of a new economic expansion. For instance, post the Nasdaq Bubble and post the Great Financial Crisis, smaller caps outperformed large caps for five to six years.

In terms of portfolio positioning, we have an attractive mix of secular and cyclical growth holdings that should continue to benefit the Strategy as the market continues to be so rotational. By sector healthcare remains our largest absolute weight, followed by technology, consumer discretionary, industrials and financials. Relative to the benchmark, the Strategy is overweight technology, financials, consumer staples, consumer discretionary and energy. The Strategy is underweight health care, industrials, and real estate.

Overall, we see many dynamic investment opportunities in attractive and strong industries, which fit our investment philosophy of companies exhibiting growth inflections, differentiation, market share gains, strong revenues and expanding profitability.

Quarterly Contributors

- Grid Dynamics Holdings, Inc. (Ticker: GDYN) provides digital engineering and information technology services. In August GDYN reported 2Q21 earnings above consensus, with revenue 13% above and 3Q21 revenues guidance 15% above. The stock reacted positively to this earnings update with positive revisions to out period revenues and earnings estimates. The strategy maintained the position in the stock as growth prospects remain robust and GDYN's valuation continues to be at discount to its peer group.
- Cytokinetics, Incorporated (Ticker: CYTK). Cytokinetics is a clinical stage therapeutics company developing novel treatments for heart disease. In July, the company reported updated data for their cardiac myosin inhibitor that for the first time, demonstrated a profile competitive with a peer's program valued in a takeout at $12 billion. As a result, the stock appreciated significantly as the treatment's probability of approval rose.

Quarterly Detractors

- GrowGeneration Corp. (ticker: GRWG) owns and operates 62 specialty retail hydroponic and organic gardening stores. The Team initiated a position in May 2020, as stay at home orders due to COVID and a rapid pace of new store additions yielded accelerating revenue and earnings growth. In June and July 2021, growth has slowed, as difficult growth comparisons from 2020 are lapped and wildfires in California disrupted outdoor growing activity. This was reflected in more muted guidance for 2021 that GRWG provided on its 2Q21 earnings call. Due to the decelerating growth profile the Team exited the position.
- Ardelyx, Inc. (Ticker: ARDX) is a clinical stage therapeutics company developing novel treatments for kidney disease. In July, the company received notice that the FDA would not be approving their therapy for the control of serum phosphorus in patients with chronic kidney disease on dialysis due to insufficient evidence and suggested that an additional clinical trial would be required before seeking approval. As a result, the stock depreciated significantly as the treatment's probability of future approval fell and the time and capital required to get to that point increased.

Outright Buy

- Couchbase, Inc. (Ticker: BASE) engages in the development of document database management solutions. In early September BASE reported 2Q21 earnings results and provided 3Q21 guidance that was better than consensus expectations but fell short of elevated investor expectations which pressured the stock price. The strategy marginally added to the position on weakness as BASE's growth trajectory and fundamentals remain on the right track.

Outright Sell

- GrowGeneration Corp. (ticker: GRWG) owns and operates 62 specialty retail hydroponic and organic gardening stores. The Team initiated a position in May 2020, as stay at home orders due to COVID and a rapid pace of new store additions yielded accelerating revenue and earnings growth. In June and July 2021, growth has slowed, as difficult growth comparisons from 2020 are lapped and wildfires in California disrupted outdoor growing activity. This was reflected in more muted guidance for 2021 that GRWG provided on its 2Q21 earnings call. Due to the decelerating growth profile the Team exited the position.

Sincerely,
Heptagon Capital and Driehaus Capital Management

Sector performance attribution- Q3 2021

	Driehaus Micro Cap Growth Composite (Port) (%)		Russell Microcap® Growth Index (Bench) (%)		Attribution Analysis (%)		
GICS Sector	Port Avg. Weight	Port Contrib To Return	Bench Avg. weight	Bench Contrib To Return	Allocation Effect	Selection + Interaction	Total Effect
Comm. Services	2.38	-0.90	2.44	-0.26	0.06	-0.65	-0.59
Consumer Discretionary	18.29	-3.22	15.12	-2.34	-0.20	-0.20	-0.40
Consumer Staples	6.64	0.63	2.04	-0.14	0.05	1.09	1.15
Energy	5.29	0.02	4.00	-0.17	-0.22	0.63	0.41
Financials	7.51	0.19	2.35	0.09	0.70	-0.12	0.58
Health Care	28.93	-0.53	44.14	-4.70	0.20	2.53	2.72
Industrials	10.92	-0.31	10.58	-0.56	0.02	0.27	0.29
Information Technology	18.03	0.82	14.44	-0.87	0.10	1.85	1.95
Materials	0.90	-0.04	2.21	-0.06	-0.10	-0.04	-0.14
Real Estate	0.00	0.00	2.08	-0.09	-0.12	0.00	-0.12
Utilities	0.00	0.00	0.60	-0.01	-0.05	0.00	-0.05
Cash	1.12	0.00	0.00	0.00	-0.03	0.00	-0.03
Other*	0.00	-0.31	0.00	0.00	-0.33	0.00	-0.33
Total	**100.00**	**-3.66**	**100.00**	**-9.11**	**0.08**	**5.36**	**5.44**

Sources: Driehaus Capital Management LLC, Factset Research Systems, Inc., eVestment Alliance
**Other refers to the securities not recognised by Factset.*
Data as of 30 September 2021

Annualized Total Returns as of 30th September 2021, gross of fees

	Q3 21	YTD	1-Year	3-Year	5-Year	10-Year
Driehaus Micro Cap Growth Composite	-3.4%	17.4%	65.0%	32.3%	32.4%	28.1%
Russell Micro Cap Growth Index TR	-9.1%	9.6%	42.1%	12.5%	14.0%	15.0%

Source: Driehaus Capital Management, Bloomberg

Driehaus manages the Irish regulated Driehaus US Micro Cap Equity UCITS Fund according to the same investment principals, philosophy and execution of approach as it manages the Driehaus Micro Cap Growth Composite, however it should be noted that due to different regulation, fees, taxes, charges and other expenses there can be variances between the investment returns demonstrated by each portfolio. The Driehaus Micro Cap Growth Composite is provided in the table above to show a longer track record for the underlying strategy.

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

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.

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

Risk Warnings

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

SFDR

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

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

Disclaimers