HEPTAGON
Capital

Driehaus Emerging Markets Sustainable Equity Fund

Q4 2021 Commentary

Fund Manager

Richard Thies

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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. The firm was founded in 1982 and has USD 15.1 billion of assets under management.

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The **Driehaus Emerging Markets Sustainable Equity Fund** (the "Fund"), 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. Driehaus exercises discretionary investment authority over the Fund. The Fund was launched on 25th June 2012 and had AUM of USD 91m as of 31st December 2021. Driehaus Capital Management LLC was appointed Sub-Investment Manager of the Fund on 6th December 2016. Prior to this OFI Global Institutional, Inc. was the Sub-Investment Manager from 25th June 2012 to 5th December 2016.

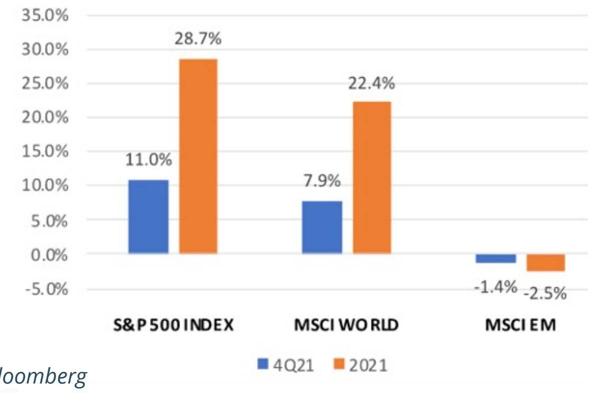
The Fund (I USD share class) has a 5-star Morningstar rating over the past 3 and 5 years since Driehaus took over portfolio management.

Market Overview

Going into 2021, many market observers had positive outlooks for emerging markets (EM) given the asset class was expected to benefit from global reopening after lockdowns in 2020. At the beginning of the year, vaccines were on the cusp of being widely distributed and some countries were beginning to emerge from restrictive lockdowns. Rebounding global growth, the resumption of tourism, and rising commodity prices were expected to support EM equities.

However, EM performance meaningfully lagged developed markets in 2021 (Exhibit 1). While new virus variants, supply chain bottlenecks, and rising inflation weighed on EM, these risks were not unique to developing markets. Thus, the underperformance of EM this year was for different reasons.

Exhibit 1: Global Indices 2021



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

Given both its massive economy and large index weight, China was and is the dominant influence within EM. Considering the MSCI China Index declined by 21% in 2021, it is not surprising that broad EM equities underperformed developed markets.

There were numerous issues in China that pressured growth and market sentiment this year:

- Numerous laws and regulations were passed to restrict the power of the internet industry and to increase competition.
- The country continued with its zero tolerance COVID policy that requires strict lockdowns anytime new local infections are found.
- There were growing concerns that Chinese ADRs will be forced to delist from US exchanges due to new audit rules.
- Shortages of raw materials and decarbonization targets led to power rationing and forced blackouts.
- Restrictive policies were kept in place in the property sector to reign in leverage, even as multiple developers were pushed into default.

Amidst all of this, the People's Bank of China (PBOC) refrained from easing policy until late in the year. And the changes that were made were relatively minor.

Outside of China, EM performance among the major constituents was mostly strong in 2021. Saudi Arabia and Russia both posted robust gains on the back of higher oil prices, up by 38.0% and 20.0%, respectively. Taiwan rose by 26.7% as global tech demand continued to outpace supply, fueled by changes in work practices and more tech-enabled products (e.g. autos, industrial equipment, and smart-home devices). Mexico was up 22.9%, benefiting from its positive leverage to US economic growth. Many Mexican companies have high exposure to US consumption and housing especially.

India was a notable standout, up 28.9% in 2021. GDP rebounded sharply after a very devastating COVID experience in Q1 which, until the arrival of the Omicron variant, effectively ended the virus nationwide. Government policies have been broadly supportive as well, making it a stark alternative to China this year- India saw its highest ever foreign direct investment in 2021 at $82bn. Additionally, there are signs that India is on the verge of a new capex cycle, driven by both government spending and the private sector. Lastly, India's start-up ecosystem is blossoming, and a growing number of dynamic companies are listing publicly. Earnings grew strongly for the year and are expected to post more growth in 2022, but with valuations quite high relative to history, some more caution is warranted this year.

Brazil was a laggard, down 17.1% this year. Equities derated amidst rate hikes to combat double-digit inflation, concerns over the fiscal balance, and political uncertainty ahead of a presidential election in 2022.

Moving to the fourth quarter specifically, EM equities declined by 1.3%. There was broad based pressure on EM currencies as the USD appreciated on the back of more hawkish Fed policy. Value and cyclical stocks outperformed as inflation readings continued to run hot and the market priced in a faster pace of Fed balance sheet tapering and interest rate hikes.

Beyond that, a few idiosyncratic events led to selloffs across the EM complex. First, Russian assets sold off as concerns rose that the government might invade neighboring Ukraine. Turkey saw its currency decline by over 100% only to quickly appreciate by over 40% in the span of a week, whipsawed by unorthodox policy announcements. And in Chile, leftist President-elect Gabriel Boric, 35, won a runoff election and will pursue an agenda that will meaningfully expand state control and entitlements.

Performance Review

The Heptagon Driehaus Emerging Markets Sustainable Equity Fund (Class I USD) returned -0.8% in the fourth quarter, ahead of the -1.3% return of the MSCI EM Index. For the year 2021, the Fund returned -0.2%, beating the -2.5% index return.

Information technology was the top contributing sector during the fourth quarter. The Fund's semiconductor holdings outperformed driven by positive earnings revisions as industry supply has been unable to keep pace with strong end-demand. For example, a US-domiciled semiconductor design company saw strong uptake of its newest generation gaming and datacenter chips (customers in China and Taiwan make up roughly 50% of sales). The Fund also holds a position in a Taiwanese substrate company that sells materials needed to enable "advanced packaging", an important design trend in the semiconductor industry. Outside of semiconductors, a Taiwanese company held by the Fund that sells connectors outperformed as they are seeing accelerating orders from EV charging facilities and renewable energy.

Communication services was the largest sector drag on attribution in the fourth quarter. One of the Fund's Russia-related internet companies declined with broader Russian equities due to fears that the country would invade Ukraine. Additionally, Fund holdings with exposure to ecommerce detracted as growth-exposed stocks largely underperformed.

On a country basis, the above referenced semiconductor and electronic components companies largely contributed to Taiwan and the US being the largest positive contributors to attribution during the fourth quarter. The Fund continued to carry a large underweight to China relative to the benchmark given the unfavorable top-down environment and weak earnings growth. This underweight contributed positively to relative results as well.

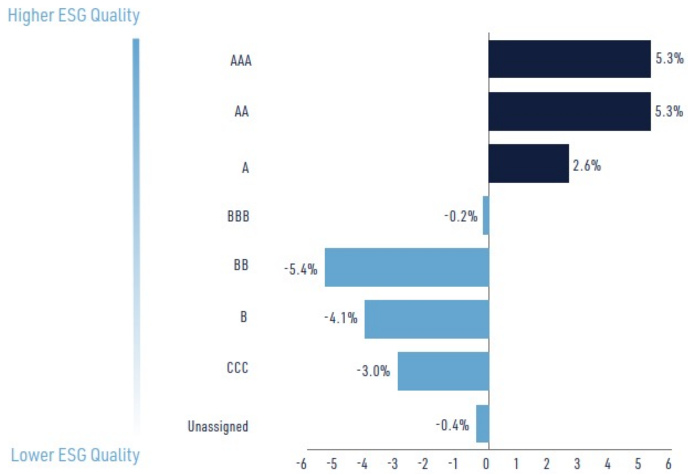
India and Uruguay were the largest country detractors to relative performance. In India, the Fund lost performance due to its underweight to IT Services. The industry is seeing very strong demand, especially for "digital transformation" services that enable customers to capture more data across channels, analyze it, and ultimately make better business decisions as a result. The Fund owns one of the leaders in India IT Services as well as digital pure plays domiciled in other countries, but multiple companies in the industry outperformed this quarter. The Fund's Uruguay-domiciled holding, a payment solutions provider, underperformed following an earnings miss and cautious commentary regarding the margin outlook in the near-term. Sentiment on fintech stocks in Latin America was also extremely poor during the second half of the quarter.

For 2021, information technology was the top performing sector. The Fund also benefitted from its positioning in consumer discretionary and health care. Energy was the largest sector detractor as the Fund avoided many state-backed oil companies that benefitted from higher crude prices. Unsurprisingly, China was the top country contributor in 2021 owing to the Fund's underweight in addition to value-added stock selection within several sectors led by consumer discretionary. India, Brazil and Saudi Arabia were the top country detractors for the full-year period. The fund had zero exposure to the Saudi Arabian market, which performed well along with rising oil prices.

Sustainability

The Fund finished the quarter with markedly better ESG characteristics, on an aggregate basis, than its benchmark index (Exhibit 2).

Exhibit 2: ESG Ratings: Fund vs. MSCI EM Index as of 31/12/21
Relative Weights (%pts) versus MSCI Emerging Markets Index



Source: FactSet Research Systems LLC & MSCI Inc.

We continue to see long-term attractive growth opportunities in the renewable energy space. As we have described in previous commentaries, the combination of elevated valuations in many of these areas alongside very poor recent supply growth in more traditional energy sources has made the near-term outlook a bit more challenging. As a result of that, we have reduced our exposure to this area tactically while remaining upbeat on some companies we see continuing to add durable value in the energy space. This includes many parts of the battery supply chain, the energy storage system related companies and companies related to the increasingly obvious need for investment in the electrification space at large. While most materials companies in the emerging world are still lacking in key sustainability criteria that the Fund values, we have identified some materials companies with best in class environmental performance for inclusion in the Fund as well.

Outlook and Positioning

Two policy pivots will likely define the market landscape in 2022. First, the US Fed has become meaningfully more hawkish over the last few months to curb headline inflation that is running at multi-decade highs. While obviously a supremely important subject, we will not dwell on the specifics of the Fed dynamics here given how widely covered this is elsewhere. The second pivot is that China's authorities have indicated they prioritize supporting growth this year. As noted earlier, what happens in China is likely to be the key determinant of EM returns in 2022.

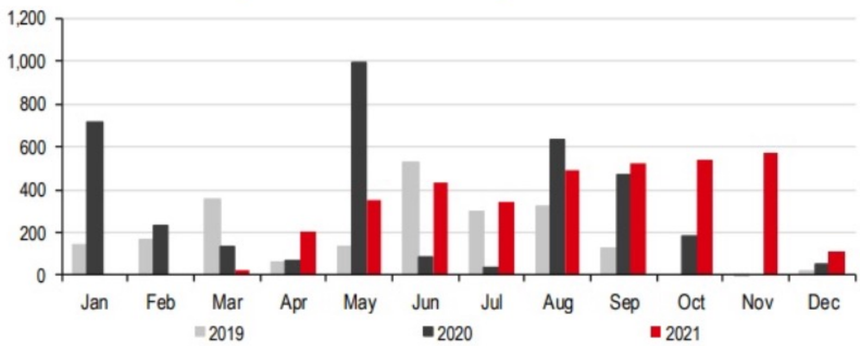
China did show signs that it was adopting a more supportive stance in late 2021. For example, they announced small cuts to the Reserve Requirement Ratio (RRR) and one of their benchmark lending rates. The moves were ostensibly done to support growth, but the actual impact was not very meaningful.

More significantly, right after the New Year China announced that it would relax its "three red lines" policies for property developers that make acquisitions of troubled assets. This is significant for two key reasons. First, the three red lines policy, initially announced in August 2020, was the clearest indication of how serious China was about reigning in the property sector. Any relaxation, even if it only pertains to mergers and acquisitions (M&A), is a clear signal of a more accommodative stance and provides more flexibility for the industry.

The other reason it's important is because M&A can help revive confidence in the market. Many potential property buyers have put purchases on hold due to fears that they will pay for a unit that will never be finished (if the developer goes bankrupt). That has exacerbated home price declines which of course makes the incentive to wait even stronger (i.e. why buy today if prices are falling?). When stronger developers start buying distressed assets and projects-under-construction begin to get completed, buyer confidence will increase. That's critical given the property industry has a large impact on the broader economy, both because of material and construction demand but also the impact of property prices on the household wealth.

Beyond property, local government financing picked up in the fourth quarter. This has historically been a leading indicator for infrastructure investment (Exhibit 2).

Exhibit 3: Monthly Local Government Special Bond Issuance in China



Source: Wind, HSBC

Even with the outlook for property and infrastructure pointing up, China's zero-tolerance COVID-19 policy will remain a challenge for the economy. Even before the omicron variant began spreading locally, China was still deploying large scale testing and lockdown campaigns. No one knows how long this policy will be retained but it is a safe bet that it will last at least through the Beijing Winter Olympics in February (there are no signs that it will be changed after the games either). Given the omicron variant's contagiousness, it is likely that lockdowns will pose an ongoing challenge to domestic consumption (as well as aggravate global supply constraints and inflation).

Nevertheless, given how weak China was in 2021, the outlook is better at the margin. Indeed, manufacturing PMIs (Purchasing Managers Index) have already shifted back into expansionary territory in November and December. The Fund carried a large underweight to China throughout 2021 but has recently been finding more opportunities to increase exposure. If we are right that China's economy and markets see a rebound, that will likely have a positive spillover impact on other EMs, particularly if Chinese consumption accelerates.

Regarding the pandemic, we can reasonably expect there to be rolling waves of outbreak throughout the world, but short of a more severe new variant, we expect vaccinations, treatments, and lockdown fatigue to result in a lower impact compared to earlier waves.

Of course, we stopped trying to guess what will happen with COVID-19 a long time ago. Instead, we continue to focus on identifying fundamental earnings inflections that are not well captured by consensus expectations. We look forward to doing so on your behalf in the coming year.

Sincerely,
Heptagon Capital and Driehaus Capital Management

Sector performance attribution- Q4 2021

	Driehaus Emerging Markets Sustainable Equity Fund (Port) (%)			MSCI Emerging Markets Index (Bench) (%)			
GICS Sector	Port Avg. Weight	Port Total Return	Port Contrib. To Return	Bench Avg. weight	Bench Total Return	Bench Contrib. To Return	Total Effect
Communication Services	10.21	-7.73	-0.95	10.72	-0.53	-0.08	-0.86
Financials	21.47	-2.13	-0.37	19.55	-0.39	-0.07	-0.29
Unassigned	0.00	-103.05	-0.16	0.00	8.10	0.00	-0.15
Utilities	0.58	-8.45	-0.06	2.23	0.73	0.02	-0.10
Consumer Staples	4.60	-1.67	-0.14	5.82	-2.08	-0.11	-0.08
Energy	2.14	-7.19	-0.14	5.70	-3.74	-0.18	-0.01
Cash	5.45	0.61	0.03	0.00	0.00	0.00	0.03
Industrials	4.69	0.78	-0.02	4.87	-0.28	-0.01	0.06
Real Estate	0.12	-9.81	-0.04	2.03	-8.50	-0.18	0.11
Health Care	4.97	-8.15	-0.51	4.48	-15.35	-0.77	0.27
Consumer Discretionary	9.47	-8.12	-0.83	14.81	-8.23	-1.23	0.35
Materials	4.60	10.34	0.53	8.54	-2.95	-0.22	0.73
Information Technology	31.70	7.25	2.19	21.25	7.43	1.52	0.79
Total	**100.00**	**-0.46**	**-0.46**	**100.00**	**-1.31**	**-1.31**	**0.85**

Sources: Driehaus Capital Management LLC, Factset Research Systems, Inc., eVestment Alliance
Data as of 31 December 2021

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Country performance attribution- Q4 2021

	Driehaus Emerging Markets Sustainable Equity Fund (Port) (%)			MSCI Emerging Markets Index (Bench) (%)			Attribution Analysis (%)
Country	Port Avg. Weight	Port Total Return	Port Contrib. To Return	Bench Avg. weight	Bench Total Return	Bench Contrib. To Return	Total Effect
India	15.46	-3.57	-0.58	12.18	-0.21	0.00	-0.53
Uruguay	0.47	-46.82	-0.33	0.00	0.00	0.00	-0.36
Brazil	3.11	-13.43	-0.46	4.11	-6.47	-0.26	-0.26
Singapore	1.09	-33.25	-0.24	0.02	-12.55	-0.00	-0.24
Hong Kong	2.38	-18.01	-0.56	3.00	-8.28	-0.26	-0.24
Unassigned	0.00	-0.15	-0.15	0.00	0.00	0.00	-0.15
Netherlands	2.75	-8.76	-0.25	0.33	-23.56	-0.08	-0.13
Hungary	0.65	-20.63	-0.09	0.25	-9.68	-0.02	-0.05
Mexico	2.85	2.91	0.10	1.91	6.24	0.13	-0.05
Japan	0.91	-0.84	-0.04	0.00	0.00	0.00	-0.01
South Africa	0.54	-0.60	0.04	3.07	-0.43	0.01	-0.01
Cyprus	0.12	-3.75	-0.03	0.20	-20.32	-0.04	0.00
Indonesia	2.14	5.87	0.11	1.45	6.43	0.09	0.02
Cash	5.45	0.61	0.03	0.00	0.00	0.00	0.02
Argentina	1.46	-0.65	0.01	0.11	-7.03	-0.01	0.03
Russia	1.45	-14.92	-0.15	3.24	-7.24	-0.21	0.04
Kazakhstan	1.24	10.17	0.10	0.00	0.00	0.00	0.12
Germany	1.08	10.92	0.10	0.00	0.00	0.00	0.12
France	1.05	14.72	0.14	0.00	0.00	0.00	0.15
Canada	1.77	7.49	0.17	0.00	0.00	0.00	0.19
China	21.04	-7.63	-1.50	30.89	-5.87	-1.87	0.25
Australia	0.66	55.85	0.27	0.02	-24.13	-0.00	0.30
South Korea	9.11	4.23	0.37	12.44	-0.90	-0.12	0.47
Taiwan	13.97	13.04	1.64	15.10	8.43	1.20	0.48
United States	9.28	8.63	0.81	0.08	3.88	0.00	0.93
Other countries in benchmark	0.00	0.00	0.00	11.61	8.21	0.13	-0.24
Total	**100.00**	**-0.46**	**-0.46**	**100.00**	**-1.31**	**-1.31**	**0.85**

Sources: Driehaus Capital Management LLC, Factset Research Systems, Inc., eVestment Alliance. Data as of 31 December 2021

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Annualized Total Returns as of 31st December 2021, (I USD share class)

	Q4 21	YTD	1-Year	3-Year	5-Year
Driehaus Emerging Markets Sustainable Equity Fund	-0.8%	-0.2%	-0.2%	17.8%	13.9%
MSCI Emerging Markets NR Index	-1.3%	-2.5%	-2.5%	10.9%	9.9%

Source: Morningstar

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Important Information

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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)

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