HEPTAGON
Capital

European Focus Equity Fund

Market Commentary and Attribution Analysis for 1H22

Fund Manager

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.

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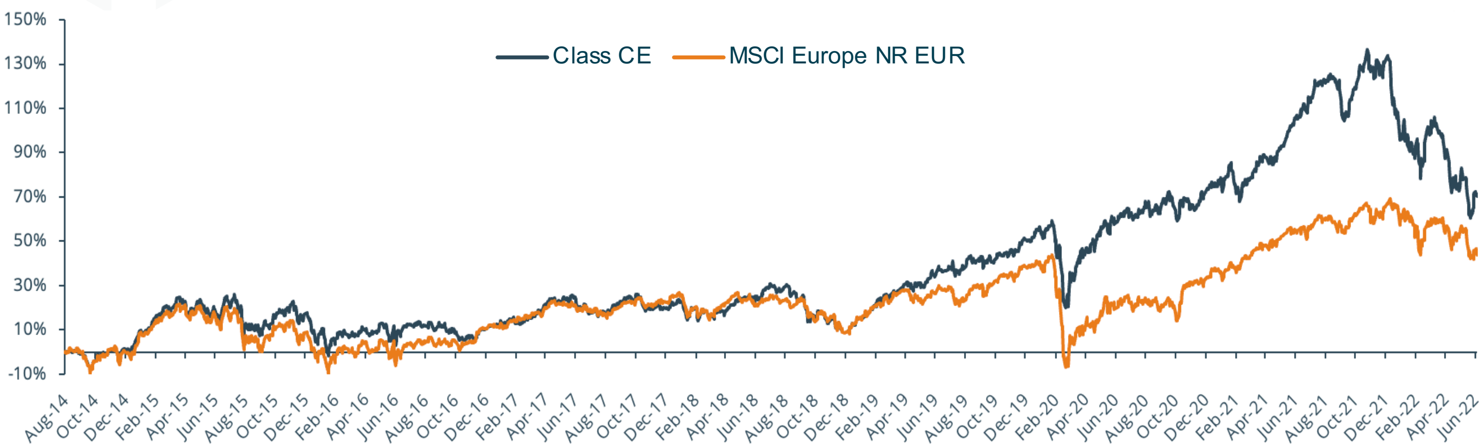
Performance and executive summary

1H22 was a weak period for the Heptagon European Focus Equity Fund. The Portfolio's CE share class fell by -26.84% vs. the benchmark MSCI Europe NR (EUR) index which dropped -13.84% in comparison.

Vladimir Putin's invasion of Ukraine has overshadowed all other news during 1H22 and the follow-on effect of inflationary pressures, which had already started to build during 2H21, have reached historic proportions. In equity market terms, the Energy sector thus stole the show during 1H22. In fact, the dichotomy between this sector and the rest of the stock market is unlikely to bear any similarity when compared with history. During 1H22, the Energy sector advanced by +19% in EUR terms while the broader MSCI Europe benchmark index fell by nearly -14%. In other words, for long-only investors who were not solely invested in Energy, it has been nearly impossible to generate positive returns in 1H22.

At the same time, given higher inflation expectations and the fact that Western central banks are now uniformly tightening their monetary policies, technology and stocks with similar growth-like characteristics, fell by nearly -33% during 1H22. This happened irrespective of how these companies guided investors and what happened to consensus sales and profit forecasts. While most of these companies continued to gain market share, raise their profit margins, grow their cash flows, increase dividends etc. during 1H22, they still saw sharp declines of their underlying stocks as the higher discount rate affected their valuations.

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



**From Fund launch 26/08/2014*
Source: MSCI, Bloomberg

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

The table below, illustrates the sector-rankings of the MSCI Europe benchmark and the performance of European Focus on a monthly basis in 1H22. The table makes sober reading as the Fund only outperformed the benchmark in three out of six months; possibly more important is the fact that the drawdown of the Portfolio has been significant.

Sector performance of the MSCI Europe NR (EUR) index and European Focus in 1HQ22

	Jan-22		Feb-22		Mar-22		Apr-22		May-22		Jun-22		1H22
Energy	13.00%	Utility	1.83%	Healthcare	5.52%	Cons Stap	3.93%	Energy	10.27%	Healthcare	-2.30%	Energy	18.61%
Finance	3.90%	Material	0.57%	Energy	5.01%	Energy	3.45%	Comm Serv	1.34%	Cons Stap	-2.52%	Comm Serv	-1.57%
Comm Serv	1.48%	Healthcare	0.50%	**EuroFocus**	**2.64%**	Utility	1.88%	Finance	0.65%	Comm Serv	-5.01%	Healthcare	-4.60%
Real Estate	-0.10%	Cons Stap	-0.97%	Technology	1.47%	Healthcare	1.69%	**MSCI EUR**	**-0.78%**	**EuroFocus**	**-5.72%**	Cons Stap	-9.47%
Material	-2.19%	Energy	-1.50%	Comm Serv	1.31%	Comm Serv	1.19%	Utility	-1.00%	Cons Disc	-6.56%	Utility	-12.89%
Utility	-2.48%	Comm Serv	-1.71%	Finance	1.01%	Material	-0.44%	Cons Disc	-1.42%	**MSCI EUR**	**-7.73%**	**MSCI EUR**	**-13.84%**
MSCI EUR	**-3.20%**	Real Estate	-2.16%	Material	0.86%	**MSCI EUR**	**-0.60%**	Material	-1.51%	Finance	-8.54%	Finance	-14.84%
Cons Disc	-3.82%	**EuroFocus**	**-1.94%**	**MSCI EUR**	**0.84%**	Industrial	-3.48%	Industrial	-2.73%	Utility	-10.29%	Material	-17.69%
Cons Stap	-4.10%	**MSCI EUR**	**-3.01%**	Industrial	-0.06%	Cons Disc	-3.53%	Technology	-3.67%	Industrial	-10.70%	Cons Disc	-25.75%
Healthcare	-5.91%	Industrial	-3.43%	Cons Stap	-1.57%	Finance	-4.10%	Healthcare	-3.77%	Energy	-11.05%	Industrial	-26.05%
Industrial	-8.60%	Technology	-4.10%	Utility	-3.06%	**EuroFocus**	**-4.97%**	Cons Stap	-4.41%	Technology	-11.52%	**EuroFocus**	**-26.84%**
Technology	-12.68%	Cons Disc	-7.36%	Real Estate	-3.35%	Real Estate	-5.87%	**EuroFocus**	**-5.44%**	Material	-15.40%	Real Estate	-31.40%
EuroFocus	**-14.20%**	Finance	-8.08%	Cons Disc	-6.22%	Technology	-6.92%	Real Estate	-6.08%	Real Estate	-17.86%	Technology	-32.60%

Source: Bloomberg

Closer analysis shows that this was caused primarily during January when European Focus dropped by -14.2% in absolute terms (the strategy's worst ever monthly performance) and the relative underperformance was -1101bps (the strategy's worst ever monthly relative underperformance).

The other two particularly poor months in 1H22 were May and June when we believe the penny finally dropped for the investment community that inflationary pressures will be higher and longer lasting than anyone thought a few months earlier.

During May, European Focus fell by -5.4% and showed a relative underperformance of -466bps. Although June was a worse month in terms of absolute losses (the Portfolio fell by -5.7%), the Fund showed relative gains of +201bps against the benchmark.

On a number of recent occasions, we have commented that the price action of equities was somehow different in June compared with the other months in 2022. In short, the Energy sector does not seem to be the only game in town. A look at the sector-rankings for June indicate that the market took a more conservative view as defensive industries, such as Healthcare, Consumer Staples and Communication Services, were the three-top performing sectors. At the same time, the Energy sector and Technology and growth-like stocks did equally poorly at around -11% of the benchmark.

We are acutely aware that '*one swallow doesn't make a summer*', but we are hopeful that the equity markets are slowly getting over the worst of the rot. This is especially relevant now when we are approaching the 2Q22 and 1H22 reporting season as we anticipate a number of companies in the broader equity market to lower their guidance for FY22. Against this backdrop, we are hopeful that the quality-growth investment strategy, which tends to be less accident-prone and which we abide by, will come to its own.

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

The inflation genie is now distinctly out of the bottle

When looking back over 1H22, hindsight confirms that the inflation genie is now distinctly out of the bottle. A year ago the Fed Chairman, Jerome Powell, declared that investors better put the word '*transitory*' to rest. The Fed's narrative gradually became more succinct and the Bank announced its first +25bps increase to 0.50% (15th March). Since then, the Bank has been extremely clear about its intentions; a second +50bps rise to 1.00% was declared (4th April) and another +75bps to 1.75% at the following FOMC meeting (15th June). Looking ahead, we believe it seems to be a near certainty that another +75% will be announced at the next FOMC meeting (27th July) and possibly a third consecutive +75bps rise at the following meeting (21st September). This implies that the Fed will have swiftly moved the Fed Funds rate from 0.25% in the beginning of March to around 3.25% by late September. A look at the US yield curve (see page 5) shows that interest rate expectations will then be approximately flat across all durations. At this stage, we believe that the Fed will take a breather in order to ascertain whether more rate hikes are needed to put the economy into recession depending on how inflationary pressures are deriving from the labour markets and the commodity sector.

Turning back to Europe, although the BoE was the first major central bank to start raising interest rates (15th Dec 2021), Andrew Bailey's awkward narrative trying to put his own spin to the same story the Fed has already vocalised has backfired since UK inflation is now running higher than anywhere else in the Western developed world. Since the first interest rate hike last year, the BoE has raised the base rate by +25bps on five consecutive occasions. However, to us it seems like the Bank is still running behind continuously rising inflation, which is expected to peak around 11% some time in 2H22.

Meanwhile, the ECB, under Christine Lagarde, has not even started raising interest rates even though inflationary pressures across most of the Eurozone region are running at 40+ year highs. The Bank has been caught in a perfect storm as dwindling Russian gas and other supplies are delivered through the war-torn Ukraine. This implies that prices of commodities have spiked while at the same time, strict lockdowns in large parts of China have limited the supply of components, which are crucial for Europe's export-dependent economy. All of this has led to compounding inflationary expectations while the Bank, in our opinion, has been sleepwalking through current macro-economic developments.

There is much speculation around how to best compare the current inflationary environment with history. It seems logical to assume that many market participants have not experienced price increases similar to how they were running in the 1970s and 1980s with the effect that market commentators debate whether comparisons should be made to the oil-shock of 1973-74, or if it is more relevant to look at what the then Fed Chairman, Paul Volker, did to eradicate US inflation from 1979 and into the 1980s.

One of the more insightful analyses on this topic we have seen is a comparison of today's economic environment with that of the post-World War 2 period in 1946-48. At that time, inflationary pressures derived from supply shortages during peacetime refits of manufacturing capacity. This was accompanied by a sharp rebound in demand for consumer goods which followed from high savings ratios and an earlier period of soaring money supply. A look at the inflationary development around this time gives further insight into what may happen today. US CPI stood at 3.1% in June 1946 and it peaked at 20.1% in March 1947; pent-up demand for consumer goods ultimately subsided as the supply of goods increased as the US manufacturing apparatus transitioned from a wartime to a peacetime setup. At the same time, the Fed's monetary policy tightened. Price increases slowed in 1948 and actually declined in 1949 and a brief (and mild) recession ensued.

To us, this period bears considerable similarities with today. Central banks have effectively been printing money at an unabated pace since the Financial Crisis in 2008-09; most economies were in strict lockdowns during the pandemic, which led to high savings rates. Following the opening up period after Covid-19, demand for consumer goods spiked (which led to sharply higher prices due to the demand-shock) and companies rushed to rehire staff (which led to wage inflation due to shortage of manpower). At the same time, ongoing supply-chain issues were (and still are) holding back deliveries of crucial components exacerbated by China's strict zero-tolerance stance to Covid-19, such as in the semi-conductor sector, automotive and many more industries.

We construe that whether we will enter a recession – which we now believe is more likely than not – is irrelevant. The human mind tends to believe that '*this time it is different*', but when we look back at most volatile periods, they tend to display similar patterns but with only slight variations.

Looking ahead

We continue to believe that Vladimir Putin's invasion of Ukraine in many ways has turned the conventional investment outlook on its head. Not only will inflationary pressures, which were already on an upward trajectory, become exacerbated, but supply-chain bottlenecks are also likely to be longer-lasting compared with projections a few months ago, and notwithstanding China's strict zero-Covid policy.

What appeared to be extremely unlikely in mid-February before the invasion has since become a reality and it is anyone's guess whether the current war will escalate to something unimaginable, or if the current situation is even solvable (which at the time of writing, it seems like the war will go on for a long time). In any case, it looks probable that Russia will be held responsible – both from moral as well as financial points of view. Moreover, these factors are likely to have wide implications not only on the Russian economy for several years to come, but also on commodity prices and thus inflation as well as demand and other supply-chain related matters.

Against this backdrop, our current investment focus is on inflation and the narrative of central banks (i.e. the Fed). Economists' knee-jerk reaction is to cut projections – top-down as well as bottom-up – and that indeed is what has been the case. The table below illustrates the magnitude of downward revisions of quarterly GDP forecasts from early February to early July for some leading economies.

Changes to quarterly GDP forecasts from 1 February to 1 April 2022

01/07/2022	4Q21	1Q22	2Q22e	3Q22e	4Q22e	1Q23e	2Q23e
USA	5.5%	3.5%	2.6%	2.7%	1.5%	2.3%	1.9%
Euroland	4.7%	5.4%	3.1%	1.3%	1.4%	1.6%	2.0%
Germany	1.8%	3.8%	1.7%	0.4%	1.3%	1.7%	2.0%
France	4.9%	4.5%	3.9%	1.0%	0.8%	1.4%	1.8%
UK	6.6%	8.7%	2.8%	2.2%	1.2%	0.7%	1.2%
Italy	6.4%	6.2%	3.3%	1.0%	0.6%	1.2%	1.6%
Japan	0.4%	0.4%	1.1%	2.6%	2.3%	2.9%	2.1%
China	4.0%	4.8%	1.5%	4.6%	5.0%	4.6%	7.1%
India	5.4%	4.1%	14.1%	6.3%	5.0%	4.8%	5.8%
Brazil	1.7%	1.7%	1.9%	1.2%	0.6%	0.2%	0.5%
Russia	5.0%	3.5%	-8.8%	-14.1%	-14.8%	-14.1%	-0.8%
Average	**4.3%**	**4.4%**	**2.7%**	**1.1%**	**0.6%**	**0.8%**	**2.3%**

01/02/2022	4Q21	1Q22e	2Q22e	3Q22e	4Q22e	1Q23e	2Q23e
USA	5.5%	4.4%	3.7%	4.0%	3.2%	3.0%	2.7%
Euroland	**4.6%**	5.4%	4.3%	3.0%	3.3%	3.3%	2.6%
Germany	**1.4%**	4.4%	3.9%	3.2%	3.7%	3.7%	3.7%
France	**5.4%**	5.5%	5.1%	2.7%	2.4%	2.5%	2.2%
UK	6.0%	7.9%	3.4%	3.2%	3.1%	3.0%	2.3%
Italy	6.3%	6.6%	4.8%	3.0%	2.8%	2.5%	2.0%
Japan	0.5%	2.3%	2.8%	4.2%	2.9%	2.2%	1.5%
China	**4.0%**	4.3%	4.7%	5.8%	5.7%	5.6%	5.3%
India	6.0%	5.0%	16.6%	8.0%	5.2%	5.5%	6.6%
Brazil	1.2%	0.6%	0.2%	0.1%	0.3%	0.4%	0.5%
Russia	3.2%	3.1%	2.4%	2.4%	2.0%	1.9%	2.0%
Average	**4.0%**	**4.5%**	**4.7%**	**3.6%**	**3.1%**	**3.1%**	**2.9%**

Source: Bloomberg

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The table on the previous page, shows that every country has seen sharply reduced GDP forecasts over the past few months. Clearly, the severest downgrades have been for Russia, which has moved from average quarterly GDP growth for 2022e of +2.5% in early February to nearly -9.0% in June. The US has seen moderately lower revision from +3.8% to +2.6% for 2022e. Germany still appears to be the worst affected economy in Continental Europe where GDP forecasts have been reduced from +3.8% to +1.8% for 2022e and while the Eurozone at large from +4.0% to +2.8%. All forecasts indicate that the impact on economic activity will be particularly hard during 2H22e. Moreover, in terms of the timing and duration, it looks as if forecasters believe the Russia/Ukraine war will take at least another year to come to a resolution.

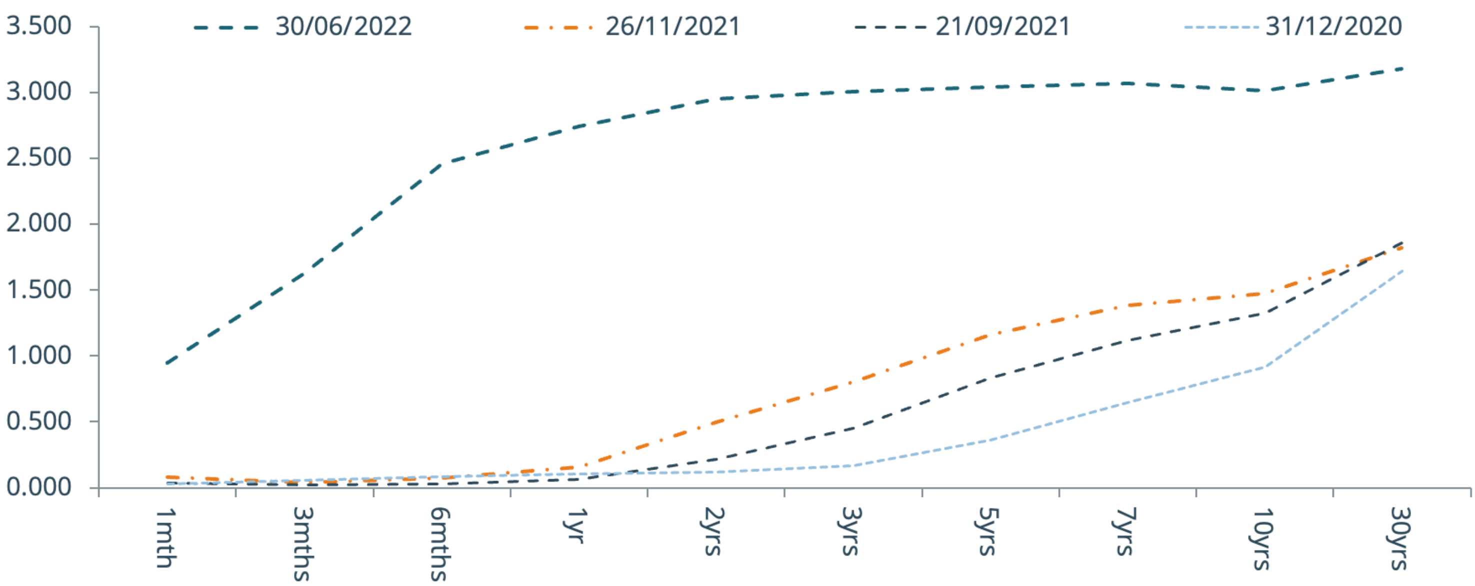
Short-term outlook

Faced with the choice of conducting business in Russia, we continue to believe most businesses are pondering whether to discontinue activities there or not. It seems likely that companies will have to make a distinction between what are essential goods, like basic food or infant nutrition, and more discretionary products and services. In any case, we believe most management teams will use the opportunity to lower market expectations during the forthcoming 1H22 reporting period. CEO's will also have to address social issues along with existing and new sustainability requirements.

When looking at the US economy, which sets the temperature for overall global economic activity, we believe it is inevitable for the Fed to slow down inflation expectations and wage growth. Earlier in this report, we alluded to the fact that we anticipate another two +75bps interest rate increases in July and September, which will bring the Fed Funds rate up to around 3.25%. A look at the US yield curve (see below) implies that bond yield expectations will then be flat across all durations.

The graph below illustrates the US yield curve at four different times between the end of 2020 and June 2022. The chart implies that bond yield expectations (i.e. inflation), have risen sharply in 2022. We have depicted four points in time: *(i)* the starting point at the end of December 2020; *(ii)* the date before the Fed communicated that it would speed up their tapering process (21st September 2021); Black Friday when the Omicron-variant took a toll of the financial markets (26th November 2021) and 30th June 2022.

US yield curves since December 2020



Source: Bloomberg and Heptagon

Later in September when we believe the Fed will have swiftly cooled off economic activity through rapid increases in the Fed Fund's rate, we believe the Fed will take a breather and ascertain what inflationary pressures and the US employment situation looks like. In any case, we construe that the Fed's primary objective is to slow down economic activity.

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Why should European Focus perform well if economic activity is slowing

Despite the poor performance of European Focus in 1H22, we are optimistic that the market rot and the tide for quality-growth investing has turned. As commented on earlier in this report, the month of June illustrated that although only three sectors outperformed the benchmark (Healthcare, Consumer Staples and Communication Services). However, European Focus only invests in two out of three of these sectors, yet the Portfolio still had its best relative month for the year.

Looking ahead, although we believe that many European companies will be forced to cut their market guidance for FY22, this is less likely for the high-quality companies in European Focus since they are international leaders with global footprints. In addition, they are well-capitalised which implies that higher interest rates will not impact their profitability as much as less well-capitalised businesses. Moreover, the Portfolio companies of European Focus have strong moats and they have stood the test-of-time (their average age of foundation is 1928). Last but not least, they have pricing-power which is essential during periods when inflationary pressures are being embedded in society at large.

In the Portfolio changes section (page 14) we illustrate how we have shifted the exposures of the European Focus to an overall more defensive positioning in 1H22. However, in the next few paragraphs, we highlight what we believe are key-attributes to the strategy of quality-growth investing.

The power of compounding

We first introduced the below table in April 2021 which illustrates the significant benefits of compounding. The top section of the table illustrates how sales, EBITDA and EBIT growth have developed and are expected to progress for the European Focus Fund and for Europe (the MSCI index) from FY20 to FY23.

The lower section illustrates how the impact of the sales, EBITDA and EBIT growth rates affect the sales and the earnings power based on current consensus expectations are for FY22e and FY23e. In short, this section highlights the impact and importance of not losing sales or profits during economic weakness, such as during the pandemic in FY20.

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

HEFEF	FY19	FY20	FY21	FY22e	FY23e	MSCI	FY19	FY20	FY21	FY22e	FY23e
Sales		1.5%	19.9%	8.9%	9.9%	Sales		-19.3%	13.5%	13.3%	1.0%
EBITDA		4.7%	31.0%	15.3%	11.9%	EBITDA		-21.8%	38.7%	19.0%	1.6%
EBIT		3.6%	60.7%	21.1%	13.0%	EBIT		-38.7%	105.6%	27.8%	3.2%

HEFEF	FY19	FY20	FY21	FY22e	FY23e	MSCI	FY19	FY20	FY21	FY22e	FY23e
Sales	100	101.5	121.7	132.5	144.9	Sales	100	80.7	91.6	103.8	104.8
EBITDA	100	104.7	137.2	158.1	176.9	EBITDA	100	78.2	108.5	129.1	131.1
EBIT	100	103.6	166.5	201.7	227.9	EBIT	100	61.3	126.0	161.1	166.2

Source: Bloomberg dated 30-Jun-22

The above table shows that the European Focus Fund grew its sales by +1.5% while the MSCI index saw sales fall by -19.3% during the Covid-19 crisis in FY20. In a similar fashion, the Portfolio's EBITDA increased by +4.7% while the MSCI index saw EBITDA fall by -21.8% with the Portfolio's EBIT rising by +3.6% while the MSCI index saw EBIT fall by -38.7%.

Since profits (and cash flows) need to be generated from revenues, turnover is critical to any business. However, some commentators argue that: '*While sales are vanity, profits (and cash flows) are sanity*' but we tend to disagree with this remark. We consider revenues to frequently be regarded as an underrated attribute since it forms the base from where businesses grow. However, we believe it essential to analyse sales in a '*correct*' fashion. Hence, sales need to be broken down into 'organic growth' (i.e. price and volume) and 'residual growth' (such as M&A and foreign exchange rate movements). If companies continuously grow their sales organically (which is one of the core tenets for the companies in European Focus), it creates an ever-larger platform from where they can compound their profits – year in and year out.

What happens when sales decline which was the case for Europe (the MSCI index) in FY20? Europe 'lost' -19.3% of its revenue base that year which means that the region would have needed to grow its revenues by +23.9% in FY21 to get back to square one. Since the region only grew its revenues by +13.5% in FY21, according to Bloomberg, its sales base has shrunk to 91.6% of its pre-pandemic base. Consequently, Europe now needs to 'run faster' to stand still, i.e. to generate similar levels of profits and cash flows compared with its pre-pandemic levels. In other words, profit growth needs to be higher.

While the above table shows that this is indeed the case for EBITDA and EBIT of the MSCI index (assuming that consensus current growth rates are correct). This implies that the region regained its poise to its pre-pandemic levels last year. However, we note that the expected +105.6% EBIT growth last year derived from much more moderate expectations of some +45% at the end of June 2021. What changed were two factors. *First*, Europe's banks started to reverse significant loan-loss provisions which they made during the pandemic in FY20 (which means that it is essentially an 'accounting-stunt' and thus suggests a relatively low quality of earnings). *Secondly*, the higher prices of oil and other commodities helped to bolster consensus expectations for raw materials-based industries.

European Focus on the other hand never lost any sales during the pandemic in FY20 or in FY21 and has thus continuously been able to grow its profit base since 2019. The above table thus shows the significant benefit of compounding from an ever-rising revenue stream, which consensus estimated was at a notional level of 121.7 at the end of FY21. More important, the earnings power of European Focus in EBIT terms (based on Bloomberg's estimates) should have grown to 166.5 vs. it pre-pandemic level and more than doubled to a notional 201.7 by the end of FY22e. This compares with the MSCI Europe index which will have grown, albeit it still only sits at 126.0 vs. its pre-pandemic level based on FY21 and at a notional 161.1 for FY22 based on current consensus estimates. In other words, European Focus does not need to run faster – the Portfolio's companies only need to continue to execute operationally and generate earnings as they have been doing. Given that the average age of a Portfolio company in European Focus currently dates back to 1928, we regard the probability that our Portfolio companies will continue to execute in an exemplary manner as highly likely – or put differently – they are extremely likely to outlast Vladimir Putin as well as Covid-19.

Balance sheet strength

We regularly analyse the weighted balance sheet strength of European Focus. The optimal times for doing so are after the year-end and the half-year reporting periods since all Portfolio companies publish at least full P&L, balance sheets and cash flow statements bi-annually. Due to seasonal cash flow movements caused by dividend payments etc, we have used the weighted balance sheet strength at the end of FY21 reporting season vs. the end of the FY20 reporting season.

Our findings confirm that on average, our Portfolio holdings have continued to improve their financial strength. Using FY22e as a 'common-denominator year' the weighted net debt / EBITDA ratio (which includes pension-liabilities, long and short-term financial debt but excluding operational leases), shows that European Focus is currently net cash neutral, down from 0.5x a year ago (where EBITDA for FY22e is based on Bloomberg's consensus expectations). The Portfolio's net debt including pension liabilities, long and short-term financial debt as well as operational leases, shows that European Focus is extremely well capitalised in FY22e at 0.3x, down from 0.8x a year ago.

Balance sheet strength of European Focus in FY22e vs. FY21e

Summary post-FY21 results	Wgt 22e	Wgt 23e	Unwgt 22e	Unwgt 23e
Net debt / EBITDA (excl leases)	0.0	0.1	0.1	0.2
Net debt / EBITDA (incl leases)	0.3	0.4	0.4	0.5
Summary post-FY20 results	**Wgt 21e**	**Wgt 22e**	**Unwgt 21e**	**Unwgt 22e**
Net debt / EBITDA (excl leases)	0.4	0.4	0.5	0.4
Net debt / EBITDA (incl leases)	0.7	0.6	0.8	0.7

Source: Company accounts and Bloomberg consensus estimates for EBITDA.

Volatility – Beta

The traditional weighted, or 'blended' Beta of European Focus, which spans over many years, tends to be in the range of 0.6-0.8. However, in our experience, the sharp drawdown of Technology and other growth-like stocks in 1H22 has been unsurpassed.

Calculating the average Beta of European Focus during the two-year pandemic (January 2020 to December 2021) based on the Portfolio weightings of 30th June 2022 gives a blended average of 0.74.

By changing the timeline to Bloomberg's two-year core setting (1st July 2020 to 1st July 2022) shows that the blended Beta of the European Focus rose sharply at the beginning of 2022, but the Beta has since come down as we have rebalanced the Portfolio to a more defensive stance (see Portfolio changes below). Using Bloomberg's current Beta (vs. the MSCI index), but based on the Portfolio weightings on 31st December 2021, 31st March 2022 and 30th June 2022, the blended Beta of the Portfolio has fallen from 1.0 at the end of 4Q21; to 0.97 at the end of 1Q22 and further to 0.93 at the end of 2Q22. In due course, we expect the Beta of European Focus to converge back to its traditional range of 0.6-0.8 as market volatility settles down and the sharp outperformance of the Energy sector comes to a halt.

Current high-level conviction positions (as of 30th June)

Below is a synopsis of European Focus' high-level conviction positions. Of these top-five positions, in our view only one is a non-defensive holding, ASML. We highlight in more detail why we still hold on to this stock despite its poor performance in the YTD in the Portfolio changes section below.

- **Novo Nordisk (9.2% exposure):** insulin is crucial for people suffering from diabetes. The diabetes market grows by 5-7% annually (of which 3-4% is through volume and 2-3% from higher prices due to product improvements). Novo Nordisk holds an estimated 50% global market share across all relevant types of insulin (and obesity) treatments; the other leading players in the diabetes industry are: Sanofi and Eli Lilly. We estimate that these three companies jointly control approximately 85% of the relevant world market for insulin.

- **Diageo (6.5% exposure):** is the world's largest distiller with a multitude of brand names under its umbrella (such as Johnnie Walker, Gordon's, Tanqueray, Smirnoff and Captain Morgan to mention a few). In a recessionary environment, '*alcohol and cigarettes stocks*' typically perform well as most consumers rarely give up on 'bad habits' – they merely continue to do them in a less costly manner. Given European Focus' strict ESG criteria and the fact that 'tobacco' is on our ESG exclusion list, the Fund will never invest in any tobacco business.

- **Nestlé (5.8% exposure):** is the world's largest food manufacturer. Irrespective of the economic climate '*you have to eat*'. The Nestlé share has historically performed well during periods of economic contraction.

- **ASML (5.7% exposure):** the Dutch and world-leading supplier of machinery for semi-conductor manufacturing is currently the only large exposure which is a non-defensive industry. However, consensus sales and profit revisions have been positive throughout 2022 given the company's effective monopoly in the smallest and most energy-efficient EUV-technology. Management recently announced an investor day for 4Q22 (11th November) when ASML has communicated that the company will raise the long-term guidance (see Portfolio changes on page 14 for further comments).

- **Lindt & Sprüngli (5.2% exposure):** the Swiss and the world's largest producer of premium chocolate, which we de facto classify as '*affordable luxury*'. Lindt & Sprüngli holds a unique position in this industry which is expected to show long-term growth of 6% - 8% per annum. The core strength of this company is its strict focus on premium chocolate, where the small players tend to be family-owned businesses which do not have the aspiration to grow internationally and the large players (such as Nestlé, Mondelez etc.) are too large to focus on the premium segment in isolation. In a nutshell, it is more important for Nestlé (and its likes) to sell higher volumes of '*KitKats*' than to sell its premium '*Cailler*' brand.

ESG considerations are continuously gaining higher priority

The European Focus has an exclusion list with prevents it from investing in businesses, such as fossil-fuel, nuclear, weapons, tobacco, gambling etc. ESG as a concept has always been integrated into our strategy given the mantra that it is essential for businesses that '*doing well and doing good are mutually dependent*'. In other words, it is not good business practice to cut corners in any of the ESG-dimensions given potential repercussions – be it financial risk, such as becoming liable to fines, damages and/or reputational risk (which is ultimately likely to have financial implications).

As investors and companies are continuously re-prioritising various aspects of ESG, we note that more and more companies are aligning their managers remuneration to measurable ESG targets. We construe that practically all Portfolio companies in European Focus have now at least partly aligned their managers' compensation to measurable ESG targets effective from their 2022 AGMs.

Risks and uncertainties

Below are a few bullet points regarding risks and uncertainties which we are currently considering in terms of priority.

- **Inflation and bond yields:** will higher inflation and bond yields lead to excessive wage pressures and put economies into recession? The vast majority of the Portfolio holdings in European Focus have a high level of refinement and pricing power. This implies that their product offerings are generally price inelastic, i.e. when price levels of products rise, the level of demand stays broadly the same.

- **Vladimir Putin's war with Ukraine:** the short-term impact has already been noted given the sharply higher prices of oil, gas and other commodities (such as wheat). There is also a risk that Vladimir Putin will escalate the scope (or rather the lack) of his war-efforts by using tactical nuclear weapons.

- **High level of corporate indebtedness:** higher interest rates may continue to affect the valuation of equities and companies' profitability, which already started to be visible late September and in December 2021. However, the balance sheet strength of an average European Focus company is considerably better than that of an average MSCI Europe company. The Portfolio currently shows a net debt to EBITDA ratio of 0.3x including leased debt obligations as well as pension liabilities, which compares with 3-3.5x of the average constituents in the MSCI index.

- **The Delta, Omicron, BA... variants (and more) again spiralling out-of-control vs. vaccine-rollouts:** Most economies appear to have partly discarded the pandemic given the calamities in Ukraine and governments seem to have got control of the new and fast-spreading Omicron and BA... variants. However, we cannot exclude a re-emergence of Covid-19 clusters which will continue to affect businesses' end-markets and/or supply-chains. Nonetheless, we believe most countries are now much better equipped to tackle such new variants and cases in a more efficient manner as science has gained better understanding of the virus.

- **China's debt crisis and relationship with Russia:** We believe the current credit-crisis in China's largest construction companies and their contagion to the rest of the Chinese real-estate market and banking sectors will continue to pose a threat. Moreover, Russia's invasion of Ukraine has exposed the obvious dilemma between where China's geopolitical heart sits and where its economic interests lie. The EU and the US rank as Beijing's most crucial economic partners in terms of trade, investment and capital market linkages. However, China has yet to officially condemn Putin's Russia for invading Ukraine. Given the strong worldwide opinion against Russia, and the severe sanctions which have been imposed on the country, it seems probable that China will be adversely affected by not taking the side against the invasion.

Attribution analysis for 1H22

1H22 was an extremely weak period for the Heptagon European Focus Equity Fund. The Portfolio's CE share class fell by -26.84% vs. benchmark MSCI Europe NR (EUR) index which dropped -13.84% in comparison.

Although we construe that several factors are likely to have led to this weak performance, the overriding one is that the Energy sector completely stole the show in terms of investors' preference during 1H22. The sector performance table on page 15 shows that this sector outperformed the MSCI Europe NR benchmark in five out of the six months (it only underperformed the benchmark index in June). Moreover, on an individual month-by-month basis, the Energy sector had two stunning months; one was in January when the sector advanced by +13.0% (benchmark +1.9%) and the other was in May when the sector leapt by another +10.3% (benchmark -0.8%).

In order to not style-drift and stick to our mantra of not investing in price-takers, sadly the odds for European Focus to outperform this investment environment during 1H22 were nearly impossible. We will discuss how we have aimed to mitigate these severe headwinds in the Portfolio Changes section below.

When looking at the best-performing stocks in the Portfolio, there were hardly any changes between their performance during 1Q22 and 1H22. There were only three stocks which outperformed the benchmark during the 1H22 period (**Beiersdorf, Novo Nordisk** and **Nestlé**) vs. four during 1Q22 and their individual rankings were the same in 1Q22 as well as in 1H22. **Diageo** (DGE LN), the world-leading distiller which owns several world-renowned brand names like Johnnie Walker, Gordon's, Tanqueray, Smirnoff and Captain Morgan and others, slightly underperformed the benchmark during 2Q22. This was due to the fact that the GBP lost ground against the EUR. Closer analysis shows that DGE fell by -8.6% in GBP terms in 2Q22 (vs. -9.0% of the benchmark), but converted into EUR, the DGE share fell by -10.5% (i.e. it lost -146bps on a relative basis in EUR terms).

In terms of the worst-performing stocks in the Portfolio, it was the same five stocks in 1H22 compared with 1Q22 (**Zalando, Tomra, Atlas Copco, Adyen** and **Straumann**), but their rankings slightly differed. While **Zalando** and **Tomra** were the worst performers in 1H22 as well as in 1Q22, the rankings of the other three stocks slightly differed between the two periods (see below).

Given our mantra that: '*stocks which perform well tend to perform well for longer and stocks which perform poorly tend to perform poorly for longer*', we will discuss why we have decided to hold on to the bottom-performing stocks despite their poor performance.

Contributors

Beiersdorf (BEI GY)

Beiersdorf

Beiersdorf (Germany: +7.9%), the owner of the world's largest skincare brand, Nivea, was the best performing stock in the Portfolio in 1H22 (as well as in 1Q22: +5.3% vs. -5.3% of the benchmark index). With hindsight, it is likely that a week after the release of the FY21 set of results (1st March) marked the low point of the BEI share (8th March: €80.64) and that it has now turned the corner.

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Vincent Warnery, who took over as CEO of the group on 1st May 2021, and Astrid Hermann, who became CFO a few months beforehand, appear to have eradicated the stigma of BEI's inability to grow in e-commerce, which the previous management appeared inept in achieving. BEI's year-end report was solid and reflected sequential growth-rates in some regions, but more importantly – significantly more information was provided in respect of the group's online and e-commerce accomplishments. Furthermore, management announced the acquisition of the US skincare brand, *Chantecaille*, in March which should enhance BEI's overall growth rate.

At the year-end presentation, management commented that BEI had adopted a '*Digital Fast Forward*' program with the aim of further expanding the group's business in the digital space – from e-commerce to '*co-innovation platforms and various digital service offerings for its consumers*'. A significant share of the €300m restructuring provision (announced by the previous CEO, Stefan De Loecker in March 2021) was ear-marked for this purpose. BEI commented that e-commerce revenues in the important Consumer Division (80% of group sales and 75% of group EBIT) grew by 32% in FY21 and represented more than 10% of divisional sales.

BEI's 1Q22 sales (28th April) were ahead of market expectations. Management showed confidence that the business outlook will improve by highlighting ongoing e-commerce efforts and market share gains in all geographies. Although management (only) maintained the FY22 guidance at the 1Q22 stage, we believe BEI is one of the opening-up winners partly given that the luxury and high-margin, *La Prairie*, should boost the company's overall profitability. We believe management's digital progress will be a key driver to the performance of the BEI share stock in 2022 and its prospects of regaining the traditional premium-rating against its peer group. The company hosted a long-awaited and highly appreciated investor day in Hamburg (9th June). BEI's 1H22 set of results are due on 4th August.

Novo Nordisk (NOVOB DC)

NOVOB (Denmark: +7.1%), the world's largest manufacturer of insulin, was the second-best performing stock in the Portfolio in 1H22 (as well as in 1Q22: +1.9% vs. -5.3% of the benchmark index). NOVOB is the largest Portfolio holding in European Focus (30th June: 9.4% exposure) and since 2Q21, the underlying share of this fine company has gone from strength-to-strength supported by management's upgrades to the organic top-line guidance on the back of accelerating interest and momentum in the anti-obesity drug, '*Wegovy*'. Wegovy works with the once weekly subcutaneous (under-the-skin) semaglutide dosage (2.4 mg) alongside dietary and exercise programs for chronic weight management in adults who are living with obesity (i.e. BMI> 27kg/m2).

A supply-chain related matter forced NOVOB to issue a cautionary statement (17th December 2021) regarding Wegovy, suggesting that the company would only be able to supply existing patients during 1H22. However, when the 4Q21 set of results was published (2nd February), management had regained confidence that full production of Wegovy would be up-and-running again by 2H22 and this was re-confirmed during the investor day in Copenhagen (3rd March). Since Wegovy offers a new form of treatment where NOVOB holds considerable first-mover advantage, we believe the drug will act as a growth-driver for several years to come. Consensus sales and profit revisions for NOVOB continue to be solid reflected by higher upgrades for future years further out (i.e. FY24-FY25) compared with FY22. This implies that analysts' growth assumptions are expected to accelerate, which is generally a good indicator for a business' long-term fundamentals. NOVOB's 1Q22 set of results was pre-announced (29th April as opposed to the original date 4th May) as management made a substantial upgrade to the FY22 guidance. LfL revenue growth is now expected at +10-14% (vs. previously +6-9%) while LfL EBIT growth is projected to grow by +9-13% (vs. previously +4-8%). NOVOB is due to announce 2Q22 results on 4th August.

Nestlé (NESN SW)

NESN (Switzerland: -9.2%), the world's largest food-producer, was the third best-performing share in the Portfolio in 1H22 (as well as in 1Q22: -4.2% vs. -5.3% of the benchmark index). In many ways, the traditional and extremely defensive characteristics of the NESN share came to fore in 1Q22. In a nutshell: '*You have to eat irrespective of economic and geopolitical environment*.' During 4Q21 NESN issued a joint announcement with L'Oréal, in which NESN is the largest shareholder, that it would reduce its stake from

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23.3% to 20.1% by selling 22.26m shares to L'Oréal. L'Oréal would pay €400 per share valuing the transaction at around €8.9bn. The announcement had a positive impact on the NESN share as the company would free up capital which will be used to enhance the current 2022-24 share buy-back program.

FY21 set of results (17th February) were solid. At the webcast, management came across as confident regarding the FY22 prospects as price increases were being gradually introduced. The organic growth guidance for the year was set at +5% with an underlying EBIT margin of 17-17.5% (FY21: 17.4%). NESN's 1Q22 sales (21st April) were ahead of market expectations. Management again came across as confident regarding FY22 prospects as price increases (+5.2%) were being implemented across the product-range. While NESN maintained the guidance for FY22, the more important takeaway from the 1Q22 sales report was the comment made by the CEO, Mark Schneider, that the underlying long-term top-line LfL growth rate of +4-6% has been restored. NESN is due to release the 1H22 report on 28th July.

Detractors

Zalando (ZAL GY)

ZAL (Germany: -64.9%), Europe's largest online fashion retailer, was the worst-performing stock in the Portfolio in 1Q22 (as well as in 1Q22: -36.3% vs. -5.3% of the benchmark index). This poor performance sharply contrasts with 2020, when the ZAL share was by far the best performing share in the Fund (+101.6% vs. -3.3% of the benchmark) as the business was a clear '*lockdown winner*'. ZAL is the smallest position in European Focus (30th June: 1.2% exposure). Despite the dismal performance, we are reluctant to abandon this company since we consider the structural and long-term fundamental shift away from brick-and-mortar apparel retailing to e-commerce has been completely disregarded.

Although we understand the short-term 'opening-up attraction' for some other brick-and-mortar retailers, we still find the harsh reaction on the ZAL share in 1H22 somewhat bizarre. Our initial purchase of ZAL (26th June 2017) was around €41 per share. At the end of 1Q22, the ZAL share was priced around €46 (or +12% from our original purchase price), down from an all-time high of €104.65 (7th July 2021) and by 30th June it was around €25. Over the five years, the company has shown organic CAGR sales growth of 23% while EBIT has compounded by 21%. In other words, the business is now some 2.5x larger in terms of sales and EBIT compared with what it was in 2017 while at the same time its balance sheet remains net cash positive. Meanwhile, ZAL's market shares across Continental Europe are considerably higher and its product range is vastly bigger partly due of the extended Partner Program with 3rd party retailers.

Furthermore, ZAL's product offering now also includes the cosmetics category and the company has a close cooperation with cosmetics-retail giant, Sephora (owned by LVMH). According to ZAL's management, Putin's war in Ukraine has had a significant adverse effect on European consumer confidence. At the time of writing, ZAL does not expect European consumer confidence to recover in the short-term and for this reason, ZAL issued a profit-warning (24th June) for 2Q22 and for FY22. Management's new FY22 guidance indicates the following in LfL terms: GMV (gross merchandise value) growth is now expected in the +3-7% range (down from +16-23%) and net revenue growth is expected in the range of +0-3% (down from +12-19%), i.e. each -12% from the guidance that was provided at the 1Q22 stage (5th May). Meanwhile, FY22 EBIT is expected to be in the range of €180-260m (down from €430-510m), corresponding to a -53% reduction from the mid-range. Nonetheless, ZAL is still expected to show positive growth in the current year. ZAL is due to publish 2Q22 results on 4th August.

Tomra (TOM NO)

TOM (Norway: -43.7%), the world's leading supplier of recycling and sorting equipment, was the second-worst performing stock in the Portfolio in 1H22 (as well as in 1Q22: -26.2% vs. -5.3% of the benchmark index). In our opinion, the TOM share fell victim on two counts in January, when the drawdown in the stock was the most severe: *(i)* broader profit-taking in technology and '*growth-like*' business on which we commented on earlier in this report; *(ii)* overall profit-taking in premium-rated ESG stocks. The company's 4Q21 set of results (23rd February) met market expectations. While TOM's new CEO, Tove Andersen, came

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across as confident, there was an announcement that the long-standing CFO, Espen Gundersen, will step down in 2022 after assuring a smooth transition to successor, Eva Sagemo.

Unfortunately, in our view TOM's management slightly 'over-played' their hand during the 4Q21 webcast by saying that although there had been no delays in deliveries of equipment to any of its customers, the company would make a NOK100m (some 3% of FY21 OPEX) provision for extra costs as the company needs to secure sourcing of components in 1Q22. The market took a dim view to this excuse and marked the stock lower. When the company published the 1Q22 set of results (29th April), unfortunately management made a 'repeat performance' during the webcast by down-playing various supply-chain issues.

Nonetheless, TOM's order intake and the order backlog stand around all-time highs and we have few doubts regarding the strong medium to long-term fundamental outlook for this interesting company. Looking beyond the Russia/Ukraine war, we believe accelerating environmental concerns and the EU's '*single-use plastics directive*' from March 2019', which states that 77% of all single-use plastic bottles should be recycled by 2025 and 90% by 2030, will continue to drive TOM's long-term fundamentals. Management hosted a long-awaited investor day at its German plant in Koblenz (23rd June) and the stock has sharply recovered since that day. TOM will release the 2Q22 results on 15th July.

Atlas Copco (ATCOA SS)

ATCOA (Sweden: -41.3%), the leading provider of compressed air and other capital goods equipment, was the third weakest performing stock in the Portfolio in 1H22 (and the fourth weakest performer in 1Q22: -22.0% vs. -5.3% of the benchmark index). ATCOA was one out of two companies in European Focus which did not fully match the market's 4Q21 expectations (the other one was Givaudan). ATCOA's year-end results (25th January) fell slightly short of consensus as supply-chain related issues affected deliveries and its service offering (limited access to customers' premises – we estimate ATCOA's services business represents around 30% of sales). Nonetheless, the company's order intake was excellent (LfL +26%) –for all compressor-types, vacuum pumps (which are used in the semi-conductor industry) and in power-equipment.

Management's generic financial guidance ('ATCOA expects that the customers' *business activity level will remain at the current high level*.'), has been kept unchanged from since the beginning of 2022. The 1Q22 report (26th April) matched market expectations as supply-chain related problems hit both the top-line and profits. Management commented that supply-chain related problems will last at least until the summer (depending on the Russia/Ukraine war). Nonetheless, ATCOA's order intake in 1Q22 was excellent at (LfL +23%) across the different divisions and regions. Although the stock has been a miserable performer in the YTD, consensus sales and profit estimates have been raised. The ATCOA share is traditionally a strong USD beneficiary as much of the product range is exported out of the Eurozone, but we suspect the increasingly important vacuum-pump business (used in the semi-conductor manufacturing industry) is currently having a negative bearing on investor sentiment. ATCOA's 2Q22 set of results is due on 19th July.

Adyen (ADYEN NA)

ADYEN (Netherlands: -40.0%), the leading provider of payment solutions, was the fourth weakest performing stock in the Portfolio in 1H22 (and the fifth weakest performer in 1Q22: -20.6% vs. -5.3% of the benchmark index). The ADYEN share showed significant volatility in 1Q22 as well as in June. While it was the second worst performing stock in the Portfolio (after Tomra) in January (-23.0% vs. -3.2% of the benchmark), it was the best performing stock in the Fund in February (+5.6% vs. -3.0% of the benchmark). In our opinion, the sharp rise in treasury yields in January as well as in June, which typically has a direct impact on credit-card payments, caused the ADYEN share to have poor months in January and June along with other businesses that are perceived to be affected by credit-card spending (such as Mastercard and Visa). However, when ADYEN published its FY21 set of results (9th February), the stock bounced back strongly as the company reported 46% organic revenue growth and 59% organic EBIT growth.

A look at the business helps to explain this massive swing. ADYEN offers merchants an integrated platform to seamlessly process payments online, over mobile devices and through POS (Point-of-Sales terminals) in physical stores. We characterise ADYEN as a truly '*unique business*' where competition is more or less absent and the service is entirely developed in-house. ADYEN is one of the youngest companies in European Focus. The company was founded in 2006 and floated on the Euronext Exchange in June 2018. Given its short history as a public company, we believe the investment story and the underlying share sometimes become misinterpreted – January and June were such months.

Management explained very clearly that the investment story of ADYEN is not predicated on credit-card spending, but based on the penetration (and growth) of merchants which are linking up with the company's integrated payment system (what ADYEN calls '*unified commerce*'). ADYEN's current financial objectives are to generate 25-30+% net sales growth and to reach an EBITDA margin of more than 65% (FY21: 62.9%). We believe the concept of 'unified commerce' alongside platform-related businesses and other digital solutions will enable ADYEN to reach these targets. The company hosted a well-orchestrated investor day (31st March). ADYEN's 1H22 set of results are due on 18th August.

Straumann (STMN SW)

STMN (Switzerland: -38.6%), the global leader in dental implants and ancillary orthodontal materials, was the fifth weakest performing stock in the Portfolio in 1Q22 (and the third weakest performer in 1Q22: -22.1% vs. -5.3% of the benchmark index). Despite an excellent investor day (16th December 2021), which showcased the company's unique position in several fields of orthodontics as well as its superior product suite and the excellent set of FY21 results (15th February), which matched extremely highly set market expectations, the STMN share fell victim of higher bond yields that adversely affected growth-stocks in 1Q22 and in June in particular.

The company's 1Q22 sales report (28th April) also reflected extremely strong LfL top-line growth of +27.9%. STMN's extremely conservative management team maintained the FY22 guidance of '*low double-digit organic sales growth and EBIT of around 26%'* (FY21: 26.8%) at the 1Q22 stage, where the lower EBIT margin is explained by the commencement of business travelling and trade exhibitions which will push OPEX higher. Since the 1Q22 sales report, consensus estimates sales and EBIT estimates of STMN have been raised by around +1% respectively. Meanwhile, management's encouraging long-term guidance (to 2030), reflects the business strong fundamentals as STMN is expected to reach a turnover target of CHF5bn (which implies a CAGR of 13.3% from the FY20 base year). STMN is due to publish 1H22 set of results on 16th August.

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 only generally comment on trades exceeding this level.

Over-and-above smaller changes to the Portfolio, which primarily relate to market opportunities and/or correction of passive UCITS breaches, we have nonetheless gradually rebalanced the Portfolio by making smaller 'indirect' changes to our Portfolio exposure during 1H22 (1H21: 9 active changes) by using subscriptions and redemptions whenever possible, as well as the natural price moves in the equity markets.

The net result is that we have made the Portfolio more defensive. The table on the next page, shows the evolution of the 10 largest exposures in European Focus, i.e. those positions where we have the highest level of conviction since year-end. We have used three points in time to illustrate how these ongoing changes have impacted the robustness of the Fund: the end of 4Q21, the end of 1Q22 and the end of 2Q22.

End-of-quarter 10 largest Portfolio holdings in European Focus

31/12/2021	% exposure	31/03/2022	% exposure	30/06/2022	% exposure
ASML	6.9%	**Novo Nordisk**	8.2%	**Novo Nordisk**	9.4%
Tomra	6.6%	**ASML**	6.7%	**Diageo**	6.4%
Novo Nordisk	6.0%	**Tomra**	5.8%	**Nestlé**	5.8%
Straumann	5.7%	**Diageo**	5.0%	**ASML**	5.6%
Coloplast	4.5%	**Coloplast**	5.0%	**Lindt & Sprüngli**	5.3%
Eurofins Scientific	4.4%	**Lindt & Sprüngli**	4.9%	**Tomra**	4.9%
L'Oréal	4.4%	**EssilorLuxottica**	4.8%	**EssilorLuxottica**	4.9%
Dassault Systèmes	4.4%	**Hermès**	4.8%	**L'Oréal**	4.6%
Lonza	4.3%	**Straumann**	4.7%	**Beiersdorf**	4.6%
Atlas Copco	4.3%	**Lonza**	4.6%	**Givaudan**	4.3%
Total	**51.5%**		**54.4%**		**55.7%**

Source: Heptagon Capital and Bloomberg

Another '*qualitative way*' of looking at this is to categorise the Portfolio holdings into three different 'buckets', i.e. stocks with:

- Technology and/or growth-like characteristics
- Medium defensive characteristics
- Defensive characteristics

As 2022 has progressed, the defensive bucket in European Focus has increased at the expense of Technology and growth-like businesses – not only in terms of number of holdings – but also as a percentage of the aggregate exposure in the Portfolio.

End-of-Quarter Style Exposure in European Focus

4Q21	% exposure	1Q22	% exposure	2Q22	% exposure
Tech/growth-like	23.5%	**Tech/growth-like**	22.0%	**Tech/growth-like**	10.4%
Medium-defensive	17.6%	**Medium-defensive**	14.3%	**Medium-defensive**	4.9%
Defensive	10.4%	**Defensive**	18.1%	**Defensive**	40.4%
Total exposure	**51.5%**	**Total exposure**	**54.4%**	**Total exposure**	**55.7%**
Tech/growth-like:	–	**Tech/growth-like:**	–	**Tech/growth-like:**	–
ASML, TOM, STMN, DSY	–	**ASML, TOM, RMS, STMN**	–	**ASML, TOM**	–
Medium-defensive:	–	**Medium-defensive:**	–	**Medium-defensive:**	–
COLOB, ERF, LONN, ATCOA	–	**COLOB, EL, LONN**	–	**EL**	–
Defensive:	–	**Defensive:**	–	**Defensive:**	–
NOVOB, OR	–	**NOVOB, DGE, LISP**	–	**NOVOB, DGE, NESN, LISP, OR, BEI, GIVN**	–

Source: Heptagon Capital and Bloomberg

We have held on to technology/growth-like stocks despite their poor performance in 1H22. Over-and-above the fact that these companies in our view have extremely credible management teams, show ongoing market share gains, strong balance sheets, healthy cash flows, have overall clean accounts and are ESG-friendly. Moreover, they have unique business models with superior moats and their businesses have also stood the test-of-time (their average age of foundation in European Focus is currently 1928). In short, they are unique businesses, which are irreplaceable and they will thus command a European scarcity value (i.e. premium-rating).

- **ASML (year of foundation: 1984; end 2Q22 exposure: 5.6%):** there is currently a structural shortage of semi-conductors in the world which is unlikely to disappear in the medium-term. ASML holds a de-facto monopoly in the EUV technology, which is the most advanced, smallest (and thus the most energy-efficient) technology to manufacture semi-conductors. Earlier this year, ASML's management commented that the company will raise the long-term growth target. Most likely, this will be announced either when the 3Q22 set of results are published

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(19th October) or at the next investor day (11th November). Consensus sales and profit expectations have been raised since the start of the year and since Russia's invasion of Ukraine.

- **Tomra (year of foundation: 1972; end 2Q22 exposure: 4.9%):** holds a unique position in the environmental field where its core competence focuses on how to collect beverage cans and bottles most efficiently. The company's traditional flagship product is the RVM (Reverse Vending Machine), i.e. a machine which facilitates collection of beverage cans/bottles in aluminium, glass and plastic. Tomra's expertise is not only concentrated around the RVMs; rather it is how different countries should most efficiently: *(i)* implement collection-points for beverage cans and bottles and; *(ii)* how to best finance such '*circular-systems*'. At the recent investor day in Koblenz (23rd June), management raised the long-term (2027) guidance to show LfL top-line growth of 17% per year (from +10% traditionally) and to grow the EBITA margin towards 18% (FY21: 16.2%). Consensus sales and profit expectations have been raised since the start of the year and since Russia's invasion of Ukraine.

- **Dassault Systèmes (year of foundation: 1981; end 2Q22 exposure: 4.2%):** holds unique positions across a multitude of 3D-software applications that are used for industrial designs (such as in the aviation, marine and automotive industries), simulation of workflows, PLM (Product Lifecycle Management) solutions and much more. As the world's computing-power has accelerated, the company's product suite has been dramatically expanded to include simulation of molecular structures in life-sciences and biotechnology and other high-tech solutions. Dassault Systèmes' has an extremely stable management structure (where the current CEO Bernard Charlès joined the company in 1983). The company typically guides for individual quarters, but management has a tendency to gradually increase current full-year forecasts as each quarter in the fiscal year progresses. Consensus sales and profit expectations have been raised since the start of the year and since Russia's invasion of Ukraine.

- **Straumann (year of foundation: 1954; end 2Q22 exposure: 4.0%):** has evolved from a distant #3 or #4 to become the world's undisputed leader in dental implantology and orthodontics. This achievement has been accomplished by an unsurpassed focus on the core competence – dental implants and ancillary technologies. As Straumann's business has grown and gained global prominence so has its product suite, which now includes biomaterials and digital solutions for use in tooth correction and much more. Straumann hosted an impressive investor day (16th December 2021), where management issued a long-term LfL revenue target of CHF5bn by 2030, which implies a CAGR of 13.3% from the base-year 2020. Consensus sales and profit expectations have been raised since the start of the year and since Russia's invasion of Ukraine.

- **Hermès (year of foundation: 1837; end 2Q22 exposure: 4.2%):** is by far the most focused European luxury goods company, which is targeting the ultra-high-end consumer group. Unlike its other European luxury goods competitors, Hermès is an organic grower as opposed to a consolidator of brand names. Not only has this been reflected in the stock's much stronger long-term performance compared with its peers, but it is also reflected in the valuation of the Hermès share, which over time has been approximately 2x its peer group. What also differentiates Hermès from its competitors is its hard-core focus on controlling the entire value-chain: from the sourcing of raw materials to the interaction with the end-consumer. This implies that none of its businesses go through 3rd party wholesale channels. Consensus sales and profit expectations have been raised since the start of the year and since Russia's invasion of Ukraine.

Thank you for your interest in the fund and for any questions please don't hesitate to contact us at Heptagon Capital.

Christian Diebitsch, Fund Manager, Heptagon Capital

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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.

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