HEPTAGON Capital

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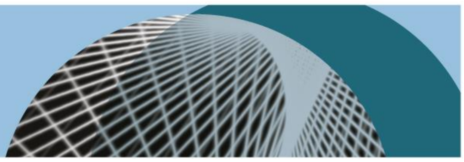
# Helicon Fund: Monthly commentary

February 2018



**February saw global equities deliver their worst monthly performance since January 2016. Indeed, intra-month, several markets entered 'correction' territory, declining by over 10% from their peak, even if some of this was later recovered. It was pleasing to see Helicon outperform during this period, losing 4.0%, compared to the 4.2% fall recorded by the MSCI All-Country World Index. We have positioned the portfolio relatively conservatively for some time (which partly explains why the Fund underperformed in January), but believe such a strategy positions us well for the coming months. Our focus is on cashflow-generation and valuation.**

Our most important take-away from the past month is that **higher volatility, rising bond yields and nervous equity markets may be the new normal.** At the least, it is naïve to assume that the near future will resemble the recent past. Something fundamental has changed, in our view. Sure, the move in early February was probably an accident waiting to happen given exceptionally low levels of volatility and arguably elevated investor complacency that preceded it. Moreover, corrections and bull markets are not mutually exclusive concepts. What's different, in our opinion, is that **the era of low rates and yields has ended**. This is a regime change.

There has been a collective failure of the imagination in assuming that the near future will resemble the recent past. History, unfortunately, is not linear. The elephant in the room – or the question that perhaps haunts investors, yet they have been unwilling fully to acknowledge – is **what happens when the economy returns to normal?** This has major ramifications for all asset classes. Indeed, the magnitude of the problem is exacerbated by the fact that assets are now more correlated than was historically the case. In other words, previously, investors could look to own fixed income when equities were expensive, and vice-versa. Now, neither looks undervalued and both correspondingly suffered during last month's market wobble.

What we do know is that Central Banks are moving from a period of monetary expansion to contraction. Additionally, we see clear evidence that wages are rising and that inflation risks are weighted on the upside. The challenge is whether Central Banks are equipped to deal with this environment. Not only is there the concern over whether Central Banks may already be behind the curve (whether current policy represents economic reality), but also if they have the appropriate tools at their disposal. Furthermore, history suggests that there is never just 'a bit' of inflation. Once it starts, it becomes self-perpetuating, with upward pressures reinforced by higher expectations. The current Central Bank mantra of policy gradualism does not sit well with such an environment.

All the above implies **a high degree of caution when it comes to investing in equities.** We have tried to balance the perceived fear of missing out with an insistent focus on fundamentals. Put another way, we would be happy *not* to participate in all the upside in equity markets *as long as* we can protect, or limit drawdowns effectively, on the downside. Our approach in this respect is simple: we seek only to invest in **businesses with sustainable competitive advantages that are capable of generating high and consistent levels of free cashflow**. As of the end of February, Helicon's portfolio of businesses was forecast to grow its free cashflow at a compound annual rate of 10.4% over the next three years, superior to that of the growth rate projected for the MSCI All-Country World Index (ACWI) of 7.8%.

Another factor worth consideration, which we believe will increasingly come to the fore looking ahead, is indebtedness. With the direction of travel for rates (and yields) upwards, **businesses with robust balance sheets** should be well-placed. More difficult times favour asset-rich businesses over those which are more highly geared. On a net debt/EBITDA basis, Helicon's portfolio trades on a multiple of 1.1x, which compares favourably to the 1.7x figure for the ACWI.

**During February we made two notable changes to the portfolio, adding Aeroflot and selling Rakuten.** Aeroflot had been on our screen for some time, and we were attracted to its cashflow-generating characteristics as well as its valuation. In general terms, as we have written regularly in recent editions of *View From The Top*, we see better relative value in emerging markets relative to developed. Aeroflot, the leading Russian airline, trades on ~5x estimated earnings for 2018, with a 7%+ dividend yield and double-digit forecast free cashflow growth. We see multiple drivers for the business including domestic passenger growth, the implementation of efficiency programmes and the expansion of Pobeda, its low-cost airline franchise. Regarding Rakuten, we believe that the Japanese e-commerce business with its own payment ecosystem offers attractive growth potential, but it has been unable to translate this into positive shareholder returns (the business has seen annual declines in its share price for the last three years). Furthermore, its planned expansion into mobile services may represent an additional execution burden. Put simply, we have higher conviction (and a cheaper valuation) in Aeroflot.

There was large dispersion in performance terms across the portfolio in February, with the gap between our best- and worst-performing businesses being equivalent to almost 28 percentage points. Although we only purchased Aeroflot mid-month, for February, it recorded the second-best return among our holdings, up 6.1%. The month's top-performer went to **Pandora**, which delivered a 12.6% gain. While pleasing, this move needs to be seen in the context of a 15.9% decline for the business in January. Pandora negatively pre-announced at the start of the year (which explains January's move), while in February, management demonstrated the first tangible signs of delivery on its new strategy. Additionally, Pandora committed to its dividend plans (equivalent to a 5.1% historic yield) and announced a further share buyback, both of which were taken positively by investors. In contrast, **Tupperware** was February's notable laggard, losing 15.1% of its value. The business reported mixed results at the end of January and in spite of its ~5% forecast dividend yield combined with a 2018 forecast earnings multiple of ~10x, investors would seemingly prefer to wait on the sidelines until there is evidence of more executional delivery. We currently have ~3% of cash in Helicon, which we will look to deploy tactically as opportunities arise.

Thank you for your interest in and support for the Helicon Fund.

*Alexander Gunz, Fund Manager*

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

Glossary

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| Balance Sheet | A document that provides information on the financial position of a company at a point in time. It includes what it owns (assets), what it owes (liabilities) and the value of business to equity holders (shareholders' equity). |
| Bond Yield | The income that is generated from an investment. |
| Dividend Yield | A percentage that shows how much dividends are paid out by a company in any given year relative to the company's share price. |
| Drawdown | The amount an investment or fund declines from peak-to-trough during a period, usually shown as a percentage. |
| Equity Markets | The market for securities that represent ownership in an entity and that may pay income as dividends. |
| Fixed Income | A security that pays the investor regular or periodic income at a rate that is known by the investor in advance. |
| Free Cash Flow (FCF) | A measure of the cash that a firm produces after the cost of expenditures to maintain or expand its asset base. |
| Inflation | The rate in which the cost of goods and services is rising |
| MSCI All Country World Index | A market cap weighted benchmark index that captures large and mid caps across 23 Developed Markets and 24 Emerging Markets countries (Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the UK, the US, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Russia, Qatar, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates) |
| Valuation | The process of determining how much a company or an asset is currently worth at a point in time. |
| Volatility | A statistical measure to show the degree of movement of asset prices over a set period. |

## 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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## 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.

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