aperture investors

March 31, 2021

Aperture European Innovation Fund Q1 2022 Review & Market Outlook

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Dear All,

In this quarterly letter, I will review in turn the market performance that was impacted by the significant geopolitical events this quarter. I will then examine how our fund faired during this period. Given the sharp divergence between performance of expensive and cheap stocks, I am taking this opportunity to revisit the argument for our flexible and adaptive investment approach. As usual, I also drill down into the contribution by stocks, before finally providing some insight on our outlook and our positioning as we head into Q2.

I hope you find this letter helpful. As always feel free to reach out to our IR with any questions.

A quarter of shocks and resilience

The key story this first quarter has been one of significant geopolitical and macroeconomic shocks. Yet at the same time it was also a story of impressive resilience, as we watched equity markets absorb these shocks, bounce-back and recover. Chronologically, we could compartmentalise equity returns into three distinct periods:

1) **Shock #1: Dragged down by expensive stocks, the equity market started this year by selling off c-8.5%in January.** It found a catalyst in freshly released FOMC minutes which came in more hawkish than the December testimony. Investors sold highly valued stocks (mostly in the Growth and Tech zip codes) while they re-rated much cheaper stocks (mostly in the industrial and financial sectors). Attention was paid to supply chain, slower normalisation, scale and duration of no-longer “transitory” inflation, and the increasingly decisive Fed policy meant to contain it.

2) **Shock #2: Russia’s invasion of Ukraine on February 24 caused a panic sell-off.** European equity markets dropped 5% intraday, oil gained +18% to a high of $140, and commodities like nickel squeezed by more than 250% forcing the LME into an embarrassing 1-week halt. Naturally inflationary, war shifted investor attention from inflation scale and duration to stagflation, recession and tail risks that derive from increased geopolitical uncertainty and market volatility.

3) **Resilience: Oversold European markets managed to bounce back around +10% from low levels, closing the quarter ~ -5.3%.** Multiple de-escalation talks between Russia and Ukraine managed to support the market even though the ultimate failure to resolve the conflict maintained a certain level of volatility. Admittedly, this resilience took many market participants by surprise with many L/S hedge funds reported to have recorded negative alpha returns.[1]

1. Source: Bloomberg. Equity markets, NDDUWI Index; European equity, SX5E Index; oil, CL1 Comdty. As of March 31, 2022.

March 31, 2022

Chart 1: Shocks and resilience in the Stoxx 600 index

Source: Bloomberg, as of April 2022.

How did we do this quarter?

Aperture European Innovation (ticker APEIIED LX, or the "Fund") was down 6.97% net of fees in the first quarter of 2022, trailing the MSCI Europe Net Total Return Index (the Fund's benchmark), which lost 5.32% in the quarter. Inception-to-date through March, the annualized return of the Fund was +13.59%, outperforming the benchmark by +7.38%.

RETURNS AS OF QUARTER-END (%, net of fees)

	Jan	Feb	Mar	Q1	2021	1-Year	Since Inception
Fund	(7.84)	(2.71)	3.76	(6.97)	28.79	10.43	13.59
Benchmark	(3.20)	(3.01)	0.84	(5.32)	25.13	9.34	6.21
Relative Performance	(4.65)	0.30	2.92	(1.65)	3.66	1.09	7.38

Despite the shocks throughout Q1, most of the fund's underperformance was in fact recorded in January alone when it underperformed by 4.65% before recovering by +0.3% in February and +2.9% in March.

January's performance creates a good opportunity to remind our readers of our strategy's behaviour during periods of so-called Growth/Value "rotations."[2] It maintains flexibility in stock picking across both Growth and Value alpha opportunity sets.

The fund's performance (white line) compared with MSCI Europe Growth (orange line) and MSCI Europe Value (blue line) illustrates this flexibility. Chart 2 below shows that the fund has outperformed both indices since inception.

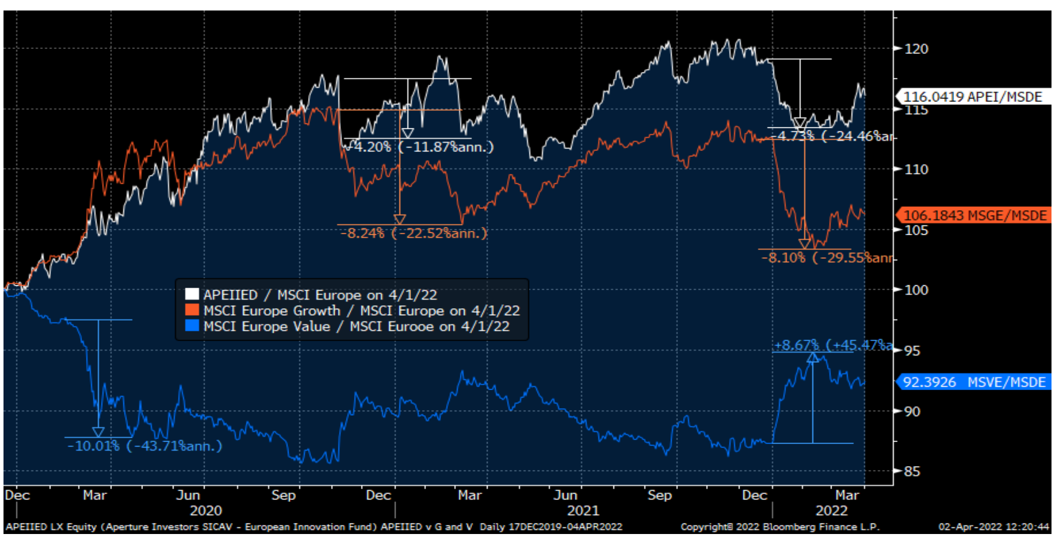
2. In my opinion, "rotation" is no longer the correct term regarding Value and Growth, as I discussed in last quarter's letter.

Chart 2: Aperture European Innovation (white) outperformed both MSCI Growth (orange) and Value (blue) since inception

Source: Bloomberg, as of April 2022.

To further zoom-in on the periods of signiciant so-called "rotations" between Growth and Value, another helpful chart shows the fund and the MSCI Growth and Value indices each as a relative line to the broader market (MSCI Europe). This is the chart 3 below:

Chart 3: Relative performance of Aperture European Innovation (white) vs. MSCI Europe Growth (orange) and MSCI Europe Value (blue) – a Flexible strategy that has outperformed both

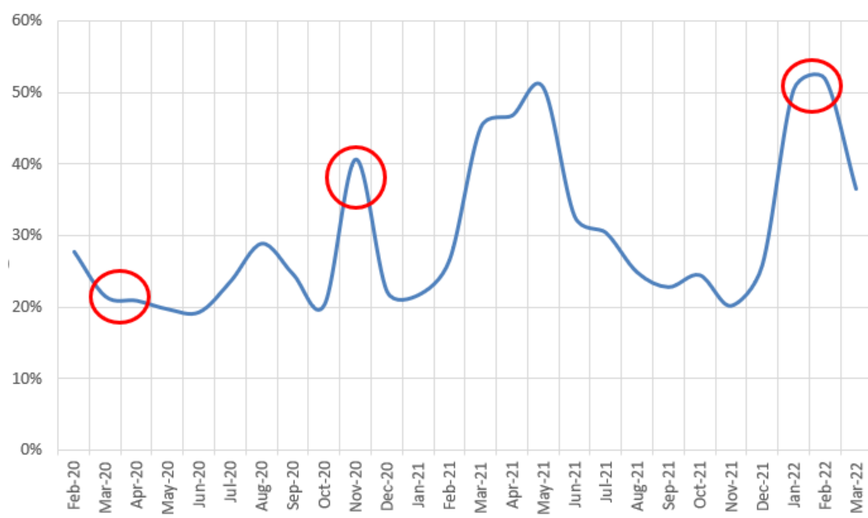


Source: Bloomberg, as of April 2022.

As has been typical of Growth (orange line) and Value (blue line), periods of significant and sharp underperformance of one (i.e., relative graphs declining sharply) correspond to significant sharp outperformance of the other. Hence the term "rotation."

The advantage of our strategy's adaptive and flexible approach becomes even more apparent in the next chart. In March 2020, during the onset of the pandemic, MSCI Europe Value was down 10% (e.g., Banks, Autos, and Industrials) and it was crucial to steer clear. At that time the fund's exposure to Value was only about 20% (chart 4 below). The discovery of a vaccine in November 2020 had just the opposite effect, and MSCI Europe Growth was down about 8%. We weathered this period better, underperforming by only the index's drawdown thanks to our higher Value exposure of c40%. January of this year was similar. This time the catalyst was the FOMC minutes, and although we again underperformed MSCI Europe (by -4.7%), this was again about half the drawdown recorded by MSCI Europe Growth index (-8.1%) due to fund's exposure to Value stocks at almost 50% (chart 4).

Chart 4: Aperture European Innovation (white) outperformed both MSCI Growth (orange) and Value (blue) since inception



Source: Bloomberg, Aperture Investors (UK) Ltd, Value definition based on P/E, FCF and P/B and P/NAV for Banks and real estate. As of April 2022.

Single stock stories

Stocks that added, stocks that detracted

Despite the significant shocks this quarter, when we decompose the portfolio into the best and worst contributors we see that the outcome was largely a function of cheap stocks that benefited from the higher inflation and yield backdrops (e.g., Eramet, Norsk Hydro and Shell PLC in the Commodities complex, HSBC in Financials and AstraZeneca in Pharma) vs expensive stocks derating in Tech and high growth zip codes (ASM International, Infineon, Polypeptide Group) as well as stocks impacted by the Ukraine conflict (Société Générale).

Among the contributors: French manganese and nickel mining producer Eramet (Ticker: ERA FP) more than doubled, up +108%. Rising commodity prices supported this growth and the stock also got a boost from the nickel short squeeze on the LME after the Ukraine invasion. Eramet's exposure to manganese and nickel makes it the real "pick and shovel" play for a rush to increased production of battery-powered electric vehicles. We fundamentally believe that Eramet is a cheap stock trading on low single digit P/E, supported by strong mark-to-market upgrades, free cash flow and a de-geared balance sheet.

The same can be said of Shell PLC (Ticker: SHELL NA). This stock increased +31% for the quarter. The Anglo-Dutch oil major is capable of major cash returns to shareholders at $100/bbl+ oil price. While we acknowledge that it may not currently be best-in-class for ESG among its peers, we believe that any ESG risks are dwarfed by Shell's lowest exposure to Russia relative to other majors.

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Finally, the UK International bank HSBC (Ticker: HSBA LN) is another sub-10x P/E stock in the portfolio with an improving earnings outlook supported by BOE interest rate hikes. HSBC cash deposits with the UK Central Bank are likely to generate significant earnings contribution by year end, which in turn, we believe, should ultimately be returned to shareholders. HSBC rose +20% this quart

Among the detractors: In what was largely a derating exercise, Dutch semiconductor equipment manufacturer ASM International (Ticker: ASM NA) lost -15%. ASM International derated by 1/3 from its peak of c39x PE'22 to the present c26x.

German power semiconductor manufacturer Infineon (Ticker: IFX GR) derated to an even greater extent: 50%+ from highs of 30x down to 17x now. It lost 23% this quarter. The magnitude of these moves explains our underperformance in January.

Finally, French retail and merchant bank Société Générale (Ticker: GLE FP) lost -19% this quarter despite announcing excellent results in early February. This poor performance followed the Russian invasion of Ukraine as concerns mounted regarding Société Générale's Rosbank exposure.

What have we done?

Given the exceptional shocks we discussed above, churn in the fund remained elevated during the quarter and certainly above our 1.5x target run rate. We worked hard to increase and maintain our exposure to cheaper alpha opportunities and in some cases to reduce our exposure to the most expensive ones. We first had to trade in the context of Ukraine conflict risk, and then of course the volatility which followed the invasion thereafter.

For example, we had to swap our position in BP for Shell PLC in mid-February. Although this proved to be a positive trade it increased churn by ~3% on each side. We also had to quickly reduce our exposure to Continental banks shortly after the invasion (Société Générale above and others) which also proved to be a wise move but again increased churn, this time by another 7%.

We selectively trimmed certain cyclical and high P/E stocks even in names we liked where the investment thesis had not changed. We needed to adapt and consider the change in the macro environment. Finally, we added some companies benefiting from increased investments in LNG and Defence in Europe because of the ongoing geopolitical tensions.

What about the future?

Looking to the future for equity markets requires us to examine a) recent market resilience despite deteriorating macroeconomic cyclical indicators, b) the inflation outlook, and c) the outlook for innovation opportunities.

a) Recent equity market resilience

Many investors were puzzled by the market's resilience, finding it hard to reconcile rising equity markets with so many headwinds to the global and European economies. These included a squeeze on consumer spending, corporate margins, and geopolitical tail risks. It wasn't lost on the pessimists that the highly-watched recession gauge 10-2Y US curve ultimately inverted in the last days of the quarter, who believed it was a strong predictor of recession in the next year or so. But the flip side warrants our full attention as well.

1) **Positioning: Regardless of the 10-2Y inversion, positioning matters. And not just Bull & Bear indicators or RSIs but also the lack of leverage in the system.** Most market participants were running all-time-low net and gross exposures long before 24-Feb. These exposures went even lower after February 24. So, if there is to be a recession, it will indeed be the most anticipated recession in recent history (see also chart 5 below from Google Search Trends). As such, we didn't see the house of cards casualty game that we would normally get in big crises: not when the market dropped abruptly on news of the Ukraine invasion, not when oil prices shot up to $140, and not when the Itraxx Europe Crossover peaked at +70% YTD. Some valuations are still elevated, and those highly valued assets generally do not perform well in a rising yield environment. Although true, the US is likely to face problems sooner versus the rest of the world.

2) **Real yields are still negative:** Interest rates are rising but real interest rates are still negative. In the US they remain below their local max from February, and in Germany they are at an all-time low. In other words, the real picture rather than nominal picture looks much more supportive of growth. The gap between equity dividend yields and 10-year interest rates illustrates the cushion we would argue equities have. Specifically, a measure of the S&P500 index forward dividend yield relative to 10-year nominal interest rates is near a multi-decade high, according to a Goldman Sachs Investment Research analysis. This would argue for equity resilience as they have rarely looked so cheap in real terms - almost counterintuitively. In other words, we believe equities are a much better inflation hedge than bonds .

3) **A new slow-growth environment:** One of the most important inputs for the size and length of economic recession is oil price holding above $115 for a sustained period. Recent global measures have tried to tame that price ahead of driving season and the next winter. It is tempting to anchor the analysis on historical precedent to argue that if the oil price holds around or below $115/bbl we may have a growth slowdown rather than a recession. In fact, the pain threshold for a recession to occur may be much higher for the oil price because the absolute number today has to be related to long term inflation and the size of today's economy. By these two measures, a $115/bbl oil price in 2012 is likely to be a much higher number today. In which case, the likelihood of the economy muddling through is much higher. Note that for the past decade we have had both low rates AND low growth, and equity markets have benefitted strongly from this.

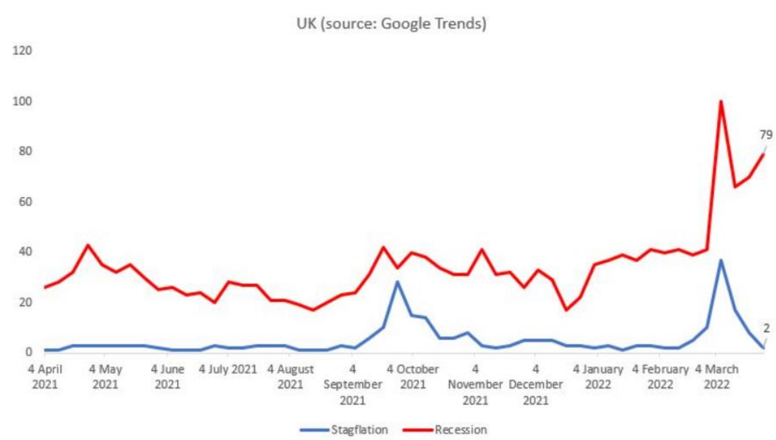


Chart 5: The most anticipated Recession in recent history

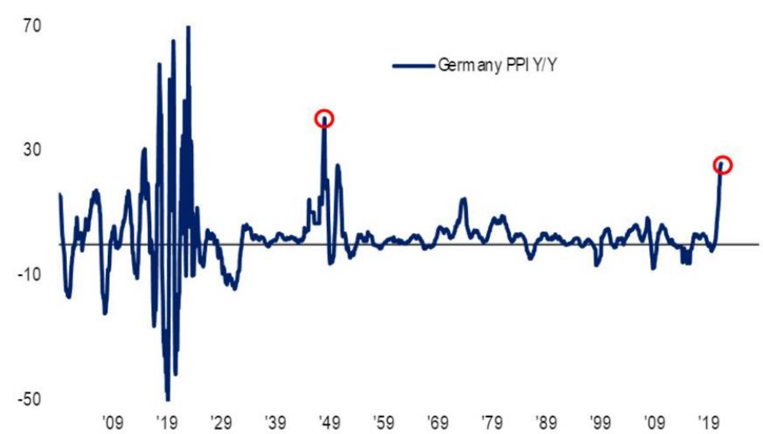
Source: Google Trends as of April 2022

b) Outlook for inflation

We are in a totally different world compared to the end-of-cycle pre-pandemic market of 2019, which differed from the pandemic market of 2020 and was again totally different from the re-opening market of 2021. We are now in a world of elevated inflation even though certain drivers may be "temporary" (although the definition of "temporary" can vary if for example we compare semiconductors to port congestions). These could include supply chain bottlenecks and reopening demand shocks. But there are larger factors are play that are very inflationary and which will take far longer to resolve:

- **Local sourcing is now an established trend, and it is very inflationary.** This trend follows continued US/China tech decoupling and the importance of tech sovereignty seen in 2019. The opportunity cost associated with dependency on the global supply chains, higher transportation costs and higher geopolitical risks all mean that companies are no longer in a singular search for the lowest cost production regions. Instead, they are clustering around regional hubs. These costs will of course be passed on. Have a look, for example, at the cost of German manufactured goods (PPI), which reached their highest point since 1948, up by +26% y-o-y in February as seen in Chart 6. In my opinion, we haven't seen the whole story yet - full local sourcing hasn't even yet become the new norm!

Chart 6: German PPI Y/Y



Source: BofA Global Investment Strategy as of March 2022.

- **War and Russian energy dependency are very inflationary**. Regardless of measures meant to ease pressure at the pump, LNG investments, supply shocks to metal prices and food inputs (Russia is a top 5 exporter of many metals like steel and aluminium, as well as grains and fertilisers) and replacing 40% of Europe's energy supply won't happen overnight and not without an impact on costs. Assuming the economy manages to muddle through, prices will have to go up significantly for the foreseeable future to account for this supply shock.

- **Richly-valued financial assets vs cheaply-valued real goods and services.** During the pandemic, Central Banks around the world printed trillions of dollars to deal with the sudden halt of global economies. US consumers received cheques which they happily spent on discretionary online purchases, but the most significant part of the QE money found its way into financial assets. Given the low yields, this extended all the way up the risk ladder to equities. We all saw the many triumphant Silicon Valley IPOs emerging at extremely elevated valuations, and they were covered in a matters of hours, many times over. Investors were lucky if they were allocated a few shares that then popped 100%+. As a result, billionaires were made many times over, often overnight.

- Theoretically, if we were to cash-in all those stock market billionaires in an orderly fashion (note - Elon Musk's orders alone would crash the Nasdaq) and give them the cash in dollar notes to spend, the stock market billionaires would of course go and spend it in the real world, to buy real goods and services. After all, this is the only reason they endeavoured to get rich in the first place: to buy more real goods and services. Imagine, for example, Brian Chesky of AirBnB and Whitney Wolfe Herd of Bumble spending their cashed-in billions on an early retirement vacation: jet fuel for the private jets, expensive food, real goods like clothes and real estate they would purchase…all multiplied by the Keynesian effect of the people working around them. Of course, this is a theoretical exercise, but you can see what I'm getting at: the prices of financial assets are elevated. If we were to spend all of this on real goods and services (many of these are in Europe by the way: Oil and Gas, Banks, Commodities) there wouldn't be enough real goods and services assets to fulfil that demand and prices would need to rise. This is what is happening right now, and we have come a long way on this journey: money leaving the pond of richly valued stocks has been inflating the cheaper pond of real goods and services. Central Banks are running after the excess liquidity injected into the system by raising interest rates and parking some of it in shorter-term deposits. Getting the quantum of liquidity that the economy requires to grow without overheating is never going to be perfect but for the moment the Central Banks are behind the curve. Until something gives this can only mean more inflation to come.

c) Outlook for innovation opportunities

In light of the shocks we discussed in detail and the inflation outlook, it is very unlikely that this is the end of the shocks, drawdowns and volatility. However, we can draw some basic conclusions.

The inflationary environment and rising bond yields favour cheaper valuations and more upfront/shorter duration cash flows. Valuation really does matter. This means that we find it easier to pick stocks in the cheaper camp, **but it does not mean that all high P/Es will underperform either.** It simply means that the hurdle has risen considerably, and stock picking and portfolio construction need to be more adaptive. Some of the best-of-breed, highest quality / barrier-to-entry stocks like ASML should continue to compound their high ROIC over time. Negative earnings stocks, or stocks with more questionable barriers-to-entry will find it harder to perform.

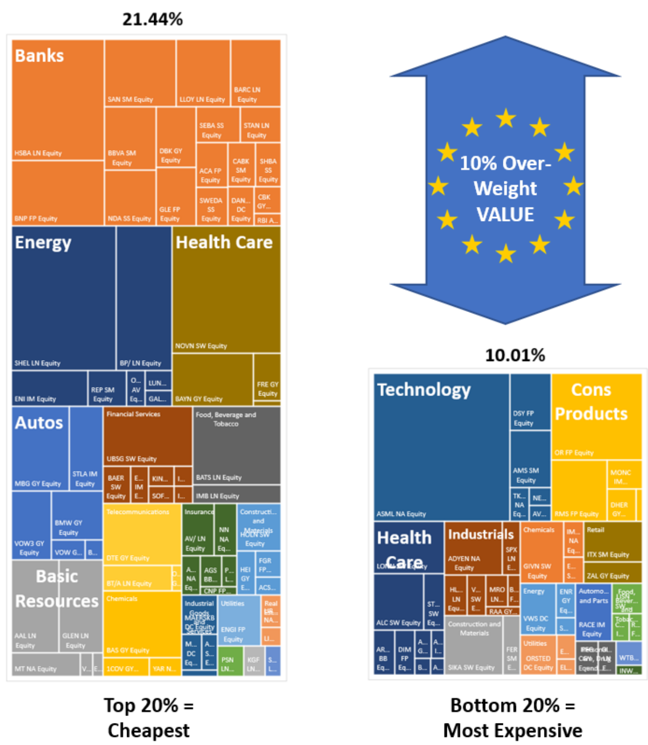
Innovation will continue at a pace, exponential growth in AI, xEV or newer drug adoption such as Novo Nordisk's obesity Wegovy will not stop just because of macroeconomic and geopolitical shocks. Our portfolio will remain positioned to capitalise on both valuation opportunities and acceleration of the innovation adoption curves.

We also believe that the recent geopolitical tensions and rising prices are opening up new innovation opportunities in LNG and clean tech (to deal with energy independence and higher oil prices), automation (to deal with higher cost and wage inflation) and defence, for obvious reasons.

Final comments on European equities, patience and managing cash exposure

In this inflationary and volatile context, European equity valuations stand out once again. Europe borders the epicentre of the military conflict in Ukraine, and this is the only thing we hear about right now. Europe, however, is also home to the cheapest, most inflation-hedged assets in the world and at the same time, some best-in-class world innovators trading at a discount to their global peers. The composition of its benchmark indices could act as a surprising cushion for equity return downside given it is 10% overweight in Value stocks (chart 7).

Chart 7: MSCI Europe Index composition is 10% over-weight Value



Source: MSCI, Aperture Investors UK, Ltd as of February 2022

What this chart means is that, all things being equal, if we have a re-rating exercise in which the most expensive stocks de-rate by 20% and the cheapest re-rate by 20%, the European index should be up by +2%. This is of course in stark contrast with some of the most overcrowded and expensive assets in the US and global tech scene.

There is a time for everything, but considering current volatility and inflation, I believe this is the time to own less crowded, higher quality, cheaper assets. In my opinion, that's just another name for European Innovation.

This is also the time also to lengthen the investment horizon and stay invested. Diversification into cheaper, inflation-hedged real assets should help avoid the temptation to exit the market at the wrong moment, or worse, end up over-exposed to cash. I believe, cash is pretty much guaranteed to depreciate at the minimum rate of inflation!

Wishing you a great Q2 ahead.

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Investors should note the specific risk warnings:

Equity Risk: The strategy will be affected by changes in the stock markets and changes in the value of individual portfolio securities. At times, stock markets and individual securities can be volatile, and prices can change substantially in short periods of time. The equity securities of smaller companies are more sensitive to these changes than those of larger companies. This risk will affect the value of the strategy, which will fluctuate as the value of the underlying equity securities fluctuates.

Investment in Smaller Companies Risk: Investment in smaller companies may involve greater risks and thus may be considered speculative. Many small company stocks trade less frequently and in smaller volumes and may be subject to more abrupt or erratic price movements than stocks of larger companies. The securities of small companies may also be more sensitive to market changes than securities in large companies.

Short Exposure Risk: The strategy may proceed with short-term sales of their investment via the use of derivatives. The short exposure risk results from short sales achieved through the use of derivatives and includes the potential for losses exceeding the cost of the investment, as well as the risk that the third party to the short sale will not fulfil its contractual obligations.

Derivatives Risk: The strategy may use derivative instruments, such as options, futures and swap contracts and enter into forward foreign exchange transactions. The ability to use these strategies may be limited by market conditions and regulatory limits and there can be no assurance that the objective sought to be attained from the use of these strategies will be achieved. Participation in the options or futures markets, in swap contracts and in foreign exchange transactions involves investment risks and transaction costs to which the strategy would not be subject if it did not use these strategies. If Aperture's predictions of movements in the direction of the securities, foreign currency and interest rate markets are inaccurate, the adverse consequences to the strategy may leave the strategy in a less favorable position than if such strategies were not used. Risks inherent in the use of options, foreign currency, swaps and futures contracts and options on futures contracts include, but are not limited to (a) dependence on the Aperture's ability to predict correctly movements in the direction of interest rates, securities prices and currency markets; (b) imperfect correlation between the price of options and futures contracts and options thereon and movements in the prices of the securities or currencies being hedged; (c) the fact that skills needed to use these strategies are different from those needed to select portfolio securities; (d) the possible absence of a liquid secondary market for any particular instrument at any time; and (e) the possible inability of the strategy to purchase or sell a portfolio security at a time that otherwise would be favorable for it to do so, or the possible need for the strategy to sell a portfolio security at a disadvantageous time. Where the strategy enters into swap transactions it is exposed to a potential counterparty risk. In case of insolvency or default of the swap counterparty, such event would affect the assets of the strategy.

Rule 144A and Regulation S Risk: SEC Rule 144A provides a safe harbor exemption from the registration requirements of the US Securities Act of 1933 for resale of restricted securities to qualified institutional buyers, as defined in the rule. Regulation S provides an exclusion from registration requirements of the US Securities Act of 1933 for offerings made outside the United States by both US and foreign issuers. A securities offering, whether private or public, made by an issuer outside of the United States in reliance on Regulation S need not be registered. The advantage for investors may be higher returns due to lower administration charges. However, dissemination of secondary market transactions is limited and might increase the volatility of the security prices and, in extreme conditions, decrease the liquidity of a particular security.

IPO Risk: The market value of shares issued in an IPO may fluctuate considerably due to factors such as the absence of a prior public market, unseasoned trading, the small number of shares available for trading and limited information about a company's business model, quality of management, earnings growth potential, and other criteria used to evaluate its investment prospects. Accordingly, investments in IPO shares involve greater risks than investments in shares of companies that have traded publicly on an exchange for extended periods of time. Investments in IPO shares may also involve high transaction costs, and are subject to market risk and liquidity risk, which are described elsewhere in this section.

For further information on risks related to the Fund please see the Prospectus.

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