LIONTRUST

THE SUSTAINABLE FUTURE PROCESS

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Liontrust GF SF Pan-European Growth Fund: Q2 2022 review

Fund managers: Martyn Jones and Peter Michaelis

The Fund returned -17.2% over the quarter in euro terms, performing the MSCI Europe Index's -9.0% (which is the comparator benchmark)*†.

Prevailing conditions continue to offer considerable headwinds for our Sustainable Future investment approach, with central banks around the world still raising interest rates to curb inflation. As we have written before, for companies where the market expects growth for years to come, a large proportion of the valuation is attributed to cash flows in the future (known as long duration); conversely, for stocks with lower expectations, less value is ascribed to future growth and the bulk of the value is in near-term cash flows.

Companies with strong growth expectations, therefore, have higher sensitivity to interest rate changes than those with lower growth prospects, with the market discounting future earnings more heavily and bringing down their present valuation as a result. This shift has hit our funds hard given their growth bias and longer duration relative to the market. Figures above show this portfolio has fallen more than benchmarks but, to reiterate, the MSCI index contains many currently outperforming 'value' companies in oil, tobacco and defence sectors, where we have never invested.

We have recently reviewed each of our holdings to ensure that, in this new higher interest rate and inflation world, our conviction remains strong, and, in almost all cases, it does. We have therefore not altered our portfolios significantly; this may sound as if we are not managing the assets actively but it has never been our approach to trade rapidly, only when necessary.

Looking forward, we cannot say exactly when the qualities of the businesses we own will become evident in their share prices; what we can say is that we have used the same approach for more than 20 years and it has served our clients well. There have been weaker periods of performance as a consequence of value rallies – notably in 2003, 2009 and 2016 – but by sticking to our process, we have more than compensated for these over the last 21 years and are confident that backing sustainable businesses is the path to making good recent underperformance once again.

There are many businesses in the portfolio offering significantly higher upside potential after recent derating and we are as positive on opportunities as we have been for several years.

Against such a challenging short-term backdrop, a handful of our holdings were still able to post positive returns in Q2, with consumer goods giant Unilever among the strongest contributors. After a drop in the company's shares since a September 2019 peak, news of activist investor Nelson Peltz taking a stake and joining the board was welcomed by the market. Peltz has a track record of driving change and his arrival comes as Unilever has faced criticism for its recent corporate direction, particularly a £50 billion bid for GlaxoSmithKline's consumer drugs business earlier this year.

Reiterating its sustainable credentials, with the company held under our *Leading ESG management* theme, Unilever announced it has achieved top spot in the GlobeScan SustainAbility Leaders Survey for the twelfth consecutive year in June, highlighting businesses showing commitment to integrating sustainability.

Other solid performers included French payment company Edenred again, which we own under our *Improving the resource efficiency of industrial and agricultural processes* theme. Edenred's payment solutions bring efficiency and value for money for customers and it has benefited from an environment of higher inflation where companies are having to offer higher wages to attract and retain talent. This comes on the back of record earnings and growth for 2021, with this cash generation allowing the business to strengthen its financial profile and pay out a higher dividend than before the pandemic, while also maintaining an ambitious M&A strategy.

Qiagen and Grifols, held under our *Enabling innovation in healthcare* and *Providing affordable healthcare* themes respectively, also had a strong period. Qiagen provides molecular diagnostics technologies for use in the clinical and life science sectors and shares rose as the company was able to increase its full-year 2022 net sales outlook to at least $2.12 billion. Grifols, meanwhile, announced what it called a strategic and transformational acquisition over the period, buying haematology and clinical immunology business Biotest. This deal is expected to expand its product portfolio, increase the availability of plasma therapies for patients, and drive revenue growth and margin expansion.

Finally, we would highlight positive contributions from two UK businesses that underline our long-term approach, with Trainline and Compass Group among the hardest hit in the portfolio during Covid lockdowns.

Trainline faced additional uncertainty as the UK government announced plans to create a new public sector body to oversee Britain's railways, with fears this could threaten its business model as an online platform for tickets and railcards. This ambiguity now appears to be receding and we feel Trainline is well placed to win the government's contract to white label the train ticket solution, as well as potentially benefiting from a major growth opportunity in Europe as that market is democratised and opens up to independent providers.

Compass Group, meanwhile, continues to recover from lockdowns, recently hitting the key milestone of revenue exceeding pre-Covid levels on a run rate basis. The catering business said it has seen a notable improvement in Business & Industry and Education sectors as employees return to the office and students to in-person learning, with this allowing the company to increase FY 2022 organic revenue guidance from 20-25% to around 30% and start a share buyback programme.

We added to both companies at depressed levels in the wake of Covid lockdowns and the market is now recognising their improving prospects with higher share prices.

Among weaker performers, as has been the case since the value rotation began, are several technology-focused businesses that continue to suffer from higher discount rates, including names such as Zur Rose, Trustpilot, Spotify and Nagarro. We have outlined our ongoing conviction in these and other indiscriminately sold-down businesses in previous commentaries and would make the additional comment that they have all executed well on growth plans.

Trustpilot, for example, is becoming the world's leading review platform, allowing an independent and objective space for customers and merchants to interact online. As the economy continues to digitise, we believe Trustpilot's dominant position in this fast-growing market will result in strong cashflow generation over the long term with millions of reviewers and merchants on this two-sided platform. The shares have dropped precipitously since IPO in March 2021, yet the results continue to positively surprise us. While the market might want to see profitability sooner than the company is targeting, currently guiding to EBITDA profitability in FY24, Trustpilot is delivering exactly what it set out at IPO.

Digital engineering business Nagarro, meanwhile, recently updated its profit guidance yet again and continues to see rising demand from clients looking to digitise in order to drive efficiency, and yet despite firing on all cylinders, the share price has been falling.

Our experience over the years has shown that indiscriminate sell-offs provide opportunities to add to our highest-conviction companies at more attractive valuations and we continued increasing exposure to most of these beaten-down names over the quarter. Such derating also allows us to start positions in stocks we have long admired but, prior to now, were fairly valued by the market and we added Sartorius Stedim in Q2, which has been on our watchlist for some time.

This is a leading German bioprocessing equipment and consumables manufacturer, with its products used by the pharmaceutical industry in the development and manufacture of ground-breaking treatments (biologics) including gene and cell therapy. Sartorius's equipment enables its customers to develop this next generation of healthcare in a cost-efficient, operationally flexible and environmentally friendly manner and is therefore another strong fit for our *Enabling innovation in healthcare* theme.

The biologics market is growing around 8-10% per annum, as these outgrow small-molecule drugs as more effective and targeted treatments. As for bioprocessing, this is expected to grow more like 10-12% as products in clinical trials move through to commercial manufacture and, with a shift from reusable to single-use technology, companies focused on the latter have an additional tailwind.

Over the quarter, we made the call to sell our position in German braking system manufacturer Knorr Bremse, which we added back in 2019. While we like the company from a product perspective, with strong exposure to transport safety (in trains and trucks), and returns have been high, we have been concerned about recent management churn from a governance standpoint.

Most recent CEO Jan Mrosik left the company at the end of April and, to give some history, was the third chief executive since Knorr Bremse listed in 2018. We have downgraded our Matrix Rating to A4 as a result, as we have little confidence the business will be able to execute a credible strategy, not least on M&A given its aborted attempt to buy Hella – even if they insisted this was a communication issue.

While our original thesis was based around safety and braking systems in trains, fundamentals have also weakened in China, the company's biggest market in this area. Given the latest CEO departure, we believe this puts Knorr Bremse's medium-term group sales and EBIT margin targets in doubt; if it can keep to original aspirations, the company looks cheap, but having lost confidence in the senior management team, we choose to watch this from the sidelines rather than our clients being invested.

Key Features of the Liontrust GF SF Pan-European Growth Fund

INVESTMENT OBJECTIVE & POLICY[1]:	The Fund aims to achieve capital growth over the long term (five years or more) through investment in sustainable securities, mainly consisting of European equities. The Fund is biased towards companies that provide or produce more sustainable products and services as well as having a more progressive approach to the management of environmental, social and governance issues. The Fund will seek to achieve its objective through exposure mainly to equities of companies incorporated in any European Economic Area Member State, the UK and Switzerland, although it can invest globally. In normal conditions the Fund invests at least 75% of its Net Asset Value in European equities. In addition, the Fund may invest in debt securities for liquidity and cash management purposes. Any investment in bonds will be in corporate and government fixed or floating rate instruments which may be rated or unrated up to 25% of the net assets of the Fund. The Fund may also invest in exchange traded funds and other open-ended collective investment schemes. The Fund is not expected to have any exposure to derivatives (contracts whose value is linked to the expected future price movements of an underlying asset) in normal circumstances but may on occasion use them for investment, efficient portfolio management and for hedging purposes. The use of derivatives should not lead to a significant change in the risk profile of the Fund.
RECOMMENDED INVESTMENT HORIZON:	5 years or more
SRRI[2]:	6
ACTIVE / PASSIVE INVESTMENT STYLE:	Active
BENCHMARK:	The Fund is considered to be actively managed in reference to the MSCI Europe Index (the "Benchmark") by virtue of the fact that it uses the benchmark(s) for performance comparison purposes. The benchmark(s) are not used to define the portfolio composition of the Fund and the Fund may be wholly invested in securities which are not constituents of the benchmark.
SUSTAINABILITY PROFILE	The Fund is a financial product subject to Article 9 of the Sustainable Finance Disclosure Regulation (SFDR).

Notes: [1]As specified in the KIID of the fund; [2]SRRI = Synthetic Risk and Reward Indicator. Please refer to the KIID for further detail on how this is calculated.

Discrete years' performance*, to previous quarter-end:
Past performance does not predict future returns

	Jun-22	Jun-21	Jun-20	Jun-19	Jun-18
Liontrust GF SF Pan-European Growth Fund A1 Acc	-22.5%	29.4%	8.1%	1.0%	1.1%
MSCI Europe	-6.5%	27.9%	-5.5%	4.5%	2.8%

	Jun-17	Jun-16	Jun-15	Jun-14	Jun-13
Liontrust GF SF Pan-European Growth Fund A1 Acc	17.6%	-12.1%	25.8%	16.3%	18.0%
MSCI Europe	18.0%	-11.0%	13.5%	22.7%	16.0%

*Source: FE Analytics, as at 30.06.22, primary share class, in euro terms, total return, net of fees and income reinvested.

Key Risks and disclaimer