LIONTRUST

THE SUSTAINABLE FUTURE PROCESS

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Liontrust SF Defensive Managed Fund: Q4 2022 review

Fund managers: Peter Michaelis and Simon Clements

The Fund returned 3.3% over the quarter, outperforming the 3.1% IA Mixed Investment 20-60% Shares sector average (the comparator benchmark)*†.

2022 has been the most challenging year since the inception of the Sustainable Future range of funds in 2001. We are continually challenging our conviction in our companies, and we are pleased with how our portfolio companies are navigating an extremely difficult period where supply chains have been disrupted and customer demand has been extremely difficult to forecast. So, despite the sharp decline in valuation multiples, we remain confident in the Fund's prospect over the next five years with sustainable growth drivers, high quality companies and attractive valuations.

A legitimate challenge to our approach would be to ask whether our sustainable investment themes have run their course. This would only be the case if we had solved every problem and satisfied every need; we are a long way from that! There is still plenty of growing to do for sustainable companies.

We are now operating in a very different environment to the past decade, with higher interest rates in place to try and contain runaway inflation. This abrupt change in macroeconomic backdrop has sent markets into a tailspin, with all asset classes falling to a greater or lesser extent in response to a higher cost of capital. Our job in these turbulent times is to focus resolutely on the long term and on our investment process which has delivered strong performance until the past year.

We also want to take the opportunity in these periods of extreme market dislocation to add to our holdings with the most conviction and highest risk-adjusted upside, as well as take the opportunity to buy businesses we have long admired but were not previously attractively valued.

Asset allocation for the quarter was marginally negative. The key detractor was our overweight position in infrastructure, which underperformed as an asset class. Our underweight to cash and overweight credit position were all positive contributors over the period.

With regards to changes, we did not adjust our asset allocation over the period. After reducing our Gilt underweight in late September, we continued to run our overweight to corporate bonds, overweight infrastructure, underweight cash and underweight Gilts (although this has been halved as discussed). We maintain our neutral position on equities.

Looking at our top performers over Q4, Intuitive Surgical is once again leading the way. Held under our *Enabling innovation in healthcare* theme, Intuitive Surgical is committed to advancing patient care in surgery and other acute medical interventions. The company is focused on innovating to enable physicians and healthcare providers to improve the quality of and access to minimally invasive care, with Intuitive's products all relating to minimally invasive robotic surgery, a clear growth theme with better outcomes for patients.

Over the quarter, Intuitive Surgical posted strong third quarter results and lifted its forecast for procedure growth this year. The company announced Q3 revenue of $1.56 billion, an increase of 11% compared with last year's comparable, driven by volume growth for its da Vinci surgical system procedure, though this was partially offset by a decline in system placements.

Private equity company 3i Group performed strongly after announcing a total return of £1.77bn in its first half earnings release, or 14% on opening shareholders' funds. The company noted that its position in discount retailer Action was a significant contributor to performance, with 3i also seeing strong earnings growth and momentum in a number of its portfolio companies in the consumer, healthcare, specialty industrial and business and technology service sectors.

Exposed to our *Increasing financial resilience* theme, 3i predominantly invests in retail, infrastructure, healthcare, technology and industrial and it has strong responsible investment policies and firm exclusions on no-go areas. The company has a model based on investing and supporting businesses for growth. This helps to develop the infrastructure and technologies we need in a sustainable transition.

Also among the top performers over the quarter was specialist UK lender Paragon Banking Group which performed strongly on the release of robust full year results for the year ending 30 September. Held under our *Building better citi*es theme, Paragon provides finance for professional landlords and SMEs, with a long history of low impairments and high service levels. Despite a challenging economic backdrop over the past year, Paragon announced that underlying profits had increased 16% to £226m. In addition, the company stated that its cautious risk appetite and high quality loan book leaves it well positioned heading into 2023.

Ringkjoebing Landbobank (Rilba) is a long-term outperformer and was again among the notable contributors over the fourth quarter. The company is exposed to our *Increasing financial resilience* theme, a theme we believe is crucial to ensuring a stable economy. You only have to go back to September 2008 to see the impact that weak financial institutions, inadequate regulation and supervision, and a lack of transparency had on the global economy. Businesses that provide simple products that consumers need, like current accounts and mortgages, contribute to a more resilient financial system – we believe Rilba, as one of the best-run banks in the industry, is doing just that.

The Danish bank performed strongly into the close of the year after raising its pre-tax profit forecast for the full year at the start of December; it now sees profit between Dkr1.70 billion to Dkr1.95 billion, compared with Dkr1.55 billion to Dkr1.80 billion previously. The company cited the primary reasons behind this upward adjustment as continued levels of positive activity, higher interest rates and growth in lending for the first three quarters of the year.

Among the weaker performers, GB Group shares fell after the identity verification company posted lower growth in its largest division, Identity. Within the division, the company stated that volumes were impacted by the challenges faced by cryptocurrency markets and internet-economy customers, primarily in the Americas region where a significant number of these businesses operate. Outside of these areas, Identity's performance was said to be more resilient, in particular, from established financial services and gaming.

Advanced Drainage Systems was among our weaker names over the period after cutting its net sales guidance for the full year. It expects net sales of between $3.10 billion - $3.20 billion, a drop from the previous guidance of $3.25 billion - $3.35 billion. At the start of the fourth quarter, the company began to see the impact of the uncertain macroeconomic environment in isolated pockets across some regions and product lines. In particular, its infiltrator and retail businesses began to feel the impact of channel destocking as well as some project slowdowns within its non-residential business.

Home REIT was also among the detractors over the quarter with the company's share price falling sharply after the release of a short-selling report by Viceroy Research LLC.

Following the allegations made in the report and the full response from Home REIT on 30 November, Liontrust is continuing to engage with the management of Home REIT and are awaiting more information from and discussions with Home REIT before taking any decisions.

Over the two decades that the Sustainable investment team have been managing the Sustainable Future funds, a key lesson that we have learned is that 'sustainable' should not be taken to mean perfect. Investing involves making predictions about the future, which is extremely difficult. Therefore, we have to expect occasions – albeit rare – when the future does not turn out as predicted and the companies we hold become embroiled in a controversy that may challenge the initial assessment of their sustainability.

As soon as we are aware of any controversy, the next stage is to analyse the situation in detail, investigating to ascertain the involvement of the company in question, the seriousness of allegations made and how the business is responding.

In terms of portfolio changes, we initiated a position in Alcon under our *Enabling innovation in healthcare* theme. Alcon is an American-Swiss medical device company specialising in design and manufacture of interocular lenses, consumables used in ophthalmic surgery and consumer contact lenses.

We also opened a position in US firm Trex under our *Delivering a circular economy* theme. Trex manufactures non-wood decking and railing products from waste-wood fibres and recycled plastic, upcycling 400 million pounds of plastic each year from post-consumer and post-industrial. Although the products mimic wood, they require less maintenance and last longer.

Last, we added NatWest, a UK-focused bank that sits within our theme of *increasing financial resilience*. We feel that NatWest will benefit from a higher interest rate environment and has ambitious targets around decarbonisation from its client base, including the provision of green mortgages to help households improve their energy ratings.

We sold our holding in Cellnex Telecom. Our belief is that the consolidation of the European telecommunication tower market is nearing the end of the road, with fewer options left in terms of acquisitions. This is coupled with higher valuations and increased costs of debt all of which we believe could result in reducing returns on capital.

Aveva, held under our *Improving the resource efficiency of industrial and agricultural processes* theme, was sold over the quarter after it agreed to a takeover offer from Schneider (the company's majority owner). We felt that the deal was opportunistic and undervalued the long term prospects of Aveva, and we reluctantly exited the position.

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

	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18
Liontrust Sustainable Future Defensive Managed 2 Inc	-18.4%	6.8%	11.3%	16.8%	-2.2%
IA Mixed Investment 20-60% Shares	-9.5%	7.2%	3.5%	11.8%	-5.1%
Quartile	4	3	1	1	1

***** Source: FE Analytics, as at 31.12.22, primary share class, total return, net of fees and income & interest reinvested

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

Key Risks and Disclaimer

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