

ANNUAL REVIEW 2020

Improving industrial and agricultural processes - Increasing waste treatment and recycling - Making transportation more efficient - Improving healthcare globally - Connecting people - Improving from renewable sources - Delivering healthier foods - Building better cities - Providing education - Enabling innovation in business - Improving auto safety - Enhancing digital security - Better monitoring of supply chains and ESG management - Delivering ESG management - Improving financial resilience: Saving for the future, insuring the future, managing water, lifestyle - Providing affordable housing



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Introduction

'How can the stock market be doing so well, when the economy is tanking and so many people are suffering?'

This was the question raised at our Advisory Committee meeting in the midst of the first lockdown in the spring of 2020.

By the end of the year, the divergence between these elements had become starker still. Wealth (as measured by equity indices) had increased, economic activity had slowed, and the overall well-being of people had diminished even further. The link between wealth creation and people's overall welfare was not evident in 2020 and that is a challenge for our Sustainable Investment approach. Our long-held belief is that it is through investment in sustainable businesses that we will create a cleaner, healthier and safer world in the future; which means wealth creation and welfare generation are very closely aligned.

In our 20th year of managing the Sustainable Future (SF) funds, we still maintain this belief. While it may not be true in aggregate yet, we endeavour to make it so at the fund level and were able to post another strong year of performance for our clients, against what was clearly a challenging backdrop. Over the year, eight of our 10 UK-registered funds were first quartile in their peer groups and the same eight were also top quartile over three and five years to the end of 2020*.

We focus on companies that are generating economic profit while also improving some aspect of human welfare via links to our 21 sustainable investment themes: innovating in areas such as healthcare, energy efficiency or connecting people; developing vaccines and helping us lead healthier lifestyles; or generating and using energy and materials in ways that do not damage our planet.

To demonstrate this, our investors will, I hope, have noticed we have improved our disclosure on the positive impact our companies have, with each fund now having a sustainability and impact report. There is a simple investment logic to this approach – there should be greater demand for products and services that improve well-being.

Over the year, we also continued to develop, write about and invest in our themes, examining the issues and identifying the companies solving the challenges of healthier foods, energy-hungry data centres, clothing supply chains, social housing development, and clean electricity provision, among many others. We increasingly see overlap across our themes, linking better food to better health and reductions in carbon dioxide emissions and biodiversity loss, for example. As a stark fact to consider, if cattle were a country (with this 'Republic of Cattle' a combination of the beef and dairy industries), it would be the third largest global CO2 emitter, behind only China and the US.

We also added a new theme to our roster over the year, Encouraging sustainable leisure (for more, see page 21): to repeat a quote we used to explain the theme, 'It is not how much we have but how much we enjoy that matters', which is surely a learning point from 2020.

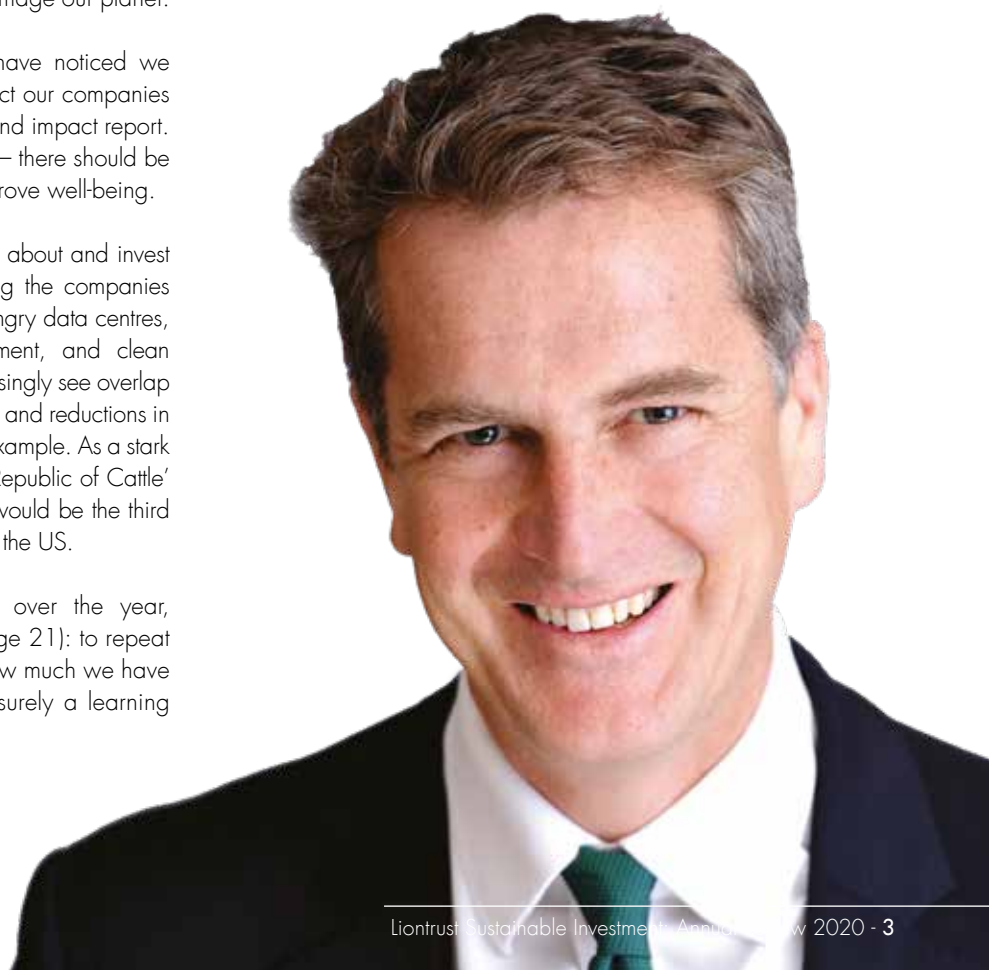
Looking to the future, we are well aware there is always room for improvement so we continue to challenge companies to do better, whether on diversity, climate change or responsible investment. And when companies fall short, we engage to ensure lessons are learnt and better practices implemented. Our goal is to select only the best examples of sustainable companies, which are able to improve our world and deliver strong investment returns.

We anticipate the next year being one of recovery and it seems the shape of this will be more aligned with better welfare and lower environmental impacts. The idea of a just energy transition, for example, has gained traction (2020 was perhaps an example of an unjust reduction in emissions), and we expect many of the themes that have accelerated through Covid-induced lockdowns to persist: remote and paperless working, reduced travel, healthier lifestyles, and a greater focus on illness prevention, as well as a recovery in many of the social activities we have sorely missed. Along with all that, we hope to see a slight realignment of values so that, in the future, wealth and welfare creation become two sides of the same sustainable coin.

Peter Michaelis, Head of Sustainable Investment at Liontrust

For more information on Sustainable Investment plus our funds and team, go to www.liontrust.co.uk/sustainable

*Source: FE Analytics, primary share class, total return, net of fees, interest/income reinvested, to 31.12.20. Past performance is not a guide to future performance. Investment can result in total loss of capital.





HOW WE INVEST: OUR SUSTAINABLE VISION

Identifying superior stocks

01

Thematic analysis

- identifies companies with strong and dependable growth prospects due to alignment with our themes

02

Sustainability analysis

- focuses on those companies with excellent management and core products or services that contribute to society or the environment

03

Analysis of business fundamentals

- selects only those companies positioned to deliver high returns on equity

04

Valuation analysis

- determining that the shares of the company will be worth significantly more in the future

Our Sustainable Future Investment process is based on the core belief that sustainable companies have better growth and are more resilient than the market gives them credit for. We use this underappreciated advantage as we look to deliver outperformance across equity, bond and managed portfolios and, in supporting sustainable companies, accelerate environmental and social improvements.

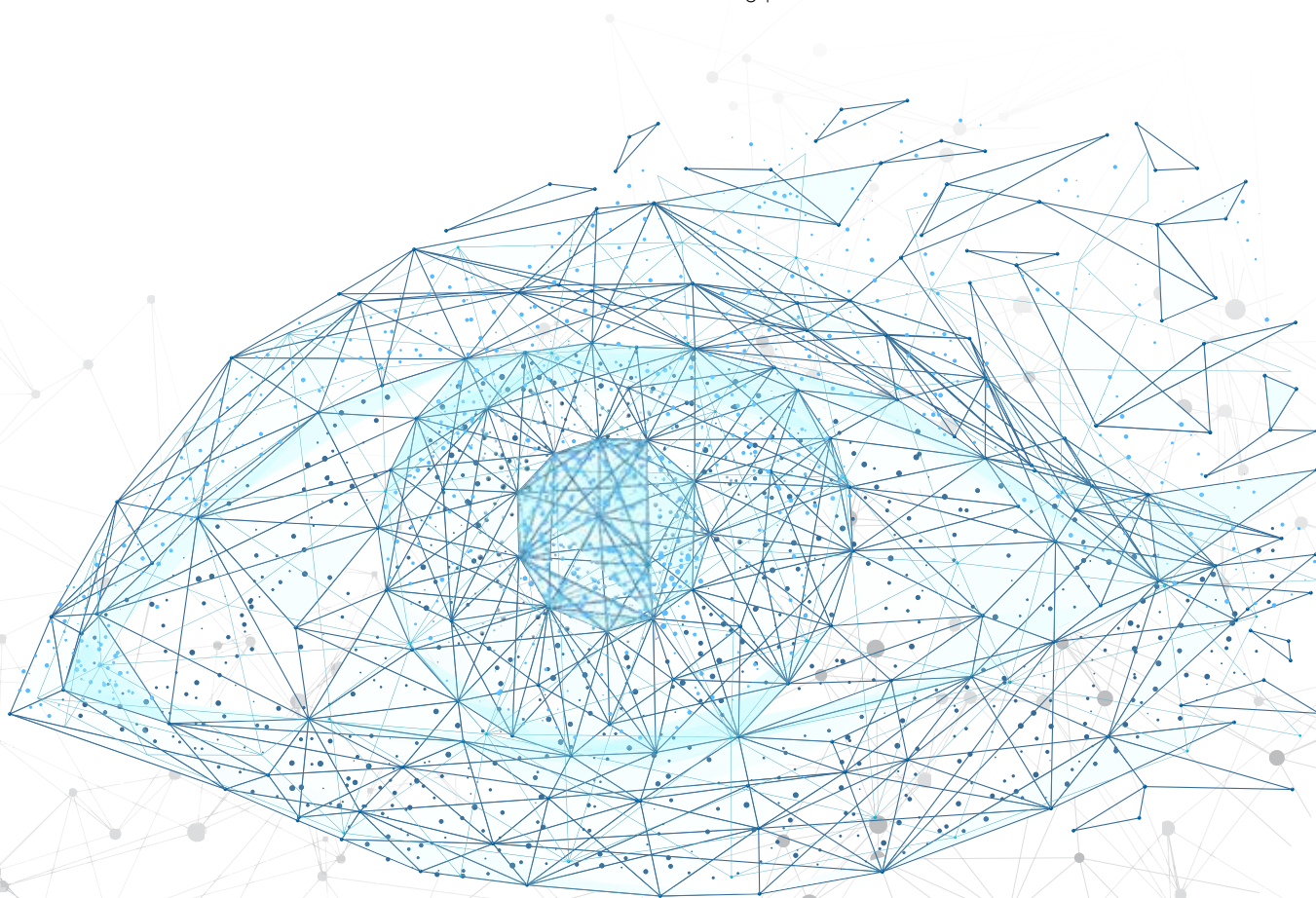
We are seeking to invest in the economy of the future and to do this, the team looks at the world through the prism of three mega trends – *Better resource efficiency*, *Improved health* and *Greater safety and resilience* – and 21 themes within these, all contributing in different ways to creating a cleaner, healthier and safer world.

Cleaner: Using our resources more efficiently (water, increasing recycling of waste, lower carbon energy sources and energy efficiency).

Healthier: Improving our quality of life through better education, healthier lifestyles and diet or better healthcare.

Safer: Making the systems we rely on safer or more resilient. This includes transport safety, keeping our online data safe with cyber-security and spreading risk through appropriate insurance mechanisms.

Understanding these trends helps to identify areas of long-term structural growth and we then look to invest in companies on the right side of these transitions, contributing towards a better world while making profits for our investors.



01 Themes – strong and dependable growth prospects

Better resource efficiency

- Improving the efficiency of energy use
- Improving the management of water
- Increasing electricity generation from renewable sources
- Improving the resource efficiency of industrial and agricultural processes
- Delivering a circular materials economy
- Making transportation more efficient

Improved health

- Providing affordable healthcare
- Connecting people
- Delivering healthier foods
- Building better cities
- Providing education
- Enabling innovation in healthcare
- Enabling healthier lifestyles
- Encouraging sustainable leisure

Greater safety and resilience

- Increasing financial resilience
- Saving for the future
- Insuring a sustainable economy
- Leading ESG management
- Improving transport safety
- Enhancing digital security
- Better monitoring of supply chains and quality control

While themes are at the heart of our idea generation, there are three further criteria all companies have to satisfy.

02

Sustainability analysis: A company might have significant exposure to a theme, but we also have to check how sustainable the rest of its activities are. For each business, we determine key ESG factors that are important indicators of future success and assess how well these are managed via our proprietary Sustainability Matrix (as shown on page 26). Every company held across the portfolios is given a Matrix rating, which analyses the following:

- Product sustainability (rated A to E): Assesses the extent to which a company's core business helps or harms society and/or the environment. An A rating indicates a company whose products or services contribute to sustainable development (via our investment themes); an E rating indicates a company whose core business is in a conflict with sustainable development (such as tobacco or polluting activities like coal-fired electricity generation).
- Management quality (rated 1 to 5): Assesses whether a company has the appropriate structures, policies and practices in place for managing its ESG risks and impacts. Management quality in relation to the risks and opportunities represented by potentially material ESG issues are graded from 1 (excellent) to 5 (very poor).

Companies must score C3 or higher to be considered for inclusion in our Sustainable Future (SF) funds.

03

04

Business fundamentals and valuation analysis:

Companies in which we invest have robust business fundamentals with a proven ability to deliver high returns on equity (RoE) through sustaining margins and asset turnover. Typically, these companies have a maintainable competitive advantage through scale, technology or business model.

We then predict the likely sales, earnings and other financial returns we expect to see from these companies over the next three to five years, integrating our view of their quality into these. Applying the relevant valuation multiple allows us to derive a price target achievable in the next three years. When this shows significant upside (we typically look for greater than 10% per annum), the investment is recommended as a buy and available to be included in our funds.

Meet the team

We have a 13-strong investment team that has been managing funds in this way for 20 years. A key differentiator is the fact all the sustainable elements are fully integrated within a single team. We do not have separate fund management and ESG divisions, for example; instead, every member is responsible for all aspects of financial and ESG analysis relating to an investment decision. Because of this approach, our team engages with companies across a broad range of issues relating to different stages in our process,

including screening criteria, sustainable themes and company-specific ESG issues (details of which can be found throughout this Annual Review).

We also have a five-strong external Advisory Committee to provide another layer of expertise in key areas of social and environmental impact: Jonathon Porritt, Sophia Tickell, Tony Greenham, Tim Jackson and Valborg Lie.

Equities

🕒 Theme and other responsibility

🎓 Academic background

📅 Industry tenure / Team tenure



Peter Michaelis
Head of Sustainable Investment team

- 🕒 - Better monitoring of supply chains and quality control
- Building better cities
- Enhancing digital security
- Improving the efficiency of energy use

- 🎓 - MA in Physics from Oxford University
- MSc in Energy & Environmental Engineering from Sussex University
- PhD in Environmental Economics from the University of Surrey

📅 - 21 years / 20 years



Simon Clements
Investment Manager

- 🕒 - Improving the management of water
- Improving the resource efficiency of industrial and agricultural processes
- Improving transport safety

- 🎓 - BSc in Economics from the University of Newcastle, Australia
- Graduate Diploma in Applied Finance & Investment from Securities Institute of Australia
- CFA Charterholder

📅 - 25 years / 12 years



Mike Appleby
Investment Manager

- 🕒 - Delivering a circular materials economy
- Increasing electricity generation from renewable sources
- 🎓 - Making transport more efficient
- Business development

- BSc (Hons) in Biological Sciences from the University of Edinburgh
- 📅 - MSc in Environmental Management from Imperial College London

- 21 years / 17 years



Harriet Parker
Investment Manager

- 🕒 - Connecting people
- Leading engagement activities

- 🎓 - BSc in Economics & Management from the University of Bristol

📅 - 17 years / 17 years



Laurie Don
Investment Manager

- 🕒 - Enabling innovation in healthcare
- Providing affordable healthcare

- 🎓 - BSc (Hons) in Computer Science from Durham University
- CFA Charterholder

📅 - 13 years / 6 years



Martyn Jones
Investment Manager

- 🕒 - Delivering healthier foods
- Enabling healthier lifestyles
- Encouraging sustainable leisure
- Providing education

- 🎓 - MA in Management from The University of Glasgow
- CFA Charterholder
- MSt in Sustainability from the University of Cambridge

📅 - 9 years / 7 years

Equities (continued)

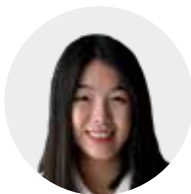


Chris Foster

Investment Manager

- 🎯 - Increasing financial resilience
- Insuring a sustainable economy
- Leading ESG management
- Saving for the future
- 🎓 - MA in Economics and Mathematics from the University of Edinburgh
- CFA Charterholder

📅 - 8 years / 6 years



Mingming Huang

Portfolio Manager Assistant

- 🎯 - Analytical support for thematic analysis and engagement
- 🎓 - BSc Mathematics with Business Management from Queen Mary University of London

📅 - 2 years / 2 years

Fixed Income



Stuart Steven

Head of Fixed Income

- 🎯 - Portfolio construction
- Banks
- 🎓 - BA in Accountancy from Stirling University
- MSc in Investment Analysis

📅 - 27 years / 11 years



Kenny Watson

Investment Manager

- 🎯 - Credit positioning and high yield
- Utilities, retail, household goods, travel and leisure
- 🎓 - BA in Accounting and Economics from the University of Strathclyde
- Chartered Accountant

📅 - 24 years / 7 years



Aitken Ross

Investment Manager

- 🎯 - Interest rates
- Insurance and financial services
- 🎓 - BSc in Accountancy and Finance from Dundee University
- MA in International Financial Analysis from Newcastle University
- CFA Charterholder

📅 - 11 years / 9 years

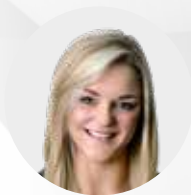


Jack Willis

Investment Manager

- 🎯 - Credit positioning
- Telecoms, property, healthcare, industrials, chemicals
- 🎓 - BSc in Mathematics with Finance from the University of Leeds
- MSc in Finance and Investment from the University of Leeds
- CFA Charterholder

📅 - 7 years / 5 years



Hannah Jones

Portfolio Manager Assistant

- 🎯 - Sustainability analysis and portfolio administration
- 🎓 - Studying for the IMC

📅 - 6 years / 4 years

🎯 Theme and other responsibility

🎓 Academic background

📅 Industry tenure / Team tenure

Governance & Stewardship team

The Governance & Stewardship team works closely with the Sustainable Investment team and supports other Liontrust investment teams on areas such as AGM voting and policy implementation, and PRI and FRC Stewardship Code reporting.



Sinead Lennon
Governance & Stewardship Manager

- ✉ - Postgraduate certificate in International Business Ethics and Corporate Governance, Birkbeck University
- BA (Hons) in Business Studies, Dublin Business School
- IMC

📅 - 8 years / 8 years



Natalie Bell
Stewardship Manager

- ✉ - BA (Hons) in Politics from the University of Nottingham
- 📅 - 7 years in corporate governance / 2 months



Shakeel Ahmed
Governance Executive

- ✉ - Liontrust internship programme
- 📅 - 1 year / 1 year

Advisory committee

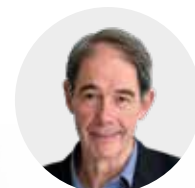
Our sustainable investment team employs the services of an Advisory Committee which provides guidance and expertise in key areas of social and environmental impact.



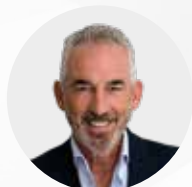
Sophia Tickell is Co-founder and Director of Meteos, a non-profit company, which runs senior dialogues, focused on finance, health and the environment. She is the author of *Banking on Trust*, *Vital Connections: Science, Society and Sustaining Health*, the EnergyFutures report, and the PharmaFutures (www.pharmafutures.org) series. Sophia was previously Chair of the Board at SustainAbility Ltd and led Oxfam's policy work on the private sector. Sophia is also Non-Executive Director of Liontrust Asset Management.



Tony Greenham is Executive Director of South West Mutual, which is seeking to establish a customer-owned regional bank for SMEs and residents of Cornwall, Devon, Somerset and Dorset. He is a former corporate stockbroker and has written extensively on financial sector reform including the undergraduate economics textbook *Where Does Money Come From?*



Jonathon Porritt is Founder Director of Forum for the Future, the UK's leading sustainable development charity. His book, *The World We Made*, seeks to inspire people about the prospects of a sustainable world in 2050. He is also Chancellor of Keele University and President of The Conservation Volunteers and former Chair of the UK Sustainable Development Commission.



Tim Jackson is Professor of Sustainable Development at the University of Surrey and Director of the Centre for the Understanding of Sustainable Prosperity (CUSP). From 2004 to 2011, he was Economics Commissioner on the UK Sustainable Development Commission, where his work culminated in the publication of the controversial bestseller *Prosperity without Growth* – economics for a finite planet.



Valborg Lie is Stewardship Manager at LGPS Central, responsible for bespoke engagement and voting services to support investment objectives. Valborg has a wealth of experience, working on responsible investment (RI) issues over the last 15 years. From 2005 to 2013 she worked as Head of RI within the Norwegian Ministry of Finance overseeing the management of the Norwegian Government Pension Fund Global (GPF), one of the biggest sovereign wealth funds globally. Valborg leverages an extensive network of institutional investors and SWFs globally to help promote and build RI best practices.

Performance of our funds - IA quartile rankings to 31.12.20

	Sector	1 year	3 years	5 years	10 years	
Sustainable Future Managed	IA Mixed 40% - 85% Shares	1	1	1	1	
Sustainable Future Cautious Managed	IA Mixed 40% - 85% Shares	1	1	1	N/A	
Sustainable Future Defensive Managed	IA Mixed 20% - 60% Shares	1	1	1	N/A	
Sustainable Future Managed Growth	IA Flexible Investment	1	1	1	1	
Sustainable Future Global Growth	IA Global	1	1	1	1	
Sustainable Future European Growth	IA Europe Excluding UK	1	1	1	1	
Sustainable Future UK Growth	IA UK All Companies	1	1	1	1	
UK Ethical	IA UK All Companies	1	1	1	1	
Sustainable Future Corporate Bond*	IA Sterling Corporate Bond	3	3	2	N/A	
Monthly Income Bond Fund	IA Sterling Corporate Bond	4	4	3	2	
GF SF Pan-European Growth Fund**^	FE peer group	1	1	1	1	
GF SF European Corporate Bond Fund**	FE peer group	4	N/A	N/A	N/A	
GF SF Global Growth Fund+	FE peer group	1	N/A	N/A	N/A	

Source: FE Analytics, as at 31.12.20, total return (net of fees, income/interest reinvested), primary share class, in GBP. Quartiles as at 31.12.20, generated 07.01.21 *Manager inception date 20.08.12. ** In Euros. ^The Luxcellence – Liontrust SF Pan-European Equity Fund, which launched on 14 March 2001, merged into the Liontrust GF Sustainable Future Pan-European Growth Fund, which launched on 19 October 2018. + in US dollars. Sustainable Future Absolute Growth changed its name to Sustainable Future Managed Growth on 10.02.20.

Past performance is not a guide to future performance, investments can result in total loss of capital.

Discrete returns (%) - To previous quarter 12 months ending

		Dec-20	Dec-19	Dec-18	Dec-17	Dec-16
	Liontrust Sustainable Future Managed 2 Inc	21.3	24.7	-0.5	16.1	11.8
	IA Mixed Investment 40-85% Shares	5.3	15.8	-6.1	10.0	12.9
	Liontrust Sustainable Future Cautious Managed 2 Inc	12.8	19.5	-2.2	13.4	9.7
	IA Mixed Investment 40-85% Shares	5.3	15.8	-6.1	10.0	12.9
	Liontrust Sustainable Future Defensive Managed 2 Inc	11.3	16.8	-2.2	11.9	9.3
	IA Mixed Investment 20-60% Shares	3.5	11.8	-5.1	7.2	10.3
	Liontrust Sustainable Future Managed Growth 2 Acc	33.2	26.4	1.1	18.1	15.0
	IA Flexible Investment	6.7	15.7	-6.7	11.2	13.8
	Liontrust Sustainable Future Global Growth 2 Acc	32.3	29.4	1.3	18.8	17.3
	MSCI World	12.3	22.7	-3.0	11.8	28.2
	IA Global	15.3	21.9	-5.7	14.0	23.3
	Liontrust Sustainable Future European Growth 2 Acc	24.3	25.9	-14.8	19.8	16.0
	MSCI Europe ex UK	7.5	20.0	-9.9	15.8	18.6
	IA Europe Excluding UK	10.3	20.3	-12.2	17.3	16.4
	Liontrust Sustainable Future UK Growth 2 Acc	5.3	30.2	-6.7	20.7	8.0
	MSCI UK	-13.2	16.4	-8.8	11.7	19.2
	IA UK All Companies	-6.0	22.2	-11.2	14.0	10.8
	Liontrust UK Ethical 2 Acc	2.8	37.8	-7.3	22.5	4.5
	MSCI UK	-13.2	16.4	-8.8	11.7	19.2
	IA UK All Companies	-6.0	22.2	-11.2	14.0	10.8
	Liontrust Sustainable Future Corporate Bond 2 Inc	7.0	11.8	-3.6	7.2	10.5
	iBoxx Sterling Corporate	8.6	11	-2.2	5.0	11.8
	IA Sterling Corporate Bond	7.8	9.5	-2.2	5.1	9.1
	Liontrust Monthly Income Bond B Gr Inc	5.5	9.4	-3.0	8.9	9.4
	iBoxx Sterling Corporates 5-15 years	8.6	10.7	-1.7	5.7	10.8
	IA Sterling Corporate Bond	7.8	9.5	-2.2	5.1	9.1
	GF Sustainable Future Pan-European Growth A1 Acc*	13.5	32.4	-17.0	13.6	13.5
	MSCI Europe	-3.3	26.0	-10.6	10.2	-3.3
	GF Sustainable Future European Corporate Bond A5 Acc*	1.0	7.3	N/A	N/A	N/A
	iBoxx Euro Corporates All Maturities Index	2.7	6.3	N/A	N/A	N/A
	GF Sustainable Future Global Growth B5 Acc USD	38.0	N/A	N/A	N/A	N/A
	MSCI World	15.9	N/A	N/A	N/A	N/A

Source: Data as at 31.12.20. FE Analytics. Primary share class, total return (net of fees, interest/income reinvested). Funds versus comparator benchmarks.
 * In euros. ** In US dollars. The GF SF European Corporate Bond Fund launched on 29.05.18 and GF SF Global Growth Fund on 12.11.19 so discrete performance is not available for five full 12-month periods.

Please refer to the Key Risks section for more information.

Another strong year in 2020

As the previous two pages show, we continued to generate strong performance in 2020, against an unprecedented backdrop, with all but two of our UK-domiciled funds in the top quartile in their respective IA peer groups over one, three and five years to the end of 2020.



Outperformance over the longer term

Our funds are built to outperform over the longer term and Liontrust SF Managed remains in the top quartile in its sector over one, three, five and 10 years to the end of 2020. Over the past 10 years, SF Managed has generated a return of 187.8% versus the IA Mixed Investment 40-85% Shares sector average (the comparator benchmark) of 82.0% and we continue to feel this represents significant outperformance for a managed portfolio*.

SF Managed

187.8%

IA Mixed
Investment
40-85%
Shares sector

82.0%



ESG: surviving (and thriving) in the 'next downturn'

As long-term sustainable investors, we have had many questions over the years about whether ESG (environmental, social and governance) will survive the next economic downturn, and the pandemic has prompted renewed scrutiny. Our answer remains firmly in the affirmative but rather than engaging in a long philosophical debate about sustainability, we can address the question through the prism of our investment process and funds.

As outlined earlier, our investment process – developed and honed over two decades – begins with 21 themes, all focused on the structural shift towards a more sustainable economy. Building on this initial thematic work, we require excellence in ESG and our holdings will tend to have processes in place to manage customer

relationships, employees and supply chains. We have long believed outperformance on these social issues will deliver more resilient businesses over the long term. We bring all this information into our forecast earnings for companies, only selecting those that can make money from their good work and offering an attractive valuation.

As a result of our thematic work, our funds came into the coronavirus crisis with no exposure to airlines, casinos, pub chains, luxury shopping or cruise ships, all sectors that suffered the worst declines in the initial aftermath. Because of steps two and three, on ESG and business fundamentals, we are largely invested in companies making products that the world genuinely needs, demonstrating close relationships with their customers, treating their employees with respect, and understanding the complexities of modern supply chains. And, finally, because of step four on valuations, even after a strong 2019 for our funds, we were not invested in a lot of overpriced thematic plays.



Assessing portfolios in light of Covid-19

As the impact of the pandemic became clear in the first quarter of 2020 and markets lurched into bear territory, we took the opportunity to revisit every holding in our portfolios and ask two key questions: have the prospects for five and 10 years from now changed and how were companies positioned for the next six to 12 months in terms of cash position and the ability to flex down their cost base and access debt facilities? In the majority of cases, we remained confident in the long-term prospects for the companies held across the funds.



Accelerating trends: digital infrastructure

Crises often super-charge societal shifts and this is currently happening across many areas, with decades of development squeezed into a few months. Over the course of the year, we saw this happen in many of our themes, with a particular acceleration in *Connecting people* and *Enhancing digital security*, for example, as millions of us worked from home and stayed connected with friends and family digitally. These themes are all about the infrastructure and tools we need to stay in contact digitally and safe from cyber-attacks online. Those companies producing kit that helps manage IT issues remotely, replacing the need for physical signatures, and providing safe payment mechanisms to fulfil the commerce that has moved online have all seen huge demand pulled forward.

*Source: FE Analytics, primary share class, total return, net of fees, interest/income reinvested, to 31.12.20. Past performance is not a guide to future performance. Investment can result in total loss of capital.



We believe such increased appetite for their products is not transient but the beginning of a permanent shift in communication habits. Now so many of us have shown we can successfully work from home, it would be disappointing to see a return to widespread unnecessary travel.



Strong year for healthcare

As would be expected, many of our healthcare-related themes have experienced accelerated demand from the specific needs of combatting Covid-19, highlighting the innovation that continues to attract us to this sector. Lessons learnt over the course of 2020, and continuing to be absorbed every day, should encourage greater understanding of how best to manage health over the years ahead. Our focus as sustainable investors is on a cleaner and safer world in the future, but people have to be healthy enough to enjoy this. In broad terms, the answer is taking a proactive stance in monitoring and preventing disease before it occurs; although this may feel expensive, it is far cheaper than dealing with disease later.



Fast-track vaccines

In the case of Covid-19, the most critical step was clearly the development and production of vaccines and these began to come to market less than a year after the need was identified. This is in stark contrast to the traditional timeline for the development, trialling and production of around 10 years. Other requirements focused on testing and therapeutics: testing to ensure we can isolate those with the disease and monitor ongoing dynamics of its spread (as well as mutations) and therapeutics to lessen the burden on individuals and healthcare systems by reducing the severity of the virus in those who do contract it.

Looking forward, we expect healthcare companies to continue to do well by doing good; a company like Roche has seen significant demand for its diagnostic machines during the pandemic and we believe it will continue to expand its global footprint. Even as levels of Covid-19 testing fall, these machines will be put to work to scan for other serious diseases where governments have been less keen to invest the initial outlay, such as Tuberculosis or Hepatitis C. For more on healthcare innovation, see page 22.



Sustainable energy production

Elsewhere, we also saw several of the major trends we follow hold up well amid the pandemic such as *Increasing electricity generation from renewable sources*. Companies were able to continue building new US solar farms, for example, and many of the sustainable infrastructure funds that own and operate renewable energy electricity generation assets were remarkably resilient through the lockdowns.

A third category comprised trends that were put on temporary pause as the result of stay-at-home requirements such as *Enabling healthier lifestyles* as gyms closed or *Making transport more efficient*, with companies operating public transport networks suffering major disruption. This was where our work on companies came to the fore and we remained confident about the majority of our holdings despite the temporary upheaval.



Paused trends restart as economies reopen

Overall, the pandemic has highlighted that our 21 sustainable themes are not correlated as a result of the many different areas of structural growth to which they lead us. It has also showed sustainability trends seldom move in a straight line. Given the long-term nature of these trends, however, we are confident about the direction of travel and the secular demand; some of the themes that experienced super-normal growth last year will slow down before continuing, while other trends that were paused will restart as the economy gradually reopens.

We had no better insight into the pandemic than anyone else, but our chosen companies have been thinking about resilience in the face of structural change for years. They have been grappling with how to offer decent work in stressed supply chains, how to reduce their business travel and how to create the incentive structures and diversity to form Boards that can make the best decisions at critical times.

Our view remains that when we are able to look past Covid-19, the tools and techniques that companies have developed to outperform in the face of a climate emergency, an obesity epidemic or failing Boards will be the making of sustainable investment.



The Bond angle

Three pillars of the process

Maximise Sustainability

1

Sustainability analysis

Positive screening
Negative screening
Best In Class



Maximise Quality

2

Credit analysis

High-quality issuers
Macro analysis



Maximise Value

3

Finding value

Dynamic approach
Focused portfolio



As sustainability continues to extend its influence across equity investments, we also see considerable benefits of an ESG-based approach to fixed interest, potentially enhancing performance and reducing volatility. Like all managers in this space, we face the ongoing challenge that direct causation between ESG credentials and performance remains difficult to prove and this is especially true for fixed income.

There are clear correlations, however, and we believe focusing on more sustainable parts of the bond markets and avoiding companies and sectors challenged by environmental and societal considerations can drive performance. We are looking to invest in businesses providing solutions to the world's problems and coupling

this with strong credit fundamentals and, most importantly, attractive valuations. Combining all three elements – sustainability, value and fundamentals – has helped steer us through volatile markets and deliver returns to clients.

Industries and sectors that damage society and the environment are susceptible to either enforced regulatory change and/or evolving consumer habits, both of which can be detrimental to long-term returns. The SF Corporate Bond Fund has never had exposure to oil, coal, mining, autos (internal combustion engine), nuclear or tobacco, to name a few – and these sectors have not only underperformed on the whole but done so with considerable volatility.



Assessing banks – focusing on the E and S as well as the G

STUART STEVEN

From an ESG perspective, our analysis of individual banks for the SF bond funds has traditionally focused on the third element. In recent years, however, a growing number of banks have been looking to help facilitate the energy transition through a more aggressive and constructive approach to managing carbon within their corporate loan books and reallocating capital and funding away from carbon-intensive companies towards those actively seeking to address the climate crisis.

Until recently, best-in-class banks would be those reducing exposure to the most carbon-intensive sectors, such as oil & gas and mining, via a form of negative screening, or introducing or tightening policies to restrict lending to companies that derive a stated percentage of revenues from business lines like coal. It is important not to take such commitments at face value, however, as some banks set such limits at high levels, above 30% or even 50%, coupled with unambitious targets to reduce these over time.

Given the shift within the sector, with many large-cap banks now looking to shape the energy transition, we aim to invest in those most

committed to improving environmental exposure and demonstrating best practice to deliver on this. Factors for analysis include lending policies related to controversial sectors, lending to green projects and compliance with the Equator Principles for project financing; these are a financial industry benchmark for determining, assessing and managing environmental and social risk in projects.

Central banks are also pushing in this direction and this will likely serve to broaden and accelerate participation. The European Central Bank, for example, recently announced it is introducing climate-related stress tests (physical and transition risk) into its assessment of banks.

Based on such developments, we have increased the relevance of how banks are managing the environmental impact of their loan books within our methodology. As we move forward, we will engage further with any laggards to try to effect positive change across the entire sector.





The case for sustainable insurance

AITKEN ROSS

Although a long-term favourite in our SF bond funds, it is fair to say insurance is hardly the first sector that comes to mind when thinking about sustainability or positive ESG characteristics.

From an individual perspective, however, general insurance protects our homes and possessions and provides an economic safety net; it affords people the confidence to invest, which in turn contributes to broader economic growth and development. Life insurance and income protection give families financial security should the worst happen.

Looking beyond such a broadly net positive impact, we believe the leading insurance companies also contribute in a more sustainable way by devoting capital to researching ESG aspects. The best companies in the sector research specific sustainability, environmental and social risks, for example, and are therefore able to better understand and price these and help clients protect against them.

European insurance companies are generally highly rated with a parent credit rating of single A and above and this is evidence of their underlying quality and strength of balance sheet. Combine this with highly cash-generative business models, strong levels of capitalisation and a creditor-friendly regulator that prioritises capital and cash retention over dividend distribution, and we have a sector that is fundamentally stable and robust.

Despite these positives, insurance bonds still trade at a discount to the broader market. This is partly explained by the subordinate nature of many of these bonds, which carry a higher level of volatility; fair value for the insurance sector overall should therefore naturally be wider than the benchmark average. When we factor in underlying credit quality, however, this spread differential should be much less than the market is currently pricing.

Insurance provides an economic safety net to millions, facilitates economic development and growth, and advances our knowledge of sustainability and key environmental and social issues. It is a sector that has robust fundamentals and strong solvency on average and, most importantly, continues to offer long-term value to bond investors, demanding its core position across our SF Corporate Bond and Monthly Income Bond Funds.



on and access to clean water - Le
- Increasing financial resilience - Prov
Improving industrial processes - Increasing elect

KEY THEMES



Sustainable investment themes: 2020 update

Themes sit at the heart of the Sustainable Future process, identifying areas of structural growth associated with improvements in resource efficiency, quality of life and the safety and resilience of society. We review these themes every two years to ensure they are current, consistent and clear, adding in new areas if we believe they are warranted or reorganising and combining existing themes if this makes sense given changing circumstances.

As a result of the 2020 review, we added an additional theme – *Encouraging sustainable leisure* (taking the total to 21) – and changed the language around three others, as set out in the table below.

Old theme	New theme
Increasing waste treatment and recycling	Delivering a circular materials economy
Improving auto safety	Improving transport safety
Improving industrial and agricultural processes	Improving the resource efficiency of industrial and agricultural processes

New definitions



Delivering a circular materials economy

With finite resources on earth, recycling remains a huge part of the shift to a more sustainable world. But to make better use of materials, we need to consider the whole life cycle rather than just the 'waste' stage, moving beyond the current take-make-waste model towards a more circular economy. This is based on three core principles – designing out waste and pollution, keeping products and materials in use and regenerating natural systems – and we believe companies built on these lines should benefit from this trend.



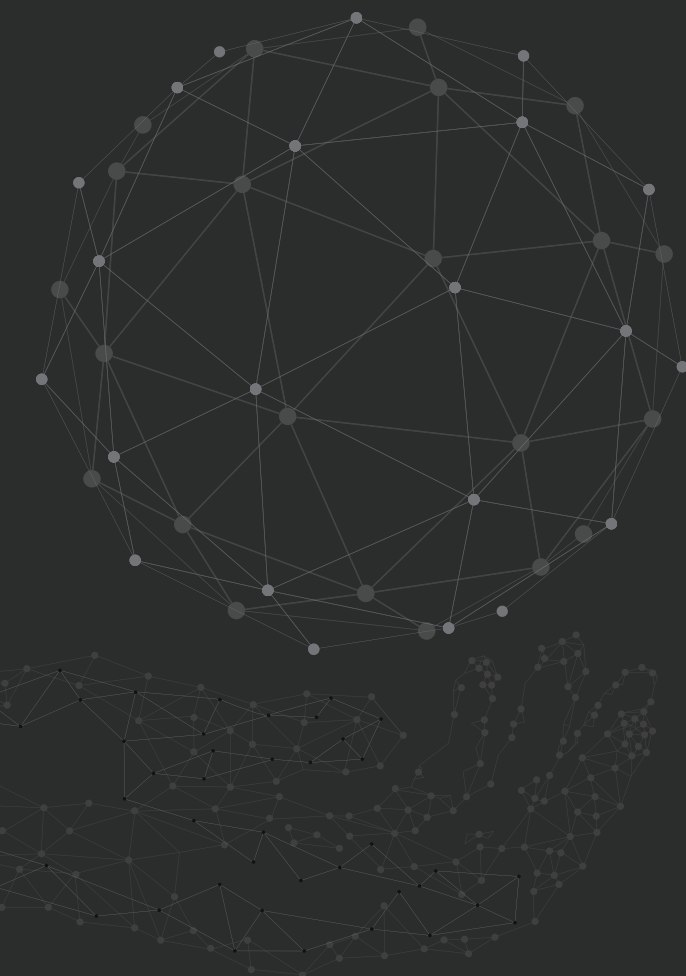
Improving transport safety

We have identified companies whose products improve the safety of travel and reduce accidents. Much of our work has focused on autos, in areas such as collision avoidance, active braking and semi-autonomous driving, but we should not assume cars will remain dominant, particularly with safe, efficient mass transport key to reducing emissions. Whatever the mode of travel, we concentrate on the specialist companies making the kit to improve safety, from better lighting to more efficient braking.



Improving the resource efficiency of industrial and agricultural processes

We like companies that provide products or services that help to make industrial processes more resource efficient, as well as safer for workers and users. We see investment opportunities in software and systems that help to implement life-cycle design (including the disposal of products) and manage supply chains as they modernise and improve industry. We are looking for companies driving real improvements in energy and material use.



Introducing our newest theme: *Encouraging sustainable leisure*

Economic growth and subsequent poverty alleviation over recent decades have enabled more people to enjoy leisure time. As ecological economist Tim Jackson (who sits on our Advisory Committee and has the Final Thought in this year's Annual Review) puts it in his book *Prosperity without growth*: 'In the advanced economies...material needs are broadly met and disposable incomes are increasingly dedicated to different ends: leisure, social interaction, experience... what really matters to us: family, friendship, sense of belonging, community, identity, social status, meaning and purpose in life.'

Leisure can facilitate these social interactions and help people find that meaning and purpose, with activities as diverse as going to a concert, to the cinema, having dinner at a restaurant or playing a video game with an online community. These all have negative externalities but the social experience is an important factor in a more sustainable and pleasurable economy.

Many investors still classify leisure stocks as 'nice to haves' rather than necessities, the classic definition of discretionary rather than staple in consumer land. Sustainable investors may also struggle with these companies as they are not providing a solution to pressing issues such as the climate crisis or inequality. But it is worth considering the work of Chilean economist Artur Manfred Max Neef, whose list of fundamental human needs includes a leisure category.

Leisure had previously been part of our *Enabling healthier lifestyles* theme but we decided to introduce a distinct *Encouraging sustainable leisure* theme to clarify our thinking. We are not, for example, claiming music companies (we added both Spotify and CTS Eventim to our funds in 2020) make people 'healthier' but leisure is playing an increasingly important part in the economy and has a beneficial impact on mental well-being.

From an investment perspective, leisure is difficult to analyse due to its broad scope, encompassing everything from traveling around the world to listening to music or reading at home – and, as the cost of these activities varies, so too does their sustainability profile. What is clear, however, is that in the UK alone, the leisure market is worth around £117 billion (accounting for 7% of GDP according to a Deloitte report from 2016) and the sector is attracting 50% more discretionary spend than retail and growing twice as fast.

Spending priorities are a good indicator of structural growth, particularly among younger generations, and millennials have a clear preference for experiences over buying things. We believe this trend may be amplified amid a general Covid-inspired reassessment of priorities, creating a growing experience-based economy and a shift away from traditional material consumption.

Leisure: facts and figures



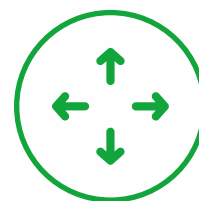
In the UK alone the leisure market is worth around **£117 billion**



It accounts for **7% of GDP**



The sector is attracting **50% more discretionary spend than retail**



And **growing twice as fast**, as millennials have a clear preference for experiences over buying things

Source: Deloitte, *Passion for leisure* report, 2016.

Developing themes

As highlighted in the introduction, we continued to develop and write about our themes in 2020 and the following is a selection of our most recent thoughts.



Early detection and ongoing innovation key in cancer fight *(Enabling innovation within healthcare)*

LAURIE DON

Pharmaceutical companies are in the public eye at present and, beyond their urgent efforts against Covid-19, ongoing innovation in healthcare is vital for a more sustainable future.

We continue to see huge advances in technology across areas such as gene editing and DNA sequencing and these are revolutionising how we think about the concept of treatment. The traditional model has a large element of trial and error, with people seeking help when they feel ill and hoping whatever drug or procedure prescribed is effective – but this intervention often proves too late. In contrast, we are moving towards a more personalised system where we can understand how someone's genetic make-up leaves them vulnerable to certain diseases.

With cancer, the healthcare industry has made substantial progress in the prognosis of certain types but many others continue to elude early detection. Late discovery of lung, colorectal, stomach, liver and

breast cancers are exceptionally costly in terms of patients' lives and the healthcare system aiming to help them – and ongoing innovation in the field of liquid biopsies shows the possible impact of earlier, more convenient testing. This technology, which allows doctors to detect cancerous cells from a blood draw rather than source tissue, can provide the detail necessary to personalise treatment and has the potential to help millions of cancer sufferers.

Liquid biopsy can be useful in several situations and, around that central theme of early detection, a key one is in asymptomatic cancer screening, both population wide and among individuals deemed to be at high risk. The ability to innovate to solve medical needs is what attracts us to healthcare as a sector and with World Health Organisation (WHO) figures predicting up to 16.4 million global deaths a year from cancer by 2040, equivalent to almost a quarter of the UK population, this is another area where such expertise must be brought to bear.



From Los Angeles to Copenhagen *(Building better cities)*

PETER MICHAELIS

Urbanisation has been a demographic talking point for years but data from the United Nations show just how quickly this is happening. Today, around half of the world's population (55%) lives in cities but by 2050 this proportion is expected to reach as high as 68%. With 6.5 billion people living in such environments within 30 years and our current cities emitting 50-60% of global greenhouse gases (GHG), a sustainable future is impossible without significantly transforming how we build and manage urban spaces.

Today's cities only take up around 3% of the planet's land surface but have a disproportionate impact on the environment, also consuming three-quarters of primary energy – and these figures will only increase. As a counterpoint, cities are also where people can often be at their best and are responsible for 75% of global GDP; when done well, cities can encourage tighter community cohesion and be inherently low impact in environmental terms.

This 'done well' is the key point and the driver behind our *Building better cities* theme, which focuses both on developing current infrastructure to make it more efficient and improving what has gone before when

building urban areas. Many developed world cities will have to invest in some retrofitting to limit environmental impacts but sustainable development will increasingly depend on successfully managing global urbanisation. As evidence of this, cities are considered one of four global systems that can accelerate climate action; as the IPCC laid out in its Special Report for Cities in 2018, 'climate science must be accessible to urban policymakers, because without them, there will be no limiting global warming to 1.5°C'.

Comparing a couple of cities illuminates the huge differences: if a citizen of Los Angeles, built on the concept of urban sprawl and the hegemony of the car, moved to Copenhagen, where half of travel is by bike, they would cut their carbon emissions by 75%. Given the scope of *Building better cities*, we see this theme as a prime example of how employing capital today with progressive, sustainable companies can define and shape the world people inhabit in the future.





The retirement challenge (Saving for the future)

CHRIS FOSTER

We continue to see opportunities in changing savings patterns, both in the UK and around the world. There are two key forces behind this: one is demographic, as people are living longer, and the other is political, as governments and employers continue to shift the burden of retirement saving onto individuals.

Due to improvements in healthcare and standards of life more broadly, people are living longer in retirement and putting increasing strain on public pensions. In terms of state provision, it is widely expected that younger people are unlikely to receive pensions as generous as today and, in the worst-case scenario, there could well be no government support at all in some regions. In the UK specifically, there have also been major changes in private pension provision, with a shift away from traditional employer-funded defined benefit (DB) plans towards individual defined contribution (DC) schemes.

World Economic Forum data predict we face a large financial shortfall by 2050 if savings rates do not increase substantially and, in the starkest terms, that could lead to rising pensioner poverty. OECD figures from 2016 showed that 14% of those aged 66 and

over in the UK are already in this category, receiving less than half the median household disposable income, and this figure is closer to 23% in the US.

To improve this, governments will likely continue to incentivise individuals to save more, which we believe creates a long-term structural growth story around businesses helping people to provide for their own financial future. We see a number of ways to invest in our *Saving for the future* theme: we hold insurers and wealth managers across the funds, for example, but currently see a particularly attractive opportunity in investment platforms.

Platforms derive their revenues from either a fee or a commission by allowing direct or advised clients to manage their own wealth. The key metric of success is new business inflows, primarily driven by reputation, customer satisfaction and performance of any advice given. Demand is generally linked to the state of the economy in question and levels of saving per capita, and, as we have established, many are seeing user numbers grow as individuals are forced to take more interest in their own financial futures.



Why low-cost gyms remain fit for our funds post Covid-19 (Enabling healthier lifestyles)

MARTYN JONES

We are in dangerous territory for global health and many conditions are caused by lifestyles built around too much unhealthy food and too little exercise. One statistic that reveals the sheer scale of this is that, globally, the number of obese people has tripled over the last 40 years – with more than 1.9 billion adults now considered overweight.

To be clear at the outset, many of our companies exposed to the *Enabling healthier lifestyles* theme have been hit hard by Covid-19, with gyms forced to shut and suffering drastically reduced revenues. This has led to questions about how quickly people will return and the rise of home workouts (with the likes of Joe Wicks) – and we have been thinking hard about these factors and the long-term implications. While we recognise the risks to the gym industry and understand that the short term could be challenging, we continue to believe long-term demand for more active lifestyles will persist. As with many of our themes, we think the pandemic is accelerating existing trends; in this case as shown by the market share gains of the low-cost gyms that are technology enabled with virtual classes, offer at-home apps, have large national networks of 24-hour facilities and have access to capital markets.

Many low-cost gyms first sprung up in the depths of the financial crisis in 2007-08, offering no-frills flexible membership at less than

half of the price of traditional operators. When we initially worked on this theme, we said the market was ripe for disruption as low-cost providers undercut expensive incumbents. Post-Covid, we still believe this to be the case, although it will be the well-established low-cost players taking market share rather than a swarm of new entrants, and in the UK, this means The Gym Group and PureGym.

These large low-cost leaders have national flexible site networks, economies of scale that enable higher operating profitability and, crucially, access to capital markets; this has been a critical advantage in surviving the current period.

Over recent months, there has been rising media speculation about people not returning to gyms in the UK post-Covid; for us, this fundamentally misunderstands a generational and cultural mindset, particularly among users of lower-cost gyms. Working out at home has clearly taken off but few people have either the space or finances to replicate expensive and heavy gym equipment. Comments to 'go and exercise in the garden' are of little use to the thousands of people without ready access to outside space, particularly considering the average age of a Gym Group member is around 30 and a third of them are students.



IMPACTS

Delivering healthie
control
– Making transportation m
– Making the healthcare system
– Making supply chains and quality control
– Making the transition to lower carbon fuels

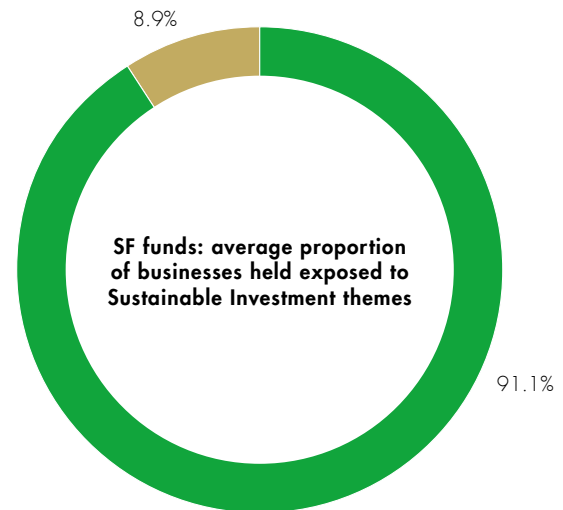
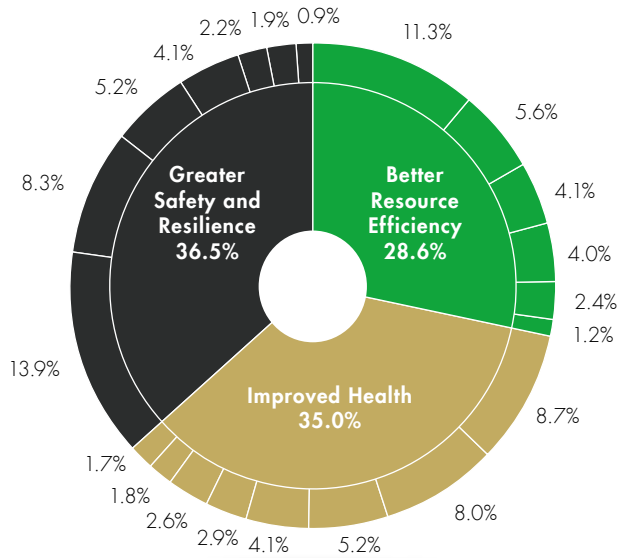
Sustainability and impact

Measuring impact 1: Exposure of the SF funds to our Sustainable Investment themes

Our ultimate aim is to outperform the market by investing in sustainable companies and use our influence as investors to drive positive change. As set out on page six, we have identified 21 themes to help us understand positive trends and identify companies exposed to structural (long-term) growth, as well as those facing structural decline. On average, our funds had the following broad weightings in these themes at the end of 2020; this demonstrates the diversified nature of our themes, giving the funds exposure to many different areas of the economy that are expected to experience secular growth.

We also calculate and disclose thematic exposure for each fund individually and this is available at liontrust.co.uk/sustainable.

For a company to be associated with one of our themes, it must have at least 25% of the business exposed to the theme in question. On average, the main SF funds have very meaningful exposure to these themes, with 91.1% more than 50% exposed and the remaining 8.9% over the 25% threshold.



Better resource efficiency 28.6%	
Improving the efficiency of energy use	11.3%
Improving the resource efficiency of industrial and agricultural processes	5.6%
Making transport more efficient	4.1%
Delivering a circular materials economy	4.0%
Improving management of water	2.4%
Increasing electricity from renewable sources	1.2%
Improved health 35.0%	
Enabling innovation in healthcare	8.7%
Connecting people	8.0%
Building better cities	5.2%
Enabling healthier lifestyles	4.1%
Providing education	2.9%
Providing affordable healthcare	2.6%
Delivering healthier foods	1.8%
Encouraging sustainable leisure	1.7%
Greater safety and resilience 36.5%	
Increasing financial resilience	13.9%
Insuring a sustainable economy	8.3%
Saving for the future	5.2%
Leading ESG management	4.1%
Better monitoring of supply chains and quality control	2.2%
Enhancing digital security	1.9%
Improving transport safety	0.9%

- Strongly exposed to theme (>50% of business)
- Moderately exposed to theme (>25%, <50% of business)

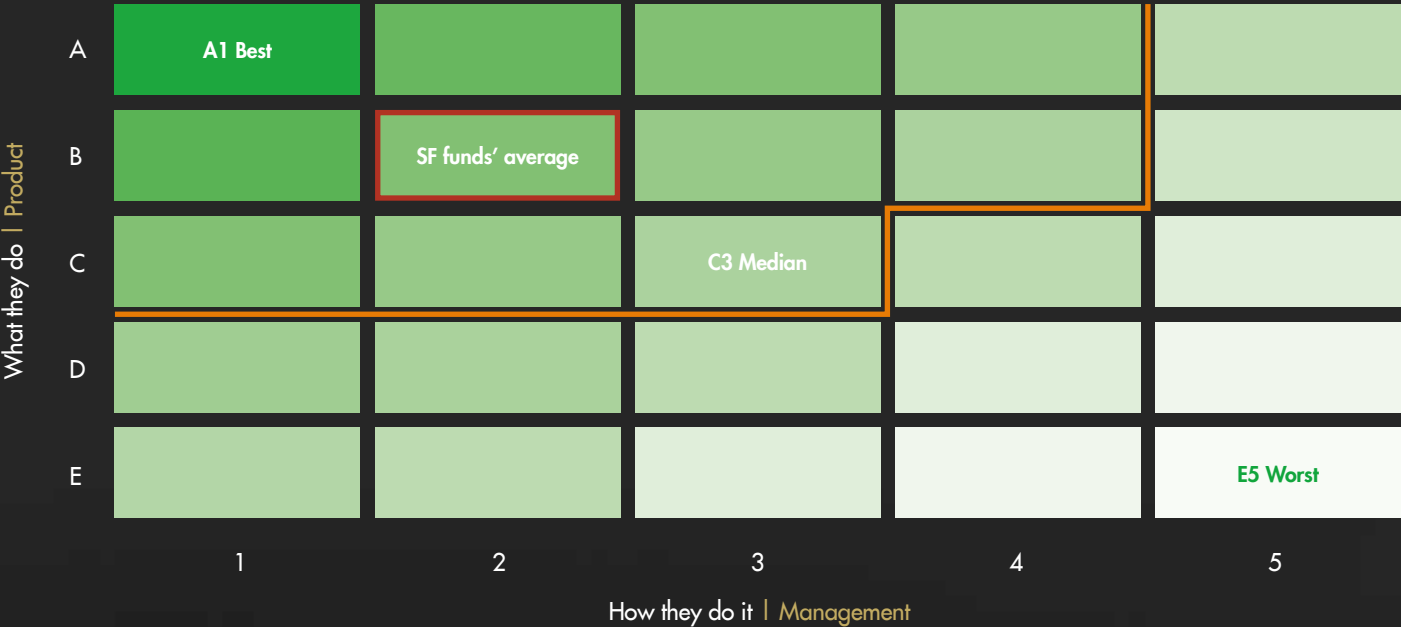
Source: Liontrust, Factset, 31.12.20.

Source: Liontrust, Factset, 31.12.20. Average thematic exposure across the SF UK Growth, SF European Growth (ex-UK), SF Global Growth and SF Corporate Bond funds.

Measuring impact 2: The overall sustainability of the businesses in which we invest

We measure a company's overall sustainability using our Matrix ratings. These capture the net contribution to sustainability from a company's products and services, as well as how proactively the management team is handling its interactions with the environment and society to maximise positives while minimising negative externalities. For the SF funds, the weighted average matrix rating is close to B2. This demonstrates our funds are investing in companies

whose products and services are better than the median, and this is also true for the quality of the management teams, who are running their businesses more proactively – in terms of sustainability – than the market. We believe this is where we can find the best opportunities, while also avoiding companies in the area of the market below the line in this graphic.



Source: Liontrust, 31.12.20

We are often asked why we chose to have our own rating system rather than using one of the many options available from external ESG data providers. The reason we maintain our own system, and use our own discretion, is that we often disagree with ratings from third-party providers because we believe different aspects of a business are important when assessing overall sustainability. We do use third-party ESG data providers as we find their research

interesting and useful, but this is a starting point rather than the end point of our analysis.

There is also no universally agreed linear measure of sustainability, and we believe drawing our own (often different) conclusions avoids taking third-party analysis at face value, in what will inevitably become a commoditised area where the only barrier to use is what it costs.



Measuring impact 3: Alignment of the SF funds with the UN's SDGs

We understand investors want additional information on the impact of their investments and therefore also disclose how our sustainable themes are aligned to the United Nation's Sustainable Development Goals (SDGs) at specific performance indicator level for those

who want to use that vernacular. Each of our themes is limited to one main SDG, although, in reality, there are overlaps and most companies are exposed to areas helping to meet more than one goal.

Investment themes mapped to primary SDGs

Our Sustainable Investment theme	Sustainable Development Goal	
Delivering healthier foods	3 Good health and well-being	
Enabling healthier lifestyles		
Enabling innovation in healthcare		
Providing affordable healthcare		
Encouraging sustainable leisure		
Improving transport safety		
Providing education	4 Quality education	
Improving management of water	6 Clean water and sanitation	
Improving the efficiency of energy use	7 Affordable and clean energy	
Increasing electricity generation from renewable sources		
Increasing financial resilience	8 Decent work and economic growth	
Insuring a sustainable economy		
Saving for the future		
Improving the resource efficiency of industrial and agricultural processes	9 Industry, innovation and infrastructure	
Connecting people		
Enhancing digital security		
Building better cities	11 Sustainable cities and communities	
Making transportation more efficient		
Delivering a circular materials economy	12 Responsible consumption and production	
Better monitoring of supply chains and quality control		
Leading ESG management	Multiple SDGs, depending on company operations	

SF funds' exposure to primary SDGs

- **SDG: 3**
Good health and well-being
- **SDG: 4**
Quality education
- **SDG: 6**
Clean water and sanitation
- **SDG: 7**
Affordable and clean energy
- **SDG: 8**
Decent work and economic growth
- **SDG: 9**
Industry, innovation and infrastructure
- **SDG: 11**
Sustainable cities and communities
- **SDG: 12**
Responsible growth and consumption



Source: Liontrust, Factset, average weight of SDGs mapped to our themes, for the SF UK Growth, SF European Growth (ex-UK), SF Global Growth and SF Corporate Bond funds as at 31.12.20 (unweighted simple average).



How our themes are aligned to the SDGs where we have most exposure

Decent work and economic growth (SDG #8)

We have three themes aligned to this development goal to promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.

Increasing financial resilience: A resilient financial services sector is necessary for economic well-being through utility-like provision of banking, lending and effective ways of appropriately saving for the future, as well as mitigating risks through insurance. This is aligned with SDG Key Performance Indicator 8.3, to encourage growth of business through access to financial services.



PayPal is a US-based company that makes transacting online easier and safer for consumers and businesses. Identity theft and fraudulent transactions are significantly lower on PayPal than its competitors, and the value we see from this business should come from a long runway of growth, amplified by the excellent position the company has created for itself.

Insuring a sustainable economy: We believe insurance can spread the risk faced by an individual or corporation and makes a beneficial contribution to society.



PRUDENTIAL

Prudential is predominantly a life and health insurer, listed in the UK and focusing on growth in Asian markets. It is bringing insurance to those who have not had access to it before and those unlikely to be supported by the state.

Saving for the future: We see a growing need for people to be able to access good advice and choose appropriate investments to ensure they have saved enough for retirement. Failing to invest for the future and relying on state-funded pension schemes will result in a significant drop in quality of life as government finances come under increasing pressure.



Avanza is a Swedish savings platform in an underpenetrated market, providing clear benefits to society by helping individuals manage their savings in a cost-effective manner. This company is proactive on sustainable investment products, having decided to go with an opt-out mechanism that means over 90% of the funds its clients use are Morningstar sustainability rated three globes or better.

Good health and well-being (SDG #3)

We have five themes aligned with this SDG to ensure healthy lives and promote well-being for all at all ages.

Improving auto safety: We have identified companies whose products improve the safety of travel and reduce road traffic accidents, principally through active safety, which involves collision avoidance, active braking and semi-autonomous driving.



KNORR-BREMSE

Knorr-Bremse is a German company whose products are used around the world to make travel more efficient, safer and quieter. It makes systems used in braking high speed trains, as well as collision avoidance systems for commercial vehicles. Changing modes of transport to a modern train network is estimated to be 12 times more efficient than by road and air (per passenger mile) and eight times more efficient than freight in trucks.

Delivering healthier foods: There is a trend in the food industry of consumers changing their preferences and demanding healthier options. We have identified companies that provide reformulation services to change the recipe of foods to make them healthier (less fat, sugar and salt) while maintaining the taste. This improved diet has positive health impacts, helping reduce non-communicable diseases such as obesity and cardio-vascular disease. This contributes to Key Performance Indicator 3.4 of this SDG to reduce by one third premature mortality from non-communicable diseases through prevention and treatment.



Irish firm **Kerry** was established in 1972 as a dairy cooperative and has evolved to become one of the largest and most technologically advanced ingredients and flavours technology companies. Kerry enables food manufacturers, restaurants and supermarkets to improve the nutritional characteristics of their meals to be tasty, natural and appealing while reducing salt, sugar, fat and calories.

Enabling healthier lifestyles: Companies that promote healthier lifestyles, principally through increasing activity, taking exercise and sport, help meet the same Key Performance Indicator.



The Gym Group is the UK's second largest and lowest-cost gym group with more than 170 sites across the UK. Gym Group promotes physical activity through the provision of exercise classes, weights and cardio equipment at less than half of the price of traditional gyms. This makes membership more affordable for the broader population and helps to improve public health.

Providing affordable healthcare: Companies that help to deliver affordable, positive patient outcomes in managing disease also help to achieve this goal.



IQVIA is a US company that uses data to design and run trials for new drugs before they get approved for general use. Designing these trials is complicated but IQVIA's innovation means drugs can be used quicker and cost less to test.

Enabling innovation in healthcare: Companies whose products or services promote innovation within healthcare are also helping towards this SDG by coming up with new, more effective ways to treat diseases, providing essential equipment or services for biotechnology research, or through software to help make treatments more effective.

illumina®

Illumina is a global leader in sequencing for genetic analysis. The company's ability to read and interpret a patient's DNA is a core first step in the shift towards more personalised medicines. Illumina continues to lower the cost of gene sequencing over time, enabling broader adoption of these techniques and helping to accelerate further beneficial trends for patients. These trends include progress in liquid biopsy technology, which allows doctors to detect cancerous cells from a blood draw rather than source tissue.

Industry, innovation and infrastructure (SDG #9)

We have three themes aligned with this SDG to build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation.

Improving the resource efficiency of industrial and agricultural processes: We like companies that provide products or services that help to make industrial processes more resource efficient, as well as safer for workers and users. We see investment opportunities in software and systems that help implement life-cycle design (including disposal of products) and manage supply chains, and in the automation of factory processes to remove repetitive or dangerous mechanical tasks. These all help to modernise industry and meet this SDG.



Autodesk is a leading software business, listed in the US, which serves the global construction and manufacturing industries. It is bringing technology to areas of the global economy that have been nascent in terms of adoptions, such as manufacturing design and particularly construction and building sites. The global construction industry is at an inflection point, as traditional paper architectural designs are replaced by digital devices.

Enhancing digital security: As more of our lives and critical services are carried out online, we need to protect the data from theft. Digital security helps to make this growing area of the economy secure.

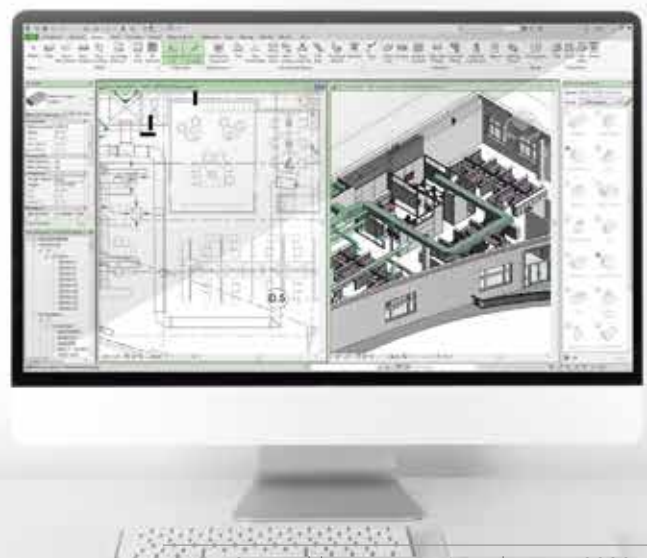
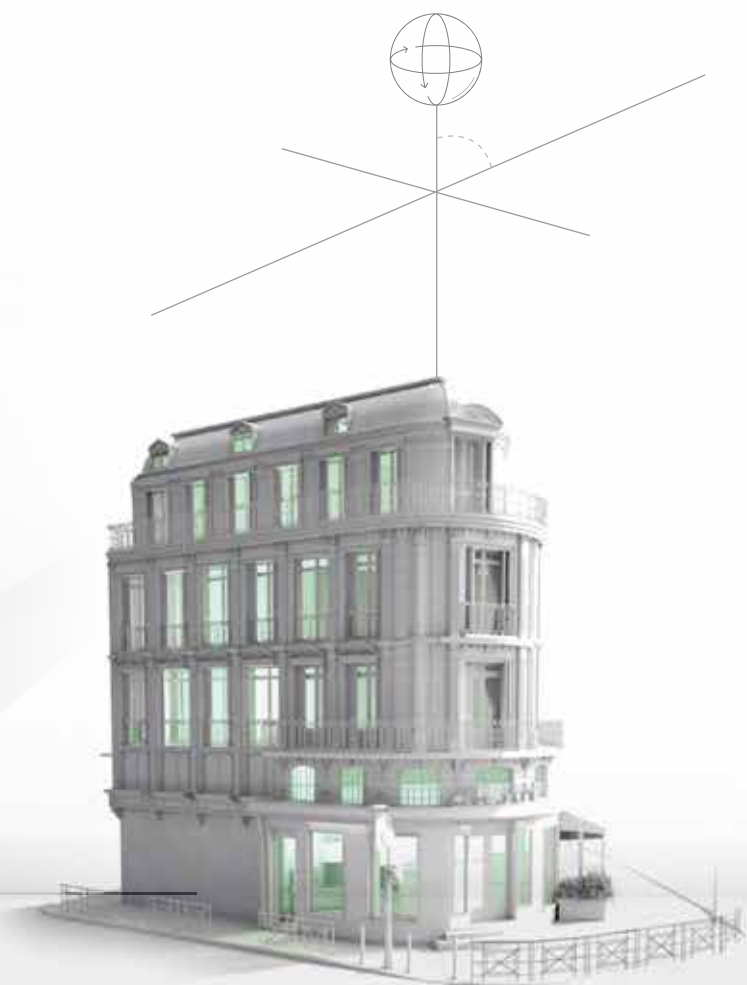


Palo Alto Networks provides technology to protect our digital way of life. Its firewall product is consistently rated the best by Gartner and the company achieves very high customer satisfaction scores, giving us confidence it will succeed in making online information available only to those permitted to see it.

Connecting people: We believe access to easy communication tools and information, increasing amounts of which are online, is a positive requisite for a more sustainable economy.



Helios Towers is the UK-listed owner and operator of telecom infrastructure assets. The company's assets are in high-growth African markets and its strategy is to grow assets in underserved markets and contribute to providing reliable access to communications in these countries. This will enable telecom operators to make their networks denser to offer the greater capacity necessary to meet increased demand for mobile data services.



Affordable and clean energy (SDG #7)

We have two main themes aligned with achieving this SDG to ensure access to affordable, reliable, sustainable and modern energy for all.

Increasing electricity generation from renewable sources:

Substituting coal-intensive fossil fuel electricity generation with renewable power sources reduces carbon emissions as well as providing a cost-effective means in some off-grid situations to connect people to cheaper, more reliable power sources.



US Solar Fund PLC is a London-listed renewable electricity generation company that builds new and operates existing solar farms in the US. Solar is becoming an increasingly cheap source of electricity generation, which can now outcompete natural gas derived from fracking on economic grounds. Therefore, we see this company as having a positive impact as well as providing access to long-term power price agreements, with large demand from US corporates.

Improving the efficiency of energy use: We see many ways of making energy cheaper by reducing wasted energy while also reducing emissions through more efficient use. This cuts across many areas of the economy and includes building insulation, efficient lighting, energy-efficient climate control, travel and industrial processes. Companies that provide services or equipment, particularly in upgrading the power grid network to be able to deal with changing production and consumption patterns of electricity, are an important part of achieving affordable clean energy.



SDCL Energy Efficiency Income Trust PLC is listed in the UK and invests in projects or assets that reduce the amount of energy wasted, thereby cutting energy bills for users and emissions. The projects owned cover a broad range of technologies globally, such as combined heat and power providing efficient heat and backup power to a London Hospital, cogeneration of heat and power in olive processing using olive wastes, and recycling waste gas technologies used in steel smelting in the US to make it more energy efficient.



Sustainable cities and communities (SDG #11)

We have two themes aligned with achieving this SDG to make cities and human settlements resilient and sustainable.

Building better cities: Shelter is a basic human requirement and companies that build quality affordable homes or key infrastructure needed in cities are helping to provide this.



Places for people is an issuer we hold in the SF Corporate Bond Fund. This company funds the provision of social housing, which is a long-term positive for society.

Making transportation more efficient: Urban transport systems are improved by reducing congestion as well as transport emissions (which make the local air toxic) as the mode of transport shifts from self-driven cars to public transport systems such as trains, tubes and buses as well as active transport such as bikes and e-bikes.



National Express Group operates bus, coach and rail services, with an exceptional record on safety and a progressive approach to environmental improvements, particularly in adopting the lowest emission buses in the UK.

Clean water and sanitation (SDG #6)

We have one theme aligned to this development goal, which pledges to ensure availability and sustainable management of water and sanitation for all.

Improving the management of water: Companies that can manage waste-water treatment, or produce products or services that improve the efficiency of water distribution, are vital and in demand. Sanitation is a first line of defence against disease, much of which comes from contaminated water. We like companies that improve sanitation and provide affordable access to clean water.



Ecolab, listed in the US, is the global leader in providing customers with technology that allows them to save key resources, particularly water and energy, in the industrial and hospitality sectors. From restaurants to steel mills, Ecolab's products and technologies significantly reduce water usage and save customers money by driving cost savings and efficiencies. The business drives much of its sales through innovations delivered to target customers' specific needs.

All use of company logos, images or trademarks are for reference purposes only.

Measuring impact 4: The climate change crisis

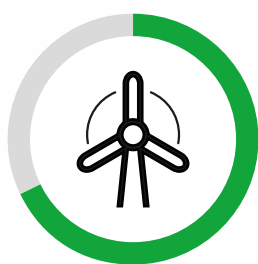
The world continues to grapple with the consequences of the climate change crisis and now is the time to accelerate the shift to an ultra-low carbon economy. The science is telling us we need to quicken the pace of decarbonisation, as current progress and ambition both fall considerably short of internationally agreed goals to limit average global temperature rises to less than two degrees centigrade, and ideally less than 1.5, in line with the Paris Accord.

In 2020, the world grinding to a halt during the Covid-19 pandemic led to a 2.6 gigatonne (a billion tonnes) drop in CO₂ emissions and a so-called anthropause, a term coined to describe the more welcome ecological consequences of lockdown. Academics suggest similar cuts are needed every two years to meet

Paris targets, highlighting the huge scale of the decarbonisation challenge. On average, among countries cutting their output during the pre-Covid period of 2016 to 2019, carbon dioxide emissions fell by 0.19 gigatonnes, roughly 10 times less than the necessary levels of one to two gigatonnes a year.

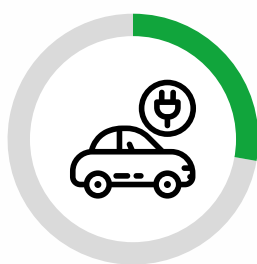
We have been thinking about how climate change will affect our economy and how we can best position our investments for this since our SF funds launched 20 years ago. We believe investors continue to underestimate both the rate of change needed to decarbonise and the magnitude of the positive impact on companies helping towards this, as well as the structural decline in businesses continuing with carbon-intensive products and services.

Active mitigation of carbon exposure – SF funds' average



68%

less carbon emitted
than comparator indices



28%

of the portfolios invested
in better resource
efficiency themes



0%

invested in fossil
fuel extraction

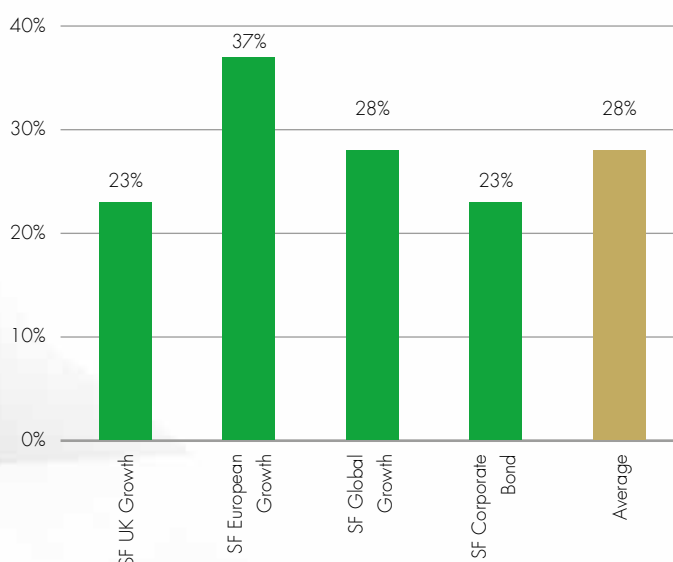
Source: MSCI Carbon Analytics Report, December 2020; average across SF UK Growth, SF European Growth, SF Global Growth and SF Corporate Bond Funds.

How does this affect our investment decisions? First, we want to invest in companies helping to reduce emissions as they will experience significant growth and of our 21 sustainable themes, all those associated with increasing resource efficiency will benefit from, and contribute to, the shift towards an ultra-low carbon economy. As well as using more renewables to generate electricity, equally important is reducing the amount of energy we waste, increasing recycling, improving how we manage water, making industrial processes more efficient, ongoing shifts in transport and how we heat and cool buildings. On average, the SF funds have 28% invested in companies exposed to our better resource efficiency themes.

Second, we want to ensure the companies we own understand the magnitude of the energy transition and are managing their businesses in a proactive way that protects them from inevitably tightening regulations. We launched our 1.5 Degree Transition Challenge in early 2020 to engage with companies in our portfolios, encouraging them to increase their ambition to decarbonise and capture the benefits of doing so in an increasingly carbon-constrained world (for more on this, see page 38).

Finally, there are some industries, no matter how proactively managed, on the wrong side of this transition and these will experience secular decline in demand for their products and services. We choose to avoid areas such as fossil fuel extraction and production, internal combustion engine car manufacturers, airlines and energy-intensive businesses that are not positioning themselves for a lower-carbon world.

SF funds' exposure to better resource efficiency themes

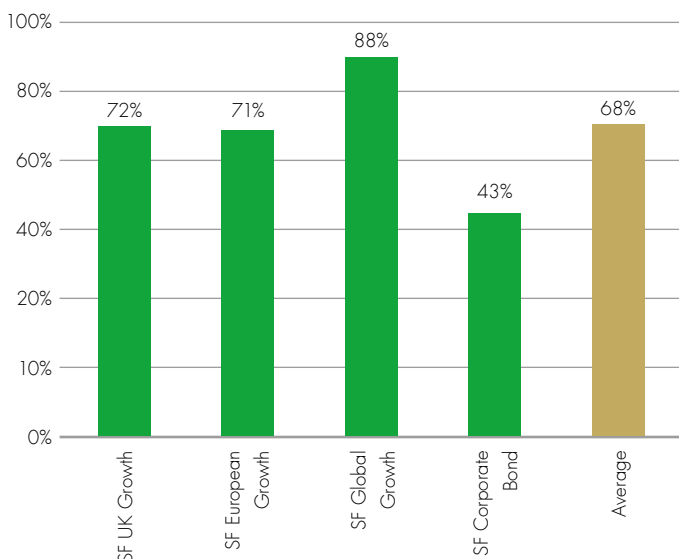


Source: Liontrust/Factset, as at 31.12.20.

Independent analysis of carbon emissions in SF funds

We disclose the portfolio carbon emissions for our single strategy funds and have been doing this since 2012; this work is carried out independently using MSCI Carbon Analytics. On average, the SF funds emit 68% less carbon dioxide than the markets in which they invest, have 22% exposure to companies whose products help reduce emissions, and hold 0% in companies exposed to the extraction and production of fossil fuels (such as coal miners and oil and natural gas exploration and production).

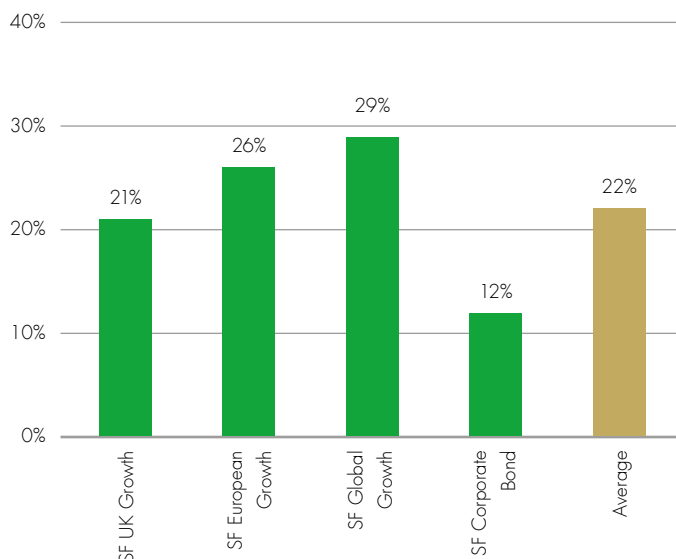
Average carbon emissions reduction in SF funds compared to mainstream benchmarks



Source: MSCI Carbon Analytics/Liontrust, as at 31.12.20.

In addition to the funds emitting less carbon, there are important positive attributes of lower-carbon portfolios. In the event of a tax on carbon, companies that can pass this cost on to their customers will not face a negative impact on their margins (and profitability); in contrast, those unable to pass these costs through to clients will have to bear it themselves. The low carbon emissions coming from the businesses in our funds mean they will have more resilient margins as carbon-related regulations tighten.

Average exposure of SF funds to companies offering cleantech solutions



Source: MSCI Carbon Analytics/Liontrust, as at 31.12.20.

Measuring impact 5: Third-party models

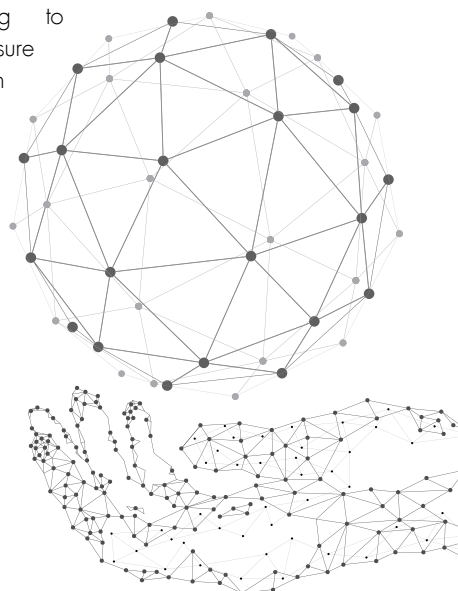
In our previous reviews, we have discussed client demand for impact measures and the challenges of proving 'additionality', along with the recognition that all businesses have positive and negative impacts. We want to be confident in the information we provide to estimate these measures and there remains no standardised approach to this rapidly evolving discipline. Impact reporting is interesting, needed and constantly changing, but can be confusing.

Ultimately, however, we believe the terminology used to describe this performance is not that important; call it impact or not as it continues to change. What is important is how we communicate it and critically how it guides our investment process and influences the decisions we make.

Therefore, we are committed to developing ways of measuring impact and meeting the demand from clients who want to know what influence their investments are having on the real world. We will continue to review the growing number of approaches and are encouraged to see that these are becoming more detailed; some are much closer to identifying the specifics of companies and having measures based on revenues from individual businesses rather than at industry level. The latter misses out on the vital differentiation between companies in the same industry and how they can be very differently positioned to contribute to or detract from our common goals.

Where we find a third-party assessment that is broadly consistent with our approach and helps clarify what the impact is, we will make this information available. However, we want to be confident in what we claim about our funds and ensure we do not overstate or make what we regard as tenuous assumptions towards the goal of finding real world impact indicators. In due course, we will be discussing what we have learnt from some of the more promising analysis we have been reviewing from independent impact researchers in 2021.

We are also responding to increasing regulation on disclosure requirements from the European Sustainable Finance Disclosure Regulation (SFDR). The SF funds distributed in Europe are classified as 'Article 9' as sustainable investment is a major part of the investment objective. We anticipate further increasing disclosure for all the SF funds.



ENGAGEMENT

Our approach to engagement and voting

Engagement is integral to how we ensure we invest in high-quality companies. Engaging with companies on key ESG issues gives us greater insight, helps us to identify leading companies and is used as a lever to encourage better business practices.

Our team has been engaging in this way for two decades and we have found this approach challenges and encourages companies to proactively manage the wider aspects of their business, which, in turn, protects their longer-term prospects. Engagement is a resource-intensive process and our team conducts sustainability research alongside traditional financial and business fundamental analysis. This approach enables us to better target engagement on material issues and integrate this into our financial assessment of a company, maximising the information advantage that engagement can bring to analysis.

Our team also conducts considered annual voting for companies held in the portfolios, and we are very active owners. Our voting policy is publicly available and our voting decisions and rationale are also disclosed.

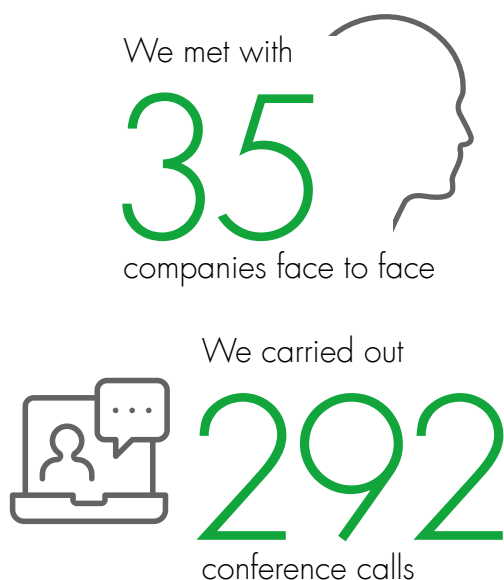
In 2020, we engaged with 111 companies and, highlighting the drastically changed working conditions during the pandemic, the team had just 35 face-to-face meetings and 292 conference/video calls. In total, we raised 318 ESG issues through various forms of correspondence and there was a notable shift towards engagement on proactive initiatives versus reactive issues over the year.

Overall, the team made 106 specific requests for change and we have so far identified that 32 of these have been either actioned or committed to by companies. We will be following up on requests that have not yet been actioned or where we have received commitments over the course of 2021.

	Examples include	Number of times issue raised with companies			
		2020	2019	2018	2017
Environmental	Climate crisis, water management	73 - 23%	29 - 12%	18 - 8%	24 - 13%
Social	Supply chains, employee issues	149 - 47%	74 - 30%	38 - 17%	29 - 16%
Governance issues	ESG and impact disclosure, corporate tax	74 - 23%	73 - 30%	84 - 37%	41 - 22%
Corporate Governance	Remuneration, auditors, diversity	22 - 7%	69 - 28%	86 - 38%	93 - 50%
Number of ESG issues raised		318	245	226	187

Priority engagement initiative versus reactive engagement (2020)

Priority initiatives	Impact/SDG (including climate crisis, sustainable plastics)	249	78%
	Anti-bribery & corruption		
	Diversity		
	Workforce well-being		
	Transition to sustainable investment		
	Covid-19		
Reactive engagement	Controversies, ESG impacts, supply chains, tax	69	22%



Priority initiatives for 2020

Progress and next steps

We prioritised six proactive engagement initiatives in collaboration with our Advisory Committee at the beginning of 2020. The following details some of the highlights across these areas, together with our engagement as a result of the ongoing Covid-19 pandemic.



Climate Crisis | 1.5° Transition Challenge

To ensure companies have strategies to reduce absolute carbon emissions at a rate consistent with limiting global warming to 1.5 degrees.

In early 2020, we committed to our 1.5° Transition Challenge. This involves engaging with all the companies held in the SF funds and challenging them to revisit their decarbonisation targets and raise their ambition to reduce absolute levels of emissions at a rate consistent with a 1.5 degree global average temperature rise.

In terms of our targets in this area, the pandemic slowed our progress as we briefly suspended new engagement on the climate crisis in Q2 and Q3 2020. During that time, we focused instead on understanding how the businesses in our funds were impacted by Covid-19, as well as how they were managing the pandemic.

Given the backdrop, we were not able to finish our climate crisis engagement or publish a report on our findings in 2020 as originally intended. We are continuing this work and intend to publish our findings in time for the United Nations Climate Change Conference of Parties (COP 26), which is due to be held in Glasgow in early November 2021 after being postponed for a year.

As part of our work so far, we have found:

- An encouraging number of companies have already taken a very proactive approach and made considerable progress in setting ambitious targets as we have requested. Many of these have done this by signing up to the Science-Based Targets (SBT) Initiative, which is helping businesses work out a consistent approach.
- The majority of companies are receptive to increasing their decarbonisation targets and actively looking into including more timely absolute emissions targets. Even so, the scale of this challenge means not all are on track for a 50% reduction in emissions by 2030.
- There are a small number of companies where it is not clear that there is an obvious pathway to achieve this accelerated rate of decarbonisation (largely in so-called hard to decarbonise industries such as materials).



Case study: Smurfit Kappa Group

We spoke to Smurfit Kappa regarding our 1.5° Transition Challenge in January 2020, asking them to do more and also to engage with the SBT Initiative. The company recognised the need to reduce emissions to zero and is working on a five-year target aligned with this ambition. Smurfit only models out to 2030 and has not gone all the way to 2050 yet. The new targets implemented are a 40% reduction by 2030 (on 2005 levels).

Later on, in May 2020, the company reported it was committing to align its CO2 target with the SBT Initiative; SBT validation will confirm Smurfit's target is ambitious and aligned with the Paris Agreement. The company will also support the recommendations of the Taskforce for Climate-related Financial Disclosures; this is encouraging and demonstrates the company is playing its part.



IN 2021, WE WILL:

- **Speak to all investee companies about their decarbonisation strategy and targets.**
- **Understand the SF funds' alignment with the Paris Agreement.**
- **Publish our findings ahead of the United Nations Climate Change Conference of Parties (COP 26).**

2

Impact and Sustainable Development Goals

We continue to prioritise our efforts to quantify the main impacts (good and bad) of the companies in which we invest. We will engage with companies to disclose their main impacts so we can report on these. This is an evolving field and we are keen to build on the work we have already done in this area.

We engaged with 27 companies to better quantify the positive impact of their products and services.



IN 2021, WE WILL:

- **Continue to engage and request disclosure on key impacts and metrics alongside how companies are contributing to the SDGs, but as part of our routine analysis rather than as a proactive initiative.**



TeamViewer

Case study: TeamViewer

TeamViewer's technology allows people to remotely maintain or repair machines, monitor networks and access computers and other devices. When the company came to the market in 2019, it published limited information on social and environmental impacts

and mitigation efforts. Initial engagement before the IPO signalled to us that TeamViewer would look to improve disclosure over time as a public company and we encouraged management to demonstrate the positive impact of its products more effectively.

We followed up on this in 2020 and also further discussed the company's ethos and strategy. The founder created what is now TeamViewer to reduce his own need for business travel and this lies at the heart of the company. Although the products are intuitively valuable in terms of energy and travel saved, TeamViewer continues working to demonstrate this more quantitatively, including CO2 reductions. In addition, the company has committed to the SDG framework and believes in the power of technological innovation to drive a more sustainable society, focusing on eight SDGs where it believes it can create a strong impact.

TeamViewer has since reported details of a study that reveals remote connectivity helps combat the continuing climate crisis. The company's solutions help avoid 37 megatons of CO2 emissions per year, equivalent to that from 11 million cars. The study was done in conjunction with the University of Munich spin-off DFGE (the Institute for Energy, Ecology and Economy), employing several hundred different user profiles and surveying over 1,000 participants.

We will continue to engage with the company to understand any learnings from the study or potential for increasing this positive impact further and tracking this over time.

3

Encouraging sustainable use of plastics

We are looking for companies that provide solutions to plastic pollution as potential investments as well as encouraging companies to reduce the amount of single use plastics they introduce to the environment.

This is an area where, despite our engagement, we are yet to see meaningful change. Over 2020, we looked at the consumer-related holdings in our fixed income portfolios and assessed them based on their policies and practices on plastics. Overall, we are happy with the approaches of the companies we reviewed but are disappointed with the slow progress being made; companies appear to be more reliant on industry targets and government policies rather than making transformative changes themselves.



IN 2021, WE WILL:

- **Increase the scope of this initiative to speed up the transition to a circular economy more widely, rather than just focusing on plastics.**
- **Explore approaches beyond company engagement to reduce the burden of plastic pollution.**

4

Increase corporate diversity

We believe companies that are more diverse are better able to prosper over the long term so we are engaging to encourage greater diversity, looking at gender balance at a Board level and among senior positions, and looking at efforts to reduce any gender pay gaps.

Between 2016 and 2020, we targeted companies that are not sufficiently gender diverse. Where companies had fewer than 30% women on the Board, we withheld our support for the annual report and accounts at the AGM. From 2019, we used the same process, but focused on the resolution to re-elect the Chair of the Nomination Committee.

We continue to see meaningful progress on this front:



26 companies in the SF funds have **increased** the proportion of **women on their Boards to over 30%...**



A further **six companies are still under the 30% threshold** but have **increased the proportion of women** on their Boards significantly, **from an average of 16% to 25%**



...with the average **rising from 23%** before we began our voting policy **to nearly 38%**



Elsewhere, **eight companies have not made progress and four have got worse** over this period, falling from an average of 26% of women on Boards to **21%**

5

Worker well-being

How companies manage the human capital of their direct operations, as well as workers further down supply chains, can affect their long-term success. We will engage to encourage companies to offer decent work and pay living wages and to ensure they mitigate risks, protect workers' rights and maximise the opportunities to support employees. We will also encourage companies to use their influence to drive forward best practice further down their supply chains.

As part of Liontrust's commitment as an investor signatory to the Workforce Disclosure Initiative (WDI), the team directly contacted 55 holdings in the SF funds to request they respond to the WDI's 2020

Although there are other external factors, we believe our voting and engagement with these companies has contributed to improvements. Most importantly, however, these figures directly translate into more diverse views and opinions inside company boardrooms, reassuring us they are well equipped and likely to be managed more effectively, which is critical when it comes to challenging times ahead as the world moves past the pandemic. Building on the momentum we have seen on gender diversity will be vital; as companies reap the benefits of more gender-balanced leadership, the merits of increased ethnic diversity and businesses that are more aligned with and reflective of the societies in which they operate should become obvious.



IN 2021, WE WILL:

- **Step up our voting pressure to increase corporate diversity in three ways: raising our threshold for voting from 30% to 33% female boards, increased stringency when it comes to voting against rather than abstaining, and targeting companies with a lack of ethnic diversity.**



Case study: Halma

On diversity, the company has made huge strides over the last four years, with the executive board now majority female. Interestingly, the breakthrough came by adjusting the type of roles (making it more strategic than operational). The company is also reporting on ethnic diversity and the CEO is very engaged and passionate on this issue.



IN 2021, WE WILL:

- **Encourage investee companies to respond to the 2021 WDI Survey.**
- **Pay particular attention to how companies deal with worker health and safety as we move through the Covid-19 pandemic.**



Encouraging the transition to sustainable investment

Individuals are having to take responsibility for their long-term finances, and adequate savings and pension provision is critical. To date, the majority of savings has been into non-sustainable funds but as demand for sustainable investment grows, companies should do all they can to promote these. We will focus on determining which are leading the way and which need to do more.

Over the year, we engaged with 12 companies on this initiative and have been encouraged by some good progress, notably for holdings with consumer savings platforms where we have seen a greater emphasis on information and investment options for sustainable strategies.

We have also seen a number of leading insurance companies furthering their knowledge of sustainability by devoting capital to researching ESG issues. The best companies in the sector research specific sustainability, environmental and social risks, for example, and are therefore able to better understand and price these and help clients protect against them. Not only does this make them better underwriters, greater understanding of such issues also turns these companies into more prudent investors through the inclusion and adoption of responsible practices.

In addition, we continue to educate investors and the market on sustainable investment by providing presentations for financial advisers as part of their ongoing training (CPD). Over the year, we presented at the SimplyBiz ESG events, one of the largest IFA organisations in the UK, which reached hundreds of advisers. This is in addition to ad hoc presentations of this type to clients and potential clients.



IN 2021, WE WILL:

- Continue to engage with our financial holdings to encourage greater integration of sustainability issues, including responsible investment policies, lending practices and increased adoption of sustainable investing.



Case study: Skandinaviska Enskilda Banken

In 2020, SEB developed a sustainability classification model for assessing, classifying and measuring how its corporate and real estate customers impact the planet and people from a climate perspective. It said this model will enable the company to steer and set strategic targets for the credit portfolio from a climate perspective. By measuring customers' transition trajectories and comparing them against sector-specific transition pathways related to temperature-based scenarios, the model enables SEB to assess to what extent customers' business activities are in line with the climate objectives of the Paris Agreement. The model is currently being piloted and will be fully validated and implemented during 2021.

SEB's sustainability goal is based on the conviction that companies working structurally with sustainability issues become more successful in the long term, and thus can become more profitable for its investors. SEB signed the UN's Principles for Responsible Investments (PRI) in 2008 and these guide its fund management company's sustainability activities.



Reaction to Covid-19

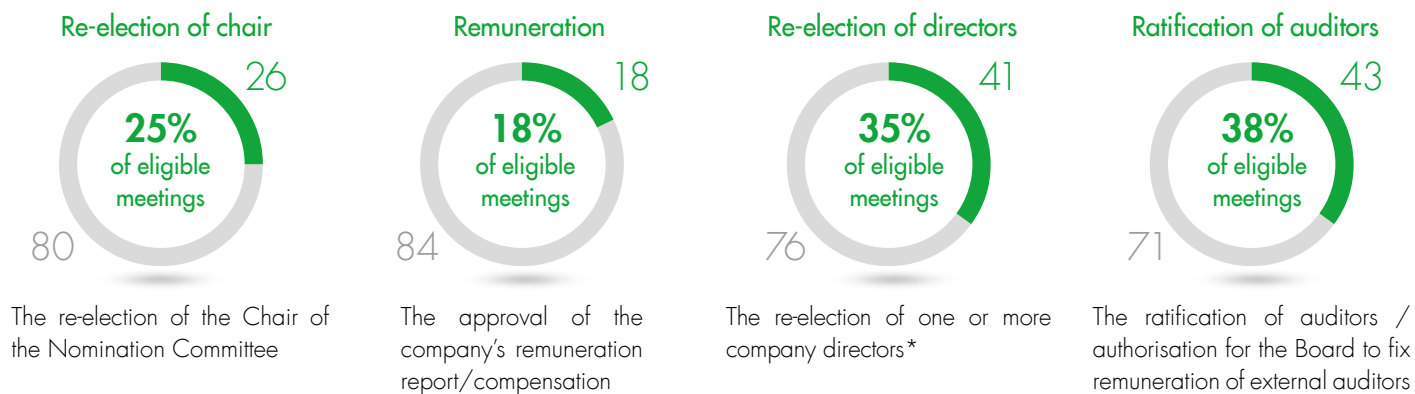
As would be expected, Covid-19 was a key engagement focus over 2020 and we looked to understand how the companies in our SF funds were impacted by the pandemic. We pushed for companies to take a longer-term view where possible and manage their businesses for eventual recovery, adopting a stakeholder approach to minimise the impact on staff and supply chains, which will be needed as the economy gradually opens up again.

We engaged with companies about how they were ensuring the health and safety of their workers. Where appropriate, we also investigated companies' actions and responses within their supply chains as a result of the pandemic, asking what percentage of orders had been cancelled, how suppliers were compensated and whether the company had changed payment terms with suppliers.

Voting summary 2020

In 2020, we voted at 99% (136 of 137) of votable meetings and voted against management or abstained on proposals in at least one vote in 60% (82 of 137) of votable meetings.

We voted to abstain or voted against:



Source: Liontrust, March 2021. *Due to lengthy terms of office, bundled director elections or lack of independence

2021 priority initiatives



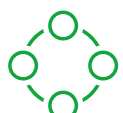



For 2021, there are four key changes to our priority initiatives:

- *Reversing the collapse in biodiversity* will be added to the list of initiatives to ensure we are more focused on this particular environmental crisis.
- Our previous *Impact metrics and SDGs* initiative will be removed and engagement in these areas will be integrated into our routine analysis and conversations with companies.
- Our *Ensuring worker well-being* initiative will specifically include engaging with companies on their response to and management of the current pandemic.

- Our *Encouraging sustainable use of plastics* initiative will be renamed *Encouraging a faster transition to a circular economy* and engagement will be broadened to a wider number of sectors and materials.

In our experience, continued engagement over a longer time period is more likely to achieve better engagement outcomes than over a yearly reporting cycle, so we will continue with our other priority initiatives in 2021.

As well as continuing our efforts to increase corporate disclosure of ESG impacts, impact metrics, mitigation efforts and performance, our team will focus on delivering improvements through the following six priority initiatives:

2021 Initiative	Description
 Climate Crisis: 1.5° Transition Challenge	To encourage companies to adopt strategies to reduce absolute carbon emissions at a rate consistent with limiting global warming to 1.5 degrees. We want to ensure companies can change in a timely, just and profitable way and have robust strategies and targets in place to achieve this.
 Reversing the collapse in biodiversity	We will engage with companies in our portfolios exposed to key biodiversity impacts either in their direct operations or through their supply chains. We will encourage these companies to do more to protect and promote biodiversity and to invest in nature-based solutions and technologies. We aim to collate examples of best practice and to see improvements in policies and practice that show how business can thrive alongside enhanced biodiversity.
 Encouraging a faster transition to a circular economy	We want to ensure companies are looking for ways to reduce their impact through circular practices. We will engage with companies to reduce the amount of single-use plastics and ask more about inputs, waste policies and the potential for more circular practices within their business models.
 Increasing corporate diversity	We believe companies that are more diverse are better able to prosper over the long term so we are engaging to encourage greater diversity, looking at gender and ethnic balance at a Board level and among senior positions, and within the workforce, as well as looking at efforts to increase transparency and reduce pay gaps.
 Ensuring worker well-being	How companies manage and look after their workforce through direct operations, and workers further down their supply chains, can directly affect corporate reputation and overall business performance. We will engage to encourage companies to offer decent work and pay living wages and to ensure they mitigate risks, protect workers' rights and maximise the opportunities to support employees. We will also encourage companies to use their influence to drive forward best practice further down their supply chains. Engagement will cover companies' response to and management of the current pandemic, including workforce adaptation, Covid-19 safety, redundancies, supply chain impacts and so on.
 Encouraging the transition to sustainable investment	To date, savings and investments have typically been geared towards traditional investments that don't necessarily incorporate ESG. However, as demand for sustainable and ESG-integrated investments grows, and regulations to better classify what constitutes 'sustainable' investment come into force, companies should play their part in promoting this approach to investing to further accelerate the transition needed to a more sustainable economy. We will focus on determining which companies are leading the way and which need to do more.

Controversies

Over the 20 years we have been managing the SF funds, a key lesson we have learned is that 'sustainable' should not be taken to mean perfect. Investing involves making predictions about the future, which is extremely difficult. We therefore have to expect occasions – albeit rare – when the future does not turn out as predicted and our companies become embroiled in a controversy that challenges our initial assessment of their sustainability. This can be due to some overlooked aspect that we could perhaps have picked up earlier or because of a new event or revelation that causes us to see the business in a different light.

We do not claim to have perfect foresight, nor that the companies held in our funds are flawless. What we do aim for is to find the best examples of sustainable companies to own for the long term, and how we process and react to controversies is an important aspect of this.

First, through our own research and monitoring, we look to be aware of any previous or current contentious issues. In addition, we use two third-party controversy monitoring services that cover news reports linked to all our companies; in practice, we are usually aware of anything before it is highlighted by these external providers.

Over 2020, MSCI highlighted 186 'controversies', with just three of these considered severe, including Kingspan. There were five controversies that led to the team reviewing our sustainability rating and for the others flagged, we were either aware of the issue or, after examination, deemed it immaterial to our assessment.

As soon as we are aware of any controversy, the next stage is to analyse the situation in detail, investigating ourselves to ascertain the true involvement of the company in question, the seriousness of allegations made and how the business is responding. This gives us the context with which we can engage with the company and we will then look to speak to senior management or non-executive directors as well as other interested parties such as non-governmental organisations (NGOs) or industry experts.

With this information, we are in a position to establish the impact of the controversy on our investment thesis (remembering that this includes the sustainability rating). The three possibilities are:

- i. The business no longer satisfies our criteria for a sustainable investment, so we exit the position.
- ii. The risk and quality of the investment is affected so we feel a smaller portfolio position is appropriate and therefore reduce our exposure. This would be reflected in a downgrading of our sustainability matrix rating.
- iii. The issue is being addressed by management sufficiently so that we can continue to hold our portfolio weighting while engaging with the company to ensure the situation is resolved.

To conclude, companies (much like the people they comprise) are not perfect, nor can our predictions about the future be flawless. We can use a disciplined process, however, to ensure we deal with the few controversies that do arise from time to time consistently and correctly. In this way, we can continue to deliver on the mandate of the SF funds for our clients



Case study: Kingspan

We have invested in Kingspan for more than 15 years and held the company in high regard for the quality of the products it sells, playing a key role in carbon reduction and the circular use of materials. Revelations from the Grenfell Tower Inquiry, however, have raised serious concerns about the culture and controls within the insulation business, which need to be taken seriously.

Based on what we learned, we decided to downgrade Kingspan's sustainability rating from A1 to A4 in December 2020. Such a downgrade means we view a company as higher risk and its weighting in our portfolios should be smaller.

Our team began questioning Kingspan the day after the tragedy in June 2017 and we have continued engaging about Grenfell in particular and the fire resistance of the company's products more generally. More recently, we requested a meeting with Kingspan's management to discuss more recent revelations, which we were eventually able to have in February 2021.

Our conclusion following these meetings is that Kingspan has accepted responsibility for the shortcomings in product fire certification and is not ducking the need to reform the governance and oversight of product assurance. The Grenfell Inquiry will run its course over the year and Kingspan has made its own representations to this, referring to unacceptable employee conduct at its UK insulation boards business and apologising unreservedly for historical process shortcomings.

Kingspan's reputation across all products has been tarnished and will take years to repair. However, it does appear this was an isolated incident of poor oversight and not systemic and the new measures put in place should ensure there can be no repeat. What it does point to is a dysfunctional fire safety control system in the UK – from building standards, testing, quality of workmanship and compliance with technical specifications of cladding systems.

This is a highly sensitive issue and we maintain a reduced holding as per option ii of the three outlined above. We will reserve judgement, however, until after the Inquiry concludes and we have been able to discuss the findings and recommendations with the company's management.

Final Thought: The post-growth challenge – confronting the new normal

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"Anyone who believes that exponential growth can go on forever in a finite world", said Kenneth Boulding, speaking to Congress in 1973, shortly after the Limits to Growth report was published, "Is either a madman or an economist."

It occurs to me that it helps to be one of those, or preferably both, if you are working in sustainable investment. It's not very kind to economists of course. But behind this remark lies an obvious truth: the fact that we live on a finite planet means there are environmental constraints on activity – most obviously climate change. We ignore those limits at our peril.

In the last couple of years, the climate debate has evolved rapidly. The Intergovernmental Panel on Climate Change's (IPCC) 2018 report on limiting global warming to 1.5 degrees has highlighted that there is a limited amount of carbon – to be precise less than 420 billion tonnes that we can burn between now and the end of the century if we want to keep the global temperature rise below 1.5 degrees.

Having done our own calculations, we found the 'fair carbon budget' for the UK until 2100 is 2.5 billion tonnes. Annual emissions currently stand at approximately 590 million tonnes a year so based on this, we have just five years left before the budget is exhausted. Based on these estimates, the speed at which we need to de-carbonise equates to a 14% annual reduction in carbon intensity over the next 30 years to get close to that net zero target.

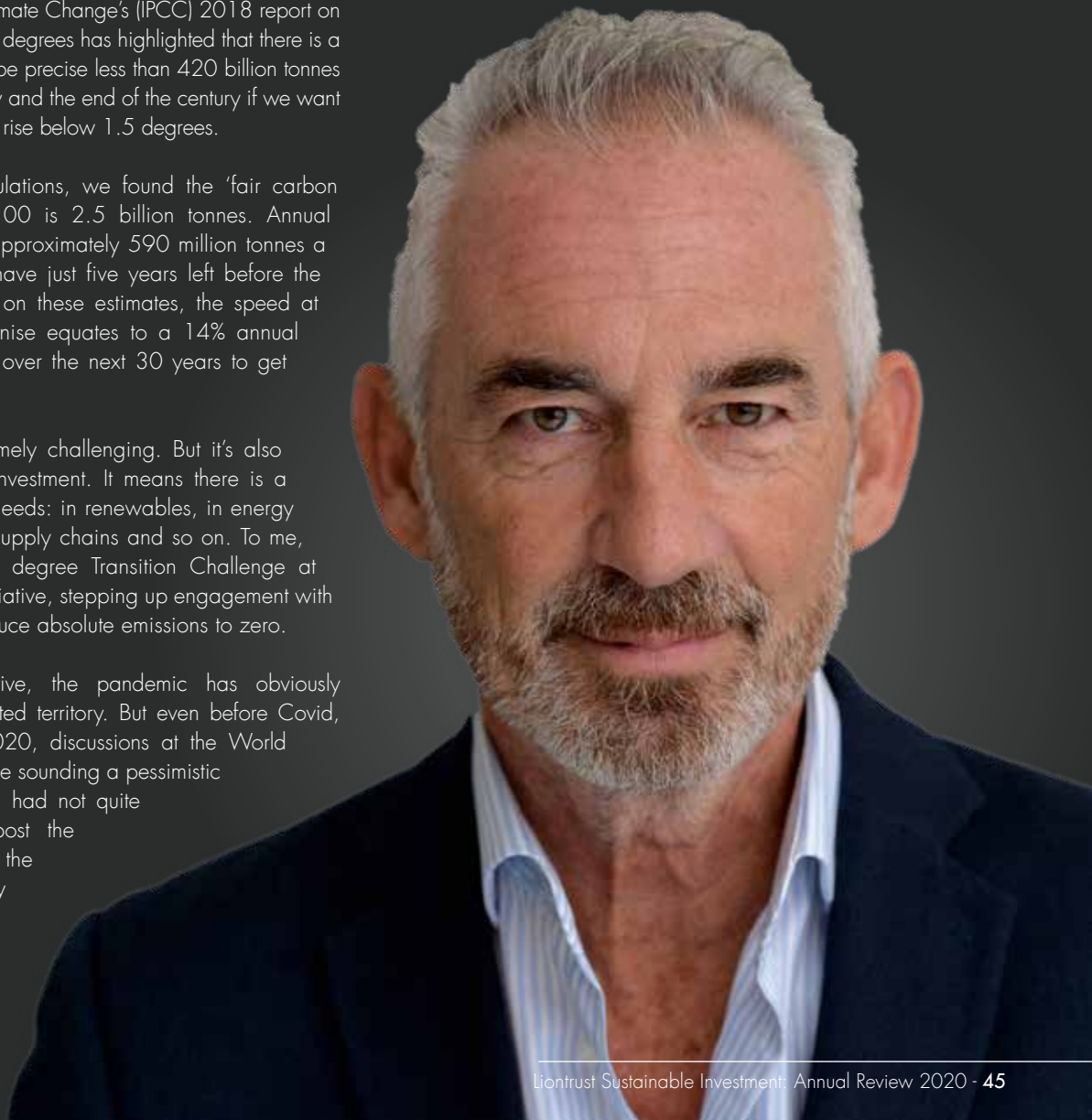
There's no doubt that's extremely challenging. But it's also good news for sustainable investment. It means there is a huge portfolio of investment needs: in renewables, in energy efficiency, in decarbonising supply chains and so on. To me, this is what makes the 1.5 degree Transition Challenge at Liontrust such an important initiative, stepping up engagement with companies to ensure they reduce absolute emissions to zero.

Taking a broader perspective, the pandemic has obviously thrown the world into uncharted territory. But even before Covid, way back at the start of 2020, discussions at the World Economic Forum in Davos were sounding a pessimistic note, with a sense the world had not quite weathered the conditions post the global financial crisis. In fact, the evidence tells a longer story still. Even before 2007, the advanced economies were experiencing secular stagnation.

Labour productivity growth across much of the world climbed consistently in the first half of the 20th Century, hitting a peak of 4% or 5% a year in the 1960s. At that point, something changed and there has been a slow but relentless descent ever since. Step changes such as the internet and AI were supposed to increase labour productivity but failed to stop its decline over the last four decades.

We might even say that, to some extent, the 2007-08 financial crisis was a result of policies that attempted to stimulate labour productivity growth by increasing liquidity in the economy, deregulating finance in ways that were unsuccessful and ultimately catastrophic. Since that time, productivity growth has declined even further and even before the pandemic struck, it had been negative in the UK for several quarters.

In other words, we are already effectively living in a post-growth society, irrespective of the pandemic. Long-term trends show a secular decline in both economic and labour productivity growth, and, against this backdrop of stagnation, we have to rethink what we are doing when it comes to investment.



One of the consequences of falling labour productivity growth, for a company or employer, is the impact it has on profit margins, which become progressively squeezed as the ability to reduce wage costs through productivity growth declines. In fact, this pressure on margins sets up an uncomfortable conflict between dividends and future investment possibilities. It also tends to squeeze wages and leads to growing inequality: the idea that wages are paid according to labour productivity began to disappear as soon as growth in the latter started to fall.

Economic growth was supposed to deliver a more equal society and, in certain periods, it did: between 1946 and 1980, the bottom 1% of earners achieved approximately 6% average annual growth in their income whereas the richest percentiles had below-average growth. Since 1980, however, that trend has dramatically reversed and the top 0.001% of earners now achieve that 6% annual growth while the poorest 5% have seen their wages not just stagnate but fall. This is a dangerous situation, leading to rising political tensions and a sense of being left behind among many communities.

Through this lens, the pandemic becomes a tale of two very different crises. The livelihoods of wage earners have become increasingly precarious. Unemployment has a tendency to grow precipitously during crises. It did so in 2008 and it did so again in 2020 during the early stages of the pandemic. More worrying is the fact that most predictions suggest we have not seen anywhere near the peak of unemployment that will come once furlough schemes and policies are withdrawn.

A somewhat different story is evident when looking at the S&P 500 over the same period. The financial crisis caused the Index to plummet followed by a slow return to growth. But during the pandemic, the blip in performance is hardly noticeable. There was a sharp decline early in 2020 but it was followed by an extraordinarily quick recovery. Clearly, this had a lot to do with the actions of the Federal Reserve in the US and central banks elsewhere, pumping enough money into the system to convince investors it is still worth trading on the stock market.

But comparing the S&P500 against unemployment over this period presents a worrying picture of stock markets no longer aligned with economic fundamentals. Governments are essentially pitting those who earn their income from investing in companies against those who work for those companies. The drive to protect share prices in an attempt to maintain market stability rewards shareholders but fails to protect workers.

This situation should force investment to interrogate its ultimate purpose: is it to protect the value of stocks despite declining economic fundamentals and the loss of livelihoods or is there another role it should be playing? How should we respond to the limits that a finite planet and a precarious pandemic have faced us with?

US author Wendell Berry wrote that 'human and earthly limits, properly understood, are not confinements, but rather inducements... to fullness of relationship and meaning'. What he is suggesting is that the current crisis provides an opportunity to think about what our economy is for.

This is something I have been considering for some time now. In a book called *Prosperity without Growth*, I attempted to tease apart the building blocks of the economy and ask these questions. Should enterprise really be about profit maximisation, making and selling products as fast as possible, or could it be conceived as the organisation of work to deliver the services people need to thrive?

This concept of enterprise as service-led is a fundamental one in the context of the pandemic. Over the last year, we have been given an object lesson in what matters in society; not mass production of consumer goods but healthcare, social care, distribution, retail, and efforts of frontline workers. And yet these are exactly the people whose working conditions have been systematically eroded under the economic fundamentals of the last decades.

Just as it is possible to reframe enterprise, and recognise the fundamental value of work, we must also reframe our vision for investment. We have to find avenues to invest in society in ways that protect the livelihoods of those most important to our quality of life, and that deliver the infrastructure for a net zero carbon economy.

One of the most fascinating avenues of possibility lies in bringing these two goals together. A sector such as social and personal services, for example, which includes many of those frontline workers who saved our lives during the pandemic, has high employment intensity and low carbon intensity. It represents a 'sweet spot' for sustainable investment that promises higher employment and lower impact on the planet.

It also makes the social purpose of investment much clearer: what we need to do, as far as possible, is move sectors with high carbon intensity onto a trajectory towards the employment and emissions profile of areas like social and personal services. This is a different kind of investment. Financial markets are no longer a gambling casino where a minority make returns from the market while the rest of the economy falters. Investment becomes a commitment to our common future.

These possibilities offer real hope for an economy that works for everyone. Beyond the privatisation of benefits and the socialisation of costs, lies an economy of care, craft and creativity, which can help the world recover from the pandemic.



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The image features a central globe with a low-poly, wireframe design, surrounded by a circular band of text listing 17 Sustainable Development Goals (SDGs). The globe is set against a background of a lion's head.

The SDGs listed in the circular band are:

- 1. No poverty
- 2. Zero hunger
- 3. Good health and well-being
- 4. Quality education
- 5. Gender equality
- 6. Clean water and sanitation
- 7. Affordable and clean energy
- 8. Decent work and economic growth
- 9. Industry, innovation and infrastructure
- 10. Reduced inequalities
- 11. Sustainable cities and communities
- 12. Responsible consumption and production
- 13. Climate action
- 14. Life below water
- 15. Life on land
- 16. Peace, justice and strong institutions
- 17. Partnerships for the goal

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