LIONTRUST

THE SUSTAINABLE FUTURE PROCESS

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Liontrust SF European Growth Fund: Q2 2022 review

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The Fund returned -17.7%% over the quarter, underperforming -8.7% from the MSCI Europe ex-UK Index and the -10.2% IA Europe ex-UK sector average (both of which are comparator benchmarks)*†.

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

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

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

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

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

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

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

Other solid performers included French payment company Edenred again, which we own under our *Improving the resource efficiency of industrial and agricultural processes* theme. Edenred's payment solutions bring efficiency and value for money for customers and it has benefited from an environment of higher inflation where companies are having to offer higher wages to attract and retain talent. This comes on the back of record

earnings and growth for 2021, with this cash generation allowing the business to strengthen its financial profile and pay out a higher dividend than before the pandemic, while also maintaining an ambitious M&A strategy.

Svenska Handelsbanken also held up well over the period, rewarding our long-term faith in this Swedish bank despite some weaker performance over the last five years. We visited the business several times last year and this reinforced our view of how well Svenska underlines its credit lending and the quality of its balance sheet. As a retail bank, it has been an obvious beneficiary of the higher interest rate environment and we continue to see this as an attractively valued financial play with a strong dividend.

We would also highlight a decent quarter from Qiagen and Grifols, held under our *Enabling innovation in healthcare and Providing affordable healthcare* themes respectively. Qiagen provides molecular diagnostics technologies for use in the clinical and life science sectors and shares rose as the company was able to increase its full-year 2022 net sales outlook to at least $2.12 billion over the quarter.

Grifols, meanwhile, announced what it called a strategic and transformational acquisition over the period, buying haematology and clinical immunology business Biotest. This deal is expected to expand its product portfolio, increase the availability of plasma therapies for patients, and drive revenue growth and margin expansion.

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

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

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

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

Our first buy was Sartorius Stedim, a leading German bioprocessing equipment and consumables manufacturer, with its products used by the pharmaceutical industry in the development and manufacture of ground-breaking treatments (biologics) including gene and cell therapy. Sartorius's equipment enables its customers to develop this next generation of healthcare in a cost-efficient, operationally flexible and environmentally friendly manner.

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

This trend is also the major driver behind our second purchase, Danish medical device company Ambu, which has developed the world's first single-use endoscopes. Ambu is a pioneer in the single-use space, particularly its bronchoscope (for examining the lungs), which has reached penetration rates of more than 30%. Reusable endoscopes are the incumbent devices today but carry the risk of infection, where dangerous bacteria can

seriously hurt and even kill patients. Single-use scopes are completely sterile by definition, removing the entirety of infection risk in endoscopy patients as well as traditional costs of reprocessing.

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

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

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

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

	Jun-22	Jun-21	Jun-20	Jun-19	Jun-18
Liontrust Sustainable Future European Growth 2 Acc	-24.5%	23.3%	14.0%	2.6%	2.5%
MSCI Europe ex UK	-10.6%	21.8%	0.0%	7.3%	1.8%
IA Europe Excluding UK	-12.6%	23.7%	0.9%	3.3%	3.1%
Quartile	4	2	1	3	3

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

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

Key Risks and Disclaimer

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