Liontrust Global Innovation Fund: December 2022 review

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The Liontrust Global Innovation Fund returned –7.0% over the quarter, compared with 1.9% from the MSCI World Index and 2.2% from the IA Global Equity sector (both comparator benchmarks).

Intuitive Surgical (+31%) was the top contributor to performance over the fourth quarter of the year. Best known for its da Vinci systems which introduced robotic assisted surgery to the world in 1999, the company continues to see growth in its installed base of systems and healthy procedure growth (growing at 20%), which drives further utlisation of its systems.

Despite the near monopoly the company has in robotic assisted technology (every 19.8 seconds a surgeon starts a procedure using a da Vinci system), the company is not sitting still. We were encouraged to see an inflection in recent innovations (such as an Ion endominal system to perform biopsys when cancer is suspected in the lung), with procedures and system placements both reaching their highest levels ever in the quarter as the company expands its offering. Given the underpenetrated nature of the robotics market generally (less than 5% penetrated globally) and Intuitive's near 20-year head start on peers, the company's scale and IP will provide a meaningful competitive advantage for years to come.

Another notable performer was Planet Fitness (+27%), the 'no fills' gym operator, which similarly posted excellent results. Planet Fitness is a disrupter in the purest sense of word: it has dramatically driven down the price of gym membership for many Americans (over 15 million and counting plus a small but growing number in Canada, Mexico and Australia) and has a business model that is almost impossible for the old guard to defend against. The average monthly gym membership subscription in the US is $50 and a high-end Equinox membership or the like will set you back $200-$250, while by stripping out everything but the basics from the cost structure, Planet Fitness's is just $10.

The beauty of driving down prices by as much as 80% is that is expands the overall market size and generates a lot of growth. Over three-quarters of Americans have never had a gym membership before and this section of the population is a big opportunity for Planet Fitness. As an over 90% franchised business, Planet Fitness runs a capital-light model with high and growing returns on capital as it scales. We see lots of growth potential ahead both in the US and perhaps more excitingly internationally given the simplicity of the concept which should transfer well in many other countries.

Strong performance also came from Moderna (+41%) with its personalised cancer vaccine clearing a pivotal trial and going some way to demonstrate the wider potential of the company's mRNA technology to be applied across therapy areas. Up until now, the company has been viewed as a 'Covid story', but this underestimates the longer term market opportunity - Covid vaccines will only constitute 15% mRNA industry revenues by 2035 (from 100% today).

The potential this brings to unlock efficiency gains is significant. Since the platform's technology is flexible, this provides accelerated R&D timelines for the company to enjoy and consumers to benefit from. For evidence, look no further than Moderna's flu and RSV vaccine candidates, which have gone from phase one to phase three in less than a year (traditionally this would have taken around four years). Key late-stage pipeline catalysts next quarter (including phase 3 readouts for both Flu and RSV) will be critical in establishing the company's reputation as a platform capable of driving multiple RNA drugs and are why we still see valuation upside to the shares.

On the other hand, new holding Tesla (-57%) was a key detractor to Fund performance over the quarter. Elon Musk's takeover of Twitter has negatively impacted sentiment, while macro headwinds have pressured delivery targets. A weak Chinese macro environment in particular took its toll on demand for electric vehicle sales, whilst there were signs that US consumers have been delaying placing orders until January 2023, when they can qualify for EV tax credits.

Long term, however, the company is well positioned to benefit from continued EV penetration globally given its dominant 65% market share position. We believe the company's manufacturing prowess is its most underappreciated competitive advantage, which enables it to command the highest operating margins of any automobile company by some degree. Innovation within the manufacturing process has, for instance, removed 75% of the robots required to make the die cast for the Model Y's car body. Such efficiencies reduce the cost structure of the business and enhance cash generation – free cashflow has climbed to an estimated $9billion in 2022, having inflected positive in 2019. With the company trading at its lowest valuation multiple since its IPO, we believe for the time being that a corporate governance discount is priced in, although are monitoring developments closely.

Silicon Valley Bank (-36%) was another lacklustre performer, in many ways epitomising the challenges of investing in innovation in 2022. The company is the lifeblood of the US innovation economy, banking nearly half of U.S. venture-backed technology and life science companies, so as these clients have experienced a period of higher cash burn, client fund net outflows have come under pressure.

That said, record client acquisition, strong loan growth and record PE/VC dry powder sitting on the side-lines ($2.5t) are all positive indicators of future business growth. Just as the company emerged stronger from the dotcom crash and the global financial crisis, we expect SVB to further entrench its unrivalled web of relationships with venture firms in Silicon Valley as we go through a period of market recalibration. The long-term tailwinds supporting the innovation economy remain firmly intact - the digital economy's share of GDP continues to climb - and the company's high-quality, liquid balance sheet has proven capable of weathering the ups and downs of previous market cycles.

Another detractor was communications software provider Twilio (-34%). A deteriorating macro-economic environment is having a greater impact than expected in the near-term for Twilio, with greater scrutiny over purchases given tighter customer budgets, yet the longer-term customer value proposition remains as compelling as ever – the company reduces communication costs for businesses by 90%. Twilio is a great example of a company that has invested heavily for growth over the past decade and has responded to a more challenging operating environment by pivoting its focus towards profitability. With a clear path to becoming a profitable business next year, our investment thesis remains unchanged.

Looking into next year, the key headwind for markets looks set to shift from inflation to slowing economic growth. In this tough operating environment, we believe the companies that will emerge as long-term winners will be high-quality innovative companies given their operational resilience, adaptability, superior growth and strong barriers to competition.

Discrete years' performance (%), to previous quarter-end:**

	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18
Liontrust Global Innovation C Acc GBP	-28.8%	12.1%	32.1%	18.3%	-2.7%
MSCI AC World	-8.1%	19.6%	12.7%	21.7%	-3.8%
IA Global	-11.1%	17.7%	15.3%	21.9%	-5.7%
Quartile	4	4	1	4	2

****Source: FE Analytics as at 31.12.22. Quartile generated on 06.01.23**

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

Key Risks

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

Investment in the Fund involves foreign currencies and may be subject to fluctuations in value due to movements in exchange rates. The Fund may invest in emerging markets/soft currencies or in financial derivative instruments, both of which may have the effect of increasing volatility.