THE SUSTAINABLE FUTURE PROCESS

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Liontrust SF European Growth Fund: Q4 2022 review

Fund managers: Martyn Jones and Peter Michaelis

The Fund returned 12.0% over the quarter, outperforming the 11.5% return from the MSCI Europe ex-UK Index and underperforming the 12.6% IA Europe ex-UK sector average (both of which are comparator benchmarks)*†.

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

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

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

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

Looking at the top performers over Q4, IT services management company Nagarro led the way after revising up their revenue and profit guidance for a fourth time. The company expects to grow revenues around 40% organically and constant currency.

Held under our *Improving industrial processes* theme, Nagarro's programmers help companies in all sectors modernise and digitise their operations – improving efficiency, customer experience, resilience and digital security. This helps their client to sales and profit growth. Nagarro's specialist IT engineers can focus on complex software programming, allowing its customers to focus on their core competencies, reduce fixed costs and be more competitive

Announcing strong Q3 results was Swedish investment platform Avanza Bank, which is held under our *Saving for the future* theme. Avanza is an investment platform helping people save for their retirement in a cost-effective manner. The company is particularly proactive on sustainable investment, where the default options are sustainable funds, with users having to opt out, meaning it has a very high proportion as compared to the market in sustainable funds. Despite a fall in the value of assets on the platform, and thus a fall in their platform fees, the company is now benefitting from higher interest rates which it earns on uninvested cash.

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

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

German chipmaker Infineon Technologies was among the top contributors, performing strongly after the announcement of its full-year earnings, most notably raising its expected average rate of revenue growth to above 10% from c.9%, with the company stating that growth will in particular be driven by electromobility, autonomous driving, renewable energies, data centres and IoT, such growth being accompanied by a significant improvement in profitability.

The company, which produces efficient power management chips and is exposed to our theme of *Improving the efficiency of energy* use, also provided a positive outlook, stating that decarbonisation and digitalisation are causing structurally increasing demand for semiconductors.

Among the detractors over the quarter was Basic-Fit, Europe's largest gym group which targets the low-cost end of the market at around €20 per month fee, and is exposed to our theme of *Enabling healthier lifestyles*. Despite a good recovery in their gym membership, the company is grappling with increased costs and concerns regarding the number of gyms they can open next year with a weak consumer environment. On a longer term basis, we believe the company is well placed to grow the market with a low cost and high return business model.

Bus operator National Express also softened on the potential for bus and rail strikes to disrupt services and raise costs. The company is already grappling with risings costs in its US operations due to a driver shortages. Exposed to our theme of Making transport more efficient or safer, National Express operates 27,000 buses and coaches in UK, Spain and Morocco; school buses in North America; and rail services in Germany. These mass transport solution are far more efficient than individual cars, leading to lower emissions, less congestion and improved safety. However, given the weakening fundamentals our position is under review.

Shares in Swiss healthcare giant Roche fell mid-quarter as the company's much awaited drug for Alzheimer's disease failed in a pair of large studies, with the experimental drug, *gantenerumab*, not slowing the clinical decline in people with Alzheimer's. Despite this disappointing news, Roche continues to create truly innovative therapies that help change the course of disease. In the short to medium term, this benefits western economies who pay for it while on patent, then in the medium to long term, it benefits more developing economies as patents roll off or are not enforced.

In terms of portfolio activity, we opened a position in Haleon, the consumer healthcare business formed by the combination of GlaxoSmithKline and Pfizer's consumer healthcare units. We believe the company demonstrates strong sustainability credentials, aiming to help individuals take responsibility for their health before reaching the healthcare system, with over-the-counter products such as vitamins, toothpaste and painkillers. We also feel the entity has a robust credit profile given its large scale and strong diversification by geography and product line, with a dominant position across several markets. It is highly cash generative, with resilient cash flows, which should be supportive of its deleveraging ambitions over the coming years.

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

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

	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18
Liontrust Sustainable Future European Growth 2 Acc	-27.7%	13.7%	24.3%	25.9%	-14.8%
MSCI Europe ex UK	-7.6%	16.7%	7.5%	20.0%	-9.9%
IA Europe Excluding UK	-9.0%	15.8%	10.3%	20.3%	-12.2%
Quartile	4	4	1	1	4

***** Source: FE Analytics, as at 31.12.22, 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