



## Liontrust SF Cautious Managed Fund: Q3 2023 review

Fund managers: Peter Michaelis and Simon Clements

**The Fund returned -2.2% over the quarter, versus the -0.2% IA Mixed Investment 40-85% Shares sector average (the comparator benchmark)\*.**

While capital markets have provided volatility for sustainable investors over the last two years, we believe the foundations of the key underlying sustainable themes we invest in remain very strong. The 20 sustainable investment themes that we have identified – which each in some way contribute to a cleaner, healthier and safer future – are in our view the strongest and most dependable long-term growth trends in the economy.

Our job is to think differently to the crowd by considering the longer term and focusing on understanding our companies. We aim to understand their prospects for future cashflow growth and how the market has misappreciated their potential over the long term. We want to harness the exponential effect of companies that can grow at a strong rate both now and 10 years from now as they innovate and solve sustainability issues.

Looking to the future, we see no reason why the powerful sustainable trends in which we have invested should not persist, and so look forward with great confidence.

The UK economy, while more resilient than many expected to rate rises and rising cost of living, continues to see a gradual slowdown, and our core thesis is that interest rate hikes will continue to bite as we move through the rest of the year. The US economy remains more buoyant, given inflation has receded and the benefit of an investment cycle in AI and infrastructure is already underway. That said, growth in the US economy should remain sub-trend through the rest of the year, and the risk of high rates for longer does still remain. The US stockmarket has been strong over 2023, and it trades on a significant premium to the UK market. In the fixed income market, credit spreads have tightened over the summer, and credit has performed well, particularly relative to gilts.

Our core economic view remains that the economy is slowing, and inflationary pressures will begin to abate in the UK over the second half of 2023. This leads to our current positioning relative to our central allocation: overweight credit; neutral equities and underweight government bonds. We maintain a reduced overweight to infrastructure. Within equities we have taken profits from our global ex-UK allocation and added to our UK equities position which stands out as being undervalued relative to the US and Europe.

The Fund's equity exposure of around 55% was a drag on performance over the quarter with a number of our stocks impacted by heightening volatility as the prospect of a sustained period of higher rates sank in. Our infrastructure allocation has also struggled recently. The asset class tends to provide important capital to the building of sustainable infrastructure to the global economy, such as wind and solar assets. However it has performed poorly in 2023. Despite most having inflation hedges in their cash flow streams, they have suffered alongside government bonds as interest rate expectations continue to trend upwards.

Our corporate bond allocation posted a gain as sterling corporate bond credit spreads remained relatively stable – a resilient performance considering the volatility in government bond markets. Corporate bonds were supported by a robust primary market, with year-to-date issuance levels higher than this time last year, and investors continued to flow into this asset class due to the attractive all-in yield levels.

Within the equity portfolio, **Alphabet** was the top performer after reporting second quarter revenue that exceeded analysts' expectations, boosted by the company's leadership position in AI, the continued performance of its Search division, which was aided by an increase in advertising, as well as strength in its Cloud division and strong revenue growth in its YouTube segment.

Exposed to our *Providing education* theme, Alphabet's largest business is the core Google search business. By indexing the world's information and providing it online for free to the majority of users, we believe Google provides clear benefits to society.

First quarter addition **Morningstar** was among the notable contributors for the quarter, performing strongly following the release of Q2 results. The quantitative and qualitative research company reported a revenue increase of 7.3% to \$505 million, commenting that there was solid growth in its license-based product areas.

Held under our *Saving for the future* theme, Morningstar provides both quantitative and qualitative research to the investment industry, with databases and analytical tools covering private markets, ESG, credit ratings, equity valuation, and more. On the client side, it provides software and investment management services to financial advisors and institutions.

The business is constantly trying to create new products or services that leverage existing expertise and thus create scale. For example, the investment management and model portfolio services it provides leverages the extensive equity, credit, ESG, and even private market research that it already has underneath its roof.

Accounting software provider **Intuit** was another notable performer after unveiling a solid set of Q4 results, showing 12% revenue growth to \$2.7bn, driven by a 21% expansion in its Small Business and Self-Employed division (to \$2.1bn). Its 2024 guidance forecasts a similar revenue growth rate of 11% to 12%, again fuelled by the Small Business and Self-Employed unit.

Held under our *Increasing financial resilience* theme, Intuit provides accounting software to individuals, small businesses and the self-employed, helping them manage their money, reduce their debt and file taxes. Financial resilience is crucial to 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. Small and medium sized businesses drive sustainable economic growth through innovation and creating jobs. We believe companies like Intuit that empower SMEs and individuals to operate more effectively are contributing to a more resilient financial system.

Turning to the detractors, shares in **Masimo**, the maker of pulse oximeters and other patient monitoring equipment, fell sharply after announcing preliminary second quarter results that were below average estimates following weaker performance in its healthcare segment, driven by delays in large orders from hospitals.

Exposed to our *Providing affordable healthcare* theme, Masimo's core product is pulse oximetry sensors. These enable patient's vital signs to be monitored. These in turn are connected to either a fixed or remote monitoring machine or device to communicate and display those signs to medical professionals.

**Illumina** was also a detractor. The company continues its slide after a tough few months, after pressure from activist investor Carl Icahn prompted CEO Francis DeSouza to step down. Held under our *Enabling innovation in healthcare* theme, Illumina provides technologies that enable our understanding of the genome. This has great implications for our understanding and treatment of disease, as well as much wider applications such as agriculture.

Signs of slowing growth in **Adyen's** interim results led to a sharp de-rating of the shares. Net revenues of €739m, while up 23% year-on-year, fell well short of consensus expectations of €777m. Adyen's management

commented that the moderation in growth had come about as a result of high inflation and interest rates and the knock-on impact this had on US digital clients, who shifted focus from growth to cost savings. We continue to believe that Ayden will rapidly expand its market share within a structurally growing market, and we admire the constant innovation into useful, high value add, adjacencies for customers such as omni-channel platform services, and financing for customers.

In terms of portfolio activity, we initiated a new position in leading Human Capital Management (HCM) software provider **Paylocity**. Exposed to our *Increasing financial* resilience theme, Paylocity's products enable its customers, which are primarily small businesses, to manage the increasingly complex demands of managing its employees. We believe HCM is key to the strength and resilience of SMEs as incorrect payroll and incorrect taxes have high costs when they are not processed correctly. The importance of the ensuring your workforce is engaged in a hybrid work environment places further importance on HCM within the workplace.

We also opened a position in British engineering group **Spirax-Sarco Engineering** under our *Improving the resource efficiency of industrial and agricultural processes* theme. Spirax's steam systems dramatically improve the resource efficiency of chemical and industrial plants, estimating that it saves its customers 18.2mt CO2e per annum.

In terms of sells, we exited our position in **Crest Nicholson**, a leading UK house builder, with excellent sustainability credentials built into every home, and a long-term holding. Unfortunately, there has been some management mis-steps and changes over the past few years and we believe the UK housing recovery could take longer than anticipated. With these concerns, we have decided there are better opportunities in other areas of the portfolio.

We also sold Identity verification and fraud protection specialist **GB Group**. Despite strong structural demand, GB Group's management team made an expensive acquisition linked to cyber security in cryptocurrencies in what transpired to be the height of the crypto boom. This lack of discipline around capital allocation causes us to lose faith that management are careful custodians of our client's capital – we decided to exit our position over the period.

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

	Sep-23	Sep-22	Sep-21	Sep-20	Sep-19
Liontrust Sustainable Future Cautious Managed 2 Inc	2.2%	-19.3%	15.0%	8.8%	8.4%
IA Mixed Investment 40-85% Shares	5.1%	-10.2%	16.6%	-0.2%	4.2%
Quartile	4	4	3	1	1

\*Source: FE Analytics, as at 30.09.23, total return, net of fees and income & interest reinvested.

\*\*Source: FE Analytics, as at 30.09.23, primary share class, total return, net of fees and income & interest reinvested.

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

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## Key Risks

**Past performance does not predict future returns. You may get back less than you originally invested.**

We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

- All investments will be expected to conform to our social and environmental criteria.
- Overseas investments may carry a higher currency risk. They are valued by reference to their local currency which may move up or down when compared to the currency of the Fund.
- Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result;
- The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay.
- The Fund may encounter liquidity constraints from time to time. The spread between the price you buy and sell shares will reflect the less liquid nature of the underlying holdings.
- Outside of normal conditions, the Fund may hold higher levels of cash which may be deposited with several credit counterparties (e.g. international banks). A credit risk arises should one or more of these counterparties be unable to return the deposited cash.
- Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

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.

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