

Global Innovation

Liontrust Global Innovation Fund: Q3 2023 review



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The Liontrust Global Innovation Fund returned -4.9% in Q3, behind the IA Global Equity sector average of -1.0% and the MSCI All-Country World Index return of 0.6%. Year-to-date, the Fund has returned 13.2% ahead of both the IA Global Equity sector average of 5.5% and MSCI All-Country World Index return of 8.5%.

The Fund remained more robust in Q3 than we expected as there was a parabolic upward move in longer-term interest rate expectations. In particular, the US 20-year yield moved from 4.1% at the end of June to above 5.2% at the close of the quarter.

Importantly, many companies' fundamentals are improving after a difficult 2022 and the market is starting to reward this improvement rather than aggressively reacting to moves in longer-dated interest rates.

In this update, we will focus on the major contributors and detractors to returns over this period. The contributors include Eli Lilly (+28%), PDD Holdings (+33%) and Atlassian (+25%), while the detractors include Estee Lauder (-23%) and Adyen (-55%).

Eli Lilly's stock price surged after reporting its experimental drug helped patients lose about 26% of their weight on average following extended use and combined with intensive lifestyle changes. It's the highest weight reduction seen in a late-stage clinical trial to date, the company said. The injectable drug *Tirzepatide*, otherwise known as *Mounjaro*, alone resulted in up to 22.5% weight loss in a previous phase three trial.

The data further bolsters Eli Lilly's position in the budding weight-loss drug market and establishes the company as a formidable competitor to Novo Nordisk, the Danish manufacturer of the blockbuster *Ozempic* and *Wegovy* treatments.

One trial, called Surmoun-4, evaluated more than 600 people over two periods. Patients took Mounjaro for 35 weeks and achieved 21% weight loss on average. Those who continued Mounjaro lost an additional 6.7% of their body weight on average after 52 weeks. Patients who switched to a placebo regained 14.8% of their weight on average over the same period.

The findings of the trial “reinforce that obesity should be regarded like other chronic diseases where chronic therapy may be needed to maintain treatment benefits,” Dr Jeff Emmick, Eli Lilly’s senior vice president of product development, said in a statement.

Preliminary evidence suggests that Mounjaro and Wegovy could also treat heart disease and sleep apnoea, bolstering the case for these two weight loss drugs to become the first ever super drugs.

PDD Holdings (+33%), owner of leading e-commerce company Pinduoduo, continues to execute across its two strategic priorities; firstly, to drive profitable growth and secondly to expand internationally. After many years of unprofitable growth, Pinduoduo pivoted in 2021 to focus on driving cost efficiencies and profitable growth.

The company’s success in this pivot to profitability is matched by its integrational expansion progress. The company has launched Temu, an online e-commerce platform, across developed markets and is gaining significant market share by focusing on offering customers the lowest possible price.

Temu matches buyers and sellers at prices that competitors including Amazon and other cut-price retailers cannot match. The catch is that it often takes several weeks for the goods to be shipped directly from the manufacturer in China. Most of the goods are below \$10 and many are below \$1.

The company has positioned itself as a traditional low-cost disruptor which we expect over time to move up the stack and compete with Amazon.

Conversely, **Estee Lauder** (-23%) was one of the key detractors of Fund performance in the quarter. The company continued to lag in a difficult operating backdrop, exacerbated by two key factors: 1) travel retail has remained woeful; and 2) the company has higher exposure to (Covid-impacted) China relative to peers.

The combination of these factors created the perfect storm for the company, which has historically seen Asia travel retail as a key driver of performance. In particular, inventory visibility in Hainan (a key pinch-point for the company in travel retail) has been incredibly poor, leading management to take remedial steps including making significant investments to support retailers and improve supply chain efficiency.

We continue to view this as a business cycle correction following a period of extreme growth, and see Estee’s long-term investment case still intact. Importantly, the company continues to take share in prestige beauty outside of China, driving the +10% organic sales growth for the business when excluding travel retail.

This is a continuation of the dynamic that drove the share price lower in the first half of 2023 but we starting to see green shoots in recent Chinese consumer data points.

Adyen (-55%) fell after issuing a cautious business update. Management highlighted the deterioration in North American competitive dynamics where enterprise business prioritised cost optimisation, while competition for digital volumes in the region provided savings over functionality.

These dynamics are not new, and online volumes are the easiest to transition back and forth but PayPal’s Braintree product is taking market share against Adyen as PayPal positions its offering as a loss-leader.

Beyond these dynamics, another factor that impacted Adyen’s growth over the last three years was the company’s inability to hire enough top-quality talent, so the company has ramped up investment to meet the growing demand on infrastructure and increased priority on new product launches for North American customers.

In the first half of the year, Adyen added 551 staff to take the team to a total of 3,883. Of the new joiners, a majority (75%) sat in technology roles developing both young and more mature initiatives that power its global platform customer base. The combination of a deceleration in growth combined with heavy investment resulted in the stock price collapse.

While an increase in competitive intensity in key markets is far from ideal, PayPal’s Braintree pricing strategy in the US is not sustainable and we expect Adyen’s superior customer value proposition to customers to win longer term but expect the shorter-term market dynamics to worsen before turning as macroeconomic headwinds ease.

Elsewhere in the Fund, **Atlassian** (+25%) continues to make progress away from growth-at-any-cost to a focus on efficiencies. This Australian company which sells cloud-based collaboration software to software developers is far from a household name, yet you would have been touched by the company’s productivity solutions.

If you have been on a Zoom call, you have experienced Atlassian – it is Zoom’s go-to-tool for software development and technical project management. If you use Slack to communicate in your workplace, it is Atlassian that helps to power a frictionless experience through its IT service ticketing solutions.

The athletes among us using Strava benefit unwittingly from Atlassian’s ticketing resolutions, while the non-athletes gain equal pleasure through Atlassian’s developer tools that help Domino’s deliver pizza and technology faster.

Crucially, the Atlassian innovation machine has not been sacrificed at the altar of cost efficiencies. When we talk of companies focusing on the core and pivoting to profitability, we want to see the preservation of innovation that fuels their customer growth – companies who can achieve similar growth outcomes with the same customer value proposition just at lower cost.

While senior management’s bonuses have been axed, R&D budgets have not. Atlassian is spending over 50% of its revenues on R&D, proportionately almost double its peers who instead spend twice as much on sales and marketing.

The company is turning on the cash generation machine as it pivots to profitability and evidence of this transition provides support for Atlassian’s stock price as it recovers from a difficult 2022.

As we look forward, we remain positive about the outlook for the innovative companies we invest in, with stock prices still significantly below 2021 levels and fundamentals improving. We are finding significant value across our watchlist where companies who have pivoted to profitability and are now starting to re-accelerate growth.

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

	Sep-23	Sep-22	Sep-21	Sep-20	Sep-19
Liontrust Global Innovation C Acc GBP	5.3%	-24.3%	19.5%	29.9%	2.0%
MSCI AC World	10.5%	-4.2%	22.2%	5.3%	7.3%
IA Global	7.8%	-8.9%	23.2%	7.2%	6.0%
Quartile	3	4	3	1	4

**Source: FE Analytics as at 30.09.23. Quartile generated on 06.10.23

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

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.

The Funds managed by the Global Innovation Team:

- May hold overseas investments that 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 a Fund.
- May have a concentrated portfolio, i.e. hold a limited number of investments. If one of these investments falls in value this can have a greater impact on a Fund's value than if it held a larger number of investments.
- 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, 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.
- May be exposed to Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.
- Do not guarantee a level of income.

The risks detailed above are reflective of the full range of Funds managed by the Global Innovation Team and not all of the risks listed are applicable to each individual Fund. For the risks associated with an individual Fund, please refer to its Key Investor Information Document (KIID)/PRIIP KID.

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