

ECONOMIC ADVANTAGE

PROCESS

An investment process for UK growth portfolios managed by Anthony Cross, Julian Fosh, Victoria Stevens and Matt Tonge



Fund name	IA Sector	Index	Fund type
Liontrust Special Situations Fund	UK All Companies	FTSE All Share Index	UK Unit Trust (UCITS)
Liontrust UK Growth Fund	UK All Companies	FTSE All Share Index	UK Unit Trust (UCITS)
Liontrust UK Micro Cap Fund	Smaller Companies	FTSE Small Cap ex-ITs Index	UK Unit Trust (UCITS)
Liontrust UK Smaller Companies Fund	Smaller Companies	FTSE All Share Index	UK Unit Trust (UCITS)
Liontrust GF Special Situations Fund	N/A	FTSE All Share Index	Irish OEIC (UCITS)
Liontrust GF UK Growth Fund	N/A	N/A	Irish OEIC (UCITS)



Investment philosophy

A fundamental principle of competitive markets is that profits regress to the mean. We believe that the secret to successful investing is to identify those few companies that have a durable Economic Advantage that allows them to defy this principle and sustain a higher than average level of profitability for longer than expected. This surprises the market, and leads to strong share price appreciation.

Economic Advantage is the collection of distinctive characteristics of a company that competitors struggle to reproduce, even if those competitors have understood the benefits arising from those characteristics. In our experience, the hardest to replicate of these particular characteristics fall into the following three categories of intangible assets:

1. Intellectual property
2. Strong distribution channels
3. Significant recurring business

Other less powerful but nonetheless important intangible strengths include: franchises and licenses; good customer databases and relationships; effective procedures and formats; strong brands and company culture. It is our key belief, backed by our years of experience exploiting Economic Advantage, that only distinctive and hard to replicate intangible assets can form the basis of a sustainable competitive advantage. These assets deliver pricing power, protect margins, and thus drive sustained profitability. The market rewards excess profitability, particularly when it is higher than consensus expectations.

Investment process

Evaluation of Economic Advantage

We evaluate companies in the UK stock market for their possession of durable Economic Advantage. Companies must possess at least one of the main advantages: intellectual property, strong distribution or recurring business (at least 70% of annual turnover). We believe that investing only in these companies gives us a high chance of finding companies with the ability to deliver sustained earnings growth and long-term outperformance.

Companies with the strongest Economic Advantage from the stock market capitalisation ranges for each of our portfolios form our respective investment universes. Whilst we focus on companies that should be able to grow over the long term, economic cycles will often interrupt smooth profits and share price growth. This can create opportunities to buy growth companies that are being overlooked by the market, and therefore mispriced. If these companies can then surprise the market with their profits growth, they can deliver unusually good share price returns.

Searching for surprise in companies with Economic Advantage

We measure our universe of Economic Advantage companies for the market's appreciation of their potential earnings growth. Under-appreciated companies have the strongest potential for share price growth. Companies can be under-appreciated on three different measures: surprising earnings growth, under-estimation of future recovery in earnings and re-rating of highly profitable companies.

The Portfolios

Investing in our universe of competitive companies

We measure the respective universe of Economic Advantage stocks for each of our portfolios and select those with the strongest combination of Economic Advantage and under-appreciated potential for earnings growth. We believe these stocks have the greatest potential to reward you with higher than average share price growth.

These measures help us understand and review an individual company on the basis of different trends in the market. The relative importance of the three measures, and the degree to which they are rewarded by the market, varies in different market conditions. We look for changes in the shape and composition of the measures to guide portfolio changes at different stages of the economic cycle.

The investment portfolio for each Fund is constructed from the stocks with the most compelling Economic Advantage taking into account the prevailing economic conditions. Each company is then graded for risk, using our separate risk assessment criteria:

1. **Financial risk:** Balance sheet and accounting risk, capital requirements and financial gearing
2. **Industry risk:** Margin pressure, product and customer spread, maturity of market

Companies are given a portfolio weight in accordance with their risk grade. Only the most established, robust business will be invested at the full overweight position for the respective Funds.

Employee motivation in smaller companies

Economic Advantage in smaller companies is created and maintained by talented individuals. Research demonstrates equity ownership motivates key employees, helps to secure a company's competitive edge and leads to better corporate performance.

- Equity ownership aligns the interests of employees with outside shareholders
- An 'owner-manager' culture creates a more conservative attitude towards acquisitions and gearing

Every smaller company held in the portfolios has at least 3% of its equity held by main board directors. Companies are also

assessed for employee ownership below the board. Changes in equity ownership are monitored. Although the requirement for high directors' equity ownership is confined to smaller companies (due to the lower levels of directors' ownership in mid and large companies), close attention is paid to changes in directors' ownership across all companies.

Summary: We believe the process outlined can identify competitive companies most likely to deliver surprising growth in a variety of market conditions. We know that the market rewards surprising growth with long-term share price appreciation. Our experience in identifying companies with strong Economic Advantage and our measures for identifying companies able to grow their earnings in different market conditions give us complete confidence in delivering excellent portfolio performance.

Economic Advantage:
applies to all Funds

Market Capitalisation: key differentiator

Risk Appetite: volatility versus returns

UK EQUITIES	<p>Large Cap. (FTSE 100)</p>	<p>Liontrust UK Growth Fund /Liontrust GF UK Growth Fund</p> <ul style="list-style-type: none"> • Economic Advantage companies from throughout the FTSE All-Share Index. • Approximately 90% invested in FTSE 100 and Mid 250 Indices. • Overweight positions versus the FTSE All-Share of 1-2% as per company risk grades. • If appropriate, to ensure a balanced portfolio, the Fund can invest in other under-represented sectors that exhibit particularly strong Economic Advantage and low risk characteristics. 	<p>Liontrust Special Situations Fund/Liontrust GF Special Situations Fund</p> <ul style="list-style-type: none"> • Flexible blend of companies from throughout UK stock market indices. • Minimum 3% directors' equity ownership in all smaller companies. • Portfolio weightings of 1,2,3% as per company risk grades - maximum 4% • The Fund has no limits on sector exposure in comparison to the FTSE All-Share Index. Its concentrated number of holdings could mean that its sector representation does not closely mirror that of the Index.
	<p>Mid Cap. (FTSE 250)</p>		
	<p>Small Cap. (FTSE Small Cap./Alternative Investment Market (AIM))</p>	<p>Liontrust UK Smaller Companies Fund</p> <ul style="list-style-type: none"> • Economic Advantage companies from throughout the FTSE Small Cap., Fledgling and AIM Indices • Minimum 3% directors' equity ownership • Portfolio weightings of 1,2,3% as per company risk grades – maximum of 4% 	
	<p>Micro Cap. (FTSE Fledgling /Alternative Investment Market (AIM))</p>	<p>Liontrust UK Micro Cap Fund</p> <ul style="list-style-type: none"> • Economic Advantage companies with a capitalisation of under £150m at purchase • Fund looks to exit holdings if market capitalisation exceeds £250m • Minimum 3% directors' equity ownership • Portfolio weightings of 1,2,3% as per company risk grades – maximum of 4%. 	

Liontrust Fund Partners LLP, 2 Savoy Court, London WC2R 0EZ

Client Services: +44(0)20 7412 1777

Email: clientservices@liontrust.co.uk

Website: www.liontrust.co.uk



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