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SUSTAINABLE FUTURE INVESTMENT PROCESS

SF Equity Funds
An investment process for the Liontrust Sustainable Future Equity Funds

Philosophy

Our Sustainable Investment process is based on a core belief that sustainable companies have better growth and are more resilient than the market gives them credit for. We use this underappreciated advantage as we look to deliver outperformance across equity, bond and managed portfolios and, in supporting these sustainable companies, we can also accelerate environmental and social improvements.

We are ultimately looking to invest in the economy of the future and to do that, we have identified 21 sustainable themes that are contributing in different ways to creating a cleaner, healthier and safer planet. We use these themes to highlight companies on the right side of the transition to a more sustainable world but this focus on positive trends also naturally excludes areas we believe are harming the planet or its people, from fossil fuels to tobacco, arms, and gambling (for more on this, see our screening documents at https://liontrust.co.uk/sustainable).

On the positive side, we look to invest in businesses proactively managing their interactions with society and the environment. We want to own companies with leading processes in place to manage the issues key to their business; this will depend on the industry in question but includes areas such as customer relationships, employee satisfaction and retention, and supply chains, as well as energy efficiency, waste reduction and material recycling. We have long believed outperformance on social and environmental issues will deliver more resilient businesses over the long term.

Over two decades on the Sustainable Future Funds, our focus on businesses making the global economy cleaner, healthier or safer have been successful because these companies are providing goods or services that society needs. The best investments have been in companies doing this better than their competitors and reinvesting excess returns to deliver future growth.

Ultimately, we believe companies exposed to our 21 themes that are also managing the environmental, social and governance (ESG) aspects of their business well are likely to see stronger and more persistent performance than those that are not, allowing us to identify and invest in structural growth whatever the economic background.

Our belief is that identifying these themes and selecting exposed companies can make for both attractive and sustainable investments; well-run businesses whose products and operations capitalise on transformative change are well placed to benefit financially. Our process therefore comprises two core stages, identifying superior stocks (that meet our four criteria) and building resilient portfolios from these.

Identifying superior stocks

01 Thematic analysis

Identifies companies with strong and dependable growth prospects due to alignment with our themes

02 Sustainability analysis

Focuses on those companies with excellent management and core products or services that contribute to society or the environment

03 Analysis of business fundamentals

Selects only those companies positioned to deliver high returns on equity

04 Valuation analysis

Determining that the shares of the company will be worth significantly more in the future

1. Thematic analysis

We work to better understand the big sustainable trends that are happening and analyse these themes to check which companies will be potential winners or losers from major multi-decade changes in different parts of our economy. Why is this relevant to investors? This helps us identify potential areas of the economy and companies that will experience structural growth and helps inform our investment decision and give us conviction in the businesses we own. We feel most investors underestimate the speed, scale and persistency of such trends within our economy.

We therefore look at the world through the prism of three mega trends, Better resource efficiency (cleaner), Improved health (healthier) and Greater safety and resilience (safer), and 21 themes within these.

- **Cleaner:** Using our resources more efficiently (water, increasing recycling of waste, lower carbon energy sources and energy efficiency)
- **Healthier:** Improving our quality of life through better education, healthier lifestyles and diet or better healthcare
- **Safer:** Making the systems we rely on safer or more resilient. This includes car safety, keeping our online data safe with cyber-security and spreading risk through appropriate insurance mechanisms.

While these themes are at the heart of our idea generation, there are three further criteria all companies have to satisfy.

Cleaner: better resource efficiency	Healthier: improved health	Safer: greater safety and resilience
Improving the efficiency of energy use	Providing affordable healthcare	Increasing financial resilience
Improving the management of water	Connecting people	Saving for the future
Increasing electricity generation from renewable sources	Delivering healthier foods	Insuring a sustainable economy
Improving the resource efficiency of industrial and agricultural processes	Building better cities	Leading ESG management
Delivering a circular materials economy	Providing education	Improving transport safety
Making transportation more efficient	Enabling innovation in healthcare	Enhancing digital security
	Enabling healthier lifestyles	Better monitoring of supply chains and quality control
	Encouraging sustainable leisure	

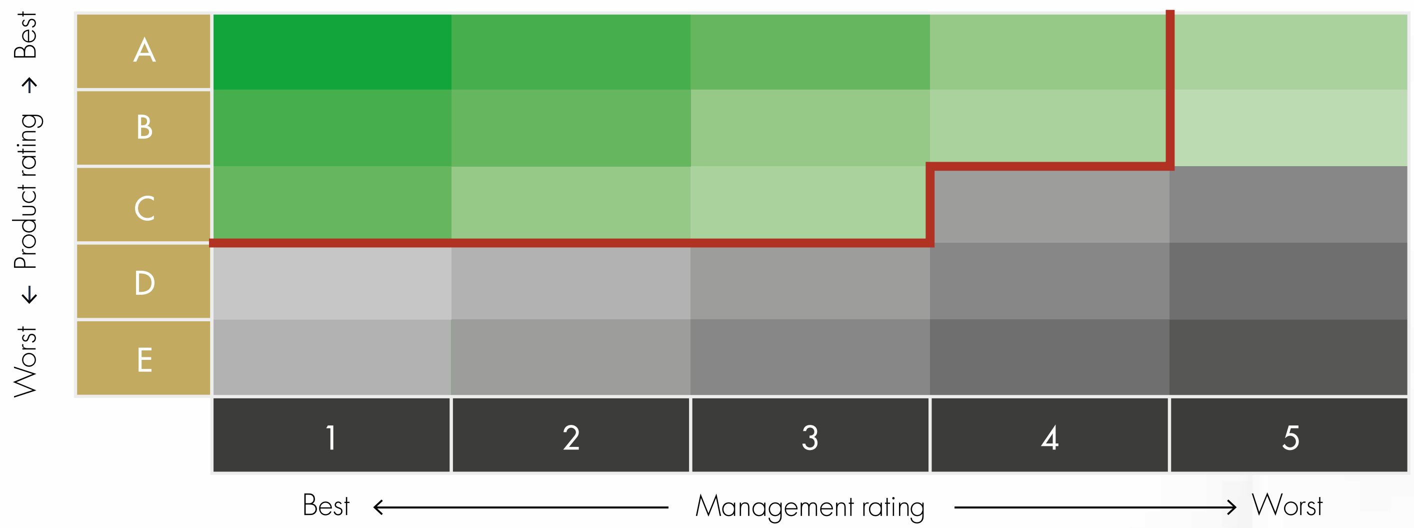
2. Sustainability analysis

While a company might have significant exposure to a theme, we also have to check how sustainable the rest of its activities are. For each business, we determine the key ESG factors that are important indicators of future success and assess how well these are managed via our proprietary Sustainability Matrix.

Every company held in the portfolio is given a Matrix rating, which analyses the following aspects:

- **Product sustainability (rated from A to E):** Assesses the extent to which a company's core business helps or harms society and/or the environment. An A rating indicates a company whose products or services contribute to sustainable development (via our investment themes); an E rating indicates a company whose core business is in a conflict with sustainable development (such as tobacco or very polluting activities such as coal fired electricity generation).
- **Management quality (rated from 1 to 5):** Assesses whether a company has appropriate structures, policies and practices in place for managing its ESG risks and impacts. Management quality in relation to the risks and opportunities represented by potentially material ESG issues are graded from 1 (excellent) to 5 (very poor).

Companies must score C3 or higher to be considered for inclusion in our funds.



3 & 4. Business fundamentals and valuation analysis

Companies in which we invest have robust business fundamentals with a proven ability to deliver high returns on equity (RoE) through sustaining margins and asset turnover. Typically, these companies have a maintainable competitive advantage through scale, technology or business model. For any stock our portfolios, we would expect to find the following:

We then predict the likely sales, earnings and other financial returns we expect to see from these companies over the next three to five years, integrating our view of their quality into these. Applying the relevant valuation multiple allows us to derive a price target achievable in the next three years. When this shows significant upside (we typically look for greater than a 10% return per annum), the investment is recommended as a buy and available to be included in our funds.

A) Growth: theme driven

- Growing addressable market
- Market Share gainers
- Structural tailwinds

B) Resilient returns: high quality companies

- High barriers to entry
- Aligned management team
- Sustainable competitive advantages

C) Quality of earnings: resilient, dependable

- Recurring revenues
- Cash flow conversion

Building resilient portfolios

From the superior stocks identified, we build portfolios combining the best 40 to 60 names to diversify risk and reduce volatility of returns. This results in exposure across a wide variety of industry sectors (via a spread of our sustainable themes) and benefits from potentially distinct and uncorrelated growth drivers. Outperformance will come from the stocks we choose, while disciplined portfolio construction aims to minimise the volatility of returns.

We have low turnover in our portfolios, with holding periods typically greater than five years. Apart from continual monitoring of relevant news, research and price movements, there are also annual reviews of every position's investment thesis.

We prefer to sell a stock when it reaches a valuation where we cannot see further upside and the case for selling and recycling it into an investment with greater return prospects is compelling. The alternative case is when the future does not turn out quite as envisaged and events reveal a side to the company or sector we did not anticipate. Where this negates the original investment thesis, we will sell the stock.

We will not formulate new reasons to hold on to an underperforming investment. Although selling is sometimes necessary, we look through short-term fluctuations in markets or share prices and focus on the long-term investment horizon. The depth and rigour of our research gives us the confidence to stand firm if the fundamentals are strong, even when the market moves against us.

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Key Risks: Past performance is not a guide to future performance. Do remember that the value of an investment and the income generated from them can fall as well as rise and is not guaranteed, therefore, you may not get back the amount originally invested and potentially risk total loss of capital. 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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