

# SUSTAINABLE FUTURE INVESTMENT PROCESS

## Fixed Income

An investment process for the Liontrust Sustainable Future Fixed Income Funds

## Philosophy

In managing corporate bonds, we invest in a focused portfolio of bonds that are attractively valued and also take into consideration environmental, social and governance (ESG) factors by investing in companies that manage these exposures to minimise risk.

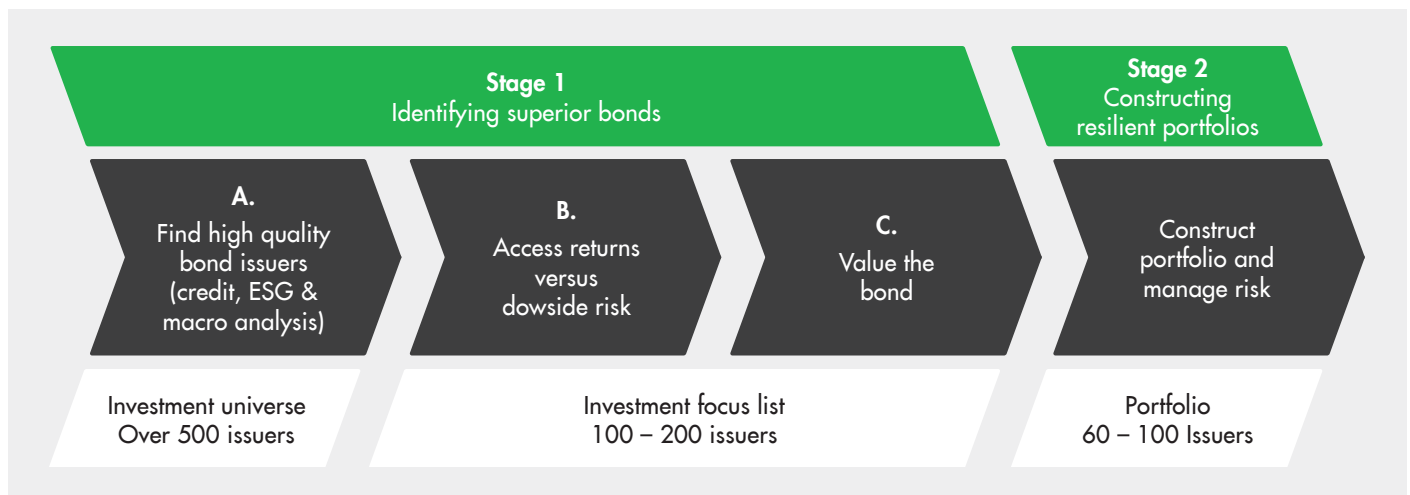
We aim to deliver strong outperformance for our clients. As active managers, we believe in a high conviction approach to ensure we develop a thorough understanding of our portfolio and the factors that influence its long-term value.

## Investing for a cleaner, healthier and safer world: our approach

Within the fixed income team, individuals specialise in their areas of expertise with a focus on generating investment ideas and recommendations for their particular segment of the market. All investment decisions are discussed by the team in a structured way, ensuring that our process is rigorous and replicable. We also benefit from being part of a single wider investment team, combining both bond and equity investing.

We use a modern investment framework that we have developed and honed over years of successful investing for our clients. There are two main stages to this:

1. Identifying superior bonds
2. Constructing resilient portfolios



## Stage 1: Identifying superior bonds

First we select the bonds that we believe will generate superior investment performance. We focus on high-quality issuers and believe this can enable us to reduce bond specific risk.

### A. Finding high-quality companies

Our assessment of quality is a distinctive part of our process. We combine credit analysis with in depth analysis of issuer specific factors, including ESG factors and macroeconomic analysis. Our in-house research includes the following:

### ESG analysis

For each company, we determine the key environmental, social and governance factors that are important indicators of future success, and assess how these are managed. We do this through our proprietary sustainability matrix [See Fig.1], which is used by both our bond and equity teams.

Where relevant, we aim to identify companies whose core products or services are making a positive contribution to society or the environment in some way. We believe that evidence of excellent company management is instrumental in avoiding issues where tail risk is under-priced. Reducing tail risk is a key element that drives long-term returns in our bond portfolios.

## Credit analysis

This involves a fundamental review of the company to identify its ability to meet its debt obligations. We look at:

- The company's management, in terms of its track record, its consistency, level of cross involvement, level of control exercised and make up of non-executives
- Company performance, from earnings stability to growth patterns to relative performance and pricing power
- The business strategy, such as its investment strategy, funding and FX policy, type of growth (e.g. M&A versus organic) and the business risk
- Industry factors, including the barriers to entry, what its capped rating would be as well as industry threats and patterns

## Macroeconomic analysis

Here we formulate strategy by looking at the interest rate positioning, asset allocation and aggregate credit rating exposure based on macro views. This approach ensures that the investment process remains balanced, incorporating top-down views as well as bottom-up analysis.

We also incorporate other macro influences in our analysis, including political factors, economic analysis, regulatory issues and ESG analysis. For government bonds, this involves a review of the sovereign from an ESG perspective in order to assess its suitability for investment. MSCI Sovereign rating data is used as an input to the process, overlaid with our own analysis. We specifically focus on the following:

**Environment** – Fossil & Nuclear usage, Water usage, energy management and CO2 & GHG emissions

**Social** – Education & Technology, Provision of Basic Needs and the Economic Environment

**Governance** – Financial Capital & Management, Political Governance and Democratic Rights

**Controversies** – General controversies, Involvement in armed conflicts and international sanctions

This information is distilled into a Sovereign rating (completed annually) and presented to the broader team for discussion and approval.

## B. Assessing returns versus downside risk

The fund managers assess individual bonds for whether they believe the bonds offer attractive long-term returns. However, given the asymmetric risk associated with corporate bond investing, the probability of default is fully assessed alongside a view of recovery values for each individual investment.

## C. Valuing the bond

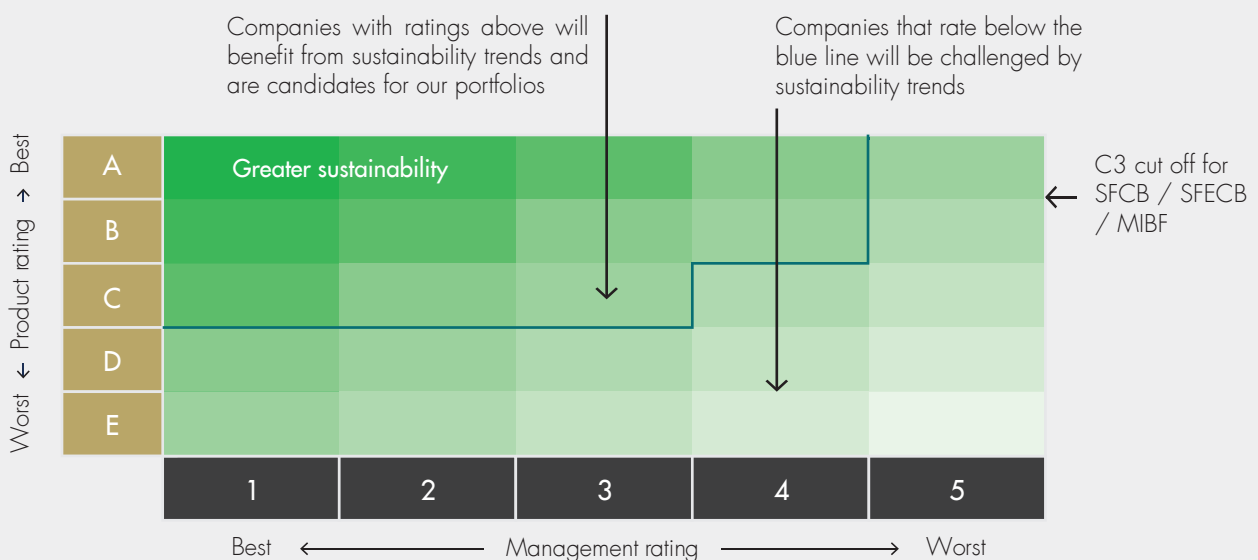
Valuations are assessed on the basis of both absolute and relevant returns. Simply put, there is no point in investing in a bond merely because it is cheap relative to other bonds in the sector if we believe that the total returns are not attractive to the end investor. As such, we look for opportunities across the capital structure of an issuer and across markets, i.e. the UK, US and Europe. Within this, we evaluate the value of a bond relative to both other corporate and government bonds. This approach is consistent with our principal aim of delivering attractive long-term returns to our clients.

## Fig. 1 - Our Sustainability Matrix

Every company held in the portfolio is given a Sustainability 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 (e.g. renewable energy); an 'E' rating indicates a company whose core business is in a conflict with sustainable development (e.g. tobacco).

- Management quality (rated from 1 to 5): Assesses whether a company has appropriate structures, policies and practices in place for managing its environmental, social and governance risks and impacts. Management quality in relation to the risks and opportunities represented by potentially material social, environmental and governance issues are graded from 1 (excellent) to 5 (very poor). Companies must score C3 or higher to be considered further for inclusion in the SF Corporate Bond Fund (SFCB), SF European Corporate Bond Fund (SFECB) and SF Monthly Income Bond Fund (MIBF).



## Stage 2: Constructing resilient portfolios and controlling risk

### Portfolio construction

From the available buy recommendations identified in stage 1, we select the best combination of 60 to 100 bonds for inclusion in focused portfolios that are constructed to aim to safeguard against sustained downside risk. Investment managers look to deliver positive investment performance relative to a relevant performance measure over the medium term while adhering to defined risk parameters and fund-specific investment restrictions.

Portfolio construction is reviewed continually to ensure that it reflects the high-level strategy of the team and is consistent with the policy objective. The portfolios are also assessed to ensure that it has appropriate levels of diversification and to identify correlation within the portfolios, with consideration given to factors such as asset allocation, duration and yield curve, sector positioning and stock selection. Portfolio positioning is reviewed by an independent performance and risk team via both daily analysis and a more formal review cycle.

### Active management

The portfolios are actively managed using a high conviction approach with a focus on access to market liquidity. We believe that having a more concentrated, lower turnover approach improves investment performance.

### Risk controls

The team ensures that it minimises unwanted risk, but will use risk where there is a high level of conviction in a particular bond or theme. The team considers the risk/return potential of each position and aims to deliver a return that is commensurate with the level of risk undertaken. In addition, consideration is given to the risk profile of the portfolio as a whole and each holding's contribution to the overall risk.

### Derivatives, dealing and counterparty permissions

Where permitted, derivatives are used for the purposes of hedging and/or to implement strategic and tactical overlays in accordance with efficient portfolio management guidelines. The use of derivatives is subject to Liontrust's derivative policy. All derivative positions are reconciled and collateralised on a daily basis to ensure all relevant systems are accurately reflecting positions and market valuations.

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