Cashflow Solution

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A stock for every season

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The Cashflow Solution investment process provides a strong, flexible stock-picking framework through which we can target the right type of cash-generative companies to suit the market backdrop. We pick four of our stocks for 2024, across a range of cashflow characteristics.

Changes to our funds' portfolios are driven by forensic analysis of historic cash flows and balance sheet developments as presented in companies' annual report and accounts. This in-depth quantitative and qualitative review is core to the Cashflow Solution investment process.

We only pick stocks for our Funds that sit within the *Cashflow Champions* watchlist – our quantitative ranking of the top 20% stocks in the European universe of companies on two core measures of cash flow.

From within this watchlist, we then aim to pick the very best investments by categorising stocks' cash flow profiles according to 'secondary scores'.

We also apply a set of key proprietary indicators allowing us to designate the prevailing market regime and, in turn, optimise portfolio construction by emphasising different secondary scores within stock selection.

The big advantage of this system is that it helps remove our natural style biases as fund managers and imposes on us the discipline to respond intelligently to the prevailing market environment.

This year calls for a balanced profile

The funds have adopted a range of style biases over the decade since secondary scores were introduced to the process a decade ago, adding dynamism in allowing us to respond to the investment backdrop at any given time.

In recent years, an underweight exposure to high forecast growth stocks and large position to unloved value companies has been among our most rewarding positions.

However, over the last 12 months, the style leadership of the market has been more balanced and the funds strong absolute and relative performance has been driven by stock-picking returns.

At the current time, we think the outlook for European markets is constructive, but prospects are fairly finely poised between growth and value styles. European share valuations are largely fair value, stock markets are in established uptrends and none of our leading indicators of market direction yet suggest cause for concern.

From a style perspective, value stocks have re-rated from their extreme low levels in recent years but are not yet expensive. However, our indicators suggest a less compelling environment for value compared with prior years where investor nervousness was creating a significant opportunity in value stocks.

Meanwhile, stocks with high forecast growth style characteristics are no longer expensive but are also not compellingly cheap.

Looking forward, we continue to seek a degree of balance with respect to value and growth styles in the current environment.

Here we pick four of our favoured stocks covering a broad range of cashflow characteristics:

1) Novo Nordisk

Danish pharmaceutical group Novo Nordisk has been a leader in diabetes care for many years, leading to steady growth in sales and earnings which has fed through strongly to an up-trending share price.

In the last two years, growth in all three metrics has moved up a gear or two as the company has applied its glucagon-like peptide-1 (GLP-1) diabetes treatments to the weight-loss market.

Since the US regulator approved injectable drug *Wegovy* for obesity treatment in 2021, Novo Nordisk has upgraded financial growth targets on multiple occasions as demand for the drug repeatedly outstripped forecasts. Other diabetes treatments based on the semaglutide active ingredient – such as *Ozempic* – have also seen rapid growth in international demand.

Future growth for Novo Nordisk could be supported by the anticipated development of an oral pill alternative to these injectable weight-loss treatments.

While Novo Nordisk's high growth prospects have lifted its shares onto a premium rating – meaning a relatively low cash flow yield per share – we still see significant attractions in the level of cash generation from its asset base, as well as the stability of these cash flows, which allows the company to self-fund its growth and commit to a healthy dividend policy and share buyback programme.

2) UBS

The financials sector has been a source of strength for the Fund over the last year, as some of its bank holdings have reported large increases in net interest income as higher interest rates fed through to wider profit margins. In light of this trend, sentiment towards the sector has been buoyed by the delay in the long-anticipated pivot of central banks towards lower interest rates.

Within the Fund's financials exposure, we think Swiss multinational financial services group UBS has some very appealing stock-specific attractions, partly due to is purchase of Credit Suisse – the highest profile casualty of the early-2023 mini banking crisis which was sparked by Silicon Valley Bank's collapse. We expect further cost savings and surplus cash following as the integration process gathers momentum.

3) Saint Gobain

Saint Gobain is a global leader in the design, manufacture and distribution of materials and services for construction and industrial markets. Its end-markets have cyclicality, including construction, transport (automotive, aerospace and rail industries) and industry (basic resources, chemicals, semiconductors, healthcare).

Following a number of disposals, the group is now leaner and generating healthy free cashflow. Its geographic footprint has also been tilted towards North America, Asia and emerging markets, giving it good short-term sales momentum. The company is returning cash to shareholders via dividends (a 2.75% yield is expected this year) and share buybacks.

4) Kingspan

Kingspan is an Irish multinational providing the construction sector with building products such as insulation and roofing.

The company was heavily caught up in the UK cladding crisis and inquiry, but we believe it has taken action to address the procedural and cultural failures which led to its involvement.

While Kingspan's core construction market has undeniable cyclicality, growing sustainability concerns are generating demand for its insulation products which we think could translate to more secular long-term growth. As it has emerged from a troubled few years, its cash flow profile has improved markedly.

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

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

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, under certain circumstances, invest in derivatives, but it is not intended that their use will materially affect volatility. Derivatives are used to protect against currencies, credit and interest rate moves or for investment purposes. There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions. The use of derivatives may create leverage or gearing resulting in potentially greater volatility or fluctuations in the net asset value of the Fund. A relatively small movement in the value of a derivative's underlying investment may have a larger impact, positive or negative, on the value of a fund than if the underlying investment was held instead. The use of derivative contracts may help us to control Fund volatility in both up and down markets by hedging against the general market.

The use of derivative instruments that may result in higher cash levels. Cash may be deposited with several credit counterparties (e.g. international banks) or in short-dated bonds. A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

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.

May target an absolute return. There is no guarantee that an absolute return will be generated over the time period stated in the fund objective or any other time period.

The risks detailed above are reflective of the full range of Funds managed by the Cashflow Solution 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.

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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