



## Liontrust Global Innovation Fund: July 2022 review

Fund Managers: James Dowey, Storm Uru & Clare Pleydell-Bouverie

The Liontrust Global Innovation Fund returned 7.9% in July. The MSCI All-World Index comparator benchmark returned 6.8% and the average return in the IA Global sector, also a comparator benchmark, was 7.1%\*.

### Innovation insights

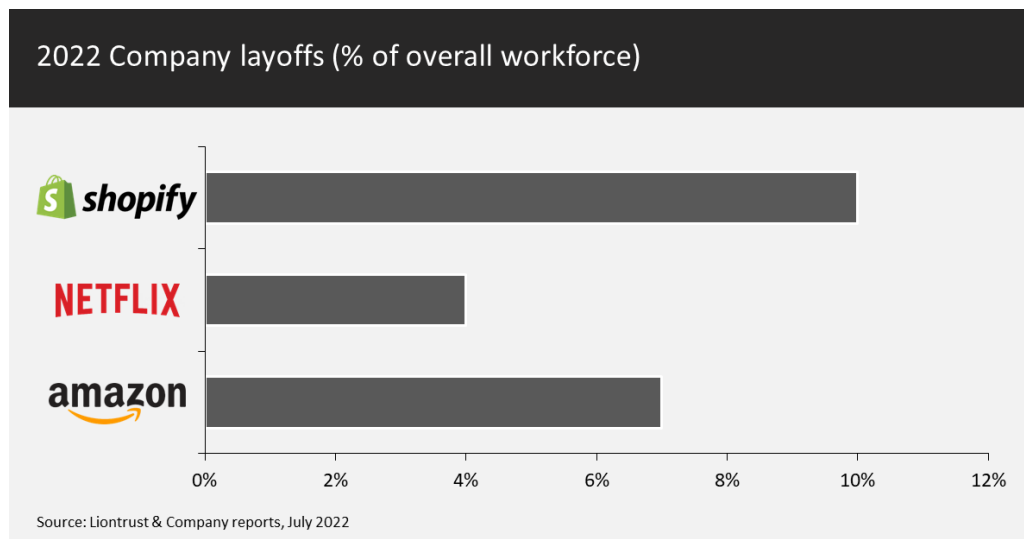
Over the past two years many industries have experienced volatile consumer demand due to Covid. Nowhere has this been more pronounced than in e-commerce, which saw a boom during lockdowns and a slump afterwards as economies re-opened. Overly exuberant extrapolations of the Covid e-commerce boom has meant that e-commerce stocks have subsequently suffered. For example, Amazon is down 15% year to date, Shopify is down 72% and Sea (in South-East Asia) is down 67%.

Where are e-commerce fundamentals now and what is the outlook for the stocks? We think the key point is that the fundamentals have likely now fully adjusted following Covid. As the chart below shows: on the eve of Covid, e-commerce represented 11% of US retail. In 2020, during lockdowns, it shot up to 16% but quickly started falling again on re-opening and now sits at 14%.



This level is now only slightly above the 13% or so, where we would have expected e-commerce to now be if Covid had not happened, and we find it difficult to believe that Covid had no impact at all on our shopping habits. This is given that i) many consumers started buying significantly online for the first time in 2020, particularly venturing into groceries for the first time, ii) many people now work a bit more flexibly so can receive orders more easily during the week and iii) significant investment has been put into the e-commerce infrastructure during the past two years improving the customer proposition. As such, given the long-term structural growth opportunity of e-commerce we are currently very constructive on the industry.

Moreover, the best e-commerce companies are among those innovators that have adapted first to tough economic conditions – clearly with further economic challenges likely ahead from inflation and an economic growth slowdown – reducing costs across their businesses. Look no further than Shopify, Netflix and Amazon, companies held in the Global Innovation Fund that have significantly reduced headcount during the past quarter.



For us there are two key insights here: 1) the importance of a leadership team that can execute. Management that are looking to build global leading businesses in today's tough and fast-paced business environment need to act quick while also thinking long-term, and 2) many of these companies who have aggressively cut costs will benefit from significant operating leverage as demand re-accelerates. And since we invest in companies that create huge customer value through innovation, we are very confident in that growth.

As such, as we exit one of the most difficult starts to the year in the stock market – ironically, particularly so for the best companies! – we are excited about the returns we believe we can generate by investing in these companies, not only over the next decade but also the next year.



**Universal Music Group**, a new holding in the fund, is the largest recorded music company in the world. The group reported a small Q2 earnings beat with organic revenue growth well ahead of consensus at 17.3%. The company continues to provide unparalleled value for its artists through development and distribution based on its unrivalled network and resources. Discovering new artists and keeping them happy is key to dominating a market where content is everything.

Taylor Swift, Justin Bieber and Drake are but a handful of the artists whose recordings Universal Music Group holds the rights to. The ownership of such content (over 3 million recordings) is a truly unique asset which UMG can monetize across multiple revenue fronts and for many years, and towers in comparison to peers - UMG dominates the \$26bn recorded music market (a 3 player oligopoly), with 31.2% market share (c.10% above the no. 2 player). At the same time, no individual artist counts for more than 1% of UMG's revenues in any given year, ensuring UMG's ability to capture value for shareholders.

Since content is a fixed-cost, this scale creates phenomenal fixed-cost leverage which the growth of streaming serves to exacerbate; unlike the sale of a CD (which UMG would pocket ~1/3<sup>rd</sup> of the retail price for each unit sold), streaming via a platform (think Spotify) on a subscription model means that UMG generates their share of revenue every single time one of their artists get played. The richness of UMG's content catalogue is hard to overestimate – products 20 years old still account for near 20% sales today, creating a flywheel where the combination of IP ownership and scale enable further investment in future content, underpinning future revenue generation.

Q2 results showed continued progress on bringing innovative monetization initiatives to market, including an expanded platform deal with META, which builds on recent greenfield expansion efforts in areas such as social media, gaming and fitness and demonstrates UMG's ability as an innovator to create expand new markets. Ownership of song rights and sheer scale mean that bargaining power firmly lies with UMG over distribution and social media platforms, resulting in strong incremental profit generation.

**NETFLIX** Netflix has been our most painful and most conspicuously wrong stock this year. After the stock took a battering following stalling subscriber growth, we wanted to see management respond. That is exactly what they did in their Q2 earnings call, sharing progress on their forthcoming ad-supported option, partnering with Microsoft to deliver the capabilities.

The key point is that the new cheaper subscription option with ads will be economically neutral for Netflix compared with the current no-ads subscription model. This means Netflix will be able to open up a huge new market – in the long-run potentially billions of subscribers compared with 200 million today for lower ability/willingness to pay customers without cannibalising existing revenues.

Netflix now sits on a P/E ratio in line with the S&P500 for one of the best moats in the whole market (based on its huge scale advantage: Netflix total minutes of viewing in the US is three times Amazon, Disney+ and Apple combined) and now likely hugely underrated growth prospects.

**Alphabet** And lastly, Alphabet earnings demonstrated that not all advertisers are created equal. Amid investor angst following poor prints from digital advertisers such as Snap, Alphabet delivered a resilient Q2, with revenues reasonably in line and a small 3% miss on operating profit. While growth slowed for you-tube ad sales and cloud revenues de-accelerated, Alphabet's core engine, Google search, produced advertising revenue growth of 14% yoy, slightly above expectations. This result was all the more impressive since it comes on top of 68% yoy growth for the comparable quarter last year and is testament to the value the company provides to its customers.

In today's challenging economic environment, businesses become more discerning over marketing spend. Advertisers that can offer the highest ROI for customers become a greater proportion of customer ad wallets, to the detriment of less effective advertisers who fall out of marketing budgets. Google has consistently ranked as a top 2 ROI ad platform on the Internet (alongside META) over the past seven years, positioning them well to gain share through a period of tough operating conditions owing to superior scale and quality. This customer value is down to continued innovation of Google's core proposition.

Late last year, we saw AI powered Performance Max campaigns rolled out, allowing advertisers to access all of their google ads inventory across all channels, in turn improving conversions. The 5x advertiser adoption YTD seen for Performance Max suggests significant value is being created for customers.

AI continues to be deployed across the business, including Google Cloud, which is growing strongly, and management is investing deeply in the opportunity set. Signaling confidence in the company's prospects, a record \$15bn stock was repurchased in the quarter.

**Top performers:**

Amazon (+26.9%), Netflix (+28.5%), Nvidia (+19.7%), CoStar (+20.0%), Planet Fitness (+15.7%)

**Bottom performers:**

Pinduoduo (-20.8%), Upstart (-23.2%), Tencent (-13.6%), Meituan (-9.4%), 2U (-6.6%)

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

	Jun-22	Jun-21	Jun-20	Jun-19	Jun-18
Liontrust Global Innovation C Acc GBP	-25.1%	24.2%	23.0%	2.0%	19.4%
MSCI AC World	-4.2%	24.6%	5.2%	9.7%	8.9%
IA Global	-8.8%	25.9%	5.4%	7.5%	9.1%
Quartile	4	3	1	4	1

\*Source: FE Analytics as at 31.07.22

\*\*Source: FE Analytics as at 30.06.22. Quartile generated on 06.07.22

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 is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.*

*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.*

*Investment in the Fund involves foreign currencies and may be subject to fluctuations in value due to movements in exchange rates. The Fund may invest in emerging markets/soft currencies or in financial derivative instruments, both of which may have the effect of increasing volatility.*

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