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Liontrust UK Ethical Fund: Q3 2022 review

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The Fund returned -6.6% over the quarter, underperforming the IA UK All Companies sector average of -5.0% and the MSCI UK Index's -2.9% (both of which are comparator benchmarks)*†.

After a market rally in July, both equities and bonds turned lower in August and September, registering negative returns for the third quarter.

The Federal Reserve, European Central Bank and Bank of England all raised interest rates in the quarter, with the latter citing Russia's restriction of gas supplies as a major factor in the escalation of inflationary pressures. The risk aversion brought about by ongoing macroeconomic struggles with inflation, the turmoil after Chancellor Kwasi Kwarteng's mini budget announcement, and the ructions from pension fund forced selling was felt in UK mid-cap names – particularly those with a domestic focus as sterling weakened. Underlying this though we have seen positive results from almost all companies in the portfolio. Of course, there may be more challenging times ahead, but longer term we remain confident in their prospects.

We continue to believe that the long-term drivers moving us to a more sustainable economy are intact – the need for energy efficiency, reducing greenhouse gases, improving health and increasing resilience are essential if we are to progress to a cleaner, healthier and safer future. However, while the macroeconomic backdrop remains so volatile, the share prices of the companies we invest in will be, shorter term, at the mercy of these events rather than the operational performance of the companies themselves.

We have been through periods similar to this before. What we have learnt is that the best long-term outcome comes from sticking with high quality dependable companies that will see strong long-term growth as they help to solve sustainability challenges.

After boosting its full year revenue forecast, Wise was among the top holdings over the quarter. In a Q2 trading update, Wise announced 47% volume growth as active customers numbers rise. In addition, the company stated that revenue growth for the year will be further supported by increasing levels of interest income on customer balances and it plans to pass much of the benefit on to customers through lower prices, but will also use it to fund investment in the company's growth. It has raised its full-year income growth target range to 55% - 60%, a large upgrade from 30% - 35% previously.

Held under our, theme of *Increasing financial* resilience, Wise aims to bring transparency and fairness into moving money around the world; a resilient financial system helps support all in society and we look for businesses that dramatically improve access to financial services and reduce the costs for everyone. Around 1.7 billion people remain unbanked in the world and foreign exchange has traditionally been costly for individuals, especially those remitting small amounts regularly. Wise offers a significantly better rate, lower fees, and a very simple app-based approach.

Identity verification, location intelligence and fraud prevention company GB Group produced a strong quarter after the Cheshire-based firm confirmed Chicago-based private equity firm GTCR LLC was considering a takeover offer. While GTCR subsequently withdrew its interest in early October, GB Group's depressed share price may mark it out as a potential takeover candidate in future.

GB Group is exposed to our *Enhancing digital security* theme and focuses on solutions helping to reduce fraud and aiding companies to meet their compliance obligations. Almost every facet of our lives has some on-line exposure, whether personal information, finances, commercial interactions and simple communications. The

same is true for businesses, governments and international institutions. Keeping this information secure and only accessible by the right people is essential for retaining trust in all these on-line interactions.

Continuing along the theme of takeovers, Aveva – a new purchase in Q2 under our *Improving the resource efficiency of industrial and agricultural processes* theme – accepted a takeover offer from Schneider Electric, in a deal that will see Schneider pay £31 per share. While Schneider was already the majority shareholder of the British firm, the company stated that a full combination would help it execute its growth strategy faster.

As a reminder, Aveva’s products provide pioneering technology and engineering solutions. Its solutions provide real time data overlaid with AI technology and predictive analytics that improve efficiency and support circularity and traceability. This supports the energy transition for its customers, who are often amongst the world’s heaviest emitters and thus the company is a strong fit for our *Improving the resource efficiency of industrial and agricultural processes* theme.

Also among the notable performers was Ashtead, which we believe is the embodiment of the sharing economy. Held under our *Delivering a circular materials economy* theme, the company rents out industrial, commercial and general equipment across the US, UK and Canada, thus maximising the utilisation of equipment that would otherwise sit idle for long periods, and offers assurance that equipment is serviced and maintained properly and is reliable. In doing so it allows its customers to concentrate on their core business competencies and to reduce their inventories of capital equipment.

In results for the Q1 period ending 31 July 2022, Ashtead stated that its business is performing well with clear momentum in supportive end markets. The company’s significant recent investment across existing locations and greenfields is enabling it to take advantage of the substantial structural growth opportunities that it sees for the business as it continues to deliver their strategic priorities to grow its general tool and specialty businesses.

Among the weaker performers was Mortgage Advice Bureau (MAB), which provides a platform for mortgage advisers to help individuals get mortgages and insurance products. While the company’s interim results reported that average mainstream adviser figures rose 19% year-on-year, revenue per adviser was down 13%. The company commented that pipelines took longer to convert and noted that the very strong comparative in H1 2021 when stamp duty holiday changes accelerating house purchase mortgage completions in that year.

In addition, companies linked to the property market such as MAB and also Paragon Banking Group saw their share prices take a hit following a shift in market sentiment with UK government borrowing costs on course for their largest ever monthly rise, and mortgage rates also set to climb, following a bond market meltdown sparked by UK Chancellor Kwasi Kwarteng’s fiscal policy announcement. A number of UK lenders have taken the decision to suspend or even pull new mortgage deals following the increase in rates, leading to predictions of a slowdown in the residential property market.

Another notable detractor for the quarter was FD Technologies – a leading provider of products and consulting services to some of the world’s largest finance, technology and energy institutions and exposed to our *Improving the resource efficiency of industrial and agricultural processes* theme. The online world and the proliferation of sensors in all areas of economic and social activity is driving an explosion in data generation but this data is only useful if it is captured and managed, so that it can be analysed effectively. FD Technologies has the leading database software for time-series databases, information where the time of the event is critical. Its architecture can deliver a 10-20x reduction in the number of servers needed for a task and 100x improvement in speed.

We added two names to the portfolio this quarter. The first, within our theme of *increasing financial resilience*, was NatWest Group. We feel NatWest will benefit from a higher interest rate environment and has ambitious targets around decarbonisation from its client base, including the provision of green mortgages to help households improve their energy ratings.

Secondly, we have taken a position in Admiral. This is a motor and household insurer in the UK which is consistently rated highly by customers. We have long admired its very strong employee culture with a focus on promotion and share ownership from within that makes it stand out from other organisations. Its low-cost operating model means it can be the most competitive on insurance rates without detracting from the quality of its cover. We have followed it for many years and used the sell off as an opportunity to start a position.

In terms of sells, we exited our position in Prudential over the quarter as we feel that the company has disappointed as an investment as its business fundamentals have weakened.

We also completed our sale of Countryside Partnerships; its share price is currently underpinned by a takeover offer from Vistry, a fellow housebuilder. This was a disappointing conclusion to an investment based on meeting strong demand for affordable, rental and open market housing. In the end, we feel that the company executed very poorly on its strategy.

Last, We also exited our position in Halma. This is a holding company for 45 high quality companies providing solutions to fire safety, lift door sensors, and ophthalmology amongst others. They own a business called Novabone that carries out animal testing to satisfy FDA requirements for its synthetic bone grafts. In line with the screening criteria applied to the UK Ethical Fund, which prohibits exposure to any company involved with animal testing, this stock was sold.

**Discrete years' performance*, to previous quarter-end:
Past performance does not predict future returns**

	Sep-22	Sep-21	Sep-20	Sep-19	Sep-18
Liontrust UK Ethical 2 Acc	-29.3%	31.9%	-2.7%	5.8%	11.7%
MSCI UK Index	3.8%	25.8%	-19.8%	2.8%	5.8%
IA UK All Companies	-15.3%	32.4%	-12.8%	0.0%	5.5%
Quartile	4	2	1	1	1

*Source: FE Analytics, as at 30.09.22, primary share class, total return, net of fees and income reinvested.

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 and disclaimer

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