LIONTRUST

GLOBAL EQUITY

Liontrust Global Technology Fund

Q4 2022 review

Fund Managers: Robin Geffen & Will Geffen

The Liontrust Global Technology Fund returned -8.4% over the quarter, versus the MSCI World Technology Index's return of -2.5% and IA Technology & Telecommunications sector's 4.0% (both comparator benchmarks)*^. Part of the Fund's underperformance can be attributed to the weaker sterling recovering 8% versus the dollar over the quarter.

Equity markets stabilised and showed some signs of recovery this quarter, with hopes of an earlier than expected fed pivot, or "soft landing" easing the market as early signs show US inflation beginning to ease. Many companies, however, are still bracing for a slowdown and a raft of downwards earnings revisions across the board does seem likely in the early half of 2023.

Unfortunately, technology equities continued to lag the broader market in GBP terms, thanks in part to the previously weakened sterling recovering c.8% of its value vs. recently strong dollar − the primarily USD listed technology equities dipped with the MSCI World Technology Index -2.5% vs. the MSCI All-Country World Index +1.9%.

Two sectors within tech were noticeably buoyant in their Q4 performance – semiconductors and payments.

Nvidia and ASML were also joined in the semiconductor space by KLA Corp, Tokyo Electron and others in return positive gains over the period. This is largely a result of an easing of concerns over the current status over the "Semis Cycle". These cycles are a recurring theme for those in the semiconductors ecosystem, from equipment manufacturers like ASML and KLA, through manufacturers (fabs) like TSMC to the end designers and distributors like Nvidia and AMD.

In these cycles, spikes in demand (like the one triggered by Covid WFH) strain supply chains and inventories, driving up prices and capital investment. Unfortunately, due to the complexity of the supply chain and ecosystem, there is long lead time with this lag often leading to overinvestment and oversupply exacerbated by deliberate excess orders from end hardware manufacturers keen to secure orders ahead of the pinch. This period is often followed by excess and fast depreciating inventory, drops in pricing and margins and downwards earnings revisions.

There are, however, countervailing forces that look to hold up and propel the semiconductor industry in the near future, such as the ongoing growth in demand for cloud computing leading to consistent data centre build out, increasing interest in AI technology such as the recent ChatGPT3 and increasing IoT connected devices. As shorter-term supply/demand issues begin to settle, we should see more come out of this complex but incredibly lucrative industry.

Mastercard was joined by its long-time rival Visa in producing a decent positive return this quarter as travel continues to normalise post-Covid seeing a return to form for its higher margin cross-border business. It is also worth noting, as payments platforms that benefit from increased utilisation of their payments rails, these companies offer a unique relative immunity to inflationary pressures, with the associated increase in volume from inflation helping to boost its revenue in excess of its expenses. It is no surprise, therefore, that both these company's stocks continue to perform well in this inflationary environment.

Mega Cap technology endured another tough quarter, drawing the line under a difficult year for these giants, most notably Alphabet, Amazon and Meta – the last of which may not even be classified as "Mega" now dropping to a ~$350bn market cap down from a high of nearly $1tn.

These companies have faced a range of headwinds and pressures – from slowing ecommerce, to difficulties in advertising post IDFA and a host of regulatory investigations and fines. They do, however, remain outright leaders in their respective fields (or range of fields!) with unique scale advantages and economic moats that make them incredibly profitable and resilient – even in the face of these pressures. Importantly, we continue to believe they still offer ample future return for patient investors.

CrowdStrike had a relatively good year up to Q4 as most cybersecurity stocks held up in the face of a strong drawdown in tech equities – largely due to the resilience of both corporate IT spend and cybersecurity's share within that. Unfortunately, CrowdStrike had a poor Q3 earnings report pointing to the economic downturn putting pressure on smaller companies (CrowdStrike's key consumer group) to delay further purchases and "right size" deals which had been previously allowed to be wider in scope and spend.

CrowdStrike is owned and valued as a high growth company and so it is of no surprise, therefore, that fears of substantial slowdown in this growth will have a large impact on its valuation. We remain confident, however that the core products and business remain strong and stands to benefit from the ongoing steady growth trend in cybersecurity spend.

In terms of portfolio activity, we exited positions in Chinese stocks Tencent and Alibaba. Avalara and Zendesk were taken out for cash by private equity buyouts.

In terms of buys, we opened positions in both Texas Instruments and Topicus.com. Texas instruments is a fantastic analogue semiconductor company that has carved out a great business in this tricky market segment with an unrivalled catalogue of low cost yet high margin chips for OEMs. This, along with masterful capital allocation has allowed Texas Instruments to reward its shareholders with a healthy long term return over the past decade with much more still to come.

Topicus.com is a spinout of our portfolio company Constellation Software (who still retain a healthy % ownership). Topicus, like Constellation, is a serial acquirer of Vendor Management Systems (VMS) companies, benefitting from the fantastic economics of these businesses and cycling their cash into further high ROI M&A that benefits from an incredible track record of capital discipline and value creation.

We have had an extended and ongoing debate over whether to include Chinese technology stocks within the portfolio. On the one hand, these technology companies have the potential to be immensely profitable as well as benefit from the long secular growth trends within the world's second largest economy.

Some, like Tencent, also have broader reach with an impressive portfolio of assets throughout emerging markets and even developed ones. This all at a hefty discount to similar (arguable less well entrenched) "western" counterparts.

However, on the other hand, these technology companies do not operate under the same economic or market conditions – nor do they really operate in an environment of free enterprise and capitalist philosophy. While "Western" companies (rightly) operate with limitations, perhaps none more so than our mega cap tech companies, there is no doubt that they are able to run more or less freely and distribute fairly earned profits to capital owners – shareholders as they see fit. It is increasingly clear this is not the case when investing in Chinese technology companies.

Not only is it often necessary to invest through difficult mechanisms like ADRs, but the shareholder is not the stakeholder that the growing economy has rewarded or seeks to reward – instead they are very much at the mercy of not just management (like all companies to a degree) but also the Government – and the CCP have made it clear through consistent action and rhetoric that shareholder interests simply does not matter when weighed against the pursuit of their larger economic and political goals.

This is reasonably understandable given their long-term strategic objectives and philosophies – and we certainly are not here to judge their merit on a moral or even economic basis – but as shareholders, this has led us to the decision to cease investing the fund in Chinese-listed technology stocks for the foreseeable future. This may no doubt be painful in the event of a substantial turnaround in sentiment, and we always retain the right to change our minds if the facts change, but this seems cogent for a while at least. While 2022 saw a tough year for equities – and an ever tougher year for technology equities, it has set the playing field for an interesting 2023.

Markets and economics may look bleak on the surface, it is hard not to be excited by the current state of affairs for investors in the technology companies. The sector now presents a large number of fantastic companies available for purchase at a cash yield not seen for many years. This, combined with the strong economics, growth opportunities and the defensive qualities of these companies as well as a clear lack of current mainstream investor enthusiasm for the space, presents a clear opportunity for medium and long-term outperformance.

While markets do move somewhat at the mercy of large forces like interest rates, inflation and economic health (at least in the short term) – the rewards are looking increasingly asymmetrically favourable for technology investors. The downside scenarios (aggressive rate hikes, high inflation, economic downturn) are fairly priced in with strong returns likely in the eventuality of a soft landing, tamed inflation and economic rebound.

Now, as ever, it is important to actively seek and discern these high performing companies from those whose value is more speculative. By focusing investment in high quality companies benefitting from strong long term growth trends, a competent management team able to allocate capital effectively for the benefit of long-term owners and a compelling discounted cash flow valuation, we aim to help provide long term outperformance in this exciting sector through careful and attentive active management.

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

	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18
Liontrust Global Technology C Acc GBP	-33.1%	23.2%	43.9%	23.7%	14.0%
MSCI World Information Technology	-22.1%	31.0%	39.3%	41.9%	3.5%
IA Technology & Telecommunications	-27.5%	17.6%	44.4%	31.0%	2.4%
Quartile	4	2	2	4	1

***Source: FE Analytics as at 31.12.22**

****Source: FE Analytics as at 31.12.22. Quartiles generated on 06.01.23**

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

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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.

The portfolio is invested in smaller companies - these stocks may be less liquid and the price swings greater than those in, for example, larger companies. 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.