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Sustainable Investment

Q4 2023 Review

Liontrust GF Sustainable Future US Growth Fund

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The Liontrust GF Sustainable Future US Growth Fund returned 15.9% in US dollar terms in Q4, compared with the 11.8% return from the MSCI USA Index (its comparator benchmark) and the 12.0% return from the IA North America reference sector.

The largest positive contributors to this were **TopBuild** (+49%), **American Tower** (+33%) and **Charles Schwab** (+26%). The biggest detractors were **Markel** (-3.6%), **Paylocity** (-9.3%) and **DocuSign** (-7.4%).

As a reminder, the Fund aims to grow capital over the long term (five years or more) with the MSCI USA Index as its comparator benchmark. This goal in essence requires us to invest differently to the index. So we expect the Fund to behave differently in both volatility and return profile. The Fund is concentrated, with 42 positions and the top 10 representing over 36% of NAV. As such, the Fund may be volatile, so understanding our process will hopefully make this volatility easier to stomach.

This has indeed already proven to be the case. Readers of the first update might recall that the portfolio had fallen 3.3% during the previous quarter, underperforming the benchmark by 1.2% during that period. If the performance clock had been stopped at the end of October, the underperformance would have further widened to over 2.5%. So where does this all leave us since the short period from inception? The fund is now up 12.0% compared to MSCI USA Index at 9.5%.

The Fund's first major trade occurred at the small end of the market capitalisation spectrum. We decided to exit our position in **Hingham Institution for Savings**. Hingham is a family-run bank where the major shareholders sit on the board of directors and sign off on any large loans. The result has been remarkably low credit losses through the cycle and a consistent, and impressive, return on equity. The problem currently, however, is that it isa small regional bank that does not enjoy the benefits of having large deposit franchises that the major banks in the US have. It is therefore reliant on wholesale funding, which has caused its funding costs to rise notably as interest rates have risen. Without getting too technical here, the shape of the yield curve inhibits the bank from earning the sort of returns it has done in the past. When this changes, we would be happy owners of the shares once again.

Hingham made way for another financial called **Trupanion**. Trupanion is a pet insurance company operating predominantly in the US with a market capitalisation of c. $1.2 billion. Unlike the UK and much of Europe, US pet insurance penetration remains remarkably low, at 2% - 3% and Trupanion is one of the largest operators in the space. We believe the company offers the best value product in the market and has a huge runway of potential growth given the low penetration rates.

This is a company we know well, first owning shares in the SF Global Growth Fund back in 2019 before selling at the start of 2021 following a strong run up in the share price that left us with limited upside. The shares went on to climb further still throughout 2021 but more recently, it has had a tough 18 months, causing the share price to fall back to those 2019 levels. It appears to be a controversial name, with the highest short interest for a stock in the Fund at over 30% of the shares outstanding (this means there is a lot of people betting against the company). If Trupanion continues to produce improving operating results, those shorts will have to liquidate their positions, resulting in upward pressure on the shares. These dynamics lead us to expect the shares to remain volatile for some time and so we have sized the position accordingly.

We also exited our position in **DocuSign** in October. After meeting with the new management team, we were impressed by their communication of their strategy and focus. We did, however, decide that reversing the current trend of stagnating sales growth would take many years to unfold and that the return to growth was anything but a sure thing. With the shares languishing at such a low valuation, there was always a risk that a potential bidder may be interested in acquiring the shares. Indeed, in December the company announced that it was exploring a potential sale. This, combined with the changes in the bond market detailed earlier, has caused the shares to rebound strongly after we had sold the position.

With the proceeds of the DocuSign sale, we started a new position in a company called **Veralto**. Veralto has a market capitalisation of $20 billion and has two main segments. About 60% of sales come from its water analytics and treatment business and the remainder in consumer packaging and printing. The company is therefore exposed to the theme of *Improving management of water*.

We had been following this company for some time and Veralto was finally spun out of its parent company Danaher at the end of September. As is often the case with spin-offs, many investors chose to sell the shares and the valuation became sufficiently attractive to meet our return hurdles. The core businesses are high margin and defensive but the bull case is that Veralto can use the cash generated by these businesses to reinvest and acquire other smaller businesses, following Danaher's playbook. However, it remains to be seen how well management will allocate capital, so this is a company we will be watching closely.

The last major trade of the quarter was exiting our holding in the thrift franchise operator **Winmark**. Due to the capital light nature of franchises, they can be wonderful businesses and Winmark is indeed a wonderful business. The shares rose over 30% in a matter of months and this left us with limited upside over the next five years. We therefore exited the position and recycled the capital into other ideas within the portfolio. We look forward to owning the shares again once the valuation becomes more compelling.

Finally, given the third quarter results season fell in the last quarter for most of our holdings, we thought it would be helpful to provide some summary figures for the portfolio, using simple weighted averages of the position sizes to compare them with the MSCI USA benchmark.

	Liontrust GF SF US Growth Fund	MSCI USA Index
Year-over-year sales growth	9%	6%
Year-over-year adjusted earnings per share growth	22%	-6%
Forward price/earnings ratio	32x	20x
Return on invested capital	35%	9%

Source: Liontrust and Bloomberg as at 31.12.23. All figures are weighted average. The MSCI USA Index is a comparator benchmark.

The companies in the Liontrust GF SF US Growth Fund are growing revenues faster than those in the benchmark, but the difference in adjusted earnings per share (EPS) is stark; the portfolio companies grew their EPS 22% on average compared to the benchmark whose shrank 6% year-over-year. The average return on invested capital for the Fund was nearly four times larger than that of the benchmark. Of course, a selection of businesses as wonderful commands a premium – the portfolio's price to earnings ratio is 50% higher than that of the benchmark. Warren Buffett once quipped that time is the friend of the great business and the enemy of the mediocre. We believe we own a portfolio of terrific businesses whose competitive advantages should enable them to continue to compound their earnings at a high rate. Our job is to continue to assess these competitive advantages and do our best not to interrupt this compounding.

Thank you as always for your time in reading this update and for your continued support.

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Key Features of the Liontrust GF SF Global Growth Fund

INVESTMENT OBJECTIVE & POLICY[1]:	The Fund aims to achieve capital growth over the long term (five years or more) through investment in sustainable securities, predominantly consisting of global equities. Typically at least 90% of the Fund will be invested in the shares of global companies, with up to 10% in bonds and cash. The Fund will only invest in companies that meet defined ethical considerations and will benefit from improvements in environmental standards and a shift towards a more sustainable economic system. While the Fund will invest predominantly in companies from developed markets it may also invest up to 20% in emerging market securities. In normal conditions, the Fund will aim to hold a diversified portfolio, although at times the Investment Adviser may decide to hold a more concentrated portfolio, and it is possible that a substantial portion of the Fund could be invested in cash or cash equivalents. The Fund is not expected to have any exposure to derivatives (contracts whose value is linked to the expected future price movements of an underlying asset) in normal circumstances but may on occasion use them for investment, efficient portfolio management and for hedging purposes including gaining exposure to financial indices.
RECOMMENDED INVESTMENT HORIZON:	5 years or more
SRI[2]:	6
ACTIVE / PASSIVE INVESTMENT STYLE:	Active
BENCHMARK:	The Fund is considered to be actively managed in reference to MSCI World (the "Benchmark") by virtue of the fact that it uses the Benchmark for performance comparison purposes. Some of the Fund's securities may be components of and may have similar weightings to the Benchmark. However the Benchmark is not used to define the portfolio composition of the Fund or as a performance target and the Fund may be wholly invested in securities which are not constituents of the Benchmark.
SUSTAINABILITY PROFILE	The Fund is a financial product subject to Article 9 of the Sustainable Finance Disclosure Regulation (SFDR).

Notes: [1]As specified in the PRIIP KID of the fund; [2]SRI = Summary Risk Indicator. Please refer to the PRIIP KID for further detail on how this is calculated.

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.

All investments will be expected to conform to our social and environmental criteria.

Overseas investments 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 the Fund.

This 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 the Fund's value than if it held a larger number of investments.

The Fund 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, the Fund 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.

Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

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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