



LIONTRUST FIRST GROWTH FUND

MANAGER'S SHORT FINAL REPORT

For the year ended 31st December 2009

ASSET MANAGEMENT

LIONTRUST





THE LIONTRUST ECONOMIC ADVANTAGE

LIONTRUST FIRST GROWTH FUND IS MANAGED BY JULIAN FOSH AND ANTHONY CROSS IN ACCORDANCE WITH THEIR INVESTMENT PROCESS FOR UK EQUITY PORTFOLIOS, *THE LIONTRUST ECONOMIC ADVANTAGE.*

The Fund is managed to produce long-term capital growth using a disciplined investment approach which aims to identify UK companies whose competitive strengths (“Economic Advantage”) allow them to sustain



a higher than average level of profitability for longer than expected. Economic Advantage is the collection of distinctive characteristics of a company that competitors struggle to reproduce. These assets deliver pricing power, protect margins, and thus drive sustained profitability. The market rewards excess profitability, particularly when it is higher than consensus expectations. The Fund invests in a portfolio of competitive UK companies which we believe will surprise the market with their profits growth.

INVESTMENT REVIEW

It is pleasing to report that the Fund performed strongly over the final quarter of 2009. Its return of 6.1% was 2.9% ahead of that of the average IMA UK All Companies fund, and placed it 16th out of 358 funds in the sector. The FTSE All-Share Index returned 5.5%, with much of the rise achieved during the final few days of the year. Despite this traditional 'Santa rally' (on typically low volumes), in general the quarter was characterised by a move away from riskier assets (even before events in Dubai). Big was beautiful again, with the FTSE 100 (+5.4%) trouncing the FTSE Mid 250 (+2.3%) and FTSE Small Cap. (down 7.7%).

This is, of course, in sharp contrast to the year as a whole, which saw the FTSE All-Share rise 30.1%, powered by particularly strong small and mid cap. performance (the FTSE Fledgling Index was up 80%, the FTSE Small Cap. rose by 57.7% and the Mid 250 was up 50.6%). The FTSE 100 rose by a relatively pedestrian 27.3%. The reason for such exuberance was the rising tide of expectation and realisation that economic recovery would finally get underway in 2009, which lifted all boats. The Fund's change of investment process from pure earnings revisions – and attendant extreme defensive positioning – to our current *Economic Advantage* process occurred within three weeks of (what turned out to be) the market low for 2009 in March. Whilst we moved to reposition the Fund to a less defensive stance, we did not, with the benefit of hindsight, do so quickly enough or to the fullest extent necessary to keep pace with the ferocious rally that ensued in the second and third quarters. In consequence, our fourth quarter outperformance was not quite enough to compensate for this, and for the year as a whole the Fund returned 26.9%, some 3.2% behind the All-Share Index, placing it 215th out of 344 peer group funds.

FUND ACTIVITY

The basis of our investment process, *The Liontrust Economic Advantage*, is that all companies are not equal. Some companies, by virtue of intangible assets which competitors are either unaware of or are unable to replicate, enjoy unique barriers to competition, which translate into superior profitability and, ultimately, share price outperformance.

We identify three specific 'must have' intangible assets ('Tier 1' Economic Advantage), of which a prospective investment must have at least one to qualify for inclusion in the portfolio. These are intellectual property, a high degree of recurring revenue, and distribution networks, either tangible or intangible. In

addition, there are other intangible assets that we look for; these include licenses and franchises, brand, customer databases and relationships, procedures, formats and culture. Such companies are found in defensive industries, in cyclical industries (where our expectation is that higher cyclical peaks will be reached in due course), and in growth industries. The aim of the Fund is to hold a diversified, balanced basket of the best such (predominantly larger) companies quoted on the UK stockmarket, suitable for a variety of economic conditions, constructed to outperform our benchmark index over a three year rolling period.

Our most important task during 2009 was to optimise this balance, and in particular to increase the growth/cyclical component at the expense of the defensive. This was achieved during the second and third quarters by adding holdings including *Fidessa*, *Rightmove*, *Michael Page*, *Hargreaves Lansdown*, *Carpentryright* and *Renishaw*, and smaller companies *Next Fifteen*, *RWS*, *Brooks MacDonald*, *System C Healthcare* and *Statpro*. These were the right stocks to buy, and have all added value.

We financed this with sales of inherited companies either with no Economic Advantage, companies which had it but were too expensive or less preferred, or companies in which we simply had too big positions, notably big oil, pharmaceutical or tobacco companies. We retained an overall tilt towards defensive/late cycle stocks, which stood us in good stead in the fourth quarter.

Over the year as a whole, the Fund had several super-achievers. *Petrofac* returned over 200%. Four stocks – *Tullett Prebon*, *Aggreko*, *Spirent* and *Fidessa* – returned over 100%. Seven stocks – *Brooks MacDonald*, *Domino's Pizza*, *Amec*, *Carpentryright*, *Michael Page*, *Next Fifteen* and *Rightmove* – returned over 50%. By contrast, we had no outright disasters; our worst individual performer was *Paypoint*, down just 12% over the year. We also had a number of big, dull performers (*Capita*, *BAe Systems*, *Wm Morrisons*, *Diageo* and the oil and pharmaceutical majors).

OUTLOOK

After the fear, the market travelled through much of 2009 in hope, and now arrives at 2010 with a consensus 20% plus earnings growth to deliver this year, against a consensus GDP expectation of 1.3%. (This is up from the forecast 1.1% at the start of Q4 2009, but there has been a corresponding reduction in expectations in Q4 for 2009's eventual GDP from -4.3% to -4.5%.)

Given the fiscal outlook, burgeoning public and private sector debt and a continuing lack of sales growth from the corporate sector, this will be challenging. Of course, overseas economies offer higher growth rates, and many companies we own have substantial overseas earnings. However, Eurozone economies are forecast to do little better, and even the US is expected to grow by only 2.7% (a far cry from the 4% plus rate being touted around earlier last year as justifying

a level on the S&P 500 considerably lower than that at which it stands today). Even if expected earnings growth is delivered, perhaps with help from the East, other risks remain, most notably that of derating as the tightening cycle continues in China (to moderate its credit expansion) and in the West (to roll back the 'great experiment' of quantitative easing).

To re-iterate: every stock in the portfolio must possess 'tier 1' Economic Advantage. In addition, we use three quantitative screens to gauge market sentiment and valuation levels:

- Positive revisions to earnings forecasts;
- Undervalued (high) return on capital; and,
- Cyclically-adjusted price to earnings ("PE") ratios.

We rank all our Economic Advantage companies on these measures, and invest only in those with the greatest unrealised potential for share price growth. Back testing demonstrates that each screen used in isolation adds value relative to Index performance. By focusing on stocks with Economic Advantage that also score well on these three measures, we are ensuring that:

- We only own stocks that are successfully exploiting their competitive edge to their financial advantage (earnings revision stocks).
- We don't overpay for growth (undervalued return on capital).
- We capitalise on underestimated cyclical recovery or growth (cyclically-adjusted PE ratios).

Changes in the range and extent of each screen (when looking at the whole market) give us strong clues regarding the state of the market and the current stage of the stock market cycle, and we can orientate the portfolio accordingly.

So where are we now? There are many more stocks experiencing positive earnings revisions than was the case a year ago, as one would expect; and positive revisions are also more likely to be rewarded by the market this year (as they were definitively not last year). Both these trends are reflected in the portfolio today, with 25 stocks (accounting for 56% by value) undergoing positive revisions, including *Spectris*, *Aggreko*, *Rightmove*, *Domino's Pizza*, *Tullet Prebon*, *Pearson*, *Carpetright* & *Michael Page*. The last two rank amongst the stocks with the highest positive earnings revisions in the entire portfolio, but, of course, are cyclicals. We bought them last year when revisions were anything but positive. They were attractive to buy then because the strength and depth of their Economic Advantage gave us confidence that they would recover and move on to greater heights in due course. That they have progressed so far already to appear at the top of this earnings revision screen is a rewarding vindication of our confidence, built upon the competitive strengths of all our investments as identified by our Economic Advantage investment process.

Turning to our second screen, undervalued return on capital; we find several attractive companies rich in Economic Advantage currently sitting at attractive valuations, including *Royal Dutch Shell*, *Unilever*, *BG*, *BAe*, and *AstraZeneca*. In total we hold ten stocks accounting for 30% of the portfolio by value.

Conversely, the view on our cyclically-adjusted PE ratio screen is not so attractive. Of the three, this screen offers the least added value on a long-term basis, but is there primarily to aid stockpicking during those (generally short) periods where explosive market performance discounts recovery before it is evident in company profitability – periods just like 2009. As such it is yesterday's story, and we currently have no holdings on the strength of this measure. This does not mean, of course, that we don't own any cyclical stocks, rather that those companies that we hold which are characteristically highly cyclical or late cycle appear in the positive earnings revisions section of the portfolio.

Comparing the current results on our latest screens with the results from several months ago, over half of the portfolio has experienced a clear improvement (typically an acceleration in the rate of earnings upgrade or improvement in the upgrade/downgrade ratio, or improvement in the valuation ratio, or all three). Only five stocks have worsened, typically due to volatile quarterly earnings (*Royal Dutch Shell*) or continuing earnings downgrades (*Petrofac* and *Rightmove*, albeit at slightly lower rates than their spectacular levels of downgrades earlier last year).

With a diverse portfolio of financially strong, competitive growth companies, we are confident that our Economic Advantage investment process has built a Fund that is well placed for the many uncertainties that lie ahead and can continue to deliver strong performance.

JULIAN FOSH & ANTHONY CROSS

LIONTRUST INVESTMENT SERVICES LIMITED

February 2010

FUND PROFILE

INVESTMENT OBJECTIVE AND POLICY

The investment objective of the Fund is to provide long-term capital growth through a portfolio of mainly United Kingdom (“UK”) equities but with the option of investing part of the portfolio overseas.

Although the Fund may invest in all economic sectors in all parts of the world, it is intended that it will currently invest primarily in securities in companies listed on the International Stock Exchange of the UK and Ireland. The Fund may also invest in shares issued by companies incorporated in any European Economic Area (“EEA”) Member State other than the UK which are listed on a recognised stock exchange of an EEA Member State.

INVESTMENT APPROACH

This unit trust is managed to produce long-term capital growth using a disciplined investment approach which aims to identify UK companies whose competitive strengths (“Economic Advantage”) allow them to sustain a higher than average level of profitability for longer than expected. Economic Advantage is the collection of distinctive characteristics of a company that competitors struggle to reproduce. These assets deliver pricing power, protect margins, and thus drive sustained profitability. The market rewards excess profitability, particularly when it is higher than consensus expectations. The Fund invests in a portfolio of competitive UK companies which we believe will surprise the market with the profits growth.

RISK PROFILE

The Fund is invested exclusively in UK equities. It is invested in stocks throughout the FTSE All-Share Index, with no sector bias. The principal risks are those associated with stock market investments.

TOTAL EXPENSE RATIO: 1.59% (31st December 2008: 1.58%)

FUND CALENDAR

Ex-dividend date	1st January
Income payment date	End of February
Accounting period end	31st December

PERFORMANCE

NET ASSET VALUES

	31st December 2009	31st December 2008	% Change
Income Units <i>Pence per unit</i>	179.61	142.99	+25.61

DISTRIBUTIONS

The Fund distributes income once per annum, at the end of February. The ex-dividend date is 1st January each year. Income can be reinvested to purchase units at no initial charge.

At the end of February 2010, the Fund will pay a dividend distribution for the year ended 31st December 2009 of 3.18 pence per unit (31st December 2008: 2.12 pence per unit).

TOTAL RETURN %

	1 year to 31.12.09	5 years to 31.12.09
Liontrust First Growth Fund	26.9	39.4
FTSE All-Share Index	30.1	36.8
IMA UK All Companies sector average	30.1	28.1

DISCRETE YEARS' PERFORMANCE %

	2009	2008	2007	2006	2005
Liontrust First Growth Fund	26.9	-32.9	9.2	23.2	21.7
FTSE All-Share Index	30.1	-29.9	5.3	16.8	22.0
IMA UK All Companies sector average	30.1	-32.0	2.1	17.4	20.9

Up-to-date past performance information (to the last calendar quarter end) may be obtained from the Fund's most recent fact sheet, available on our website (www.liontrust.co.uk) or by calling our Administration and Dealing team on **0844 892 1007**.

Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally subscribed. The issue of units in the Fund may be subject to an initial charge, which is likely to have an impact on the realisable value of the investment, particularly in the short term. Equity investment should always be considered as long-term.

Performance data source: Financial Express, total return.

PORTFOLIO

TOP TEN HOLDINGS

As at 31st December 2009	%	As at 31st December 2008	%
Royal Dutch Shell 'B' Shares	7.57	Royal Dutch Shell 'B' Shares	11.37
GlaxoSmithKline	6.33	British American Tobacco	4.83
AstraZeneca	5.03	AstraZeneca	4.72
Unilever	4.00	BG	4.55
BG	3.57	BHP Billiton	3.64
British American Tobacco	3.43	Diageo	3.08
Compass	3.33	Rotork	2.78
Diageo	3.27	Reckitt Benckiser	2.66
Reckitt Benckiser	3.20	AMEC	2.40
Petrofac	3.17	BAe Systems	2.34
Total	42.90	Total	42.37

SECTOR WEIGHTINGS

	FTSE All-Share Index		Liontrust First Growth Fund	
	31.12.09		31.12.09	31.12.08
	%		%	%
Basic Materials	11.92		0.00	7.17
Consumer Goods	11.93		13.90	10.57
Consumer Services	9.67		15.71	13.09
Financials	22.78		5.19	3.31
Health Care	7.90		13.28	5.44
Industrials	6.79		24.50	27.54
Oil & Gas	18.25		19.68	27.28
Technology	1.43		6.73	3.53
Telecommunications	5.83		-	-
Utilities	3.50		-	-
			98.99	97.93
Cash (including SSgA* cash deposits)			1.01	2.07
			100.00	100.00

FURTHER INFORMATION

LIONTRUST ASSET MANAGEMENT PLC

Liontrust Asset Management PLC is the holding company of a specialist UK and European equities fund management group, now offering world class fixed income and global equity solutions. It provides process-driven portfolio management services to a range of funds which are targeted primarily at professional investors and advisers. The Group currently manages £1.2 billion. Its management covers segregated and pooled pension fund accounts, unit trusts, offshore accounts, absolute return funds and individual savings accounts on behalf of 12,000 investors.

FURTHER INFORMATION, REPORT & FINANCIAL STATEMENTS

Further information on the Fund and its portfolio, the Manager's Long Final and Interim Reports & Financial Statements and the Prospectus and Simplified Prospectus are available free of charge from the Manager upon request, and from www.liontrust.co.uk.

THE MANAGER

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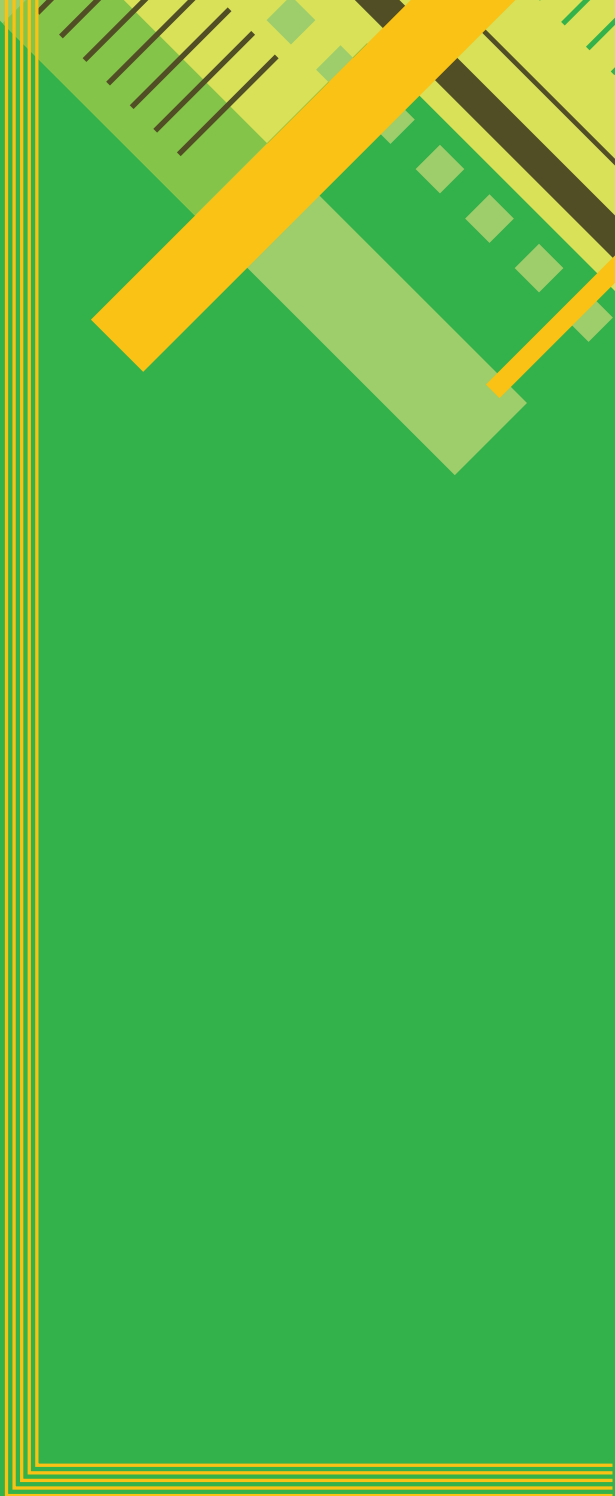
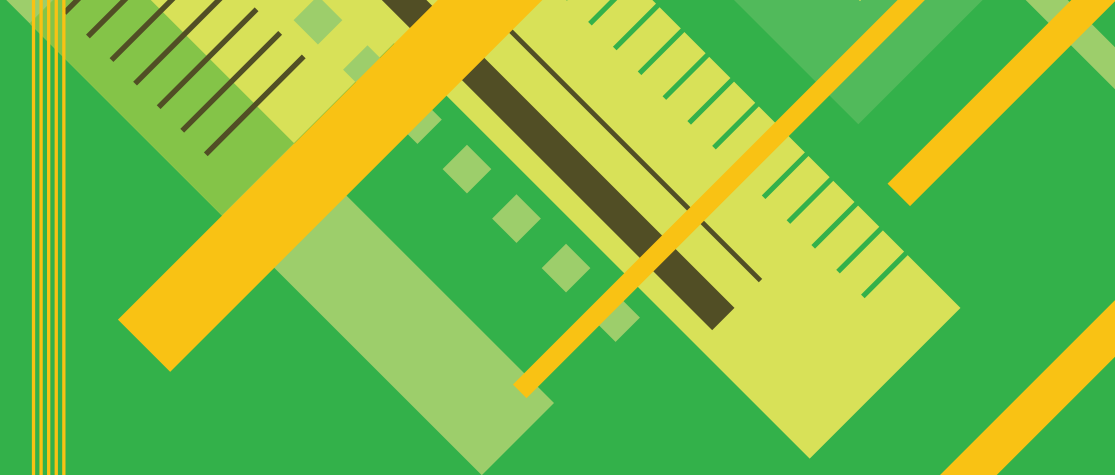
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Authorised and regulated by the Financial Services Authority.



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