

THE LIONTRUST ASIA INCOME PROCESS

An investment process for the Liontrust Asia Income Fund managed by **Mark Williams**



Fund Name	Sector	Fund Type
Liontrust Asia Income Fund	Asia Pacific ex-Japan	UK Authorised Unit Trust UCITS Fund

- The Fund seeks to deliver a high level of income with long term capital appreciation.
- Individual stocks are biased towards companies that tend to have a higher than average prospective yield backed by strong cash flows.
- The Fund aims to have a prospective yield 10% above that of the Asia Pacific ex -Japan markets.

Investment philosophy

Any single investment style is unlikely to deliver consistent outperformance when investing in Asian equities. This is because the region is subject to business and economic cycles despite attempts to dampen them by both governments and central banks. Returns generated by different asset classes and styles of equity investment substantially differ through the business cycle.

The secret to successful investing in Asia, therefore, is to choose the style of investment to suit the particular point in the cycle. In contrast, using a single framework of analysis will lead to significant periods of underperformance.

This flexible and pragmatic approach allows us sufficient freedom to seek to maximise returns from Asian equity markets throughout the cycle.

Investment process

There are four main stages to our process:

1. Identifying the key drivers for Asian equities;
2. Incorporating these into a framework to determine the likely beneficiaries and losers of these drivers and to identify appropriate valuation methods;
3. Fundamental stock analysis to identify individual companies that will benefit the most from the drivers;
4. Portfolio construction.

The process is iterative, in that the information gleaned from management and corporate analysis is as important to the framework as it is to the final stock selection. Portfolio construction is undertaken to reflect all of the aspects of the process, populating the portfolio with the most attractive stocks while diversifying as much risk as possible through a range of drivers and stocks.

Identifying the key drivers

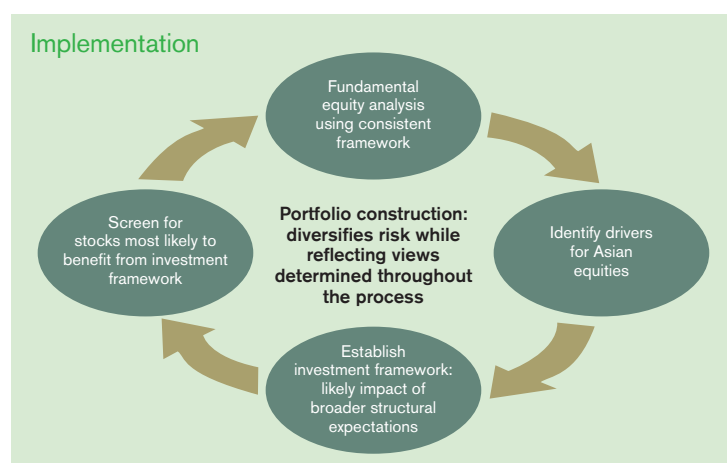
The first stage of the investment process is to identify the key drivers of equity markets through a combination of proprietary and external research, analysing both top down and bottom up information. In addition to fundamental analysis, we gain valuable information from management meetings, both about the company concerned and its competitors, suppliers, industry and market trends.

These drivers will tend to be longer term and are unconstrained, enabling us to reflect those ideas where we have the greatest conviction. They will be continually reviewed to evaluate whether they are likely to remain strong influences on equity markets.

Such drivers cover global, structural, sector and regional themes. They may be formed, for example, due to the position in the macro-economic cycle (globally and regionally), demographic trends, geopolitical developments, structural, regulatory, country and industry changes, innovation, movements in relative valuations or changes in supply and demand dynamics.

As part of this process, we include identification of what we believe to be the most appropriate valuation methodology at any stage of the cycle (in 2008 we looked only at historical price/book as there was no earnings clarity, but as the environment improved in 2009 we moved to forward P/E); size bias (again in the defensive 2008 environment we eschewed small caps, but embraced them in 2009 as government stimulus gained traction); style (although we tend to be a blend of growth and value due to our longer term positive outlook for Asian equities); general macro calls (we were significantly underweight India at the start of 2011 due to country macro concerns and high valuations); and cross sectoral themes.

To give an example from 2011, we believed that Asian demand for soft commodities would continue to rise, in part due to economic growth and in part due to double digit government-led minimum wage rises, at a time when there had been a reduction in some areas of investment following 2008's global financial crisis.



Incorporating drivers into a framework

The key drivers of Asian stock markets form the framework that shapes our research. We determine which types of companies will be the potential beneficiaries and losers of these drivers and therefore efficiently utilise our time and resources to analyse only the likely winners.

In the example we are using, the two longer term drivers of growing Asian demand for soft commodities ahead of supply increases encouraged us to focus resources on the entire food supply chain, across all countries. As a positive, the demand should remain strong and upstream supply weak in some areas; as a negative for many intermediate producers the increase in costs would be hard to pass through to the end consumer. As a result of this, we then looked as far upstream as possible.

Fundamental stock analysis

We do not automatically invest in stocks that will profit from one of the key drivers we have identified. For us to invest, in general, companies must have a high likelihood of providing higher yields than the region's average over the next six to 12 months.

In our analysis of companies, we consider, among other factors, earnings drivers, the consensus view and catalysts for each business and the industries and countries they are in. The valuation measures we use are determined by each key driver and include PER, PEG, P/CF, P/BV, SOTP, EV/EBITDA and P/NAV. An additional bias will be towards companies with high prospective dividend yields supported by strong free cashflows, at appropriate valuations. We use this analysis to compare companies in different Asian countries where earnings are likely to be impacted by the same factors and then invest with those stocks that have the most attractive relative valuations.

In our example, we invested in China Yurun (pork and pork related products) as the company likely to benefit the most from the rise in Asia consumer demand, while being in areas of potential pricing power, and low valuations with a relatively attractive yield.

Portfolio construction

We hold between 50 and 70 positions in our portfolio. The portfolio construction of the Liontrust Asia Income Fund focuses on companies that tend to have higher than average prospective yields and strong cash flows, while reflecting the views derived from the Asia investment process.

In aggregate, the aim is for the portfolio to provide a yield 10% above the Asia Pacific (excluding Japan) markets' average. The Fund seeks to deliver both income (due to vigorous yield analysis) and long-term capital growth (driven by the region's strong growth profile).

Once stocks are identified for inclusion, sizes are determined by our outlook on stock markets and our confidence in each of the key drivers and individual stocks. A target price is established for each stock we invest in.

While the geographical and sector exposures and portfolio construction reflect our key ideas, we also have to ensure there is sufficient diversification at country, sector and stock level, which combine to seek to provide outperformance while mitigating risk. The prerequisite for yield means that the Fund's asset allocation varies significantly from those of any Asia Pacific indices.

Changes in country and sector allocations result from changes in overall confidence in the drivers and the identification of attractive investment ideas within those areas, again requiring significant yields to be available.

Liquidity also represents a key component of each position's (and the overall portfolio's) risk/reward assessment. We invest in sufficiently liquid companies and manage holding sizes so that a significant majority of the portfolio can be traded in one day, within 1/3 of daily average volumes.

Sell discipline

If a target price is exceeded this will trigger a comprehensive review of assumptions, potentially leading to a sale. We will sell a holding or increase or reduce a position for the following reasons:

- An adverse stock movement will lead us to:
 - Increase a position if the investment case remains robust;
 - Sell a position if the market is reflecting new information.
- Identification of an alternative investment with better risk reward will lead to a switch.
- Ongoing alteration of individual position sizes is made to adjust portfolio risk.

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