



LIONTRUST

LIONTRUST EUROPEAN GROWTH FUND

MANAGER'S INTERIM SHORT REPORT
FOR THE PERIOD ENDED 31ST OCTOBER 2010



Managed by Gary West &
James Inglis-Jones in accordance with
The Liontrust Cashflow Solution

THE LIONTRUST CASHFLOW SOLUTION

LIONTRUST EUROPEAN GROWTH FUND IS MANAGED BY **GARY WEST** AND **JAMES INGLIS-JONES** IN ACCORDANCE WITH THEIR INVESTMENT PROCESS FOR EUROPEAN EQUITY PORTFOLIOS, **THE LIONTRUST CASHFLOW SOLUTION.**



This Fund aims to provide long-term capital growth through investment in a concentrated portfolio of mainly European companies (excluding the UK), broadly equally weighted. It invests in companies with strong cash flows which we believe are likely to beat investors' low profit expectations. Cash flows provide an accurate guide to future profits growth. They reveal valuable information about a company's investment decisions and its managers' prudence in recognising reported profits. The concentration of the portfolio could mean that the Fund will be volatile when compared with its benchmark. There are no limits on geographical or industrial sector exposures, which will not closely mirror that of the benchmark.

FUND REVIEW

The Fund made a strong gain of 7.7% in the six months to 31 October 2010. This was better than the FTSE All-World Developed Europe ex UK Index, the Fund's benchmark, which returned +4.4% and the +3.7% average return in the IMA Europe ex UK sector. Since inception in November 2006, the Fund has returned +29.3% compared to the Index return of +10.9% and sector average of +6.7%, placing the Fund comfortably in the top decile. This good return has been achieved steadily over the course of the past four years, although returns in the last year have been particularly strong, showing outperformance of the benchmark of nearly 10%.

Although Europe as a whole continues to struggle under the weight of excessive private and government debt, particularly in the periphery, European equity markets have continued to make strong progress. Investor sentiment has benefited from a stronger than expected recovery in European exports, particularly from Germany and the Nordic countries, and the prospect of further quantitative easing from the US Federal Bank. European investors have taken the view that quantitative easing in the US will leak into asset values worldwide, particularly in those countries that are growing strongly and offer more attractive interest rates.

Although the European market is not an obvious beneficiary of this development, indirectly the prospect of the Fed trying to lift bond and equity asset values and raise US consumption has had a positive, pre-emptive impact on European equities. In our view, the economic benefits of quantitative

easing in the US will prove to be modest. This action reaffirms a policy approach designed to use asset values to create wealth effects in order to boost flagging economic growth. Whilst in the past this policy has proved to have brought about the desired effect in the short term, in the medium to longer term the steadfast refusal of the Fed to moderate incipient asset bubbles has delivered a disastrous roller coaster ride of boom and bust with devastating social and economic costs.

European governments face equally intractable problems to stimulate economic growth and employment. Most European countries are embarking on austerity programmes to reduce budget deficits and long-term debt burdens. The European banking sector urgently needs to recapitalise and European governments in Greece, Ireland, Portugal and possibly Spain are extremely unlikely to be able to restructure their economies successfully without some degree of debt forgiveness. The European Central Bank is providing significant liquidity to these governments and their banking sectors, yet the problem for Europe is one of solvency, not liquidity. The lack of a unified fiscal policy in Europe is exacerbating this condition. In the short term, we would expect this policy mix in Europe to prove deflationary and growth will remain very dependent on China and other emerging markets. In the longer term, we remain of the view that European economies will turn more inflationary, due to demographic changes and a need in real terms to reduce government debt to GDP ratios.

FUND REVIEW CONTINUED

Against this volatile economic backdrop, how has the *Cashflow Solution* process used to run your Fund coped? Investors familiar with our process will know that we carry out detailed research into a company's Report and Accounts to identify conservatively run cash generative businesses with low analyst and investor expectations. When we find these companies, we buy them for your portfolio, adopting an equally weighted approach, in contrast to a weighting scheme based on company size that gives more emphasis to bigger companies in the portfolio. Over the last year, the Fund has benefited from superior stock selection. Our investment process has done a good job identifying companies that have benefited disproportionately from the recovery in economic growth. In our qualitative analysis, we have tried to make sure that companies we selected still offered good value after the exceptional rise of the equity market in 2009. In this regard, we have found it useful to refer to normalised or average measures of cash flow value and have incorporated these measures into our investment process. We are confident that this has enhanced our ability to find value across the economic cycle.

Changes to the Portfolio

The bulk of European companies report year-end annual results in December. A consequence of this is that most of our annual turnover occurs over the course of May and June as we process December year-end Report and Accounts. Companies that fail to score in the best 20% of the market measured on our cash flow ratios are sold. We then assess companies scoring in the best 20% for their

attractions. If they fit the profile of the type of company our process is designed to identify, we will purchase the stock for your portfolio.

Having sold eight companies over the course of the earnings season beginning in January of this year, we then sold a further seven companies in May that failed to generate sufficient cash flows: *Munich Re*, *Topdanmark*, *Kas Bank*, *Colruyt*, *Kuoni*, *Interroll* and *Alstom*. However, these sales were more than offset by the purchase of 20 new additions to the portfolio that passed our assessment of their final results: *Lundin Petroleum*, *Fred Olsen Energy*, *Omega Pharma*, *Nutreco*, *Societe BIC*, *Electrolux*, *Telenor*, *Metro*, *Ahold*, *Axfood*, *Mediq*, *Sodexo*, *Schindler*, *Andritz*, *Semperit*, *Kaba*, *Securitas*, *Umicore*, *Clariant* and *Tessenderlo*. Earlier in the year, we had also purchased *Alfa Laval*, *Metso*, *Kongsberg Gruppen*, *Cargotec* and *M-Real*. The holdings we retained in the portfolio from 2009 were *Bolsas y Mercados*, *Technip*, *Tekla*, *Wincor Nixdorf*, *AstraZeneca*, *Ekornes*, *Mobistar*, *Publicis*, *Vallourec*, *CFE*, *Wacker Chemie* and *Eramet*. These changes had an effect on the sector weights within the portfolio arising from our underlying stock selections. The notable difference was the reduction in your Fund's exposure to Financials which dropped from a sector weighting of 12.3% earlier in the year to only 2.5%, whilst the exposure to Basic Materials and Consumer Goods companies both increased to 10.5% and 16.7% respectively.

The scale of the changes to the portfolio reflects the impact of the financial crisis on company balance sheets and cash flows over the course of 2009. We

found a number of cyclical companies had strong cash flows as a consequence of the working capital benefit brought about by falling sales in 2009. Some of these companies had the characteristics our process seeks to identify and were included in the portfolio.

Clariant, the Swiss speciality chemicals business, was a good example of a cyclical business scoring well on our cash flow ratios with the right qualitative characteristics. New management had reset the priorities of the group to focus on cash generation and cost efficiency. The number of employees had been reduced by 13% in 2009, with a further 9% reduction planned for 2010. The valuation, however, told us that analysts and investors remained sceptical of these efforts. This attitude is not untypical. Often we find that the views of analysts and investors can become entrenched when a company delivers many years of disappointment. In particular, analysts and investors seem to find it hard to quantify the potential earnings benefit that radical restructuring programmes can yield in these cases. A company resetting priorities from a commitment to growth to a focus on cash generation and return on capital is a signal we designed our process to identify. When this shift in focus is sincere and evidenced by clear management action, our experience is that, more often than not, companies will tend to surprise investors and analysts positively with either improved returns on capital or better than expected earnings. *Clariant* has conformed to this pattern. Over the course of this year, analysts have had to roughly double their 2010 and 2011 net income estimates for the group.

Lundin Petroleum, the Norwegian independent oil and gas exploration company, is another example of a company that scored well on our cash flow measures and had the desired characteristics we seek. The group has a significant family shareholding, which in our experience often brings a sharper focus to capital discipline. We were impressed by efforts to bring more focus to the group by spinning off Enquest, the group's entire UK producing, development and appraisal assets, and return capital to shareholders via a share buyback. The group appeared focused on organic growth and appeared cheap after a bout of poor share price performance. *Lundin Petroleum* has proved a significant success for your portfolio this year. The group has doubled in value having reported better than expected earnings on higher volumes than expected in its second quarter results and, more significantly, reporting reservoir studies on its Luno field that were much higher than analysts and investors anticipated.

One particularly successful theme that has emerged from our underlying stock selections has been the high international exposure of some of the companies we own in the portfolio. To the layperson, Europe today gives the impression of a moribund economic region: roiled by sovereign debt crises in its periphery; fears of insolvency in its banks; and a weak consumer. However, Europe is also home to many world class manufacturing and service companies who are benefiting from high demand for their goods and services in the fast growing economies of Asia and Latin America. *Cargotec*, the Finnish cargo handling business we purchased owing to its strong cash flow and focus on cost efficiency, has this year

FUND REVIEW CONTINUED

benefited from significant exposure to Asia-Pacific and the Middle East. *Metso*, the Finish supplier of process plant to the paper and minerals industries we purchased on strong cash flow characteristics, has benefited similarly from its significant exposure to Latin America. Another example in the portfolio is *Andritz*, the Austrian manufacturer of plant machinery, purchased this year owing to its strong cash flow. *Andritz* has benefited from significant geographical exposure to Asia and Latin America. There are other examples in the portfolio; *Schindler*, *Publicis* and *Kaba* to name a few. These are all world class companies with strong cash flows on attractive valuations, deriving significant growth from international exposure. Many of these companies have performed extremely well this year and have made a significant contribution to the strong returns generated by your Fund.

Outlook

The current portfolio is well established and is unlikely to change significantly until we enter the reporting season next year. The content of quarterly results reported so far this year suggests that the portfolio may have less emphasis on cyclicity in 2011. Cyclical companies have begun to re-invest

in working capital as their sales have staged a recovery and this has depleted their cash flow. This may have a significant impact on the sector mix of the companies that score in the best 20% of our cash flow measures in 2011. We expect the market to continue to reward companies that deliver unexpectedly strong returns on capital or earnings. A shift from investor focus on the medium and long-term recovery potential of stocks to a more immediate concern with the content of reported results is typical of the transition to the post recovery phase in stock markets. In a recovering market, earnings expectations are raised dramatically as investors focus on the medium and longer-term benefits companies will reap from the recovering economy. In the post-recovery phase, investors are rightly concerned that companies deliver on their raised earnings expectations and an obsession with the short-term content of reported results becomes the norm. This should provide a good environment for our process to continue to add value to your Fund.

Gary West & James Inglis-Jones

Directors

Liontrust European Investment Services Limited
December 2010

FUND PROFILE

Investment Objective and Policy

The investment objective of the Fund is to provide long-term capital growth through a concentrated portfolio of investments primarily in European companies excluding the UK.

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 equities in companies incorporated in any European Economic Area ("EEA") Member State, together with Switzerland, but other than the UK, which are listed on a recognised stock exchange of an EEA Member State or Switzerland. The Fund may also invest in transferable securities, money market instruments, warrants, cash and near cash and deposits. The Fund may also invest up to 10% of its property in units or shares in collective investment schemes. The Fund is permitted to use derivatives for the purposes of efficient portfolio management and for investment purposes.

Investment Approach

This Fund aims to provide long-term capital growth through investment in a concentrated portfolio of mainly European companies (excluding the UK), broadly equally weighted. It invests in companies with strong cash flows which we believe are likely to beat investors' low profit expectations. Cash flows provide an accurate guide to future profits growth. They reveal valuable information about a company's investment decisions and its managers' prudence in recognising reported profits. There are no limits on geographical or industrial sector exposures, which will not closely mirror that of the benchmark.

Risk Profile

The Fund is invested exclusively in European securities (excluding the UK). The principal risks identified by the manager are those associated with foreign currency risk and stock market investments. The concentration of the portfolio could mean that the Fund's returns are volatile when compared with its benchmark the FTSE All-World Developed Europe ex UK Index.

Total Expense Ratio: 1.64% (30th April 2010: 1.64%)

PERFORMANCE

Net Asset Values			
	31st October 2010	30th April 2010	% Change
Income units <i>pence per unit</i>	116.04	107.70	+7.74

Distributions

The Fund distributes income once per annum, on 30th June. The ex-dividend date is 1st May each year. Income can be reinvested to purchase units at no initial charge.

On 30th June 2010, the Fund paid a distribution for the year ended 30th April 2010 of 1.24 pence per unit (2009: 1.74 pence per unit).

Total Return (%)		
	6 months to 31.10.10	Since launch (15.11.06) to 31.10.10
Liontrust European Growth Fund	7.7	29.3
FTSE All-World Developed Europe (ex UK) Index	4.4	10.9
IMA Europe Excluding UK	3.7	6.7
Quartile Ranking	1st	1st

Discrete Years' Performance (%)					
	1 year to 30.09.10	1 year to 30.09.09	1 year to 30.09.08	1 year to 30.09.07	1 year to 30.09.06
Liontrust European Growth Fund	8.8	21.5	-23.3	-	-
FTSE All-World Developed Europe (ex UK) Index	1.4	16.8	-19.7	20.1	19.3

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, bid-to-bid total return.

PORTFOLIO

Geographical Breakdown				
Country	FTSE All-World Developed Europe (ex UK) Index		Liontrust European Growth Fund	
	31st October 2010 %	31st October 2010 %	31st October 2010 %	30th April 2010 %
Austria	0.82	5.28	–	–
Belgium	2.35	12.64	–	11.97
Denmark	2.60	–	–	3.24
Finland	2.37	11.07	–	15.68
France	23.89	13.92	–	24.96
Germany	18.20	8.38	–	10.86
Greece	0.60	–	–	–
Ireland	0.52	–	–	–
Italy	7.28	–	–	–
Netherlands	6.20	7.42	–	0.61
Norway	2.02	10.22	–	10.15
Portugal	0.85	–	–	–
Spain	9.10	2.31	–	4.14
Sweden	6.90	15.53	–	9.04
Switzerland	16.29	7.66	–	6.26
		94.43		96.91
Cash (including SSgA* cash deposits)		5.57		3.09
Net Assets		100.00		100.00

*State Street Global Advisors

PORTFOLIO CONTINUED

Top 10 Holdings			
As at 31st October 2010		As at 30th April 2010	
	%		%
Lundin Petroleum	3.85	Ekornes	6.75
Umicore	3.41	Technip	6.45
Cargotec	3.27	Vallourec	5.60
Wacker Chemie	3.11	Publicis Groupe	5.51
Ekornes	2.96	Colruyt	4.98
Tekla	2.90	AstraZeneca	4.92
Metso	2.84	Tekla	4.87
Wincor Nixdorf	2.75	Wacker Chemie	4.84
Schindler	2.67	Mobistar	4.38
Nutreco	2.65	Bolsas y Mercados	4.14
Total	30.41	Total	52.44

FURTHER INFORMATION

Unitholder Notice: Investment & Borrowing Powers – Investment in other Collective Investment Schemes

Paragraph 13 (e) of the Fund's Prospectus sets out the limitations for the Fund investing in other Collective Investment Schemes. We have amended the rule references in this clause of the Prospectus so that they reflect the COLL regulations of the FSA Handbook, which replaced the CIS regulations, as previously noted within this clause. Whilst this has the potential to widen the universe of available collective investment schemes available, it is not intended that this will affect the way the fund is currently invested. The investment limits have not changed.

Liontrust Asset Management Plc

Liontrust provides portfolio management services in UK and European equities and in fixed income securities. These are managed on a long-only, long/short and absolute return basis through unit trusts, individual savings accounts (ISAs), offshore funds, pooled pension funds and segregated institutional accounts. The Group currently manages £1.1 billion (as at 30th September 2010).

We market our investment products to professional investors, predominantly in the UK and Continental Europe. These include pension funds and other institutional investors, family offices, private banks, private client managers, multi-managers, stockbrokers and financial advisers. Some private clients, to whom no advice has been given, have chosen independently to invest with us.

Further Information, Report & Financial Statements

Further information on the Fund and its portfolio, the Manager's Long Final and Interim Report & 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

Liontrust Fund Partners LLP, 2 Savoy Court, London WC2R 0EZ.

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Authorised and regulated by the Financial Services Authority.



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