EUROPEAN ABSOLUTE RETURN FUND

MANAGER'S FINAL SHORT REPORT
FOR THE YEAR ENDED 30TH SEPTEMBER 2011

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

THE LIONTRUST CASHFLOW SOLUTION

LIONTRUST EUROPEAN ABSOLUTE RETURN FUND IS MANAGED BY **GARY WEST** AND **JAMES INGLIS-JONES** IN ACCORDANCE WITH THEIR INVESTMENT PROCESS FOR EUROPEAN LONG/SHORT PORTFOLIOS, **THE LIONTRUST CASHFLOW SOLUTION.**

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 Liontrust Cashflow Solution* process identifies a list of companies with strong cash flows which we believe are likely to beat investors' low profit expectations and companies with weak cash flows likely to disappoint on investors' high profit expectations. From this we buy companies generating strong cash flows and sell those with weak cash flows. We take long and short positions in the portfolio using a Total Return Swap derivative (TRS).

FUND REVIEW

The Fund's financial year to the end of September 2011 proved to be a difficult environment for investors. In the first quarter of the Fund's financial year (the calendar fourth quarter of 2010) continued evidence of global economic recovery pushed markets higher. However, in the New Year the sense of optimism gave way to a more sober appraisal of the economic outlook as the political turmoil in the Middle East, the Japanese earthquake and further signs of stress in peripheral Europe's sovereign debt undermined the prevailing positive sentiment. Leading indicators of growth began to weaken and in August the market suffered a sharp sell-off in response to a dramatic increase in risk aversion relating to fears of an economic slowdown, compounded by renewed European sovereign debt contagion issues surrounding the potential default for Greece. Risks of a Japanese-style 'lost decade' or even a second Great Depression loomed large in investor's minds.

Dismay over the seeming inability of Europe's politicians to grasp the severity of the situation and the need for decisive action raised the very real possibility of an unmanaged default in Greece sending a cascade of shocks through the European banking system, resulting in widespread insolvencies. Valuation dispersion across the market, which at the beginning of the year had been at average historic levels, widened dramatically as financial and cyclical stocks were sold aggressively.

Overall the European market returned -11.3% over the course of the year, with the bulk of the poor returns concentrated in August. It is particularly pleasing in light of the disappointing returns of the Fund after it was launched in 2009, that the Fund did a good job insulating investors from this poor outcome, returning +9.7%, significantly better than the IMA Absolute Return universe of funds which returned +0.2%.

Since the Fund was launched in 2009 it has returned +5.9% against a peer group that has returned 9.0%. The Fund had a difficult start as it was launched at a temporary peak in the performance cycle of our *Cashflow Solution* process. Investors will recall that the Fund was launched on the back of the strong performance record of our offshore hedge fund. We wrote in our report a year ago that we felt the environment for our process had improved from the difficult conditions we tend to encounter in sharp stock market recoveries and we are pleased that investors have been rewarded for their continued loyalty. The good recent returns highlight one of the most significant benefits we believe the process brings to investors, namely low correlation with both the peer group and the market. The process generated outstanding returns in our hedge fund during the market turmoil that surrounded the subprime crisis in 2007 and 2008. Whilst performance of the process over the course of the last year has been less explosive it is clear, however, that it has again proved its mettle as a valuable diversification for investors in difficult market conditions.

Performance

There is no doubt that the marginally more defensive orientation of the portfolio in 2011 aided returns particularly in the second half of the Fund's financial year as markets deteriorated. In addition, the interim results season favoured the portfolio with a number of positive results in the long book, as well as some badly received profits warnings from some of our short positions. On a stock level the most notable positive contributors to the Fund's performance were *Lundin Petroleum* (+111.0%), *Tate & Lyle* (+40.2%) and *Stagecoach* (+39.3%).

Lundin Petroleum has been an outstanding performer in our portfolios that we first purchased in 2010, attracted by its cash flows and the clear commitment by the owner managers to careful investment and prudent management. *Lundin's* main geographical sphere of operations is the North Sea and the share price benefited from an oil find last year. Since that date the company managers have increased their assessment of the size of the find on a number of occasions, pushing the share price successively higher. Indeed the find seems to be so significant that it may well prove to be the largest in the North Sea since the 1980s.

Tate & Lyle was sold from the portfolio in June as it failed to generate the cash flow required to qualify for the portfolio in its 2010 results published this year. However, over the course of the Fund's financial year the holding made a significant contribution to performance as investors and analysts applauded the new direction of the group under the management of Javed Ahmed. Ahmed refocused the group prioritising cash flow generation and return on capital, tightening working capital control in the process and making significant asset disposals - the most notable of which was the disposal of its 150 year old sugar operations in Europe to American Sugar Refining for £211m in July 2010. Analysts and investors were slow to realise the benefits of these steps resulting in sequential earnings upgrades from brokers following the stock, driving the share price higher in the process.

Stagecoach performed well due to a number of items of good news from the group. In October last year the results of a government budget review were not as bad as feared. This was followed by a series of solid trading statements, strong final results and the well-received announcement by the group this year of a £340m cash return to shareholders.

The stocks that had the most significant negative impact on the portfolio's return were the short position in *Autonomy* (+40.7%) and two of our long positions: *Wacker Chemie* (-49.3%) and *Clariant* (-41.9%).

In August *Autonomy* received a bid from Hewlett Packard at an 80% premium. Despite the dismay of shareholders in Hewlett Packard, whose board reacted by appointing a new chief executive, the bid went ahead and proved costly to the Fund's performance.

Wacker Chemie performed poorly principally as a result of deterioration in the economic environment. Interim results published in August this year were seen as slightly disappointing by investors despite the company retaining guidance for the year. A particular concern appeared to be contract risk in their polysilicon division and general downgrades to semiconductor related industries, with obvious implications for *Wacker*.

Finally, *Clariant* performed poorly due to a disappointing set of first half results that were impacted heavily by the strength of the Swiss Franc. The Swiss National Bank's determination to announce unlimited intervention to hold back the value of their currency offered the stock some respite; however, as a cyclical chemicals business, analysts and investors perceived risk to company profits in the deteriorating economic environment and this had an impact on the share price.

Portfolio Activity

In June we made significant changes to the portfolio to reflect the outcome of our research into company report and accounts. Investor's familiar with our process will recall that the vast bulk of trading in the portfolio occurs at the beginning of summer due to the fact that most European companies have December year ends. We base our stock decisions on the evidence of cash generation presented in the audited annual accounts and this gives rise to a significant seasonality in trading activity.

The number of investments in the portfolio fell from 46 holdings to 34. This stood in contrast with the number of short positions which increased from 59 to 78. We retained 17 long positions in the portfolio from last year owing to evidence of continued strength in their cash flows. In the short book we held on to 20 positions and added a further 58 stocks to the portfolio. Greater diversification in the short book reflected a lack of the kind of obvious opportunities that were available in 2007. Most of the financial excesses since the unfolding of the financial crisis four years ago have been purged and our response to this on a stock level was to avoid the pitfalls of concentrating the portfolio too heavily on a handful of stocks with weakly poor cash flow signals. By contrast, our analysis of companies with the best cash flows in the market revealed a number of very high quality businesses with strong cash flow signals giving us greater confidence to introduce more portfolio concentration.

On a portfolio level the most notable development was a shift from cyclicality to a more defensively-biased portfolio. This was due to deterioration in the cash flows of cyclical businesses, most of whom had to reinvest in their working capital over the course of 2010 to support higher levels of turnover. The reinvestment of cash into working capital acted as a drain on cash flow with the consequence that it was only higher quality businesses, capable of generating strong cash flows over the course of the economic cycle, which managed to score highly on our cash flow ratios in 2011. By contrast, some of the weaker cyclical businesses found themselves drifting to the bottom of our cash flow screen. This development was best observed in a comparison of risk reports before and after we implemented the changes in June. This analysis showed a significant increase in the portfolios bias to high return on equity companies – a good proxy for quality – whilst the negative bias to price to book and price to sales (through the cycle measures of value that tend to favour cyclical businesses) increased markedly.

Our sector and country positions appeared more balanced than last year; however, our sector positions reflected a more defensive bias. For example, the -11% short position in healthcare stocks was closed to a small positive bet in the sector of +1.5%. The net positive exposure to industrial stocks of +5.5% became a small short position in the sector of -2.5%. On a country level the most important development was a significant reduction in the net long position of +27% in the UK to +12.7% whilst our net long position in Sweden became notable, increasing from +0.1% to +9.2%.

Top 10 Equity Exposures

Long Positions

30th September 2011	% NAV	30th September 2010	% NAV
Lundin Petroleum	3.30	Lundin Petroleum	2.87
Next	2.95	Burberry Group	2.50
Paddy Power	2.85	Cargotec	2.49
Imperial Tobacco	2.66	Ashmore Group	2.24
Shire	2.66	Tullett Prebon	2.15
Stagecoach	2.62	Metso	2.15
Reckitt Benckiser	2.44	Wacker Chemie	2.14
Schindler	2.36	Schindler Holdings	2.12
Sodexo	2.35	Petrofac	2.10
AstraZeneca	2.32	Umicore	2.05
Total	**26.51**	**Total**	**22.81**

Short Positions

30th September 2011	% NAV	30th September 2010	% NAV
Hakon Invest	-1.57	Hexagon	-1.64
Grifols	-1.38	Talvivaara Mining	-1.56
International Power	-1.37	Nokian Renkaat	-1.49
Alpiq	-1.35	Mercials	-1.44
Swiss Re	-1.35	Grifols	-1.41
Construcc Y Aux De Ferrocarr	-1.31	Klepierre	-1.41
Christian Hansen	-1.31	Vienna Insurance Group	-1.40
G4S	-1.28	TalkTalk Telecom Group	-1.39
Autonomy	-1.26	Fraport	-1.39
Randgold Resources	-1.26	Ferrovial	-1.39
Total	**-13.44**	**Total**	**-14.52**

The above table represents the top 10 underlying long and short equity positions in the Fund as can be found in the long-form accounts non statutory portfolio statement. The Top 10 Holdings table on page 10 shows the actual instruments that the Fund uses to achieve its investment objectives.

Outlook

What is concerning about the current investment environment is that never before in the recordable history of financial markets have so many countries had so much debt. If history is any guide to the future this debt load is very troubling for the US and other western developed economies, implying a painful deleveraging episode lasting six to seven years on average. The work of Kenneth Rogoff and Carmen Reinhart has shown that the impact on economic growth can be significant for governments with public debt to GDP in excess of 90% and there are many countries that are fast approaching these levels, some that have even exceeded this threshold. Policy makers appear to have little flexibility to respond to the weak economic outlook. Fiscal stimulus is problematic given the obvious requirement for austerity measures to restore government balance sheets. Interest rates are at record lows. One of the few remaining avenues for stimulus is quantitative easing and exchange rate depreciation. However these policy initiatives raise the risk of a spill over into uncontrollable inflation and the prospect of a round of destructive competitive devaluations. What is surprising in this environment is that many asset classes remain so expensive. Equities, bonds and commodities have rarely been this expensive in aggregate. Despite the recent falls in European equity markets, highlighting a seductive relative valuation advantage, in absolute terms valuations in Europe could not be described as compelling. Most asset classes are, therefore, vulnerable.

We believe the prevailing economic conditions and our assessment that asset valuations are, on the whole, expensive has obvious relevance for this Fund. Constructed to be non-directional, with the sizeable short book that this requires, provides the potential for protection against further deterioration in markets. Over the past five years our cash flow process applied within a hedge fund structure has proved to be an invaluable diversification in difficult market conditions – an apparently scarce commodity given that most hedge funds have generated negative returns in this time period. We believe that our process has the potential in this portfolio to provide better than equity market returns over the long term with significantly less risk. It is the combination of this return potential and the potential for a continuation of low correlation with equity markets that causes us to continue to commit significant sums of our own capital to this Fund.

James Inglis-Jones & Gary West
Fund Managers

FUND PROFILE

Investment Objective and Policy

The investment objective of Liontrust European Absolute Return Fund is to achieve a positive absolute return for investors through a portfolio of investments primarily in equities and equity-related securities (including derivatives for investment purposes) of European companies. It is expected that a positive absolute return is capable of being generated under all market conditions. The Fund will not be benchmarked against any European equity index.

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 and equity-related securities (including derivatives) in companies incorporated in any European Economic Area ("EEA") Member State, together with Switzerland, which are listed on a recognised stock exchange of an EEA Member State or Switzerland. The Fund will not be restricted in choice of investment by either size or sector. The Fund may invest in transferable securities, money market instruments, warrants, cash and near cash and deposits. The Fund may 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

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 Liontrust Cashflow Solution process identifies a list of companies with strong cash flows which we believe are likely to beat investors' low profit expectations and companies with weak cash flows likely to disappoint on investors' high profit expectations. From this we buy companies generating strong cash flows and sell those with weak cash flows. We take long and short positions in the portfolio using a Total Return Swap derivative (TRS).

Risk Profile

The Fund aims to deliver a positive absolute return for investors through a portfolio of long and short investments in equities and equity-related securities (including derivatives for investment purposes) of European companies. The principal risks identified by the manager are those associated with exchange rate risk, counterparty risk and market price risk. Further details on the Fund's risks are available in the full prospectus. The Investment Adviser will receive a performance fee which is based on the appreciation in the Net Asset Value per unit, and accordingly the performance fee will increase with regard to unrealised appreciation, as well as realised gains.

Total Expense Ratio

	30th September 2011	30th September 2010
Class R income units	3.03%	2.17%
Class I income units*	4.50%	–

Included in the total expense figure used in the calculation of the TER is an amount relating to performance fees. The element of the calculated TER that can be directly attributed to performance fees for each class of unit are shown below.

Class R income units 0.99%
Class I income units* 2.86%

* launched 1st November 2010

Fund Calendar	
Ex-dividend date	1st October 2010
Accumulation date	30th November 2010
Accounting period ends	30th September (Final), 31st March (Interim).

PERFORMANCE

Net Asset Value *pence per unit*			
	30th September 2011	30th September 2010	% Change
Class R income units	101.23	92.26	+9.72
Class I income units*	101.10	–	–

* launched 1st November 2010

Accumulation

The Fund accumulates income once per annum, on 30th November. The ex-dividend date is 1st October each year.

Total Return% (capital and income)			
	6 months	1 year	Since Launch (08.07.09) to 30.09.11
Liontrust European Absolute Return Fund	8.29	9.71	5.90
Quartile Ranking	1	1	3

Discrete Years Performance%					
	1 year to 30.09.07	1 year to 30.09.08	1 year to 30.09.09	1 year to 30.09.10	1 year to 30.09.11
Liontrust European Absolute Return Fund	–	–	–	-1.95	9.71

Up-to-date past performance information 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, bid-to-bid basis.

PORTFOLIO

Classification of Investments	% of trust value as at 30th September 2011	% of trust value as at 30th September 2010
Equities	6.87	1.78
Fixed Income	16.42	25.25
Short Term Deposits	40.80	40.40
Derivatives	0.00	1.50
	64.09	**68.93**
Cash (including SSgA* cash deposits)	**35.91**	**31.07**
Net assets	**100.00**	**100.00**

Top 10 Holdings

30th September 2011	%	30th September 2010	%
Close Brothers 1% Sterling Deposit	10.51	Close Brothers 1% Sterling Deposit	10.52
SSgA* Cash Management Fund	9.81	United Kingdom Treasury Bill 0% 04/10/2010	10.50
UK Treasury 0% 07/11/2011	8.59	SSgA* Cash Management Fund	9.94
Santander 0.5% Instant Sterling Deposit	7.49	Close Brothers 0.75% Euro Deposit	9.03
RBS 0.6% 14 Day Sterling Deposit	7.18	Santander 0.3% Instant Sterling Deposit	7.35
Santander 0.8% 15 Day Sterling Deposit	5.35	Santander 0.4% 15 Day Sterling Deposit	6.48
Italy Buoni Ordinari del Tesoro BOT 0% 31/10/2011	4.95	German Treasury Bill 0% 08/12/2010	6.00
RBS 0.5% 7 Day Sterling Deposit	4.32	United Kingdom Treasury Bill 0% 15/11/2010	5.25
Close Brothers 0.55% DKK Deposit	3.13	RBS 0.3% Instant Sterling Deposit	3.51
UK Treasury 3.25% 07/12/2011	2.88	RBS 0.4% 30 Day Sterling Deposit	3.51
Total	**64.21**		**72.09**

*State Street Global Advisors

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.

Change of investment adviser

On 1st July 2011, Liontrust Investment Partners LLP replaced Liontrust European Investment Services Limited as investment adviser to Liontrust European Absolute Return Fund.

Liontrust Asset Management Plc

Liontrust provides portfolio management services in UK, European, Asian and Emerging Markets equities. 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 £1.345 billion (as at 10th November 2011).

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 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.

FURTHER INFORMATION CONTINUED

The Manager

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

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Authorised and regulated by the Financial Services Authority.

NOTES

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