



LIONTRUST

LIONTRUST INCOME FUND

INTERIM REPORT

FOR THE PERIOD ENDED 31ST DECEMBER 2010



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

THE LIONTRUST CASHFLOW SOLUTION

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



This unit trust aims to provide rising dividend payments and reasonable capital growth. It invests in high yielding companies with unusually strong cash flow. We know that companies with unusually strong cash flow. We know that companies often have high dividend yields because investors have low profit growth expectations; in many cases these expectations prove to be wrong. We believe companies with good cash flows are likely to beat investors' low profit expectations, and will be able to pay a high and rising dividend. The Fund seeks to achieve a higher total return than the FTSE All-Share Index, to yield more than index-linked gilts and to provide an income stream for investors that will grow faster than inflation over a five year period. Income is distributed to investors every six months, at the end of February and August.

FUND REVIEW

In the six months to 31 December 2010, the Fund rose 18.0% in value compared to a rise of 22.0% for our UK benchmark, the FTSE All-Share Index. The IMA UK Equity Income peer group, comprising retail funds that offer a comparable dividend yield, rose 19.0% on average.

The interim dividend of 3.11 pence per unit net remains unchanged from a year ago and in line with the guidance provided in our 2010 Annual Report. Our long-term dividend target to grow the Fund's income per unit above the level of inflation remains unchanged. Our investment process is solely focused on a company's cash generation, as we have found this approach gives us a very good idea of a company's dividend paying ability and tells us a lot about how prudently a company has been managed and how profitability is likely to change over the next few years. At current levels, the yield of the Fund is approximately in line with the yield that would be generated by holding a portfolio invested in the top 20% of dividend yielding stocks available in the UK market. This is reassuring.

We know from our analysis of the historical evidence that buying stocks with strong cash flows, that also offer high dividend yields, is a potent combination with the potential to outperform the market materially over time. Our historic analysis was based on portfolios allocating investments evenly across the portfolio as opposed to weighting a stock proportionately based on company market capitalisation. In our last review, we commented that it was our intention to

move the portfolio towards a more evenly weighted portfolio and we have made some progress towards this goal in the last six months. Our intention in 2011 is to make further progress towards an equally weighted portfolio.

Investment Environment

Economic data reported in the second half of the calendar year were generally supportive of the idea that the global economy continued to recover and, as a result, fears of a double dip recession appeared to recede over the course of the six months under review. Monetary policy continued to be supportive, with the Fed embarking on a new round of quantitative easing and the ECB deciding to extend its liquidity facilities and step up purchases of government bonds. The combination of the economic evidence of recovery and increasing policy stimulus was supportive of equity markets, which performed strongly.

As a general observation, cyclical companies in the UK and Europe exposed to emerging markets drove the market higher, whilst companies exposed to domestic markets and more defensive companies tended to fare poorly. The sector composition of returns reflected this. The UK market was driven higher by strong performance from automobiles and parts (+91.1%), leisure goods (+62.3%) and industrial metals and mining (+59.6%) whilst pharmaceuticals and biotech (+2.6%), banks (+6.2%) and aerospace and defense (+7.9%) fared poorly.

Investment Focus

The most significant contributors to the portfolio's return in this period were *Hays* (+48.6%), *Ashmore* (+43.0%) and *Man Group* (+37.5%). Investors responded very well to the first quarter trading update published by *Hays* in October. Whilst there had been concerns that the impact of public spending cuts in the UK could be quite significant for the group, the trading statement drew attention to the strong rates of growth being achieved by *Hays*' international business, particularly in Asia Pacific. The momentum in the business created from its international exposure appeared to take investors by surprise.

Having reported like-for-like growth in gross profits of 8% in its fourth quarter, the trading statement issued in October revealed this had accelerated to 18%.

The strong performance of the emerging market debt specialist *Ashmore* was due to a strong trading statement issued in August, followed by final results in September that appeared to be much better than analysts had expected. Of particular surprise was the degree of growth in assets under management. *Man Group*, the UK hedge fund specialist, also surprised investors positively in its first half results reported in November, which revealed both better than expected growth in assets under management and a turnaround in the performance of its flagship hedge fund AHL.

The most significant detractors from the Fund's performance in this period were *HMV* (-42.2%), *AstraZeneca* (-5.1%) and *Next* (+0.4%). We had purchased *HMV* in July due to its combination of a very high dividend yield and strong historic cash flow.

Unfortunately, the trading environment deteriorated significantly for the group in the second half of the year and, following on from a disappointing trading statement in July, the group issued a profits warning in December. *AstraZeneca* suffered from publishing an underwhelming set of third quarter results in addition to two pipeline setbacks, underscoring the challenges that lie ahead for the group as it endeavours to replace therapies whose patents are due to expire. Finally, *Next* reported third quarter like-for-like growth in its retail stores that was slightly disappointing, causing the shares to underperform the market.

Trading activity was quite significant in the Fund during the period under review. We sold eleven holdings: *Jardine Lloyd Thompson*, *HSBC*, *CML Microsystems*, *Marks & Spencer*, *Stagecoach*, *Euromoney*, *IMI*, *Severfield Rowen*, *Keller*, *BHP Billiton* and *Zotefoams*. These sales were either due to results that failed to rank in the best quintile of our *Cashflow Solution* process or because they were more marginal holdings that we used as a funding source for new ideas. We purchased eight new stocks: *British Land*, *Scottish and Southern Energy*, *United Utilities*, *Halfords*, *Game Group*, *HMV*, *De La Rue* and *Kier Group*. All of these new holdings had the appeal of high dividend yields and strong cash flow characteristics. The effect of these purchases and sales on the sector position of the Fund has been to increase exposure to utilities from 2.9% in July 2010 to 10.5% whilst weightings in consumer services and industrials have been reduced.

Outlook

We commented in our last report that the UK market did not look particularly cheap. As markets have made further progress over the course of the last six months, valuations based on long-term average earnings and the replacement value of assets have begun to look more stretched. Whilst in the short term valuation is a poor guide to market direction, as markets have historically shown a propensity to drift well beyond fair value, over the medium to long term some caution may be warranted. However, current valuation levels highlight the attractions of yield-based strategies with their greater emphasis upon yield as a source of return, as opposed to capital growth. In addition, there is good evidence that in the post recovery phase of markets yield strategies perform particularly well. This suggests that the Fund should be well placed to prosper in the current environment.

Gary West and James Inglis-Jones

Directors

Liontrust European Investment Services Limited

February 2011

FUND PROFILE

Investment Objective and Policy

The investment objective of Liontrust Income Fund is to provide a high level of income with capital values keeping pace with inflation.

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. 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 unit trust aims to provide rising dividend payments and reasonable capital growth. It invests in high yielding companies with unusually strong cash flow. We know that companies often have high dividend yields because investors have low profit growth expectations; in many cases these expectations prove to be wrong. We believe companies with good cash flows are likely to beat investors' low profit expectations, and will be able to pay a high and rising dividend. The Fund seeks to achieve a higher total return than the FTSE All-Share Index, to yield more than index-linked gilts and to provide an income stream for investors that will grow faster than inflation over a five year period. Income is distributed to investors every six months, at the end of February and August.

Risk Profile

The Fund is invested exclusively in UK securities. It is invested primarily in companies listed on the FTSE All-Share Index, but its focus on high yielding equities can mean that its portfolio can differ significantly from the sector breakdown of the Index. The principal risks are those associated with stock market investments. The Fund can also hold fixed-interest bearing securities.

Total Expense Ratio (%)		
	31st December 2010	30th June 2010
Class R income units	1.61%	1.59%
Class I income units*	0.86%	–

* Launched 1st November 2010

Fund Calendar		
Ex-dividend date	Interim: 1st January	Final: 1st July
Income payment date	Interim: End of February	Final: 31st August
Accounting period ends	Interim: 31st December	Final: 30th June

PERFORMANCE

Net Asset Values pence per unit			
	31st December 2010	30th June 2010	% Change
Class R income units	126.53	109.87	+15.16%
Class I income units*	126.72	–	–

Distributions pence per unit			
Interim 31st December 2010			
Class R income units			3.11
Class I income units*			3.11
	Interim 31st December 2009	Final 30th June 2010	Total 2010
Class R income units	3.11	3.31	6.42
	Interim 31st December 2008	Final 30th June 2009	Total 2009
Class R income units	3.66	4.32	7.98

The Fund distributes income twice per annum, an interim dividend paid at the end of February and a final dividend paid on 31st August. The ex-dividend dates are 1st January and 1st July each year. Income can be reinvested to purchase units at no initial charge.

Total Return (capital and income)		
	6 months to 31.12.10	Fund Manager Inception to 31.12.10**
Liontrust Income Fund	18.0	64.9
FTSE All-Share Index	22.0	64.9
Quartile Ranking	3rd	1st

Discrete Years' Performance (%)					
	2006	2007	2008	2009	2010
Liontrust Income Fund	16.8	-8.9	-34.9	25.1	14.4
FTSE All-Share Index	16.8	5.3	-29.9	30.1	14.5

* Launched 1st November 2010

Gary West and James Inglis-Jones took over management of the Fund on 25.3.09. 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.

Performance data source: Financial Express, bid-to-bid basis, total return. 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

Top 10 Holdings			
As at 31st December 2010		As at 30th June 2010	
	%		%
Royal Dutch Shell 'B' Shares	9.05	AstraZeneca	8.91
Vodafone	5.98	Royal Dutch Shell 'B' Shares	7.90
BP	5.87	Vodafone	5.75
AstraZeneca	5.56	IMI	5.13
Electrocomponents	5.07	Electrocomponents	4.75
Ashmore	4.66	BP	4.66
Scottish & Southern Energy	4.22	Ashmore	3.87
Hays	4.04	Tate & Lyle	3.84
Legal & General	3.99	IG	3.79
Tate & Lyle	3.87	Next	3.74
Total	52.31	Total	52.34

Sector Weightings				
	FTSE All-Share Index		Liontrust Income Fund	
	31st December 2010 %	31st December 2010 %	31st December 2010 %	30th June 2010 %
Basic Materials	14.08	–	–	3.15
Consumer Goods	11.30	3.87	3.87	3.84
Consumer Services	9.66	12.17	12.17	14.56
Financials	22.64	25.99	25.99	24.60
Health Care	6.91	8.81	8.81	12.30
Industrials	7.29	17.44	17.44	20.55
Oil & Gas	16.85	14.92	14.92	12.56
Technology	1.57	–	–	0.34
Telecommunications	6.02	5.98	5.98	5.75
Utilities	3.68	10.51	10.51	2.89
		99.69	99.69	100.54
Cash (including SSgA* cash deposits)		0.31	0.31	-0.54
		100.00	100.00	100.00

*State Street Global Advisors

FURTHER INFORMATION

UNITHOLDER NOTICES

Introduction of the Institutional Unit Class

On the 1st November 2010 the Fund launched the institutional unit class, Class I, available to professional investors.

Change to Fund name

On 30th September 2010 the Fund changed its name from Liontrust First Income Fund to Liontrust Income Fund.

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 £1.3 billion (as at 31st December 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 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

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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