



JULY 2006

Liontrust First Growth Fund
(authorised unit trust): £219m

Liontrust First Equity Fund
(offshore fund): £13m

Liontrust First Exempt Fund
(pension fund pooling vehicle): £123m

INVESTMENT PHILOSOPHY

– *THE LANG APPROACH*

- When a company announces higher than expected profits analysts revise their forecasts. This can drive share prices upwards as the market digests and catches up with events.
- Companies that have recently surprised the market with their profits have a tendency to do so again.
- By focusing on companies that have recently surprised, *The Lang Approach* aims to identify companies whose potential to surprise the market in the future is, we believe, underestimated by stock market analysts.

THE PORTFOLIO

- The portfolio will invest in a range of companies from throughout the FTSE All-Share Index whose profits growth has recently been greater than the market's expectations.
- To reduce volatility and achieve greater consistency of performance the portfolio will be kept well diversified with no stock exceeding three times the average overweight position.

JEREMY LANG

Managing Liontrust First Growth Fund for ten years

INVESTMENT COMMENTARY

The Private Equity Three Card Trick

Private equity perplexes me. Why would a fund manager ever want to buy shares from a private equity seller? Private equity owners encourage their companies to cut capital expenditure to the bone, aggressively cut costs and squeeze as much free cashflow out of the business, as quickly as possible. They are driven by aggressive rate of return hurdles (often 25% per annum at least) and rapid payback. They attempt to sell businesses when they look at their best – with high *current* cashflow. But I am dubious as to how sustainable these cashflows are. I have noticed that companies which have been sold into the stockmarket by private equity owners frequently see a sharp pick up in capital expenditure. The companies will tell you this is to fund all their new growth opportunities, but I wonder whether it isn't just to catch up on all that capital expenditure they skipped while they were private. Also private equity funds sell their businesses once the incumbent management have made lots of money. Management have an incentive to keep the company looking good for a couple of years, so they can sell their shares, but then, who cares?

I am a member of a Holmes Place gym. I find conjuring up the enthusiasm to go to the gym pretty difficult, so going to a nice gym helps. I have noticed a distinct change in my gym since they were bought by a private equity firm. Nearly all the good staff have left, the previously spacious, relaxing foyer is now like a market bazaar, the quite nice shampoo in the showers has been replaced by cheap stuff, the changing rooms are looking scruffy and they are trying to jack up the fees. They are cutting capital expenditure, cutting costs, cutting service and squeezing the customer for more money. They will soon lose me as a customer, but I bet their cashflow looks good at the moment.





Equally, why would a fund manager ever want to sell his shares to a private equity buyer? They only want to buy your shares if they think they can make at least 25% a year from their investment. And they have no magic wand to get this incredible return. After all private equity firms buy and own exactly the same thing fund managers own – a share in a company's cashflow.

Why would anybody want to invest in private equity? Studies in the US and Europe have shown that, after fees, private equity returns are the same as the stockmarket, or less (depending on which study you read). They do not offer you diversification either. They may offer you the illusion of diversification – private equity funds typically have a 10 year life and you only really know how much you have made when the fund is liquidated. In the meantime private equity owners only usually sell their investments when they can make money, and you have to take the fund's word for it how much the currently unsaleable stuff is worth. In the end, I repeat, they own the same thing as a stockmarket investor – corporate cashflow.

Private equity can give you more than stockmarket investing. For starters you get more risk. Private equity funds leverage the underlying cashflow of their investments around four times more than a publicly quoted company. So you have four times the financial risk. By rights the private equity funds' returns should be a lot higher than a stockmarket investment because of this extra leverage. Yet they are not. You can get a similar level of gearing, if you fancy it, through a stockmarket investment. They are called Split Capital Trust Capital Shares.

Private equity owners can provide company management with more financial motivation. This is because remuneration can be delivered in a much more tax efficient way (through gifting shares to management which are then only subject to 10% tax when they are sold). This can make management much keener on running the business better. The only problem is once the private equity owners sell the business to fund managers the company management can cash in their shares (or if they are sneaky, they can borrow against them) and their incentive is gone.

I am envious of three aspects of private equity investment, which are hard to come by when investing in the stockmarket. First the fees. Private equity typically charges 2% base fee plus 20-30% of the upside. Second, no benchmark. Private equity managers don't worry about benchmarks, because there aren't any. Third, they get to be patient. Typically they have up to 10 years to get an investment right and their investors have to have a 10 year investment horizon to invest with them. Just think, if stockmarket investors would let you gear up by 4 times, pay you big fat fees, tell you not to worry about the benchmark and just make them some money over the next 10 years ... The thing is, you can buy into fundamentally the same thing as private equity funds (corporate cashflows) and get all the benefits with much lower costs if you could only relax, not look at your investment for 10 years and leave your fund manager alone so he can make you some money.





Liontrust First Growth Fund - Portfolio Review

If you have been watching share prices everyday you will have found the last quarter fairly “exciting”. In April everything felt so comfortable, so risk free, as the market strung together month after month of seemingly effortless climb. Then came the summer. For a few days in May and June the benchmark indices in the UK were showing a loss for the year. Yet not much has changed.

The Fund is still up on the year, and returning more than the market. The vast majority of our stocks have kept delivering surprisingly strong earnings growth and have been rewarded. (As you will know, I look for companies which can surprise the market with higher than expected profits growth.) The growth trends that I identified last year continue to unfold. So there has been little to do on the portfolio. I feel like a gardener doing a bit of Spring weeding, having put in all the hard work last Autumn. Not much was done, so not much to write.

Jeremy Lang

Joint Investment Director, Liontrust Investment Services Limited.

July 2006.





1. PERFORMANCE

Liontrust First Growth Fund

Cumulative years

Source: Lipper, bid to bid basis, net income reinvested at ex-dividend date. Figures to 30.6.06

	1 year	2 years	3 years	4 years	5 years	Since 1.4.96*
Liontrust First Growth Fund	+23.0%	+38.7%	+51.1%	+41.1%	+23.0%	+153.2%
FTSE All-Share Index	+19.7%	+42.2%	+66.1%	+49.9%	+27.8%	+118.0%
Average UK all companies sector unit trust	+18.8%	+37.9%	+61.5%	+49.4%	+26.0%	+118.8%
Performance vs. benchmark	+3.3%	-3.5%	-15.0%	-8.8%	-4.8%	+35.2%
Sector quartile ranking	1st	2nd	4th	3rd	2nd	1st

(* Jeremy Lang assumed the management of the Fund on this date).

Discrete years

Source: Lipper, bid to bid basis, net income reinvested at ex-dividend date.

	1 year to 30.6.02	1 year to 30.6.03	1 year to 30.6.04	1 year to 30.6.05	1 year to 30.6.06
Liontrust First Growth Fund	-12.8%	-6.6%	+8.9%	+12.8%	+23.0%
FTSE All-Share Index	-14.8%	-9.7%	+16.9%	+18.8%	+19.7%
Average UK all companies sector unit trust	-15.7%	-7.5%	+17.1%	+16.1%	+18.8%
Performance vs. benchmark	+2.0%	+3.1%	-8.0%	-6.0%	+3.3%
Sector quartile ranking	1st	2nd	4th	4th	1st

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.





2. SECTOR ALLOCATION versus FTSE ALL-SHARE INDEX

Liontrust First Growth Fund

Sector	FTSE All-Share Index %	Liontrust First Growth Fund %	Relative Weights %
Industrials	7.1	24.1	+17.1
Oil & Gas	16.7	25.8	+9.1
Basic Materials	7.7	10.9	+3.2
Technology	1.0	4.0	+3.0
Health Care	8.8	6.3	-2.5
Utilities	4.3	1.2	-3.1
Telecoms	5.5	1.4	-4.1
Consumer Goods	9.0	2.9	-6.1
Consumer Services	11.8	5.6	-6.2
Financials	28.2	15.0	-13.2
Cash	-	2.8	-

3. MARKET CAP. WEIGHTINGS

	FTSE 100 Index (%)	FTSE Mid 250 Index (%)	FTSE Small Cap. Index (%)	Cash (%)
FTSE All-Share Index	82.8	14.0	3.2	-
Liontrust First Growth Fund	54.1	32.3	10.8	2.8

4. TOP TWENTY HOLDINGS

Liontrust First Growth Fund

	(%)		(%)
1. BP	7.5	11. British American Tobacco	1.4
2. Royal Dutch Shell 'B' Shares	7.1	12. BAe Systems	1.4
3. GlaxoSmithKline	5.1	13. Vodafone Group	1.4
4. Barclays	2.5	14. Man Group	1.3
5. Rio Tinto	2.4	15. International Power	1.2
6. Anglo American	2.2	16. Charter	1.2
7. BG Group	2.2	17. Xstrata	1.1
8. BHP Billiton	2.2	18. Wolseley	1.1
9. Aviva	1.6	19. Rolls-Royce Group	1.1
10. Standard Chartered	1.6	20. Robert Walters	1.1

Total 46.5% (53.5% held in a further 77 stocks and cash)





5. RISK ANALYSIS

<i>Five years to 31.3.06 bid to bid basis, net income reinvested at ex-dividend date.</i>	FTSE All-Share Index	Liontrust First Growth Fund
Mean annual return	5.92%	5.08%
One month low	-11.76%	-8.38%
One month high	9.37%	7.80%
Maximum drawdown	-34.15%	-30.12%
Percentage of positive months	63.33%	68.33%
Alpha (annual basis)	0	-0.59
Beta	1	0.85
Correlation Coefficient	1	0.95
R Squared	1	0.90
Relative Risk	1	0.90
Risk adjusted performance (annual)	0	-0.66
Sharpe ratio (annual)	0.12	0.07

Source: Asset Risk Consultants © 2005.

Glossary of Terms

MEAN ANNUAL RETURN : An arithmetic average (mean) of the monthly returns during the review period, multiplied by twelve.

MAXIMUM DRAWDOWN : The greatest loss that could have been experienced by an investor over the entire review period.

ALPHA : A measure of the portfolio's expected return when the benchmark produces no movement.

BETA : The amount the Fund is expected to gain or lose when the benchmark moves by one unit. It takes account of the relative risk of the Fund as well as the correlation of movements between the Fund and the benchmark.

CORRELATION : Measures the coincidence of movement that occurs between the Fund and the benchmark. Correlation coefficients can take values from +1 to -1. Correlation of +1 would indicate that the two portfolios move in perfect unison. A correlation of zero would indicate no relationship between the two. A negative correlation would indicate that they move in opposite directions.

R SQUARED : Measures the degree of explanation that can be made about movement in the Fund by a movement in the benchmark. A value of 100 equals 100% explanation. R Squared is also known as 'goodness of fit'.

RELATIVE RISK : The risk of the Fund measured in relation to the benchmark's risk which has a value of 1.00. Calculated by dividing the volatility of the Fund by that of the benchmark.

RISK ADJUSTED PERFORMANCE : The difference between the Fund and the benchmark return where the benchmark's return has been adjusted to the level of risk of the Fund. It is thought of as a measure of 'value-added' by a manager.

SHARPE RATIO : A measure of the annual excess return divided by the annualised standard deviation of returns of the benchmark. Excess returns are those in excess of the risk-free rate of return.

Bulletin Board News from Liontrust

JEREMY LANG - 10 YEARS AT LIONTRUST

Jeremy Lang passes his 10th anniversary as manager of Liontrust First Growth Fund and Liontrust First Income Fund.

A ten year track record - how many other fund managers can boast a continuous record as long as this? A recent survey showed that 62% of fund managers have changed jobs in the last three years.

Jeremy Lang and William Pattison, Liontrust's Joint Investment Directors, first started working together twenty years ago.

- William has managed Liontrust First Large Cap. Fund since its launch in 1999.
- Anthony Cross has managed The Liontrust Intellectual Capital Trust for 8 years since its launch in January 1998.
- Our two new fund managers, Gary West and James Inglis-Jones, have worked together for 9 years, many of those with William prior to his arrival at Liontrust in 1999.

We understand the importance to investors of stability in an investment team. We strive to do as much as we can, both in working environment and through incentivisation, to ensure the stability of the fund management team.