1irst & Foremost

A periodic bulletin for portfolios managed by Jeremy Lang in accordance with The Lang Approach.

LIONTRUST

Fourth Quarter 2000

First Growth Fund: £333.9m, First U.K. Investment Trust: £45.4m
First Exempt Fund: £135.8m, First Equity Fund: £26.3m

Quarterly movements (1 July - 30th September): FTSE 100: -5.7%; All-Share: -5.6%; Mid-Cap: -5.4%; Small Cap: -4.0%

e-Bop

I remember watching an interview with the jazz trumpeter Miles Davis. He was old and looked like he had done too much, much too young. He wore an incongruous bright spangley jump suit. The interviewer asked Miles what drove him to be a pioneer in so many aspects of his music. He replied that all he cared about was change.

There are two types of change, and Miles only cared about one. There is flip-flop change - change that is transitory and easily reversed. This is the change of economic cycles, boom and bust. Then there is permanent, secular change, the type of change where there's no going back and the type that Miles cared about.

There is a lot of change going on. Last week I read comments on a fairly typical cross section of companies in the UK. Slightly more than a third of the companies issued profits warnings, a third had said trading was as expected and slightly less than a third were beating forecasts. This is a fairly normal split in recent times.

What was less usual was the type of companies that were surprising and disappointing. Most of the profits warnings were from companies that, on the face of it, are particularly vulnerable to temporary, cyclical change: engineering, chemical and retailing companies. These types of companies often issue profits warnings as the economy dips into a recession. But we are not entering a recession.

I am fairly sure we are not on the verge of a recession because there are industries that one would expect to be disappointing if a recession was imminent that are not. Also there are cyclical industries that contain both disappointing and surprising companies. What a lot of companies that are issuing profits warnings do have in common is that they are pretty capital intensive. Hence, it appears to me, we are involved in the type of changes beloved of Miles: a secular, no going back change.

There are a number of secular changes at the moment, but the most profound of these relates to the fundamentals of capitalism. Since the industrial revolution there has been an almost inexorable substitution of what economists call 'capital' - plant and machinery - for labour. The mechanisation of industry and the division of industrial processes into small specialist units through investment in factories, plant and equipment has caused great leaps in the wealth of capitalist countries. Since the industrial revolution companies have pushed hard to mechanise tasks so they can replace workers with machinery, and have designed industrial processes so that workers operate like machines.

This has lead some economists to worry whether we will end up with a society where practically everything is made by machines and no one works. But recently something interesting has been happening: capitalism is being re-humanised.

Companies sought to replace people with machines because the return on capital made this worthwhile. But capital doesn't hold the upper hand anymore. This is why so many capital intensive companies are issuing profits warnings at the moment: the return on capital is falling, while the return on labour is rising.

This has profound effects on the type of organisation that will be successful in a modern economy. Traditional companies own the sources of their profit - they own the factories and the machinery. Modern successful companies own virtually no capital at all, and are prevented by law from owning the main source of their profits - people. Instead they rent people, invest in them by training and supporting them, and organise them in a productive way.

Hence the perception of businesses 'where the assets walk out of the door every night' has changed. These types of businesses used to be viewed with suspicion - as a shareholder you didn't own anything tangible - and were not valued very highly. Increasingly, however shareholders are realising that these types of companies can be very valuable, especially when owning capital is a low return exercise.

Hence the valuation attached to advertising agencies, fund management and IT service companies has mushroomed, because they possess something that yields potentially high returns - smart people organised in a smart way.

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Meanwhile old fashioned capital intensive companies are finding that sustaining a return on capital much above interest rates is difficult, if not impossible. In many cases sustaining profitability at all is proving difficult as the high cost of exit leads to many industries getting trapped with too much capital.

But it isn't all high returns in businesses dominated by people. Shareholders only get a good return if the way people are organised yields significant value. Compare football clubs with ad agencies. Football is a team sport, but not much gets past the players; ad agencies are full of individually creative people, but the process of running an ad campaign has many components so the organiser is valuable.

In economic be-bop capital is dead, long live creative organisers.

Funds Review

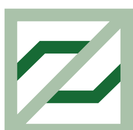
Most of our stocks have continued to release good news over the quarter, and expectations have generally been on the rise. This has resulted in another relatively modest burst of trading at the quarter end - I have taken the decision to sell seven stocks. Five of the seven sales had released disappointing news, either poor results or trading statements. Of the other two *Daily Mail* was sold because the reasons why I originally bought it appeared to have run their course. *Aggregate Industries*, while still experiencing upgrades to forecasts, was sold due to worrying news from some companies that operate in similar areas. I bought six new stocks in their place.

Hanson delivered some disappointing results during the quarter. That precipitated its sale and the sale of *Aggregate Industries*. I originally bought both companies for broadly the same reasons. They operate in a fairly simple business - digging holes in the ground to extract basic building materials like rock and sand. Rock and sand is heavy and bulky, so it becomes expensive to transport over long distances. This makes it is a fairly good business because each quarry tends to have relatively little local competition. Demand is affected by general contraction activity, like housebuilding, and infrastructure spending like road building. In the UK things have generally been disappointing, despite a lot of building. Not much activity in road building and legislation to promote the recycling of building waste have had a big, negative, impact on overall demand. However, both these companies have sizeable operations in the America. In America, after much political wrangling, a major road building and maintenance program, TEA 21, was passed by Congress. This promised to lead to a step change in demand for aggregates. I had expected this to feed through to surprisingly strong results for *Hanson* and *Aggregate Industries*. Unfortunately the impact of TEA 21 has proven to be a lot patchier than expected. Some States have been quick to implement it while others have been very slow. Meanwhile other construction activity in America has started to slowdown and oil prices (an important cost) have stayed stubbornly high. *Hanson* blamed all three for its disappointing results. It looks like I may have mistaken earlier good news from these companies as early indications of TEA 21 surprising when it was really just a burst of temporary strong demand from housebuilding. *Aggregate Industries* released some good results, ahead of forecasts, but the signs don't look good - *Hanson* has not been the only company in this area to disappoint - a large US listed company - Vulcan - has complained of similar things.

We have kept an interest in the construction sector through an earlier purchase of *RPS*, and a new holding in *WSP*. Both are consulting engineers, although with expertise in different areas. *RPS* does a lot environmental consultancy work, particularly for water utilities, as well as more conventional design work for the construction sector. *WSP* does a lot more structural engineering and design work for property development companies, but has been quite adept at expanding its offering. Both are benefiting from some favourable changes in the construction industry, such preferred provider agreements, PFI and National Lottery funded projects. However, unlike building contractors, the competitive environment is relatively benign and these firms do not take on project risk - they earn fees that are not tied to fixed price contracts. In addition the consulting engineering industry has historically been made up of a large number of small private firms. This is providing a steady stream of acquisition targets at sensible prices, so both *WSP* and *RPS* can augment strong organic growth with regular small acquisitions.

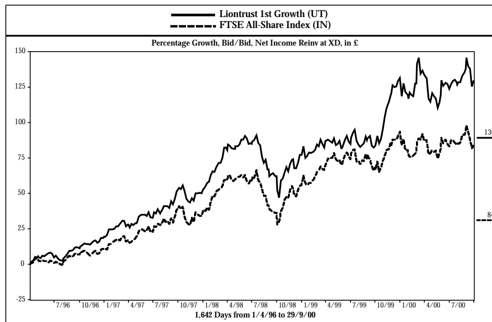
In the rest of the Funds the broad themes remain unchanged. We have a lot of stocks that are benefiting from the many forms of outsourcing. We hold a few IT stocks, particularly those exposed to the telecom or utility sectors. We have electronics companies that are experiencing strong demand from telecom and consumer electronics companies, and we have advertising related companies, such as ad agencies and market research firms to take advantage of the changes in the way all sorts of companies view advertising and marketing - necessary not discretionary, and increasingly necessary as competition intensifies.

Jeremy Lang, Joint Investment Director, Liontrust Investment Services Limited - October 2000.



LIONTRUST FIRST GROWTH FUND

Comparative Performance since 1/4/96*



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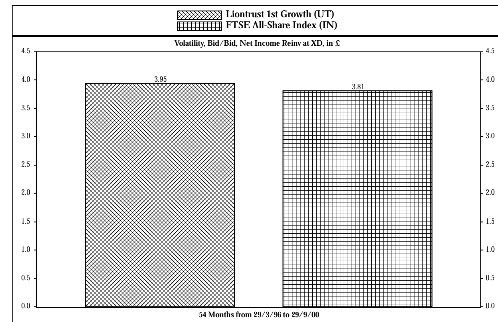
Volatility since 1/4/96*



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SECTORAL PERFORMANCE

Source: Lipper, bid to bid basis, net income reinvested at ex-dividend date. Figures to 29.09.00	**One Year**	**Since 1.4.96**	**Five Years**	**Since launch (8.3.93)**
First Growth Fund	+25.4%	+129.6%	+151.6%	+292.0%
FTSE All-Share Index	+9.8%	+84.2%	+100.7%	+167.3%
UK All Companies sector average	+13.9%	+82.7%	+99.6%	+163.7%
Performance vs. benchmark	**+15.6%**	**+45.4%**	**+50.9%**	**+124.7%**
Sector quartile ranking	**1st**	**1st**	**1st**	**1st**

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

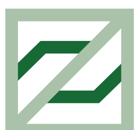
LIONTRUST FIRST U.K. INVESTMENT TRUST PLC (2 October 2000)

			NAV performance:	6 months	1 year
Share price (mid)	:	159.0 pence	First U.K. Investment Trust	+1%	+27%
Net Asset Value	:	164.4 pence	FTSE All-Share Index	-4%	+7%
Discount/(premium)	:	3.3%	UK general sector (size weighted average)	+2%	+19%

Source: Datastream

SECTOR ALLOCATION versus FTSE ALL-SHARE INDEX

Sector	**FTSE All-Share Index**	**First Growth Fund**	**First U.K. Investment Trust PLC**
Resources	13%	11%	12%
Basic Industries	2%	2%	2%
General Industrials	3%	5%	5%
Cyclical Consumer Goods	0.5%	0%	0%
Non-Cyclical Consumer Goods	16%	15%	16%
Cyclical Services	15%	21%	21%
Non-Cyclical Services	16.5%	15%	15%
Utilities	4%	3%	3%
Information Technology	6%	7%	8%
Financials	24%	17%	18%
Cash	n/a	4%	0%



MARKET CAP. WEIGHTINGS (rounded figures)

	FTSE 100 Index	FTSE Mid 250 Index	FTSE Small Cap Index	Cash
First Growth Fund	69%	21%	6%	4%
First U.K. Investment Trust	71%	22%	6%	1%

TOP TWENTY HOLDINGS (combined portfolios)

1.	BP Amoco	(7.9%)	8.	Vodafone Certificate Notes	(2.6%)*	15.	Serco Group	(1.9%)
2.	Vodafone Group	(7.2%)	9.	Royal Bank of Scotland	(2.6%)	16.	Aggreko	(1.9%)
3.	AstraZeneca	(4.3%)	10.	WPP Group	(2.3%)	17.	Capita Group	(1.8%)
4.	HSBC Holdings	(4.3%)	11.	British Telecom	(2.1%)	18.	Matalan	(1.8%)
5.	Shell Transport & Trading	(3.5%)	12.	Centrica	(2.1%)	19.	Pace Micro Technology	(1.7%)
6.	SmithKline Beecham	(3.4%)	13.	ARM Holdings	(2.0%)	20.	Tesco	(1.6%)
7.	Glaxo Wellcome	(3.3%)	14.	Barclays	(2.0%)			

First Growth Fund: 60.2% (39.8% held in a further 45 stocks and cash)
First U.K. Investment Trust: 67.4% (32.6% held in a further 44 stocks and cash)

* Held in Liontrust First Growth Fund

RISK ANALYSIS

Source : Lipper, 54 months to 29.09.00, bid to bid basis, net income reinvested at ex-dividend date.

	FTSE All-Share Index	First Growth Fund
Total return	84.2%	129.6%
Mean annual return	14.65%	19.91%
One month low	-10.65%	-9.00%
One month high	8.09%	13.00%
Maximum drawdown	-15.50%	-13.51%
Percentage of positive months	68.52%	68.52%
Alpha (annual basis)	0.00	6.06
Beta	1.00	0.91
Correlation Coefficient	1.00	0.87
R Squared	100.00	76.12
Relative Risk	1.00	1.04
Risk adjusted performance (annual)	0.00%	4.95%
Sharpe ratio (annual)	0.63	0.99

(Comparative information is not calculated for First U.K. Investment Trust PLC and is therefore unavailable).

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.

FINANCIAL CALENDARS

First Growth Fund (UK authorised unit trust)

Accounting dates	Interim	: 30 Jun	Final	:	31 Dec
Ex Dividend date	Final	: 01 Jan			
Payment date	Final	: end Feb			

First U.K. Investment Trust (London listed investment trust)

Accounting dates	Interim	: 30 Sep	Final	:	31 Mar
Ex Dividend date	Final	: June			
Payment date	Final	: July			

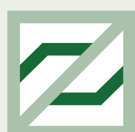
First Exempt Fund (Pension Fund Pooling Vehicle)

Accounting dates	Interim	: 31 Aug	Final	:	End Feb

Accumulates income daily.

First Equity Fund (Guernsey OEIC 'B' Scheme Sub Fund)

Accounting dates	Final	: 30 Sep
Ex Dividend date		: 01 Oct
Payment date		30 Nov



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