



September 2002

Liontrust First Income Fund: £190m

INVESTMENT PHILOSOPHY - THE VALUE DYNAMIC

- Extreme expectations, and stock prices that have moved a lot, have a tendency to come back to the average - investors over-react to extreme events.
- The unwinding of over-reaction is remarkably consistent. Five year losers, judged on previous price falls, have a strong tendency to bounce back, and generally keep going for at least three years.
- An investor can exploit this over-reaction by concentrating on stocks with unusually high yields.
- Historically, when the number of these stocks has averaged more than twenty, the returns have been spectacular. And in 1999, 2000 & 2001, there were 62, 76 & 119 respectively. Thus far the returns from these stocks have been as high as history suggests they should be. The numbers remain high.

THE PORTFOLIO - LIONTRUST FIRST INCOME FUND

- When the number of these high yielding stocks is high, the portfolio will be more aggressively constructed, with few sector constraints.
- When the number is low, the portfolio will be matched closer to the sector distribution of the benchmark index, with stock selection focused on achieving a portfolio yield 25% higher than the FTSE All-Share Index. We also aim to grow the portfolios dividend every year. We want good yield and income growth because both are important for total returns

INVESTMENT REVIEW:

2002 has been quite kind to us so far. The Fund has outperformed the FTSE All-Share Index by over 12% (with income reinvested, to 31.8.02), albeit in a pretty lousy period for the Index (down 17%).

Eight months is a relatively short period, particularly given my aims for the Fund. Sometimes the Fund doesn't return more than the two benchmarks I aim to beat over such short periods (the FTSE All-Share Index and long dated index linked gilts). This doesn't worry me when it happens, and it shouldn't worry you, because I invest for the long term. I invest in UK stocks that I think can give us a better return than both the overall UK stock market and long dated index linked gilts over the coming five years. Reassuringly, the Fund has continued to succeed in this aim - it has provided a return comfortably ahead of these two alternatives over the last five years.

I invest in a deceptively simple way: I buy stocks with attractive dividend yields. For a stock to have an attractive yield it must either yield comfortably more than a long dated fixed interest gilt, or it must yield more than a long dated index linked gilt and have dividend growth prospects at least as good as inflation.

By being strict on yield, and hence price, I am naturally led to stocks that have already performed badly and which most other investors don't like. My experience is that other investors often behave irrationally towards high yielding stocks that have performed badly. They frequently think prospects are far worse than is likely. Often the reasons why other investors don't like a particular share now will leach away with time.

I rarely buy shares in good companies. More often I buy shares in fairly poor companies other investors believe are particularly dreadful, or average companies other investors view as uninspiring or poor. I take a long term view and I am prepared to hold shares in a company for as long as five years.

Sometimes stocks on high yields do turn out to be genuinely dreadful, and subsequently cut their dividends. I try hard to avoid buying such companies in the first place, but I am not always successful. So, once a year, I do a health check on my stocks. I take a hard look at all the stocks I have bought. If I think I have got it wrong I sell them.

As a result of my fixation with dividends I often end up with a portfolio that looks very different to the FTSE all-Share Index. This has been true for the last few years, and is still the case. Despite the recent falls in the UK stock market, it still looks pretty unappealing from a dividend yield perspective. The yield is low by historical standards and the prospects for dividend growth do not look good. There are, however, still plenty of attractive stocks around, so I think we should have another reasonable year.

Jeremy Lang
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1. PERFORMANCE

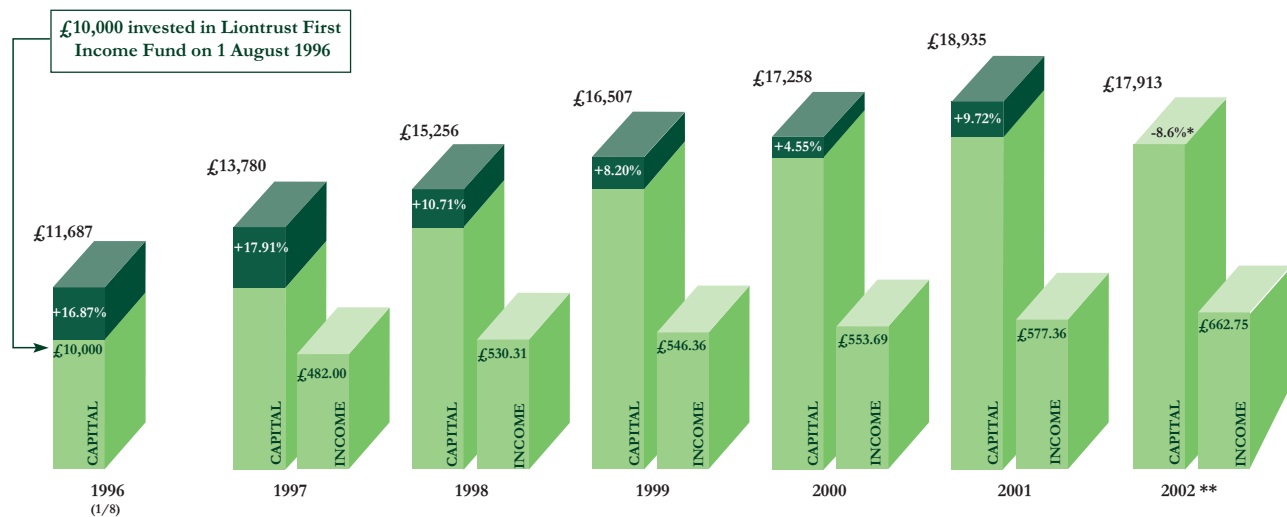
Liontrust First Income Fund:

Source: Lipper, bid to bid basis, net income reinvested at ex-dividend date. Figures to 31.08.02

	6 months	1 year	3 years	Since 1.8.96*
Liontrust First Income Fund	-6.1%	-3.6%	+18.2%	+113.6%
FTSE All-Share Index	-15.8%	-19.0%	-25.2%	+30.3%
Average UK equity income sector unit trust	-12.2%	-16.0%	-13.5%	+45.5%
Performance vs. benchmark	+9.7%	+15.4%	+43.4%	+83.3%
Position in sector	12th/98	7th/90	5th/82	3rd/74
Sector quartile ranking	1st	1st	1st	1st

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

How an investment of £10,000 would have performed under Jeremy Lang's management:



Bar charts are not to scale. Capital performance figures bid to bid basis, net income withdrawn, source: Lipper Limited. Income figures source: Liontrust Investments Funds Limited.

■ Represents the capital growth of the Fund each calendar year.

* Liontrust First Income Fund is down 8.6% in 2002, while the FTSE All-Share Index is down 19.2%

** To 31.8.02

On 1st August 1996 the full offer price of the Fund was 72.76 pence: £10,000 invested on that date would have purchased 13,838.92 units.

Liontrust First Income Fund pays a dividend twice a year, at the end of February (interim) and 31st August (final). The current estimated net annual yield is 4.6%.

Past performance is not a guide to future performance. The price of units and the income from them can fall as well as rise and are not guaranteed.



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2. SECTOR ALLOCATION versus FTSE ALL-SHARE INDEX

Sector	FTSE All-Share Index (%)	Liontrust First Income Fund (%)
Resources	17.0	4.7
Basic Industries	3.4	10.4
General Industrials	2.6	12.0
Cyclical Consumer Goods	0.3	2.0
Non-Cyclical Consumer Goods	19.3	11.5
Cyclical Services	14.2	28.7
Non-Cyclical Services	10.2	0.9
Utilities	4.0	0.9
Information Technology	0.9	1.4
Financials	28.1	19.0
Fixed Interest	0	1.9
Cash	n/a	6.6

3. MARKET CAP. WEIGHTINGS

FTSE 100 Index (%)	FTSE Mid 250 Index (%)	FTSE Small Cap Index (%)	Fixed Interest (%)	Others (%)	Cash (%)
32.6	31.7	23.0	1.9	4.2	6.6

4. TOP TWENTY HOLDINGS

1	GlaxoSmithKline	(3.9%)	11	ICAP	(1.7%)
2	BP	(3.7%)	12	Bradford & Bingley	(1.7%)
3	Lloyds TSB	(3.3%)	13	Scottish & Newcastle	(1.6%)
4	Abbey National	(2.8%)	14	Carlton Communications	(1.5%)
5	Barclays	(2.7%)	15	Low & Bonar	(1.5%)
6	Royal Bank of Scotland	(2.5%)	16	City Centre Restaurants	(1.5%)
7	Aviva	(2.4%)	17	Croda International	(1.5%)
8	Alliance & Leicester	(1.9%)	18	British Vita	(1.5%)
9	New Look	(1.9%)	19	GWR Group	(1.5%)
10	Boots	(1.8%)	20	TT Electronics	(1.5%)

Total: 42.4% (remaining 57.6% held in a further 55 stocks and cash).



5. RISK ANALYSIS

Source: Lipper. 72 months to 31.7.02, bid to bid basis, net income reinvested at ex-dividend date.

	FTSE All-Share Index	Liontrust First Income Fund
Total return	34.01%	119.38%
Mean annual return	6.00%	14.04%
One month low	(10.28)%	(10.90)%
One month high	8.18%	8.19%
Maximum drawdown	(32.6)%	(16.2)%
Percentage of positive months	61.11%	72.22%
Alpha (annual basis)	0%	8.16%
Beta	1	0.80
Correlation Coefficient	1	0.86
R Squared	100	74
Relative Risk	1	0.93
Risk adjusted performance (annual)	0%	8.14%
Sharpe ratio (annual)	0.01	0.61

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.....

■ Our Group funds under management continue to grow, despite the difficult market conditions, rising to £1.916 billion with £380 million in transition as at 4th July 2002*. This is compared to £1.750 billion with £234 million in transition on 21st March 2002*, since when the FTSE All-Share Index has fallen 11%. (*The dates of our Stock Exchange announcements.)

■ **Liontrust First Large Cap. Fund**, nearing its third anniversary, continues to achieve consistent outperformance of its benchmark. It is one of only 4% of funds that have maintained a position in the first or second deciles in the performance rankings of the UK All Companies sector over 3 months, 6 months, year-to-date, 1 & 2 years and since launch (14.10.99).

(Source: Lipper, bid to bid basis, net income reinvested at ex-dividend date, to 31.8.02.)

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