# LIONTRUST EUROPEAN GROWTH FUND

## MANAGER'S SHORT INTERIM REPORT
FOR THE PERIOD ENDED 31ST OCTOBER 2013

Managed by James Inglis-Jones &
Samantha Gleave in accordance with
**The Liontrust Cashflow Solution**

# THE LIONTRUST CASHFLOW SOLUTION

LIONTRUST EUROPEAN GROWTH FUND IS MANAGED BY **JAMES INGLIS-JONES** AND **SAMANTHA GLEAVE** IN ACCORDANCE WITH THEIR INVESTMENT PROCESS FOR EUROPEAN EQUITY PORTFOLIOS, **THE LIONTRUST CASHFLOW SOLUTION**.

This Fund aims to provide long-term capital growth through investment in a concentrated portfolio of mainly European companies (excluding the UK), broadly equally weighted. It invests in companies with strong cash flows which we believe are likely to beat investors' low profit expectations. 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 concentration of the portfolio could mean that the Fund will be volatile when compared with its benchmark. There are no limits on geographical or industrial sector exposures, which will not closely mirror that of the benchmark.

# MARKET ENVIRONMENT

## Market Environment

Speculation over the timeline for withdrawal of monetary stimulus by central banks – particularly the US Federal Reserve – dominated the six months to 31 October 2013. Nevertheless, this uncertainty did not alter an investment environment which continued to be very benign, with quantitative easing (QE) supporting broad asset price rises and indiscriminate equity market gains.

Fed Chairman Ben Bernanke made comments in a June press conference in which he indicated that tapering of bond purchases under its QE programme may begin later in 2013. The market response was sharp, with the MSCI Europe ex-UK index losing almost 5% over the month and the gold price dropping by over 10%. The Fed, ECB and BoE subsequently all sought to reassure markets that policy would remain accommodative and markets recovered the lost ground in July. Nevertheless, there was still substantial speculation regarding the timing of QE tapering, and consensus developed that the Fed's September meeting would see the first scaling back of its bond purchases, with an average expectation for a $10-$15bn reduction from the Fed's rate of $85bn/month. However, the Fed unexpectedly chose to maintain the same rate of purchases at its September meeting as it awaited 'more evidence that [economic] progress will be sustained'.

An escalation of concerns regarding Syria and the potential for western military intervention prompted a brief bout of risk aversion, but this was quelled as signs emerged that the US and Russia were making progress on an agreement to target the elimination of Syria's chemical weapons. Political brinkmanship in the US also appeared as if it might derail the equity rally as Congress initially failed to tackle either an end-September deadline to agree a budget to avoid partial government shutdown or the need to extend the $16.7tn US debt ceiling by mid-October. Investors displayed a high degree of confidence that the debt ceiling stalemate would be ended in time (which it eventually was), while the shutdown – which was also resolved in October – actually served to boost sentiment in many respects; with government departments shut, there was an effective economic data vacuum which led to the belief that QE tapering would be further postponed. While events in Europe garnered less attention than those in the US, they were also largely conducive to an environment of positive sentiment, as illustrated by ECB President Mario Draghi's October comments that the possibility of a rate cut was under consideration.

## Analysis of Portfolio Return

In the six months to 31 October 2013 the Fund returned 5.9% compared with the 10.9% performance of the MSCI Europe ex UK index and 11.7% return of the peer group (the IMA Europe ex UK sector).

The prevailing investment environment provided a headwind to the Fund as cashflow-based investment strategies did not perform well. This has been true for much of the last 18 months.

# MARKET ENVIRONMENT CONTINUED

The most rewarding investment strategy during the six months under review was a focus on stocks on inexpensive valuations as measured by metrics such as their accounting net asset value and after tax profits relative to market capitalisation. Usually, these measures of valuation perform well in an environment of rising optimism and enthusiasm for risky assets. Measures of quality continued to fare poorly with companies earning high returns on equity and high returns on invested capital meaningfully underperforming companies earning the lowest returns on capital. Cash flow is often seen by investors as a proxy for fundamental quality but as equity markets have progressed higher the attractions of company cash flows seem to have been largely ignored. Our experience, and historic analysis of the European market, suggests that the Cashflow Solution process will go through periods when it does not deliver strong relative returns. History reveals that the process can lag the market when optimism is high and market returns are strong but this tendency is more than offset by the benefits of the cash flow strategy acting defensively when markets come under pressure and risky assets are shunned. The long term record of the strategy remains strong: since its launch at the end of 2006 it has returned 58.1% to investors – better than the market which has returned 33.4% and the peer group which has returned 39.7%.

Analysing the performance of individual stocks in the portfolio over the six months under review the best returns were generated by Nobel Biocare (43.7%), UPM-Kymmene (+39.1%) and Actelion (+18.9%). Shares in Nobel Biocare rose strongly on the back of Q2 results which revealed a 2.3% constant-currency sales increase, the first quarter of growth for the dental implant manufacturer in two years. Sales in Europe returned to growth after six years of declines. UPM-Kymmene also benefited from the strength of results it reported during the period. The release of Q2 results in August showed that growth in its pulp and label materials divisions was compensating for lower volumes in its paper division. The company also stated that fixed costs saving measures announced in January 2013 were on schedule, with 40% of the targeted annualised cost savings having been achieved. It subsequently released Q3 results in October which exceeded investors' expectations as cost cutting at the paper division boosted earnings in the face of a 4% decrease in prices and deliveries for European markets. Shares in Swiss pharmaceutical company Actelion rose steadily throughout the six months. The company, which has been the subject of some speculation that it could be a bid target, in October was granted approval by the US Food and Drug Administration for its Opsumit pill to tackle hypertension. An EU advisory panel also recommended the drug be approved.

The worst performing stocks in the portfolio over the six months were TGS Nopec (-22.3%), Barco (-17.1%) and Lundin Petroleum (-16.3%). TGS Nopec and Barco both found it necessary to downgrade their profit guidance as the period progressed. Shares in seismic data provider TGS Nopec suffered a 15% drop in October on the day of a Q3 update in which it revised its full year revenue guidance down from a $920m-$1bn range to $810m-$870m. In a Q3 trading update, Barco – a provider of projections and other visual display products – said it had seen robust orders but weak shipments. This, together with the strength of the euro, led management to downgrade its full year guidance to low single digit revenue growth. A combination of underwhelming drilling results and weakness in the Swedish kroner relative to sterling contributed to a poor return from Lundin Petroleum.

## Portfolio Activity

In May there was significant portfolio activity as we restructured the Fund to bring it into line with our research findings following our annual review of companies with December year ends in Europe (representing about 80% of our universe). The aim of the Cashflow Solution investment process is to find and invest in companies that have strong cash flows that are underappreciated by the market, and are run by company managers that invest those cash flows intelligently. The most important research resource is a company's annual report and accounts. However, before we will spend time analysing a set of report and accounts the company has to be identified as attractive by our cash flow screening process.

Following the implementation of the annual review the portfolio became slightly more concentrated with 26 holdings compared with the 31 stocks we held prior to the restructuring. We initiated 12 new investments: Actelion, Barco, Bilfinger, Delhaize Group, Gerry Weber, Hugo Boss, Lonza Group, Michelin, Statoil, Swedish Match, UPM-Kymmene and Yara International. Holdings in 17 companies were sold: Aker Solutions, Andritz, Anheuser-Busch, ASML, Bolsas y Mercados, CHR Hansen, Diasorin, Infineon Technologies, Jeronimo Martins, JM AB, Leoni, Pirelli, Publicis, SAP, Umicore, Valeo and Wacker Chemie.

Following this year's review, the portfolio retains a bias towards high quality growth although the magnitude is less than prior to the restructuring. We have included a number of highly cash generative growth stocks in our selection this year. The bias against 'cheap' stocks as measured by conventional yardsticks such as price/earnings significantly reduced – with the inclusion of some companies that are attractive to us as a result of their high cash flow yields and restructuring programmes – although there is a continued modest negative exposure to more contrarian measures of value which tends to be a structural bias of the process. On a sector level notable developments have been an increased exposure to healthcare and a reduced exposure to technology. On a country level there is increased exposure to the Nordic region.

## Outlook

Having taken a back seat in the strong equity market returns of the last 18 months we believe our cash flow strategy today is now much better placed. The prospects for contrarian risk-seeking strategies emphasising measures such as price-to-book and price-to-sales would seem to be dimmer as valuation spreads globally have collapsed – implying that investors can buy growth and quality for a comparatively modest premium. In addition third party analysis has shown that contrarian value strategies have become crowded in Europe, implying disappointing 12-14 month returns, higher volatility and vulnerability to market inflections.

We remain of the view that a focus on the timing of the slow withdrawal of exceptional monetary stimulus in the US makes the prospect of further equity re-rating dimmer. In addition, the elevated expectations of recovery now embedded in through-the-cycle valuations may cause investors to scrutinise financial results as they unfold with more care looking for tangible evidence of improvement. At a point in time when company fundamentals may assume more importance investors are – through this Fund – able to access a list of European stocks on attractive share valuations which generate significant cash flows and are run by company managers committed to using that cash flow intelligently.

**James Inglis-Jones and Samantha Gleave**
Fund Managers
December 2013

Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise.

# FUND PROFILE

## Investment Objective and Policy

The investment objective of the Fund is to provide long-term capital growth through a concentrated portfolio of investments primarily in European companies excluding the UK.

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 in companies incorporated in any European Economic Area ("EEA") Member State, together with Switzerland, but other than the UK, which are listed on a recognised stock exchange of an EEA Member State or Switzerland. 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 Fund aims to provide long-term capital growth through investment in a concentrated portfolio of mainly European companies (excluding the UK), broadly equally weighted. It invests in companies with strong cash flows which we believe are likely to beat investors' low profit expectations. 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. There are no limits on geographical or industrial sector exposures, which will not closely mirror that of the benchmark.

## Risk Profile

The Fund is invested exclusively in European securities (excluding the UK). The principal risks identified by the manager are those associated with foreign currency risk and stock market investments. The concentration of the portfolio could mean that the Fund's returns are volatile when compared with its benchmark the MSCI Europe ex UK Index.

## Risk and Reward Profile

The Risk disclosures are in accordance with CESR guidelines and are consistent with rating disclosed in the KIID.

**Lower Risk**
Typically lower rewards

**Higher Risk**
Typically higher rewards

| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|

- The indicator is based upon historical data and may not be relied upon to gauge the future risk profile of the Fund.
- The risk and reward indicator shown is not guaranteed and may shift over time.
- The lowest category (1) does not mean 'risk free'.
- The Fund's risk and reward category has been calculated using the methodology set by the European Commission. It is based upon the rate by which the Fund's value has moved up and down in the past.
- The Fund is categorised 6 primarily for its exposure to securities (equity) of larger and smaller European companies.

The risk and reward indicator does not take into account the following Fund risks:

- That a company may fail thus reducing its value within the Fund.
- Overseas investments carry a higher currency risk. They are valued by reference to their local currency that may move up or down when compared to the currency of the Fund, which is pounds sterling.
- The Fund will comprise both growth and value companies as appropriate.
- The Fund may, under certain circumstances, make use of derivative instruments but it is not intended that their use will materially affect volatility.

## Ongoing Charges Figure

| | 31st October 2013 | 30th April 2013 |
|---|---|---|
| Class R income units | 1.74% | 1.74% |
| Class I income units | 0.99% | 0.99% |
| Class A income units | 1.22% | 1.23% |

# PERFORMANCE

| Net Asset Values *pence per unit* | | | |
|---|---|---|---|
| | 31st October 2013 | 30th April 2013 | % Change |
| Class R income units | 135.63 | 127.85 | 6.09% |
| Class I income units | 136.57 | 128.20 | 6.53% |
| Class A income units* | 137.21 | 129.01 | 6.36% |

| Distributions *pence per unit* | |
|---|---|
| | 30th April 2013 |
| Class R income units | 1.89 |
| Class I income units | 2.78 |
| Class A income units* | 1.08 |

The Fund distributes income once per annum, on 30th June. The ex-dividend date is 1st May each year. Income can be reinvested to purchase units at no initial charge.

* A class launched 17th December 2012.

| Total Return (%) | | | | | |
|---|---|---|---|---|---|
| | 6 months | 1 year | 3 years | 5 years | Since launch* |
| Liontrust European Growth Fund | 5.9 | 20.9 | 22.3 | 103.4 | 58.1 |
| MSCI Europe Ex UK Index | 10.9 | 32.0 | 25.4 | 74.6 | 33.4 |
| Quartile Ranking | 11.7 | 31.3 | 31.0 | 91.5 | 39.7 |

| Discrete Years' Performance (%) | | | | | |
|---|---|---|---|---|---|
| To previous quarter, 12 months ending: | Sep '09 | Sep '10 | Sep '11 | Sep '12 | Sep '13 |
| Liontrust European Growth Fund | 21.5 | 8.8 | -6.1 | 10.7 | 18.5 |
| MSCI Europe Ex UK Index | 14.7 | 0.9 | -14.0 | 11.4 | 27.8 |

* Launched 15th November 2006.

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 Fund holds a concentrated portfolio which could mean that it will be volatile when compared to its benchmark index. 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, bid-to-bid basis, total return as at 31.10.13 (based on retail units).

# PORTFOLIO

| Geographical Breakdown | | | |
|---|---|---|---|
| | MSCI Europe Ex UK Index | Liontrust European Growth Fund | |
| Country | 31st October 2013 % | 31st October 2013 % | 30th April 2013 % |
| Austria | 0.65 | 0.00 | 3.28 |
| Belgium | 2.67 | 6.42 | 5.94 |
| Denmark | 2.50 | 3.44 | 6.12 |
| Finland | 2.05 | 5.04 | 0.00 |
| France | 22.37 | 8.48 | 10.59 |
| Germany | 20.18 | 15.37 | 13.97 |
| Greece | 0.10 | 0.00 | 0.00 |
| Ireland | 0.78 | 4.59 | 3.42 |
| Italy | 5.22 | 0.00 | 6.10 |
| Netherlands | 6.08 | 0.00 | 3.16 |
| Norway | 1.89 | 15.42 | 12.63 |
| Portugal | 0.40 | 0.00 | 3.56 |
| Spain | 7.62 | 4.22 | 7.46 |
| Sweden | 7.13 | 13.40 | 13.20 |
| Switzerland | 20.34 | 21.14 | 10.41 |
| | | **97.52** | **99.84** |
| **Cash (including SSgA* cash deposits)** | | **2.48** | **0.16** |
| **Net Assets** | **100.00** | **100.00** | **100.00** |

* State Street Global Advisors

## Top 10 Holdings

| 31st October 2013 | % | 30th April 2013 | % |
|---|---|---|---|
| UPM - Kymmene | 5.04 | Roche | 4.07 |
| Nobel Biocare | 4.73 | Amadeus IT | 4.03 |
| Actelion | 4.47 | Publicis | 3.92 |
| Vivendi | 4.29 | OC Oerlikon | 3.70 |
| Wincor Nixdorf | 4.28 | Wincor Nixdorf | 3.67 |
| Amadeus IT | 4.22 | DiaSorin | 3.57 |
| Michelin | 4.19 | Jeronimo Martins | 3.56 |
| OC Oerlikon | 4.11 | Anheuser-Busch InBev | 3.55 |
| Lonza | 4.02 | SAP | 3.54 |
| Hugo Boss | 4.02 | TGS Nopec Geophysical | 3.53 |
| **Total** | **43.37** | **Total** | **37.14** |

# FURTHER INFORMATION

## Unitholder Notice

At the beginning of September 2013, Gary West retired from Liontrust and fund management and will no longer be managing the Liontrust European Growth Fund. Samantha Gleave joined Liontrust a year ago as part of the succession plan and is co-manager of the Fund with James Inglis-Jones. There is no change in the investment process and how the Fund is managed.

## Liontrust Asset Management Plc

Liontrust, which was founded in 1994, is an independent fund management group whose shares are quoted on the London Stock Exchange. We manage £3.6 billion (as of 11 November 2013) in UK, European, Asian and Global equities, Global Credit and Multi-Asset. We take pride in having a distinct culture and approach to asset management. This comes through the following factors:

- Liontrust is an independent business with no corporate parent.
- We use rigorous investment processes that are robust and scaleable to ensure they are capable of delivering superior long-term performance. Investment processes ensure the way we manage money is predictable and repeatable.
- We provide a culture that gives all fund managers the freedom to manage their portfolios according to their own investment processes and market views without being distracted by other day-to-day aspects of running a fund management business.
- We aim to treat clients, investors, members, employees and suppliers fairly and with respect. Therefore, we are committed to the principles of Treating Customers Fairly (TCF) and they are central to how we conduct business across all our functions.

## 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 Key Investor Information Documents (KIIDs) 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 Conduct Authority.

## NOTES

# NOTES

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