CF LINDSELL TRAIN UK EQUITY FUND

December 2008

All data at 31st Dec 2008

Fund Objective

To invest in the securities of companies which are listed, quoted or dealt on any of the markets of the London Stock Exchange, including the Alternative Investment Market (AIM), with the objective of achieving capital and income growth and providing a total return in excess of that of the FTSE All Share Index.

Fund Size	£120 mn
Accumulation Share Price	£0.8429
Income Share Price	£0.8462

Source: Lindsell Train Limited and Capita Financial Administrators Limited.

Portfolio Manager:	Nick Train
Fund Type:	FSA Authorised Collective Investment Scheme
Type of Scheme:	Non UCITS Retail
Class:	Accumulation & Income Units
Launch Date:	10 Jul 2006
Base Currency:	Sterling
Min Investment:	£500,000 Subsequent: £1,000
Year End:	31 May
Dividend:	XD dates: 30 Nov; 31 May Paydates: 31 Jan; 30 Sep
Benchmark:	FT All Share
Initial Charge:	0%-2%, subject to ACD's discretion
Management Fees:	Annual Fee 0.65%
Authorised Corporate Director: (ACD)	Capita Financial Managers Limited
Administrator:	Capita Financial Administrators Limited
ISIN:	Acc: GB00B18B9X76 Inc: GB00B18B9V52
Bloomberg:	Acc: LTUKEQALN Inc: LTUKEQA LN
Sedol:	Acc: B18B9X7 Inc: B18B9V5
Lipper:	65022060

Fund Breakdown

Top 10 Holdings (% NAV)	
Unilever	11.8
Diageo	11.5
Cadbury	10.9
Pearson	7.8
Reed Elsevier	5.9
Schroders	5.2
Rathbones	4.4
Thom Reuters	4.2
Sage Group	4.1
Hargreaves Lansdown	3.2

Industry Breakdown (% NAV)		
Equity	Banks & Financials	20.8
	Consumer Goods	4.1
	Food & Beverage	40.4
	Leisure & Entertainment	2.8
	Media	21.0
	Retail	2.2
Preference Shares		1.0
Cash & Equivalent		7.7
Total		**100.0**

Fund Exposure	***Bonds***	***Prefs***	***Equity***	***Funds***	***Cash***	***Total***
UK %	-	1.0	91.3	-	7.7	100.0
Total %	**-**	**1.0**	**91.3**	**-**	**7.7**	**100.0**

Fund Performance

Past performance is not a guide to future performance. The price of shares and the income from them may go down as well as up. Investors may not get back what they invested.

- CF LT UK Equity Fund comprises the Accumulation & Income Classes.
- The CF LT UK Equity Fund performance is based on total returns (dividends reinvested), net of fees.

Standardised Discrete Five Year History (%)	***Dec 2003 Dec 2004***	***Dec 2004 Dec 2005***	***Dec 2005 Dec 2006***	***Dec 2006 Dec 2007***	***Dec 2007 Dec 2008***
CF LT UK Equity Fund	NA	NA	NA	+2.2	-25.8
FTSE All Share Index	NA	NA	NA	+5.3	-29.9

Source: Bloomberg and Lindsell Train

Standardised Discrete Quarterly Performance (%)	***Jan 2008 Mar 2008***	***Apr 2008 June 2008***	***Jul 2008 Sep 2008***	***Oct 2008 Dec 2008***
CF LT UK Equity Fund	-12.1	-9.5	-2.6	-4.2
FTSE All Share Index	-9.9	-1.4	-12.2	-10.5

Source: Bloomberg and Lindsell Train.

Calendar Year 2007 Monthly Performance	***Jan***	***Feb***	***Mar***	***Apr***	***May***	***Jun***	***Jul***	***Aug***	***Sep***	***Oct***	***Nov***	***Dec***	***YE 2007***
CF LT UK Equity Fund	+0.5	-0.6	+5.0	+2.2	+4.4	-5.6	-2.0	-1.3	+1.7	+2.7	-4.9	+0.6	**+2.3**
FTSE All Share Index	-0.3	-0.2	+3.3	+2.5	+2.8	-0.6	-3.3	-0.3	+1.9	+4.4	-4.7	+0.3	**+5.3**

Calendar Year 2008 Monthly Performance	***Jan***	***Feb***	***Mar***	***Apr***	***May***	***Jun***	***Jul***	***Aug***	***Sep***	***Oct***	***Nov***	***Dec***	***YE 2008***
CF LT UK Equity Fund	-9.3	+0.7	-3.8	+1.3	+1.4	-11.9	-0.5	+6.8	-8.3	-8.5	-0.6	5.3	-25.8
FTSE All Share Index	-8.7	+0.7	-2.1	+6.3	-0.2	-7.1	-3.6	+5.0	-13.2	-11.9	-1.6	3.7	-29.9

Source: Lindsell Train.

Introduction

Your Fund outperformed its FT All-Share benchmark in calendar 2008, after a rollercoaster year. The NAV, with dividend reinvested, declined a still sobering 25.8%, while the All-Share fell 29.9%. It is noteworthy that in the second half of the year the Fund outperformed by some margin, "only" losing 6.2%, compared to the 18.2% drop for the FT All-Share. This divergence of relative return between the first and second six months of the year can be largely explained by the Company's nil exposure to shares in the Commodity/ Mining sectors. The strategy lagged badly as the bull market in such companies went "exponential" through H1 2008, but rebounded after the eventual derailing of the boom. It is important fund holders know that we still have no intention of buying Mining shares today – although this stance is informed by investment principle, rather than any view as to how the sector will perform in 2009.

It is trite for us to say it, but nonetheless true, that we are mortified by the loss of value suffered by fund holders in 2008 and earnestly hope we can reclaim the losses in coming years.

You may also regard it as trite to learn that the Investment Manager is bullish at the start of a new calendar period, as he was at the commencement of 2008. However, at the very least, there have been significant changes in the valuation of financial assets over the course of the last twelve months meaning, in our opinion that 2009 is unlikely to play out as a carbon-copy replay of last year's debacle. We highlight below the factors that seem to us to promise well for the investment strategy.

Capital Market Backdrop

The price of the 2.5% Consolidated Loan Stock rose sharply in the second half of 2008, hitting 62.3p by year-end. At this level the instrument offers a gross annual yield of 4.0%, or a feeble 2.4% after tax for a high rate payer - every year out to infinity or the bankruptcy of the British state, whichever comes first. Its income stream is fixed, meaning there is no protection against any future acceleration in inflation.

The gilt is almost certainly over-priced on a 10 year view, although we understand why it remains well-bid. In the circumstances of the UK being gripped by a Japanese-style deflation/recession, its yield could even fall further, as investors rush to lock into any cast-iron source of income.

But what interests us about the Consol - and its relevance for the portfolio - are the implications it has for the valuation of "sound common stocks" – to use Sir John Templeton's terminology. As in – "The best time to buy sound common stocks is when economic conditions are most uncertain."

Today, indeed, it's hard to recall a time when conditions have been more uncertain.

Templeton's advice accords with something one of our most thoughtful clients put to us recently – "High quality companies offer protection against both deflation and inflation". Sound companies may negotiate a recession relatively unscathed, coming out the other side stronger, while their pricing power offers significant comfort against the (surely inevitable) coming monetary inflation.

We submit that our second largest holding, Diageo, is a sound common stock. We also argue that on the same 10 year view its earnings are likely to perform as well as, or more likely better than, the coupon on the 2.5% Loan Stock. And here is why the recent appreciation of the gilt is important, because, following this argument, we believe Diageo shares ought to be worth at least as much as the gilt to a long term investor. But they are not; not by a yard of Guinness.

Diageo is forecast to earn £0.67p in 2009. If that 67p was valued as investors today value the gilt's 2.5p "earnings", Diageo shares would trade on an earnings yield of 4.0%, giving a warranted share price of £16.75, compared to today's £9.75 (67p/4.0%=£16.75).

We are not so naïve as to expect Diageo's price to approach £17.0 forthwith – although in our opinion this is a genuine value gap which corroborates Lindsell Train Limited's longstanding working hypothesis that investors persistently undervalue great companies. But we do have two related observations.

First, recently I asked Mike Lindsell – veteran of a two decade deflationary bear market in Japan - how Diageo shares might have performed from 1990 if the quote had been on the Tokyo Exchange and had offered a dividend yield of 3.5%. His opinion? They would have gone up a lot.

Next, we hear that Neil Woodford believes that investors will be amazed by the valuations attained by true growth companies in 2009 and beyond. We are sure he is right.

In conclusion, deflation gets a bad press from financial commentators (a deflationary slump is another matter). Falling prices benefit cash-rich or cash generative companies and consumers, because the spending power of their cash increases. There is no reason why the shares of such advantaged companies should not go up. And in an environment where returns from competing asset classes, like the 2.5% Consolidated Loan Stock, have been driven to multi-decade lows, those companies capable of delivering cash-generative growth are extraordinarily attractive.

We hope that much of the Fund's portfolio will turn out to comprise of such companies – we certainly intend it to.

The Portfolio

The core of the strategy is its commitment to consumer branded goods companies, amounting to 45% of assets. The individual names, in descending position size, are Unilever, Diageo, Cadbury, Barr, Dr Pepper, Burberry, Marston and Youngs. We include regional brewers here as well as fashion marque Burberry, because we think customer loyalty to their products and their inherent profitability is similar to that of, say, IRN-BRU or Johnnie Walker Green label. We don't pretend any of these companies is exempt the effects of recession, but we believe the likelihood of them not only surviving the episode, but delivering cash flows higher in real terms than today's, at some not so distant point in the future, is good. That prospect of real growth already makes these shares highly competitive relative to what a long-dated gilt can offer - before you even begin to compare their dividend yields to pittance available from Sterling cash deposit rates.

Another significant portfolio allocation is to Business-to-Business Media and Software companies, 28% of total assets - Pearson, Reed, Thomson Reuters, Sage, Fidessa and Daily Mail/ Euromoney. To a meaningful extent, the customers of these companies cannot remain in business without access to their products or services. Meantime, the provision of these services is already highly profitable and becoming increasingly so, because increasingly delivered in electronic format. We expect a number of the above companies to grow their earnings every year for the foreseeable future.

Fund Manager's Comments

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Pearson outperformed the FT All-Share by 20% in 2008, by dint of only falling 10%, while the European Media sector as a whole outperformed the broad market, for the first time since 2000. We hope "growth" companies in this part of the market will earn absolute returns in 2009.

The final meaningful industry bloc in the Fund is its financials, in all 19% of the total. Here we must make a distinction.

75% of this exposure, 15% of total, is to "stock market proxies", primarily the fund management companies Hargreaves Lansdown, Rathbone and Schroders, but also the LSE. With short term interest rates so low, we expect savers to be forced out along the yield curve in search of income. This should benefit trusted retail financial savings brands. Meanwhile, quoted companies will need to refinance maturing bank debt somehow, probably by rights and, particularly, convertible bond issues. Any upsurge in new issuance would benefit the LSE.

The rest of the financials exposure, 4.0% of the total portfolio, is to banks. Here we hold 3% in what will shortly become Lloyds Group ordinary shares and a further 0.7% in its preference shares. Finally we retain 0.2% in Nat West pref.

These bank assets have been and continue to be, a cause of worry and disappointment for us, although the preference shares have proven relatively resilient, continuing to pay their generous dividends. Our thinking on them all is as follows.

We are not convinced that Royal Bank of Scotland is a viable commercial entity, albeit in no immediate risk of collapse after the injection of taxpayer capital. We have, therefore, been reducing our holding in the Natwest pref, whenever the market bids us. Recently we have switched the proceeds from these periodic sales into a cocktail of Burberry and Marston ordinary shares, allowing us to replace the "lost" preference dividends - because, at recent lows, the yields on those two common stocks were so high. Of course, there are risks to Marston's dividend and perhaps even Burberry's, but these are tolerable compared to the threat of outright nationalization, which will be RBS' fate if it stumbles again.

The correct course of action for the investment in Lloyds Group is less obvious today. Here we can see a clear rationale for the existence of the bank – to be the dominant force in UK retail banking, in theory still an attractive business activity. We think if the UK economy muddles through Lloyds Group should be the cheapest share in the portfolio. Meanwhile, its preference shares would be very attractive, assuming confidence about the sustainability of the dividends improves – because they yield nearly 14%, or a clear 10% more than the 2.5% Loan Stock.

On the other hand, the bear case is that HBOS' loan book is so compromised it will bring the whole combination down, into state control – at which point our equity would be worthless.

On balance, given the entrenched pessimism afflicting the bank sector – meaning the shares could go up a lot if the news just turns out to be less awful than feared - we are content to hold the Lloyd's Group positions, but will alert you if our thinking changes on what, clearly, remains not a trivial allocation of your capital.

All data at 31st Dec 2008

Head Office:
CF Lindsell Train UK Equity Fund
Ibex House, 42-47 Minories,
London EC3N 1DX

Fund Administrator:
Capita Financial
Administrators Limited
+44 113 224 6000

Investment Manager:
Lindsell Train Limited
2 Queen Anne's Gate Buildings
Dartmouth Street
London SW1H 9BP

Limited Company Registered in England No. 3941727
Registered Office as above

Phone: +44 20 7227 8200
Fax: +44 20 7227 8299
Enquiry@LindsellTrain.com

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Risk Warning

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