

LINDSELL TRAIN INVESTMENT TRUST

January 2007

All data as at 31st Jan 2007

Fund Objective

To maximise long-term total returns subject to the avoidance of loss of absolute value and with a minimum objective to maintain the real purchasing power of Sterling capital, as measured by the annual average yield on the 2.5% Consolidated Loan Stock.

Fund Breakdown

Top 10 Holdings (% NAV)

HBOS 9.25% Non Cum Pref	11.9
Barr AG	11.0
Lindsell Train Global Media (Dist)	10.2
Nintendo	7.9
Cadbury Schweppes	7.6
Diageo	7.5
Marston's	7.1
Lindsell Train Ltd	6.6
2½% Consolidated Loan Stock	6.1
Lindsell Train Japan (Distr)	5.4

Industry Breakdown (% NAV)

Bonds	15.8
Preference Shares	11.9
Equity - Media	11.6
Equity - Banks & Investment Co.	6.6
Equity - Leisure & Entertainment	15.0
Equity - Food & Beverage	28.8
Equity - Consumer Goods	1.6
Equity - Internet	1.6
Investment Funds	20.0
Cash & Equivalent	(12.9)
Total	100.0

Fund Exposure	Bonds	Prefs	Equity	Funds	Cash	Total
UK %	10.7	11.9	50.5	4.4	(13.5)	64.0
USA %	5.1	-	2.7	-	4.8	12.6
Europe (ex UK) %	-	-	4.2	-	(2.2)	2.0
Japan %	-	-	7.9	5.4	(2.1)	11.2
Global %	-	-	-	10.2	-	10.2
Total %	15.8	11.9	65.3	20.0	(13.0)	100.0

Fund Performance (Fixed Calendar Year)

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

5 Year History (Jan-Dec)	2002	2003	2004	2005	2006	YTD 2007
LT Investment Trust NAV TR%	-9.6	+3.1	+23.7	+16.5	+13.7	+2.6
LT Investment Trust Price TR%	-19.8	-8.7	+20.6	+27.5	+20.1	-1.3
MSCI World Index GBP TR%	-28.6	+17.6	+5.2	+20.3	+3.5	+0.8

Source: LTL & S&P Micropal unless otherwise indicated. TR=Total Return. Launch date 22 Jan 2001. ● Source: LTL.

2006	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YE 2006
NAV TR%*	+0.9	+1.9	+1.2	-1.8	-2.0	+1.8	+1.7	+2.1	+3.2	+0.5	+0.2	+2.8	+13.7
Price TR%*	-3.0	+7.5	+1.5	-1.4	-1.5	-2.6	+3.2	+4.1	+5.7	+3.0	+3.6	-1.6	+20.1
Since Launch NAV TR%	+39.5	+42.1	+43.3	+41.0	+36.4	+39.4	+41.8	+44.9	+49.6	+50.4	+52.1	+56.4	
Since Launch Price TR%	+28.4	+38.3	+40.4	+38.3	+36.2	+31.3	+35.6	+41.1	+49.1	+53.6	+59.1	+59.1	

2007	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD 2007
NAV TR%*	+2.6												+2.6
Price TR%*	-1.3												-1.3
Since Launch NAV TR%	+60.0												
Since Launch Price TR%	+57.0												

Source: LTL & S&P Micropal unless otherwise indicated. Launch date 22 Jan 2001. TR=Total Return (adjusted for dividends). Listed securities in the portfolio are valued at the closing bid price. * Monthly performance sourced from Bloomberg & LTL. ● Source: LTL.

Market Capitalisation	£29.7mn
Net Asset Value	£152.70
Share Price	£148.50
Premium (Discount)	(2.8)%
Benchmark 2½% Consol	Annual +4.4%
(see definition below)	Monthly +0.4%

Source: NAV - Lindsell Train Ltd ; Price & Discount - Bloomberg. Share Price quoted is closing mid price.

Fund Manager:	Nick Train
Launch Date:	22 Jan 2001
Base Currency:	Sterling
Year End:	31st March
Dividend:	Ex-date - Jun Paid - Jul
Benchmark:	The annual average yield on the 2½% Consolidated Loan Stock.

Management Fees:

Annual Fee:	0.65%
Performance Fee:	10% of annual increase in the share price, plus dividend, above the gross annual yield of the 2½% Consolidated Loan Stock.

The Board:	Rhoddy Swire Donald Adamson Dominic Caldecott Michael Mackenzie
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Secretary:	Phoenix Administration Services Limited
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ISIN:	GB0031977944
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Bloomberg:	LTI LN
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Listing:	London Stock Exchange
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Fund Manager's Comments

Your NAV rose nearly 2.8% from the end of the calendar year to 2nd February (2.6% during the month). This was a good return, which, as often with this strategy, bore little correlation to that delivered by the broader indices – for instance the FT All-Share Index was actually marginally down during January. Important contributors were Nintendo up 15.0%, the largest equity position, A.G. Barr, which put on 8.6% - rather mysteriously to us, Cadbury up over 5.0% and Pearson and Reed up nearly 4.0%. These last three were mediocre performers in 2006 and we hope their gains are the start of something big.

Below I attach a piece written at the back end of last year, which reviews the span of my investment career and illustrates how certain hard-learned lessons inform the way we approach the investment challenge – at least so far as the UK equity market is concerned. You may or may not find the conclusions trite, but to the extent they are a true reflection of what we do – and they are, we hope the piece will be of interest to holders of LTIT.

An Old Timer Looks Back

As the years go by, the milestones loom up ever faster. Last year, 2005, Mike and I mustered a hearty cheer for Lindsell Train Limited's fifth birthday. Now, in 2006, I let out a hollow groan, as I bumped up against the ugly realisation that this year marked the completion of the first 25 years of my City career. Yes, it was as long ago as June 1981 that I, as a precocious seven year-old, joined a business called GT Management Limited – Good Times Management – now, sadly, long since swallowed up in the swirl of the City dance.

A quarter of a century is a long time to practice any discipline and, in the circumstances, I hope you can forgive what follows. This year I have given plenty of thought to what lessons, if any, I can claim to have learned about the investment trade over the past 25 years. And below are six I've learned, sometimes very painfully so. I share them not because I think they have any particular pedagogic value – I would not dare to lecture or teach fellow industry participants. But because each of these lessons has demonstrable relevance for the way Lindsell Train approaches the challenge of trying to outperform the UK equity market and for the current structure of our investment portfolios.

Lesson 1. Dividends Really Matter.

The first public fund over which I was given full responsibility was a UK Equity Income unit trust. I was a somewhat ungrateful appointee, hankering, with youthful hot bloodedness, to manage a dynamic "growth" fund. However, I was reconciled to the task of running an ostensibly dowdier "income" fund by the wisdom of my then boss, who persuaded me that a well-managed Income Fund will, over time, trounce the return of most hyperactive growth strategies. He further demonstrated to me that, as of early 1985, the average UK Equity Income unit trust had outperformed the average UK Growth Fund over short, medium and longer time periods. As you can see below, what was true in 1985 remains so today, with the performance of the average UK Income Fund superior to that of the average constituent of the UK All Companies sector - amazingly over all periods out to twenty years. Into the bargain, the average Income Fund has delivered a return well in excess of the FT All-Share Index. Even after all these years, the statistics surprise. Why should this particular approach to the UK Equity challenge - an approach based on the capture of above average levels of dividend return, do so persistently well? One must conclude, we submit, that the majority of investors get over-excited by short term prospects for capital growth, often chasing pure puff, while underestimating the long term compounding effect of locking into growing streams of honest-to-goodness cash dividends. And that, for the patient investor, this misplaced euphoria creates an exploitable anomaly.

We have purchased two new holdings in 2006, Euromoney and Unilever. These securities are, we think, meaningfully undervalued - Euromoney because the illiquidity of its stock (resulting from its majority ownership by Daily Mail) has depressed its rating compared to similar companies; Unilever because for years it has frustrated its shareholders into unwarranted negativity. You may disagree with our analysis – what is incontrovertible though, is that each stock offered us a starting dividend yield of 4.0% net, a third higher than average and higher than the net yield on a long-dated gilt. Any equity purchase is a bet – that one's perception of value is superior to that of the person on the other side of the trade - being paid a fat dividend shifts the odds of that bet slightly in your favour.

Lesson 2. Concentrate Your Eggs in One Basket

One of GT Management's founders, Richard Thornton, taught his young fund managers an important lesson. "Great money-making ideas are rare" he'd say, "make sure that when you find one, you make it count". Indeed, here is Richard's 4-point action plan for investment success:

- *Identify your great investment idea.*
- *Buy as much of the idea as you feel comfortable with.*
- *Buy the same amount again, so you can no longer sleep at night, because of the size of your holding. Finally,*
- **TELL EVERYONE ELSE ABOUT IT!**

This advice can be summarised, in contemporary parlance, as to build "high conviction, highly concentrated" investment portfolios. And a high conviction, high concentration portfolio is certainly what we have delivered to our clients over the years. Currently, our open-ended UK Equity Fund has just 21 holdings and the top ten positions account for 65.0% of the total.

You are probably and correctly wondering whether such a tight clutch of eggs brings with it risk of above average volatility, even capital loss. The answer is certainly – "yes". Although the risk is softened by the effects of lesson 4, below. Nonetheless, we and we're sure Richard Thornton, are unapologetic. The truth is that in the investment business as elsewhere, "you don't get owt for nowt". To outperform a capital market as efficient as the London equity market, after expensing all costs, is not easy and requires the taking of more risk than is commonly supposed.

Lesson 3. It is Supposed to Hurt

The risk that we take has, of course, hurt us periodically. However, as time has gone on, we have come to recognise that this business is actually supposed to hurt – that the pain is to be welcomed, as a sign that you're doing something right. We are comforted by this quotation from George Soros and believe that most investors, particularly professional, will agree:

"I found running a hedge fund extremely painful. I could never acknowledge my success because that might stop me worrying, but I had no trouble recognising my mistakes."

What Soros says resonates. Performing well is uncomfortable, because you never know where the next decent idea is coming from. Meanwhile,

periods of poor performance raise questions about one's judgement and strength of character. Either way, this job hurts. I think that Andy Grove got it right, both for his own industry and ours, in his choice of title for his autobiography. Andy Grove was the CEO of Intel and his book was called "Only the Paranoid Survive". If you are not paranoid about your investment portfolio, you should be worried. It is the worry that makes you good.

Lesson 4. Don't Crimp on Quality

At inception Lindsell Train Limited took a strategic decision to devote its research efforts only on businesses that it believes to be of the highest calibre. Indeed, central to our investment approach is the conviction that most outstanding business franchises are undervalued by other investors for most of the time. This conviction arises largely from our rueful contemplation of often fruitless attempts, in previous employments, to make money out of the opposite strategy – in other words the attempt to make money by investing in the shares of low quality companies (when one judges them exceptionally undervalued). This we found much harder and more uncertain work than our current policy.

One of my favourite Warren Buffett quotes illustrates the tribulations of being the business manager of a low quality company. Buffett's vehicle, Berkshire Hathaway, was, of course, a textile company when he first acquired it and continued to trade as one for many years, until even Buffett's famous patience wore thin. Here is what he had to say about running an archetypal "problem" company.

"One path leads to despair and utter hopelessness, the other to total extinction. Let us pray we have the wisdom to choose correctly."

I have no doubt that this sobering experience encouraged Buffett to adopt his "only buy the best" approach. For me, it was my third or fourth failed attempt to make money in Pilkington Glass that finally persuaded me to cease banging my head against that particular glass ceiling.

Lesson 5. Don't Try to Predict the Unpredictable

Early in my career, I read Peter Lynch's book (the great Fidelity US equity manager of the 1970's and beyond) – "One Up On Wall Street". In it he offers this uncompromising judgement. "No one can predict the economy, interest rates or the stock market. Dismiss all such forecasts." Regrettably, it was years before I took Lynch's advice seriously – years, in hindsight, spent trading client capital in and out of markets and stocks on the basis of more or less spurious

LINDSELL TRAIN INVESTMENT TRUST

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Fund Manager's Comments Continued

guesses about such imponderables as the trend in real interest rates or currency crosses. Sometimes, when I guessed right about an economy - a recession for instance - the stock market would provoke me by behaving as the text books said it shouldn't. The only certain gainers from all this activity were intermediaries in the capital markets - not our clients. So, Mike and I have stopped, or, more precisely, we endeavour to make few or no investment decisions based on assessment of macro-economic factors and, at all times, to limit, where possible, our capital market activity to a minimum. Portfolio turnover for our UK portfolios remained unusually low again in the last financial year, at 5.1% of start of year value.

Lesson 6. Be Optimistic

Reviewing the past 25 years, this last lesson strikes us as being the most important of all. At times we have been exhilarated and at others nauseated by the rollercoaster of the stock markets, but, on balance, we have learned that pessimism and cynicism don't pay. It is attractive to play the part of the worldly-wise sceptic - as John Kenneth Galbraith says somewhere - "We all agree that pessimism is the mark of a superior intellect". But it is dangerous to invest as one. The last 25 years really have proven to be "The Triumph of the Optimists" - the title of the recent book demonstrating the power of equity investment.

Accordingly, about 10 years ago, I took the decision to give up my mean, moody image as a cynical man of the world and adopt, instead, the character of a childishly naive "perma-bull". I have never had reason to regret that decision and, today, we remain earnestly optimistic about the outlook for Capitalism, for the vitality of capital markets the world over, for the UK stock market and for our investment portfolios.

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