

Performance & Portfolio Review January 2010

Performance

Toward the end of 2009 we had to alert shareholders to some unwelcome news – namely the loss for two years of the income stream from FGT's investment in Lloyds' preference shares. This hiatus has implications for the Company's own dividend, though the adverse effects can be mitigated to an extent by drawing on revenue reserves and making changes to the portfolio. As regards the latter, we have now sold all the holding in Lloyds' ordinary (quite timely, in hindsight) and a proportion of the preference share position, now down to 2.7% of total assets, using the monies raised to invest in dividend paying securities.

Bearing bad tidings is disagreeable, but it is important to do so, to promote transparency with shareholders. In the same spirit we hope that you will welcome the following rather more upbeat analysis of your Company's performance and prospects. Because there is better news to impart as well.

As the table below illustrates, calendar 2009 was a good year for the Company's NAV total return performance, with a gain of 35.3%, compared to that of its benchmark, the FT All-Share, of 30.1%. This achieved despite the poor performance of our misjudged investment in Lloyds' securities. Moreover, end 2009 marked the ninth full year of Lindsell Train Ltd's responsibility for the Company's investment affairs. Reviewing performance for each of these years you can see that the Company's NAV total return has exceeded that of its benchmark in six of the nine discrete years, with only one year of really marked underperformance.

Date	FGT %	FTSE All-Share %	%
Dec 01	-10.9	-13.3	+2.4
Dec 02	-21.6	-22.7	+1.1
Dec 03	+22.6	+20.9	+1.7
Dec 04	+31.6	+12.8	+18.8
Dec 05	+21.7	+22.0	-0.3
Dec 06	+22.0	+16.8	+5.2
Dec 07	-3.5	+5.3	-8.8
Dec 08	-31.3	-29.9	-1.4
Dec 09	+35.3	+30.1	+5.2

NAV total return with dividend reinvested
Source: Lindsell Train/Bloomberg

Taking those years in aggregate, the portfolio has delivered annualized returns of 4.5%, compared to the FT All-Share of 2.5%. All FGT's returns are calculated net of all fees and running costs, which currently average c1% pa, highlighting that the underlying investment strategy has added even more value relative to its challenging performance hurdle. Shareholders will be aware, from their own experience and reviewing peer group performance data, that outperforming a stock market as ruthlessly efficient as that of the UK over multi-year periods is neither easy nor common.

Further, an outperformance of 2% pa may not sound like much, particularly after a decade of mediocre returns from UK equities, but over time it adds up. For instance, over those last nine years FGT has delivered a total return of just shy of 50%, getting on for double the 26% of the All-Share. Of course we hope to widen this gap further in coming years and, even more so, to enjoy better overall equity returns.

Last year FGT paid a dividend of 9.5p, maintained from that of 2008. While there is uncertainty about the sustainability of this coupon going into 2010, we trust it is fair to remind shareholders that over the last nine years we have grown their dividend from 3.2p in 2001, our first full year of responsibility, almost trebling it in the process. Dividends and dividend growth remain central to our investment process and we will do our utmost, short of sacrificing the calibre of the portfolio, to ensure the dividend gets moving upward again. On the historic dividend FGT shares offer a yield of 3.9%, some 25% higher than that of the FT All-Share Index at the start of 2010.

Fund Manager: Nick Train
Lindsell Train Limited

Denominated Currency: Sterling

Year End: 30th September

Dividend:

Interim: Ex-Date - June
Payable - June

Final: Ex-Date - November
Payable - January

Benchmark: FTSE All Share Index (net dividends reinvested)

Investment Trust Sector: UK Growth & Income

The Board: A Townsend (Chair)
John Allard
Neil Collins
David Hunt
Vanessa Renwick
Giles Warman

ISIN: GB0007816068

Listing: London Stock Exchange

Portfolio

There are a number of features of FGT's investment portfolio that might be expected to deliver divergent performance, relative to benchmark over coming months and years. Of course, this divergence can be for good or ill. However, we hope that FGT's markedly differentiated portfolio is already valuable to shareholders, giving them access to investment ideas and securities not held elsewhere.

Many trusts or investment funds do little more than loosely replicate the structure of the benchmark they are measured against – begging the question why their holders do not simply invest in a lower-cost "tracker" product. But this is most certainly not the case for FGT.

For instance, it currently owns none of the top 15 companies by market capitalization in the FT All Share Index; Diageo and Unilever, at 16 and 18, being its first representatives. Indeed these two are FGT's only holdings amongst the biggest 30 UK companies, which combined make up 68% of the FT All-Share. Another way of looking at this differentiation is to note that nearly 50% of all dividends paid by UK companies arise from just six giant companies – BHP, BP, Glaxo, HSBC, Shell and Vodafone – an extraordinary concentration and, in its own way, quite "risky". Yet, for various reasons, FGT owns none of any of these shares.

This is not the place for a minutely detailed discussion of every investment idea in the strategy, but we list below what we see as the most "active" and likely influential – in terms of performance – features of the portfolio.

No Resource Stocks. Over the past two years mining companies have confirmed, for anyone who had any doubt, their traditional violent cyclicity, both of cash flow (as evidenced by widespread dividend cuts in 2009) and share price. It really didn't turn out to be "different this time". After their huge recovery rallies in 2009 we wonder if the Miners can deliver sufficient positive surprises to justify their valuations. We expect FGT's zero exposure to the sector to save shareholders a lot of money.

TMT. Last year was the first that FGT has really benefited from its longstanding commitment to the UK's handful of truly world class technology and media companies. There were strong absolute and relative performances from Euromoney, Fidessa, Pearson, Sage and Thomson Reuters. Even Reed Elsevier began to recover during December. Combined, these holdings account for 31% of NAV. In our opinion a new bull market is just beginning for them, as their relative business performance improves,

compared to the average FT All-Share constituent – from historically low valuations.

Burberry, Cadbury, Diageo, Dr Pepper, Unilever. These five make up 40% of total assets and, naturally, today all eyes are on the outcome of the Cadbury bid battle. However, it is important to take a broader perspective. Kraft wants Cadbury because the latter owns a collection of global brands, with current and future, likely significantly greater, appeal to consumers in Emerging Markets. In our opinion, either Kraft wins, but needing to pay a significantly higher price, or FGT shareholders get to retain their investment not only in Cadbury, but in each of these other companies with unique brands and multi-year growth opportunities. Simply stated we like them because they offer access to one of the best "growth" stories in global markets – EM consumers - but, at the same time, are also relatively "defensive" as businesses. As their results through the current severe developed world recession demonstrate. Reliable cash flow with growth is a great and rare combination in uncertain markets.

Domestic Earners. Everyone hates companies exposed to the UK economy, for obvious reasons. But this has resulted in some marked undervaluation. Specifically we like the resilience of beer, pub and other beverage companies. Our holdings are A.G Barr, Fullers, Marstons and Youngs (21% of total). These are long-held positions, but the brewers, in particular, look to us as cheap relative to the market as we can remember – offering decent dividend yields, discounts to asset value and, in the long run, good protection against UK inflation. We would much rather own Youngs' Brewery, with its extraordinary collection of London freehold pubs, offering a starting dividend yield of 3%, than a fixed coupon corporate bond.

No Banks, Plenty of Fund Managers. The slope of the yield curve is very positive, with little sign that it will flatten. These are classic conditions for financial stocks – and in any other capital market cycle you'd pile into banks. However, politics and impending regulatory change make it difficult to know how much profit banks will be allowed to make; indeed, how they will be allowed to make their profits at all. Happily we can capture similar effects – of cash shifting up the yield curve in search of a return – by investing in soundly capitalized, strongly branded or franchised investment management companies. We hold Hargreaves Lansdown, the LSE (a related beneficiary of increasing capital market activity), Rathbone and Schroders – all recently reporting strong increases in business activity or AUM and, combined, 13% of FGT's NAV.

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Fact sheets can be found on the
Trust's website at
www.finsburygt.com

Conclusion.

FGT is currently c11% geared. Not wholly coincidentally, the sum involved is the equivalent of the investment in Cadbury. The borrowings are cheap, at a fixed margin above LIBOR, and can, therefore, enhance both capital and income returns in clement markets.

Meanwhile, FGT has 2.3 million shares in its treasury account, all of which the Company can and does reissue to marginal buyers of its shares at a price as close as possible to a 5% discount. This 5% discount is the level the FGT Board has successfully defended as cornerstone to its buyback policy, for the last 6 years.

We believe these shares offer good value and the manager has been buying them again himself.

Risk Warning

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