



Cayenne Asset Management Limited
23 Buckingham Gate
London SW1E 6LB

T: 020 7233 8899
F: 020 7233 8989
E: info@cayenneasset.com
W: www.thecayennetrust.com

The Cayenne Trust plc August 2011

Fund Description

The Cayenne Trust plc aims to achieve consistent positive absolute returns by investing principally in the securities of UK investment trusts and other closed-end funds. The Trust will seek to ensure preservation of capital by the use of derivatives or similar hedging instruments. Up to 15 percent of the Trust's assets, at the time of investment, may be invested in Apollo Fund plc, an offshore fund which is managed by Cayenne Asset Management Ltd.

Investment Manager's Report

The much feared market shake-out finally occurred in early August. At one point during the month, the FTSE100 traded 17.6% lower but recovered to close down just 7.2%. This extreme volatility is better demonstrated by the fact that there wasn't a single day during August where the trading range was less than 1% and all but five days experienced a 2.5% range or greater. On one day alone the trading range was 7.6% with the market falling 5.5% before closing up 1.9%. This exceptional volatility is evidence that all is not well with the world. Twin concerns facing the US and Europe continue to batter confidence and, despite a significant rally into the month-end, investors remain cautious. The Trust entered such a period positioned defensively and, as a result, the NAV only declined 1.95%. Indeed, even at the depths of the market, the NAV was just 3.0% lower. The net result for the financial year to date is that the NAV is down 1.07%. The FTSE 100 is down approximately 8.5% and the FTSE Equity Investment Entities Index is 5.0% lower.

Perhaps it is pertinent to explain the care taken to ensure the portfolio is efficiently hedged for both negative and positive markets. At the start of the month the Trust had short index positions covering 35% of assets on a delta adjusted basis and 75% of gross protection. As markets declined, the delta exposure of the index puts increased dramatically to provide cover of nearly 50% of the assets. By this stage, the value of the puts had increased exponentially and any rally, as experienced later in the month, would have been detrimental to the Trust's performance. To mitigate this risk, many of the puts that were now in the money were sold, to bank a significant profit with some of this premium being reinvested in puts with lower strike prices. The net effect of such action was to substantially reduce the delta short position to approximately 20% of the portfolio while gross coverage increased to nearly 85%. As such, further market weakness would be more than adequately protected but the risk of loss on a major rally was substantially reduced. In total, the Trust made a profit of approximately 5% of gross assets on this hedging strategy and is again well positioned to weather whatever the markets throw at it over the next few months.

As often reiterated, it is possible to hedge the Trust's underlying equity assets but more difficult to protect from a negative re-rating of specialist funds such as the private equity holdings. These positions were marked down across the board and subsequently failed to participate in the rally. In the meantime, Pantheon and F&C Private Equity released positive results and a recovery in rating is anticipated when markets return to more normal levels of activity following the summer recess. Severe headwinds were faced by the sector as 3i Group, the sector's heavy weight constituent, declined over 20% making life difficult for all listed private equity entities. The opportunity was taken to start a new holding in 3i at these distressed levels. Indeed, with 15% of 3i's current market capitalisation invested in 3i Infrastructure, the remainder of the portfolio is trading at a price which implies a discount of approximately 50%. Long term shareholders are rightly concerned about such a disastrous performance and are beginning to agitate for change. Whether action will be forthcoming is a moot point but a share price of 210p represents excellent value.

While markets were at distressed levels, some of the Trust's significant cash balance was invested in funds with high quality equity portfolios. Trading volumes were thin but some success was had in purchasing Schroder Asia, Fidelity Special Values and Scottish Mortgage at discounts of close to 10%. Recent underperformance was seen as an opportunity to re-establish a meaningful position in JP Morgan Overseas. A new investment was made in Troy Income & Growth at NAV. British Empire and Law Debenture were reduced at NAV and a 10% premium respectively. The Trust repurchased 573,535 shares into Treasury at a 5% discount and, as a result, there are now 1,728,092 available for re-issue at a 4% discount.

Top Ten Holdings		Underlying Exposure		Trust Details		Ordinary Shares	
Apollo Fund PLC	5.3%	Equity	45.8%	NAV per Share		131.23p	
F&C Private Equity	4.6%	Alt. Equity	28.6%	Mid-price per Share		126.00p	
Thames River Hedge+	4.3%	Real Estate	9.1%	Premium / (Discount)		(3.99%)	
Law Debenture	4.2%	Fixed Int	7.5%	Mid-price per £100 nom culs		£104.50	
Pantheon Intl	3.9%	Warrants	2.2%	NAV Return		(1.95%)	
Treasury China Trust	3.8%	Cash	6.5%	Financial YTD NAV Return		(1.07%)	
3i Group	3.8%	Put Options	0.6%	IRR since inception		4.22%	
Edinburgh Dragon culs	3.7%	Index Short		Net Assets		£54.92m	
Caledonia	3.6%	Delta Adj	(20%)	Gross Assets		£69.81m	
Ecofin Power & Water	3.3%	Gross	(85%)	Market Cap		£52.76m	
NAV Performance to 31 August 2011				Financial Year-end		31 January	
3 Months	6 Months	1 Year	3 Years	Ordinary Shares	(TCT)	41,874,818	
(2.3%)	(0.9%)	7.9%	33.0%	CULS	(TCTL)	14,953,523	
5 Years			24.0%	Management Fee:		1%	
				Performance Fee:		10% above hurdle rate	
				Hurdle Rate:		5% per annum	
				High Water Mark 31/01/12		147.91 (141.31 xd)	

Data source: Phoenix Administration Services Ltd. / Cayenne Asset Management Ltd.

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