

Transcript of conference call for the Rathbone Blue Chip Income and Growth Fund

Tuesday 21st April 2009

Julian Chillingworth: It remains high priority to find income for our investors, especially since bank and building society deposits yield next to nothing. The Rathbone Blue Chip Income and Growth Fund yields 5.67%. At Rathbones, we have two additional income vehicles in the Rathbone Income Fund and the Rathbone Ethical Bond Fund.

Rationale

Research from Société Générale demonstrates that if we take returns from equities on a one-year time horizon, only about a third of that return stems from dividend and earnings growth; the rest is from market movements. However, on a five-year horizon, the majority of total return comes from dividend and earnings growth (80%). So, as investors, we must focus on companies that grow their earnings (cash-flow) and thus their dividends over time.

The fund

This is an equity fund that invests principally in the FTSE 100 index - currently over 70% is held in the FTSE 100 index, with the rest in mid and small caps. This is a long-term investment vehicle, harvesting our own macro-analysis with stock-picking – a traditional income and growth fund. The turnover on this fund is very low – that’s an important point. I have been managing this portfolio for almost seven years, and there are several holdings which have been in there since soon after I took over, for example AB Foods. This is a focussed list; currently, there are 29 holdings. So we are very much picking our best ideas and running with them. We have a core of FTSE 100 index stocks, around which we build interesting ideas from the mid and small cap areas which may have a low, or no, dividend yield, but will, in future, pay an income. That gives us a kicker and brings some interest to the portfolio as well. Our top ten holdings consist of a number of names where we hold substantial positions, such as BAE Systems at 5.53%. The following are all in our top ten, and all reflect our investment thesis well.

Halfords is a favoured stock and a very well run retailer of car maintenance equipment. Why are we holding retailers when consumers are under so much pressure? Halfords has what we believe to be a reasonably recession-resistant offering, but more importantly, it enjoys very strong cash-flow, and has a high quality management that has delivered, and continues to deliver, in difficult times. The stock trades on a p/e of 10.6x and yield of 4.74%.

Venture Production has crept into our top ten holdings. This Aberdeen-based company specialises in unlocking stranded North Sea assets and recently saw some stake-building by Centrica. Behemoths like Centrica have realised there is a shortage of available gas assets and has built up its stake around Net Asset Value. We believe it is highly likely that Centrica will, eventually, make a bid for Venture. Generally speaking, interest in the company underlines how investors can still find interesting opportunities within the resource space and make money, despite a falling oil price. Furthermore, management continue to impress. Venture is trading on a p/e of 15.1x and a yield of 1.63%.

Diageo encapsulates the concept of both rising dividend stream and cash-flow driving a stock price higher. For those who don’t know, Diageo is the maker of very successful brands such as

Guinness and Johnny Walker. Anecdotally, a bottle of Johnny Walker Red Label is sold every six seconds somewhere in the world, but even during these recessionary times, it only requires a consumer of Johnny Walker in the US to buy two or three bottles a year to maintain sales at the current level. This suggests that Diageo ought to weather the current storm fairly well, but more importantly, the stock price over time has been driven by that rising dividend. Diageo is on a p/e of 12x and a yields 4.52%.

Finally, mobile operator **Vodafone** has, of late, had a strong push into emerging markets. The stock price was overdone during the dotcom boom, and the dividend distribution lagged the rise in the stock price. This has now reversed, although the stock price should begin to catch up as investors realise that the stock should weather the 'telecoms storm' pretty well. Again, this company fits the bill in terms of strong dividend growth coming through; good cash flow; a cashflow yield of about 9%; a p/e of 9x and a yield of 6.15%. We will monitor how the new management team is getting on but believe we have a consistent performer here.

Fund performance

Our dividend distribution is driving our unit price higher. We have a good track record over the last 18 years or so of increasing the dividend distribution. I am not allowed to give forecasts, but what I would say is that I do not intend to lose that record under my stewardship. Consequently, we have raised the interim distribution; we have one in June (the final distribution), and hopefully that will support a reasonable dividend distribution over the year. Furthermore, we enjoy decent, long-term outperformance versus the new IMA UK Equity Income and Growth sector (the fund was formerly in the IMA UK All Companies sector).

Outlook

We believe we are in the midst of a U-shaped recession, and growth will remain anaemic into 2010. Right now, we are probably bouncing along the bottom. Despite a recent knee-jerk bounce in cyclicals, investors do not want to enter such names too early, as earnings growth and ratings might still surprise on the downside. However, the current environment presents a great buying opportunity for those prepared to take a five-year view – so that's considered entry into well managed companies with strong cash-flows and growth potential. The inflation/deflation debate continues. We believe that the huge amount of stimuli thrown at the system makes higher inflation, in the long term, inevitable. Income stocks, particularly at these levels, therefore offer an attractive hedge. Furthermore, securing income remains a high priority for investors as bank and building society deposits get left behind (and who knows how safe the banks are?).

Finally, good earnings and dividend growth generate solid total returns over the long term. Companies that have decent management teams and good cash-flow, generate these good quality returns. Also in this climate, we think investors need a mixture of defensives and more cyclically-inclined companies to protect against further downside and position themselves for a meaningful upturn. With quality income stocks, investors are being paid to wait.

Julian Chillingworth
Chief Investment Officer

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