

Rathbone Income and Growth Fund

Conference call update, Wednesday 6 August 2008

Julian Chillingworth: Suffice to say, this year will go down in history as one of the more difficult over the past decade. Indeed, in my 28 years in investment management, it's certainly one of the most challenging ones that I can recall. I would like to draw your attention to what we have been doing recently in the Rathbone Income and Growth Fund, as well as looking at the fund's structure and why we think this vehicle differs from others in the sector. All in all, this is a fund with some very interesting investments in it, a great dividend record and good, long-term performance numbers.

Our aim

The aim of the fund is, to provide you with rising dividend distribution and capital growth over the long term. We offer a focused list of around 34 stocks of our very best ideas. Quite obviously, we are aiming to beat our peer group and perform well against the relevant benchmark (in this instance, the FTSE All-Share Index). This fund is also a good example of the Rathbone Investment Process. Just to jog memories, we are looking for companies that are price-setters with strong market leadership; good cash generation; and a proven management record. These are companies that will grow their earnings, meaning we should get decent returns over a three to five-year time period. It is important to stress that this is not a tracker fund, and there are certain sectors where we have zero weighting such as pharmaceuticals. This is a long-term investment vehicle. We positioned ourselves defensively about 12 months ago.

Structure of the fund

We have a core list of FTSE 100 stocks; this is normally around 70-80% of the total portfolio, but it has dropped slightly due to our higher cash weighting. We then have the satellite mid- and small-cap names. These do not necessarily have a high dividend; in certain cases they have zero dividend. So we are driving the defensive flow from the core and adding additional value from the satellites.

Rising distribution

We are very fortunate to be able to declare a rising dividend distribution since 1994, and we are confident that we are going to deliver another rising dividend distribution this year. We are unable to say what the dividend will be at this stage, but it will be higher than last year. On dividends, 2008/2009 is going to be quite a testing year for those who have historically distributed quite substantial dividends. It is important to examine carefully how those funds have actually generated those dividends and whether they are sustainable. We have done quite a lot of work on all our income products to make sure that we can deliver a sustainable dividend stream – that is going to be crucial going forward.



Sector-orientation

We have a pretty substantial weight in oils – BP and Royal Dutch Shell in the FTSE 100, and Premier Oil and Venture Production outside of that. Moving to other areas, earlier this year, we reduced our mining exposure. In hindsight, we should have sold out miners earlier, but our exit from the likes of Rio Tinto has paid dividends. Industrials are more of a mixture, but names that stand out are Aggreko and Titan Europe. The latter has been bid for, and we have been reducing that.

We have quite a substantial weighting in utilities which includes International Power which we consider to be a very interesting medium-term play. Power generation is key for both the western world and the developing world, and everybody is clambering for electricity - International Power is at the forefront of that.

Financials is an area that everybody is interested in, and here we have participation in the banking sector through HSBC and Standard Chartered. We have a smaller holding in Barclays and in Lloyds. The view on Lloyds is that it remains a relatively defensive bank. Barclays is looking oversold and will probably fare better than some banks when things calm down. We also hold Man Group, a hedge fund manager, which has done exceedingly well over these last six months. We now have zero property exposure.

Of our top ten holdings, we have a big stake in BAE systems. We would not normally go above 5%, but the appreciation has been very good, and we will be taking profits. Aggreko, a company I mentioned earlier, is a market leader in mobile power generation, supplying plants for miners, the oil industry and the developing world, and it has done very well out of that.

Performance

Year-to-date, this Fund is oscillating between first and second quartile. We have been pretty defensively positioned since the start of the year, and have done well because of this. We have maintained that stance with a high cash position (15%). For now, we have little exposure to the consumer but are looking at the sector for when we are ready to commit cash to the market. Despite the fact the market could enjoy quite a strong rally, we feel that this is a bear rally and more volatility lies ahead once analysts have adjusted their forecasts downwards. We believe earnings numbers still seem too high, so we might be looking at lower levels towards year-end.

Examples of stocks

AIM-listed Telit is a good example of a satellite holding in the portfolio. The company develops mobile tracking devices. For example, it has a contract supplying devices to read water meters in Italy. Telit is cheap, trading on a p/e of 5x, and the market is yet to recognise how important this technology will be. At the other end of the scale, we hold

Vodafone. Recently, the performance took a hit owing to a less than comfortable outlook and difficulties in the Spanish and Irish markets. The analysts panicked and switched to sell. Earnings forecasts for 2009 have now been adjusted by up to -4%. Vodafone is trading on a P/E

of around 9.55x, and it remains the world's leading mobile phone company with a very strong position in emerging markets. We remain backers – the stock should continue to hold up well in terms of profits.

Questions and answers:

Philip Lenanton (Financial Advice & Services Ltd): Do you feel the current inflation trend is a bubble, rather like the bubble in asset prices and housing? And do you feel that the long term inflation trend we will revert to a norm, and if so over what timescale?

Julian Chillingworth: I believe we have moved out of an era of very low inflation into an era where inflation will be somewhat higher. Although we have, in the last week or so, seen raw material prices, oil and base metal prices come off the top, demand will remain pretty buoyant. And there hasn't been the investment in new production that would so obviously drive down prices. So that is why we are likely to see inflation continuing to bubble in the 2/3% area as opposed to the 1/2% area. Likewise, there is more pressure on food. We, in the western world, have been too used to very cheap food for too long. The price of food is likely to rise on the back of greater demand for grains and other food stuffs. Consequently, that will add to inflationary pressures. Certain commentators have talked about inflation hitting 7-8% and have drawn on parallels with the 1970s. The major difference is a lack of pressure on wages. Equally, in the 70s, people had inflation-linked settlements. You need the wage push to really drive inflation and, likewise, you need to be confident that unemployment is not going to rise. For those reasons higher inflation yes, but not dramatically higher. I am not a big buyer of the deflation argument, and if we can get inflation between 2%-3%, then that's satisfactory. The danger is if it's higher, prompting those higher wage claims.

Philip Lenanton: The markets are frightened by this trend of a rising oil price, with rising commodity prices, which now seems to have tapered.

Julian Chillingworth: The reason the rally has been so strong has been the retreating oil price. It is highly likely that oil could oscillate between a \$100-120 p/b.

The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance should not be seen as an indication of future performance.

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