



# One company, one income team, two very distinct income funds

*A 'value philosophy' is key to outperformance in 2010 and beyond*

Rathbone Income Fund	Rathbone Blue Chip Income and Growth Fund*
 <p>Overweight mid/small cap Mainly UK equities Broad stock list – 46 Net yield of 4.69% Manager: Carl Stick</p>	 <p>Large cap bias, target 75%+ Mainly UK equities Concentrated stock list – 29 Net yield of 4.24% Manager: Julian Chillingworth</p>

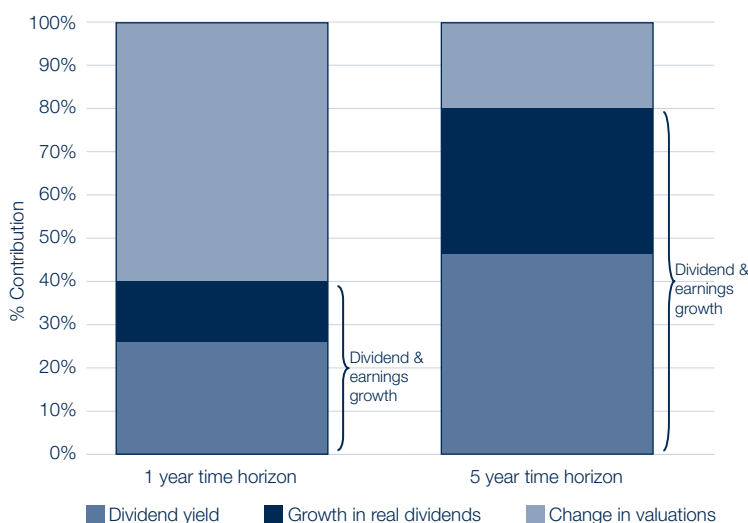
Data at 31.12.09

\*Prior to 1 March 2009 this fund was called Rathbone Income and Growth Fund

## What do we mean by 'value' and why buy into these 'value' funds now?

- 'Value' means buying low (low for no fundamentally good reason compared to net asset or intrinsic value) price assets, high cash flow, high dividend yield and we look for business strength at the right price.
- Not the opposite of 'growth' – these stocks can still be growth stories, the two are not mutually exclusive. 'Growth' strategies can lead to buying overvalued companies through a failure to relate stock price to true company value.
- Not the opposite of 'momentum' – a 'value' stock can still have momentum.
- Not 'bottom-fishing' – stocks are not necessarily cheap, some may just be void of real worth!
- Sell discipline is equally important. We sell when risk to earnings is not mitigated by asset support. That is, high price to intrinsic value, low cash flow, low dividend yield.
- 'Value' has been relegated over the last two years or so, as investors have chased an ever narrowing list of commodity and emerging market stocks.
- These may run further, but as the cycle proceeds, we contend that money will shift back towards 'value'. The historic precedent is 1999 – 2000.

## The contribution to total real return depends on your time horizon



Source: SG Equity Research, US data since 1871

According to SG Equity Research, short-term (1-year) investing is 60% driven by current sentiment with the remaining 40% based on the fundamentals such as dividend earnings and growth. However, over the long term (5-years) 'noise' is replaced by the intrinsic worth of businesses with only around 20% driven by sentiment. We use a longer-term approach to allow fundamentals to show through. The Rathbone Income Fund has an average stock holding period of 5 years.

## The three elements of intrinsic value for protecting long-term returns

**Balance sheet** – the starting point – asset-backing: cash, inventory, property – low levels of debt.

**Returns:** – high cashflow yields, high dividend yields, high returns on investment – must take capital expenditure into account.

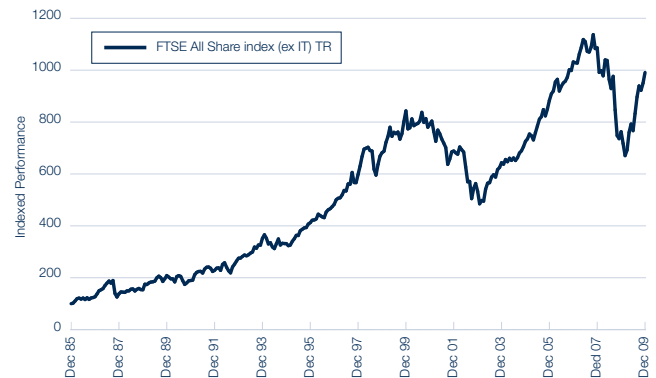
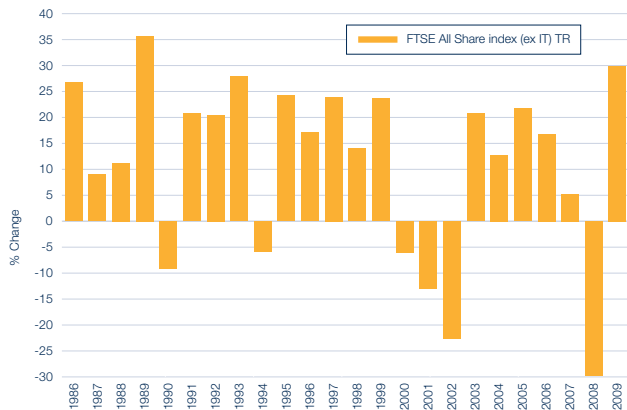
**Growth:** – the icing on the cake – pricing power, dominant market position and barriers to entry, lowest cost advantage, sustainable and structural growth, proven business models and margin expansion – value-creative and internally-funded.

Carl Stick comments:

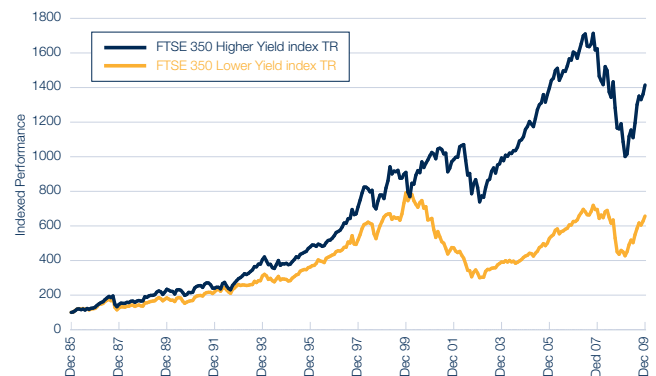
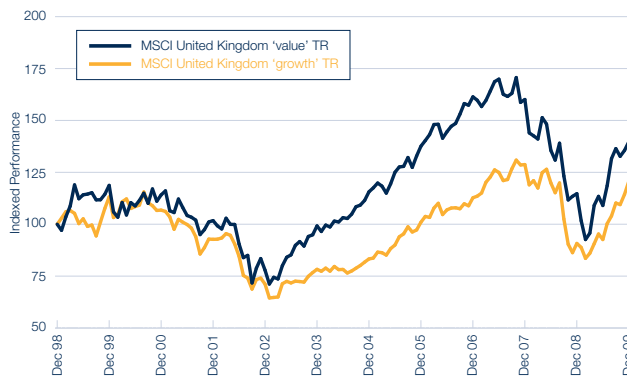
*“Value stocks are priced to disappoint, while growth stocks are priced to exceed expectations, despite the fact that this rarely happens across an economic cycle. If value strategies are most likely to underperform during the last gasps of a bull market when investors flail around looking for the hope of growth, we are now approaching the time of greatest window of opportunity for value strategies. Share prices will be weak, but in many cases, there will be an over-reaction. We believe that the foundations can be established this year for substantial progress, as long as we retain strict value criteria.”*

## History helps: Why and where to invest for the long term?

### Long-term market evidence: FTSE All-Share index – positive and upward general trends



### Long-term stock style: ‘Value’ outperforms ‘Growth’; ‘High-yield’ stocks outperform ‘Low yield’ stocks



Market data – source Financial Express. All data to 31 December 2009.

*“Following periods of very poor value performance, value tends to rebound strongly delivering somewhere around 17% per annum over glamour (for an average of seven years).”*

James Montier, Société Générale  
Source: Société Générale, Mind Matters

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