Rathbone Income Fund

Quarterly investment report, October 2009 to end December 2009

Introduction

At the end of a tumultuous year for equity markets, we believe that we can look back on 2009 with a modicum of satisfaction. We underperformed a market that has bounced back very strongly, with the fund returning +23.10% (putting it very solidly in the second quartile of IMA UK Equity Income sector) versus a resurgent FTSE All Share index, up 30.12%. This market recovery has been energised by an increased appetite for risk. In our opinion, this trend has relegated 'valuation' too far behind 'growth' and 'momentum', disregarding the risk that the global economy may not recover as strongly as some forecasts suggest. We have attempted to de-risk our approach this year, and in this context we are satisfied with our performance.

Past performance should not be seen as an indication of future performance.

Performance review

Through the final quarter, the fund gained 3.81%; the FTSE All Share Index returned +5.47%, and the IMA UK Equity Income sector rose 2.98%. A simple analysis of the market during this period draws out three points. Firstly, commodity stocks performed well across the board, with large miners and oil stocks leading the way. Oil stocks offer us value, so we have benefitted from our large holdings in ***BP*** and ***Royal Dutch Shell***, both providing above-market dividend yields. On the other hand, the mining stocks do not fulfil our value criteria, and the yields are paltry, so we have eschewed the sector. With ***Rio Tinto***, ***Anglo American***, ***BHP Billiton*** and ***Xstrata*** as four of the top five biggest contributors to the performance of the FTSE All-Share index during the period, it is clear whence the underperformance has come.

Secondly, we have seen a recovery in stocks that one may label 'defensive growth'. Our exposures to ***Diageo*** and ***Unilever*** have served us well (having lagged in the previous quarter), and our decision to create a new holding in ***GlaxoSmithKline*** during 2009 has proved opportune. Thirdly, we have benefitted from our move to further reduce the financial exposure of the fund, as banks faltered in the wake of the Dubai Holdings default crisis. Our decision was again based on risk, and whilst we certainly did not predict trouble in the Gulf, it did justify our move.

One final observation. Whilst investors seemed to take a particularly sanguine view with regard to global growth prospects in general, and China in particular, cyclical enterprises closer to home fared less well, as markets worried about domestic economic health. We therefore saw some weakness in our more cyclically-oriented sectors such as Travel and Leisure, Construction, and Industrial Transportation.

Outlook

2009 was a year when markets rebounded strongly from the brink. 2010 may prove to be more testing, as governments around the world look to exit slowly from their programmes of monetary stimuli, and focus more on reducing levels of sovereign debt. Therein lies our caution on global growth predictions. Central bankers will be treading a fine line this year, and the timing of exit strategies will be key. Furthermore, bond markets are likely to adopt a dim view of anything less than an aggressive stance on tackling those deficits. Our 'value' approach is serving us well, and this discipline shall be invaluable in what may be a difficult year.

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