Rathbone Recovery Fund

Quarterly investment report, April 2010 to end June 2010



Market overview

June was a difficult month to end a difficult quarter. Investors switched to risk-off on concerns about sovereign debt defaults and slowing growth in China; and potential for a double-dip recession in the US and Europe. Over that time, the FTSE 100 was down 12.6%; the FTSE 250, 7.13% and FTSE Small Cap (ex-IT) was down 5.29%. The move mirrored other major markets – the US (S&P 500) fell 10.19%; Europe (Eurofirst 300) -13.83%; Japan (Topix) -7.87% and emerging markets -7.01%. Similar to Gilts, US-Treasuries gained on safe-haven status. Oil ended the quarter down at $75.37 per barrel as global growth fears took hold; gold was up at $1,242.25 troy/oz, again on safe-haven status.

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

Performance and fund activity

Over the period, the fund returned -5.57% versus a return on the FTSE All-Share index of -11.80%. Underweight positions in the mining sector and an overweight position in UK mid-caps helped us to outperform the benchmark index over the quarter. During that time, we initiated holdings in ***Sanofi-Aventis*** and ***Mothercare***. French pharmaceutical company Sanofi-Aventis is a company at a crossroads. Faced with a looming patent cliff, political uncertainties and a disillusioned investor base, it is transforming itself to be less dependent on blockbuster drugs. Despite this, the stock market is pricing the company for extinction. Although cognisant of the challenges facing the pharmaceutical sector, we believe many of these are priced-in and, on a P/E of 7x, Sanofi-Aventis piqued our contrarian interest. Mothercare, with its strong position in UK childrenswear and parenting products, has a relatively defensive revenue stream. The retailer's international presence also provides an avenue for growth. On the sell-side, we took some profits from strong performers ***Volex***, ***Senior*** and ***Anglo Pacific***, and exited our holding in construction firm ***Balfour Beatty***.

Outlook

The end of the quarter was marked by a reversion in risk appetite. Macro data have been less encouraging – particularly in the US and China – and concerns about European sovereign debt continue to linger, leading to fears over a double-dip recession. We believe these fears are overdone, however. A slowing in lead indicators does not necessarily mean we're heading into another bear market. On the contrary, it is typical of this stage in the cycle, and is more likely to indicate a moderation in earnings, not a collapse. There are several other factors which reassure us. Firstly, the global government yield curve is not inverted, suggesting another recession is unlikely to be around the corner. Monetary policy remains loose and should support stronger global earnings, and the "carry trade" should provide an ongoing boost to bank profitability. Secondly, the ratio of new orders to inventories remains high and is some way off the one threshold which has often preceded previous earnings collapses. Finally, the global profit cycle is still immature. However, the Rathbone Recovery Fund is not simply banking on a macro recovery – many of our recovery situations are stock-specific, with dynamics not directly linked to the global economy. In fact, we have benefited from a bumpy period in the markets in relative terms, and remain confident of our positioning going forward, despite the uncertain backdrop.

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