RBC Global Asset Management

RBC Funds (Lux) - U.S. Mid-Cap Value Equity Fund – Fourth Quarter 2011 Commentary

U.S. equity markets produced sizable gains in the fourth quarter, but almost all of the gains were produced in a rally in October following the summer macro driven sell-off, with the equities essentially flat with high volatility in November and December. Prospects for sustained U.S. economic growth improved somewhat in the period, while those for Europe deteriorated due to sovereign debt issues and increased uncertainty with regard to the future of the Euro.

Within the Russell Midcap Value Index, the overriding determinant of performance for the year was a stock's historical beta, which at a fundamental level corresponds somewhat with a company's business model cyclicality, ROE, and long term growth rate. For the year, low beta, low cyclicality, and low growth rates outperformed given the widespread macro fears. Reassuring economic data and confirmation of current and projected business metrics coupled with extremely low valuations for many companies in the fourth quarter allowed a recovery in many stocks that had been caught up in the third quarter sell off. Thus, while the fourth quarter still retained a defensive bias, company fundamentals and valuation had a greater influence on stock performance and the quarter saw a reversal of the influence of beta.

For the month of December, the RBC Funds (Lux) – U.S. Mid-Cap Equity Fund, Class O was up 0.8% compared to a 1.2% return for the Russell 2000, a negative 0.4% differential. The most important positive performance factor in the month was a buyout offer for portfolio holding, Delphi Financial Group, at a sizable premium to its public market stock valuation. The biggest detriment to performance relative to the index was sector allocation due to our overweight position in energy, materials, and industrials, which underperformed the index in December, and conversely our underweight in utilities, which was the best performing sector for the month of December and the year.

At this juncture, we continue to believe that valuation remains very compelling with a longer term perspective for many companies that have business models, secular opportunities, and balance sheets well positioned for the long run and capable of weathering the current period of uncertainty. We also see that the most compelling of these opportunities remain in those areas that may remain out of favor until greater clarity on macro issues is achieved. Conversely, while proceeding with a defensive positioning may be warranted short term, the fundamentals and valuations in traditionally defensive businesses are not particularly compelling at this time when taking a longer term investment time frame. Given our longer term investment analysis perspective and the opportunity to identify companies whose fundamentals and valuations are well matched with our core investment tenets we feel confident in our investment portfolio, although realizing that volatility short term may require continued patience in realizing the inherent value represented in the businesses in which we invest.

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Publication Date: 1/31/12 (IC1201041)