

# Newton Falcon Fund

Investment Report - Second Quarter 2011

▶ A BNY MELLON COMPANY<sup>SM</sup>

**NEWTON**  
The Power of Ideas



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# Fund information

## Long-term track record

The Newton Falcon Fund has returned 149.2% since launch (13 November 1998), which is equivalent to 7.5% per annum. This is an outperformance of 2.7% per annum compared to the fund's benchmark. For more detail on the fund's long-term performance, please refer to page 4.

## Aim

To achieve capital growth over the long term from a portfolio invested in UK and overseas equities across a wide range of industries and countries. The manager of the fund is expected to invest with limited reference to the composition of the benchmark, and as a result the fund's performance may differ from the benchmark by a wide margin. For most of the time the fund will be fully or almost fully invested in equities, but it is permitted to hold other assets.

## Expected characteristics

Return: Significantly above cash over the long term; variable in the short term.

Volatility of return: High. Investors can expect to experience significant fluctuations in the value of their holding, driven by rises and falls in equity markets.

Income: Low, but the dividend is likely to grow over the long term.

## Performance references

Since 1 January 2010, the benchmark is 50% FTSE All Share Index, 50% FTSE W World ex UK Index (£). Prior to this it was 50% FTSE All Share Index, 50% MSCI World ex UK Index (£).

## Risk profile

Suitable for investors with a high risk profile.

## Fund facts

Fund size (millions):	GBP 139	Ex dividend dates:	28 Feb, 31 Aug
Annual management charge:	1.5%	Pay dates:	Two business days before 30 Apr, 31 Oct
Total expense ratio:	1.55%	Last distribution:	0.0572p per unit (inc units only)
Base currency:	GBP	ISIN	GB0032585050
Dividend yield:	1.0%	Sedol	3258505

# Focus on the latest quarter

## Performance over three months

<b>Newton Falcon Fund</b>	<b>-0.5%</b>				
Benchmark	1.1%	ARC £ Equity Risk (est)	0.1%	IMA Global Growth	-0.3%
FTSE All Share	1.9%	FTSE World ex UK	0.3%		

Source: Lipper, Datastream & ARC, as at 30 June 2011. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

## Major contributors to relative performance

Positive	%
Sprint Nextel Corp	0.22
Roche Hldgs AG	0.21
Cia Saneamento de Minas Gerais	0.18
L'Oreal SA	0.17
Accenture PLC	0.16

Negative	%
Pandora A/S	-0.78
Hypermarcas SA	-0.32
Applied Materials Inc	-0.29
Gafisa SA	-0.26
Mosaic Co	-0.26

## Significant transactions

Acquisitions
Mitie Group PLC
Huabao International Holdings Ltd

Disposals
Companhia de Saneamento de Minas Gerais
Petrohawk Energy Corp.
Tele Norte Leste Participacoes S/A
PTT PCL

Note: Portfolio holdings are subject to change at any time without notice and should not be construed as investment recommendations.

## Fund manager report

Equity markets were confronted with a broad range of challenges this quarter: a worsening of the European sovereign debt crisis; evidence of slowing economic growth; the lingering impacts of Japan's natural disaster; an end to the expansion of the Federal Reserves quantitative easing programme; and rising inflation in China. Only during the final few days of June, once the Greek government passed an austerity bill that freed up a further tranche of bailout money, did markets recover some of their losses.

The net result of this for markets was an insipid return for overseas equities of 0.3%, with the UK faring better, up 1.9% over the quarter. The Falcon Fund delivered a disappointing return in this context, falling by 0.5% after fees. The main culprits were to be found amongst our consumer sector

holdings, where we allowed a number of investments to get too expensive, and paid the price when challenges emerged, cyclical or otherwise. Pandora, the jewellery chain, was the worst performer in the portfolio. In spite of reporting solid growth, successfully pushing through price increases, and retaining the potential for significant growth from new markets, Pandora's shares fell heavily as investors continued to worry about the sustainability of its high margins and growth rates, concerns that are amplified by increases in its main input costs: silver and gold. Whilst some of these concerns are valid, we believe the business still has potential and the valuation is compelling. In Brazil, Hypermarcas was weak following disappointing first quarter results. The company's food and household product segment is suffering from competitive pressures, whilst in

pharmaceuticals and personal care, where end demand is growing strongly, Hypermecas tightened up the payment terms it demands from distributors. As a result the distributors stopped buying, choosing to sell products already held in inventory. This effect should be temporary, and we expect to see an improvement in subsequent results. More broadly this was a quarter in which risk aversion came to the fore, and whilst the Fund benefited from its investments in the more defensive sectors, these were insufficient to offset the losses at the stock level.

On the positive side, The Fund's healthcare investments generally performed well, including Roche and Fresenius Medical Care, and Sprint Nextel, a turnaround situation in US telecommunications, also posted a strong gain as analysts gained confidence in the company's market position and ability to improve margins. Accenture was another highlight, having released a record set of quarterly results and an encouraging update on its order book. We expect corporate spending on IT projects to remain robust following several years of cost-cutting.

We made more sales than purchases during the quarter, including a reduction in the Fund's oil sector investments. We had purchased one of these, Petrohawk, in August last year for its US natural gas assets. The gas price is unusually low relative to the oil price, because drilling activity in shale deposits has continued at a high level. With rig counts starting to fall, and with security of supply providing a strong argument for shifting US energy demand towards gas, we anticipated an improvement in the gas price. Whilst there has been some improvement, Petrohawk shares have performed well without a significant gas price increase. The company has aggressive spending plans, which always carries some risks, and we took this opportunity to sell the holding.

Tele Norte Leste, a Brazilian telecoms company, has been under a cloud for much of the last year following the announcement of a series of capital raisings aimed at changing the ownership of the company (in essence, allowing some of the controlling Brazilian Institutions to reduce their stake, and bringing in an investment by Portugal Telecom). The completion of the capital raisings, combined with the announcement that the company now intends to simplify its complex ownership structure, resulted in a jump in the share price. We took this opportunity to sell the holding, as TNE's operational performance had deteriorated significantly. Also in Brazil we sold Copasa, a water utility. Due to as yet poorly-defined regulation, the company has not been adequately

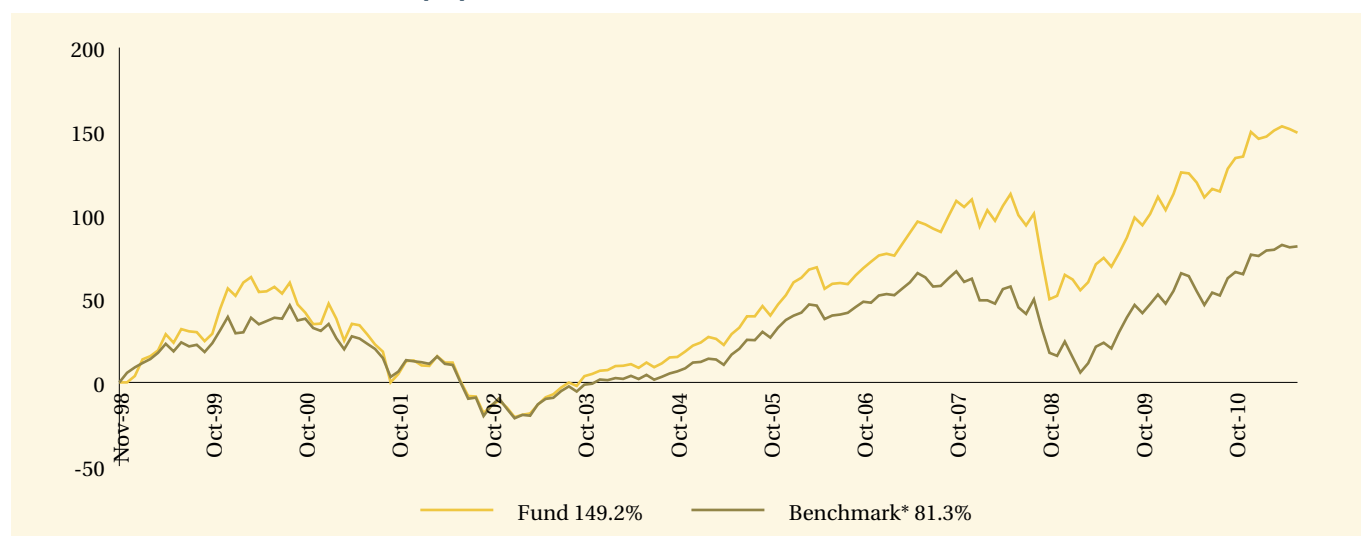
rewarded for its recent capital expenditure, and is not paying the level of dividend we anticipated when we first invested. The shares were cheap enough still to provide a reasonable return to the Fund, but mindful also that the Brazilian currency may be expensive we took advantage of good recent performance to sell the holding.

Amongst the new purchases made during the quarter, Mitie is a direct beneficiary of UK public sector outsourcing with the aim of reducing costs, where opportunities appear to be accelerating. The company provides facilities management services, including the maintenance and improvement of heating, plumbing and electrical systems, and is seeing increased contract tenders from local government, the health service, and the social housing service. The shares offer a free cash flow yield of 9% and a dividend yield of 4%, and the company has very little debt. We also purchased a holding in Huabao, a high margin producer of tobacco flavourings with a dominant position in the Chinese cigarette market. Coincident with broader weakness in emerging markets, the shares have fallen significantly from their peak as expectations for future growth have moderated. We think that the valuation is now supportive given still attractive prospects, and took this opportunity to purchase a new position.

The outlook for investors is sensitive to some considerable challenges, on which history offers only sketchy guidance. Will the weakness in recent economic data prove to have been a blip, or a portent of a longer-lasting slowdown? Will politicians succeed in maintaining a firebreak in European sovereign bond markets, or will the flames from Greece set fire to other parts of the eurozone, and particularly the banking system? Will US legislators cease squabbling in time to reach an agreement on the country's government debt? How will central bankers seek to square the conflicting threats of rising inflation and slowing economic activity in their approaches? What implications will changes in China have for economies and financial markets elsewhere? Against such an uncertain backdrop, financial markets are likely to be volatile and prone to sudden changes of fortune. However, the prospects for companies appear reasonable. Corporate earnings continue to grow healthily, balance sheets are robust, and borrowing costs for higher-quality businesses are low. Investors will have to be mindful of a broad range of risks in the coming months but, in seeking to reconcile those risks, they should take their opportunities as well.

# Long-term performance

## Performance since launch (%)



	2002	2003	2004	2005	2006	2007	2008	2009	2010	YTD 2011
Fund	-24.8	26.0	14.0	24.6	15.7	19.0	-21.5	28.3	18.5	-0.2
Benchmark*	-25.2	20.8	9.9	22.8	10.6	6.6	-23.2	22.6	15.7	2.8

## Discrete past performance (%)

From	30/06/06	30/06/07	30/06/08	30/06/09	30/06/10
To	30/06/07	30/06/08	30/06/09	30/06/10	30/06/11
Fund	22.4	2.8	-15.4	24.4	18.4

Source: Lipper, Datastream & Bloomberg, as at 30 June 2011. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

\*Since 1 January 2010, the benchmark is 50% FTSE All Share Index, 50% FTSE W World ex UK Index (£). Prior to this it was 50% FTSE All Share Index, 50% MSCI World ex UK Index (£).

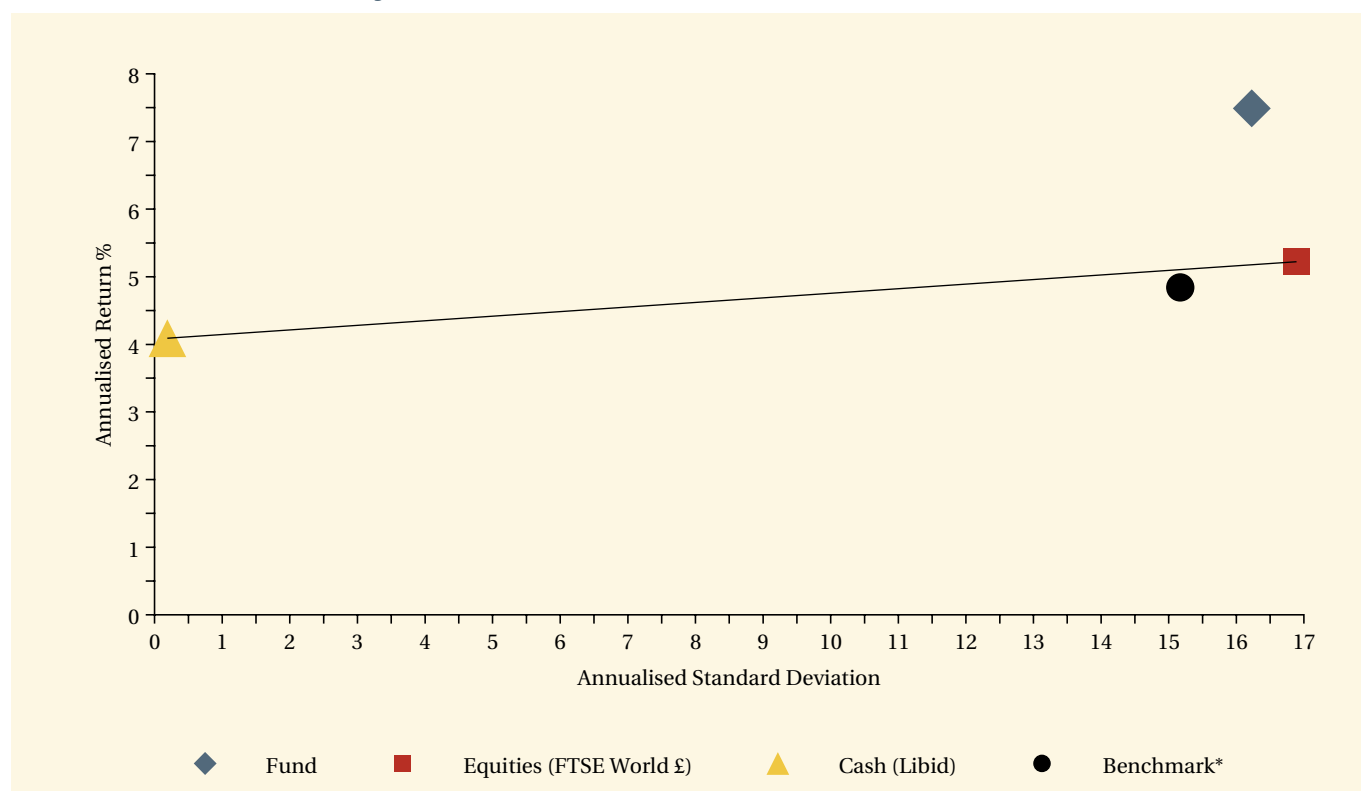
## Risk factors

The performance data shown on this report is past performance; as such it is not a guide to future performance.

Investors should remember that unit trusts should be regarded as long-term investments and that the value of units, and the income from them, can go down as well as up due to stock market and movements in exchange rates. When you sell your investment you may get back less than you originally invested. The fund may invest in emerging markets which are, by their nature, higher risk and potentially more volatile than those inherent in established markets.

# Long-term performance - risk and reward

## Fund return and volatility since launch



This chart shows both return and volatility. The Newton Falcon Fund has given a higher return than cash, world equities and the benchmark with higher volatility than that of the benchmark. The launch date of the fund was 13 November 1998.

## Risk and return since launch

	Annualised Return	Volatility	Sharpe ratio
Fund	7.5%	16.2%	0.2
Benchmark*	4.8%	15.2%	0.0

Source: Lipper, Datastream & Bloomberg, as at 30 June 2011. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

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# Newton's investment process

Newton is a global thematic stock picking company. Our style is inclusive and relies on effective communication between all of our investment personnel.

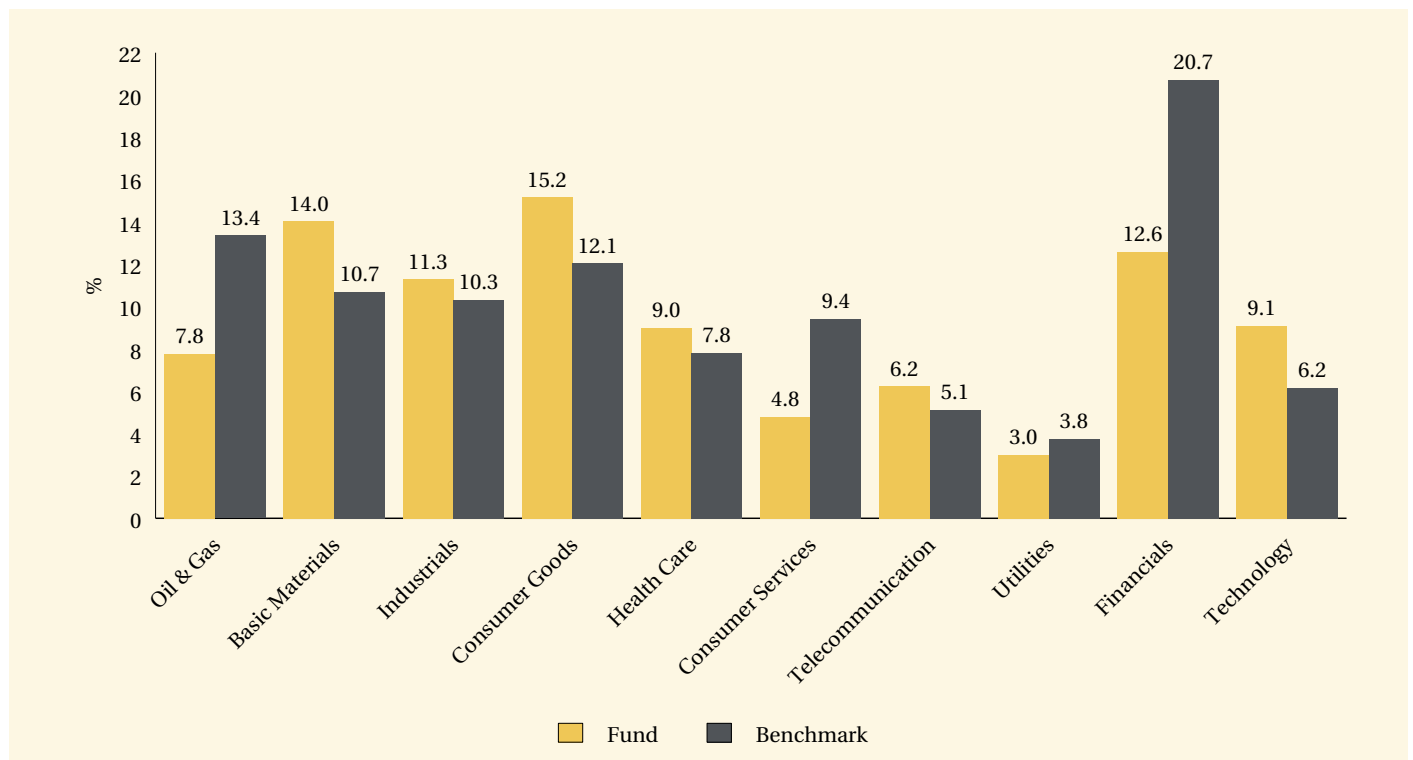
Strategy groups	Representatives from the strategy team, fund managers and research analysts identify global themes and formulate our economic view.
Research team	Global sector analysts, supported by fund managers, identify investment opportunities within the thematic backdrop.
Fund management	Fund managers debate with analysts the appropriate valuations for purchases and sales, then construct portfolios to match up Newton's investment thinking with client objectives and risk profile.

Several of these themes are listed below, along with examples of individual holdings.

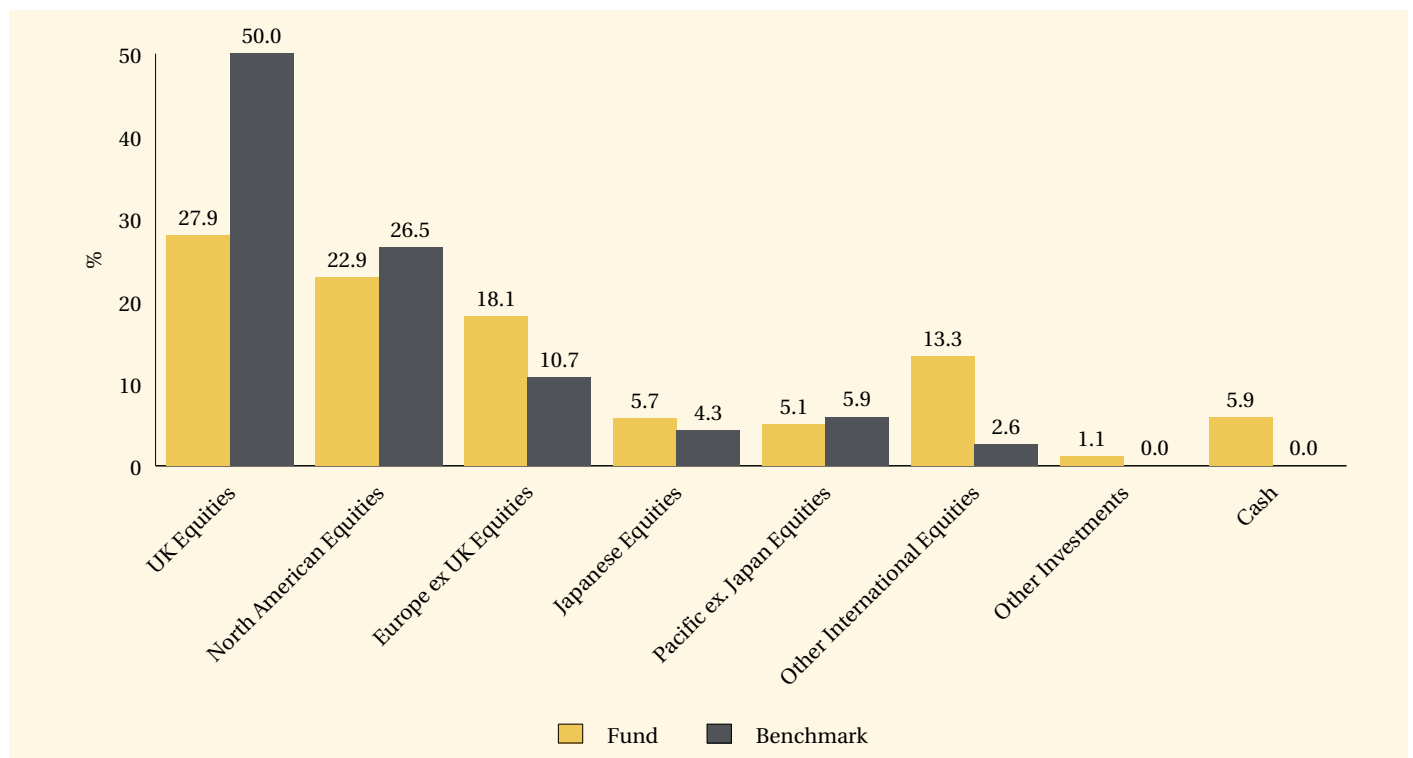
Theme	Factors	Investments
All change	The popping of the credit bubble has marked an end to the era of rapid growth in private sector debt in the developed world. Structurally impaired financial systems and impending regulatory burdens ensure that credit will be less freely available, and this has profound implications for consumer-driven economies, all asset classes and investment strategies.	Altria, British American Tobacco, China Mobile, GlaxoSmithkline, Intel, Mitie, Nestle, Novartis, limited exposure to western commercial banks
Developing economies	The influence of the developing world on the global economy continues to grow, and developing economies ultimately are on a convergence course, in terms of demographics and consumption trends, with the industrialised world. This long-term secular trend will entail the development of Western-style health and social security systems and will involve significant cyclical influences as well as frictions regarding trade policies.	Bangkok Bank, Camelot Information Systems, Gafisa, Hypermarcas, Inpex, Mosaic, MTN, Sands China, Yingde Gases
Networked world	Although networks have already transformed our lives, the trend remains at a relatively early stage. Rapid increases in bandwidth continue to increase networks' range of uses and their interactivity, which in turn is driving productivity gains. The explosive growth of mobile internet, combined with innovations in sensor technology, will generate profound changes in many industries.	Accenture, HTC, MTN, Sprint Nextel
Medical Technology	Increasingly ageing, affluent and active populations demand products and services that enhance and maintain lifestyles in addition to treating more serious medical conditions. New technologies, materials and services are continually improving the performance of existing products and procedures. Developing world demand for healthcare is rising and, in Western healthcare systems, a key challenge is to improve the efficiency of delivery by adding technology to currently archaic networks.	Bayer, Medtronic, Roche

# Fund analysis

## Equity weightings by industry



## Regional and asset class weightings



Source for all charts: Newton, as at 30 June 2011.

# Glossary

## ARC private client indicators

ARC Private Client Indicators are unique in that they are based on actual (as opposed to model) client portfolio returns provided by various investment management companies. These portfolio returns are allocated to one of four categories ("Cautious", "Balanced Asset", "Steady Growth" and "Equity Risk", in order of increasing volatility) based on the volatility of the returns relative to world equities, and an average return is calculated for each category. This is a departure from the traditional approach of comparing the performance of portfolios with similar asset allocations. It assumes that investment managers may use whatever asset allocation they deem appropriate to achieve the desired levels of return and volatility.

## Bonds

Tradable debt issued by governments, quasi government bodies or companies. Interest is usually fixed until maturity and paid either annually or semi-annually. The bond (debt) is repaid by the issuer at maturity.

## Derivatives

Instruments of a fixed maturity, the price of which is dependent upon the price of an underlying asset or variable: most commonly an interest rate, an index, a currency, an equity, a bond or a commodity. Depending on the type of instrument used, derivatives can provide the opportunity to benefit from a fall in the price of the underlying asset or from a rise. Different derivative strategies can therefore be used to hedge exposure to the underlying and to gain exposure to the underlying. Derivatives include futures, forwards, options and swaps.

## Dividend yield

The annual income (dividend) received from an equity or an investment fund divided by the price of the equity or the fund, expressed as a percentage. Dividends are typically paid semi-annually.

## Equity

Also known as a company share. A security that gives the holder fractional ownership of a company. Equities usually confer the right to vote at shareholder meetings and to receive a dividend if one is paid.

## Hedge funds

Unregulated funds with wide investment powers, which typically include the ability to hold short positions (ie, selling an asset the fund does not own in order to profit from a fall in the asset's value), and to use leverage (ie, borrowing to invest, which magnifies profits and losses). There are an enormous number of possible investment strategies. For our clients Newton gains exposure to these funds mainly by investing in listed investment trusts and companies that invest in hedge funds.

## IMA sector averages

The Investment Management Association (IMA) classifies pooled funds with similar objectives into broad sectors (eg, Global Growth, Active Managed, UK All Companies). The average performance of all the funds within a sector is calculated over various time periods to provide investors with a performance comparator.

## Index-linked bonds

Bonds with interest and capital repayment linked to inflation.

## Performance reference

In the context of investment funds, a measure or measures against which the performance of a fund or portfolio can be compared. These tend to be either an index, a combination of indices, or a peer group of comparable funds.

# Glossary

## Property

In this context we are referring to investment in commercial property. Exposure to this asset class is achieved through investment in property investment trusts and REITs.

## Risk

In this context we define risk as the volatility (ie, variability) of returns, as measured by standard deviation.

## Risk profiles – Newton definitions

*Medium risk:* appropriate for clients who are seeking a return in excess of inflation over the long term and are willing to take capital risk to achieve objectives. Portfolios are well diversified (directly, or indirectly through pooled funds) but may contain a high allocation to a single asset class, such as equities.

*High risk:* appropriate for clients who are willing to take significant capital risk to achieve objectives. This category includes portfolios containing only equities, and those containing significant exposure to high-risk funds, smaller companies, venture capital or private equity. It also includes portfolios that are made up of concentrated lines of stock, which reduces the level of diversification.

## Sharpe ratio

A measure of risk-adjusted return. The excess return (in this case, the return above cash) is divided by the standard deviation of returns. A higher number suggests a more efficient mix of returns and volatility.

## Standard deviation

A statistical measure of the variability of returns. The higher the number, the greater the variability of returns. For a normally distributed set of data, 68% of the returns are forecast to occur within one standard deviation of the average, 95% within two times the standard deviation. For example, two investments have an average return of 5%, investment A has a standard deviation of 5% and investment B has a standard deviation of 2%. In 68% of cases, we would expect investment A to return between 0% and +10% (average return of 5% +/- 5% standard deviation) and investment B to return between 3% and 7% (5% +/- 2% standard deviation).

## Total expense ratio

The total costs of the fund, made up principally of the annual management charge, but also including operating costs such as legal, administration, trustee and audit fees.

## Volatility

In this context the variability of investment returns, as measured by the standard deviation. The higher the figure the more variable the return of an investment.

## WM private client indicators

The WM Company surveys investment companies to ascertain the exposure of their principal private client model portfolios by asset class (eg, equities, bonds, hedge funds, etc) and geography. From this they derive an average portfolio in each of the categories “growth”, “balanced” and “income”. The appropriate market index return (eg, FTSE All Share, FTSE Government All Stocks) is then applied to the various elements of the three representative portfolios to generate a benchmark return for each category.

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