

# Newton Balanced Bridge Fund

Investment Report - Fourth Quarter 2008

► A BNY MELLON ASSET MANAGEMENT COMPANY<sup>SM</sup>

**NEWTON**  
The Power of Ideas



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# Fund information

## Long-term track record

The Newton Balanced Bridge Fund has returned 50.1% since launch (23 December 1998), which is equivalent to 4.1% per annum. This is an outperformance of 1.5 % 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 income and capital growth over the long term through a portfolio that is predominantly invested in equities, across a wide range of industries and countries. The equity element is balanced by cash, bonds and exposure to alternative assets, such as hedge funds, to reduce the overall volatility of the portfolio. The fund is managed in line with the Newton Private Investment Management Income and Growth Model.

## Expected characteristics

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

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

Income: Medium, and the dividend is likely to grow over the long term.

## Performance references

WM Private Client Balanced Indicator (benchmark), ARC Sterling Steady Growth, IMA Balanced Managed.

## Risk profile

Suitable for investors with a medium risk profile.

## Fund facts

Fund size (millions):	GBP 175	Ex dividend dates:	31 Jan, 31 Jul
Annual management charge:	0.8%	Pay dates:	2 business days before 31 Mar, 30 Sep
Total expense ratio:	0.84%	Last distribution:	2.5318p per unit
Base currency:	GBP	ISIN	GB0004833660
Dividend yield:	3.9%	Sedol	483366

# Focus on the latest quarter

## Performance over three months

Newton Balanced Bridge	-8.2%		
WM PCI Balanced	-4.6%	ARC £ Steady Growth est.	-5.2%
		IMA Balanced Managed	-6.2%
FTSE All Share	-10.2%	FTSE W World (ex UK)	-2.7%
		FTA Govt All Stocks	10.2%

Source: Lipper, WM, ARC & Datastream, as at 31 December 2008. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

## Major contributors to relative performance

Positive	%
Royal Bank of Scotland Grp (void)	0.71
Rio Tinto (void)	0.69
Barclays (void)	0.46
HSBC Holdings	0.41
Wyeth	0.28

Negative	%
Sprint Nextel	-0.58
AcenciA Debt Strategies	-0.49
Aker Solutions	-0.46
Petroleo Brasileiro	-0.41
Subsea 7	-0.37

## Significant transactions

Aquisitions
Treasury 2.5% Index-Linked 16/08/2013
XTO Energy Inc
L3 Communications Inc
Nestle SA
John Lewis PLC 6.375% Bds 30/01/2012

Disposals
Deutsche Boerse AG
Devon Energy Corp
Diageo PLC
E.ON AG
ConocoPhillips

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

## Fund managers' report

2008 has been a tumultuous year with the near collapse of the banking system and subsequent redrawing of the financial landscape, mainly in the latter part of the year. The demise of the US investment bank was sealed by the conversion of Goldman Sachs and Morgan Stanley to traditional banks and many institutions were (part) nationalised (AIG, RBS for example) whilst governments globally have had to intervene with the aim of providing stability to the financial system, such as the Trouble Assets Relief Program in the US. Consequently, investors have been severely tested, as most asset classes posted declines, with partial respite being found in the usual safe havens of government bonds, cash and gold. Your fund has not fared well against this troubled backdrop declining in value by 23.3% over the year.

The fund is predominantly invested in equities and this is the main reason behind the reduction in value. The FTSE All Share fell by 29.9% and the FTSE W World ex UK (£) by 17.1% over the year, with the worst declines being experienced in September and October. During 2008 we took action to lessen exposure to equities, chiefly reducing further our exposure to financial companies, increased exposure to companies with stable cash flows and strong balance sheets, for example pharmaceuticals, and remained wary of exposure to heavily indebted consumers. The positive impact of these actions on the overall performance of the fund was diminished by our positioning in the Oil and Gas sector and poor performances from Sprint, Inchcape, ABC Learning and Gildan.

From a high of over \$140 a barrel in the summer the oil price retreated dramatically to \$34 just before

Christmas, relieving inflationary pressures for consumers as the price of petrol and other oil based inputs fell. This affected the fund adversely as oil companies face rapidly declining revenues and future profits in the near term. Our *Energy Supply* theme highlights the longer term structural challenges to maintaining current levels of production of oil and, notwithstanding the current economic downturn, we believe that the price of oil will recover and are maintaining the sector position. However, within the sector we have recently attempted to remove some of the leverage to the oil price by selling Aker Solutions, Devon Energy and Oil Search and establishing a holding in XTO Energy. XTO Energy has hedged forward a high proportion of its gas and oil production at levels appreciably above current market prices. This means that they should not be facing as significant a drop in revenues as their competitors, a factor that appears to have been missed by the market.

Alternative investments have been challenged by the financial conditions as many “new” investment strategies failed to provide the expected returns. Hedge funds, with some notable exceptions, failed to produce returns in line with expectations as poor investment decisions, reduced availability of debt for gearing strategies, increased margin calls and redemption requests forced selling of assets to raise cash. The industry suffered further as sentiment was adversely hit by the Madoff scandal. The fund has a very small level of exposure to Madoff of 0.01% through one of its fund of fund holdings. The fund’s exposure to hedge funds is via closed ended vehicles, which moved to large discounts to net asset value, exacerbating the negative performance from this asset class.

The other side of the reduction to equities was that we increased the bond exposure, primarily through short dated corporate bonds owing to their higher absolute yields than Gilts. We also increased our exposure to perpetual bank bonds where we felt that the additional capital raising and dividend reductions that were announced earlier in the year strengthened the position of bond holders. The yields required by investors to compensate them for taking on the additional risk over government gilts, increased, especially for bank bonds, resulting in declining capital values.

We underestimated, indeed, both investors’ demand for ‘safe-haven’ assets such as government bonds in the markets’ downturn and the willingness to accept negligible returns in exchange for security. At one point, the yield on newly issued 1 month T Bill (US government short term debt) was negative with market participants willing to pay for the privilege of lending money to the US government over the year end rather than receive interest. In the UK, the Gilt market returned 12.8%, with 10.2% being achieved in the last quarter. Our preference for corporate bonds over government bonds hurt absolute as well as relative performance. Nevertheless, the outlook for Gilts is uncertain given the large amount of issuance required to meet the government’s planned spending combined with falling fiscal receipts.

At the end of November the Index Linked Gilt market was predicting that we would be entering a period of deflation and that over the next seven years the average inflation rate would be zero. Whilst there are many factors which will depress near term inflation in the UK – falling petrol prices, expected cuts in gas and electricity bills, reductions on the High Street and the VAT cut – the weakening currency and longer term impact of the recent (and ongoing) fiscal and monetary stimuli suggested to us that inflation is not dead. Therefore we purchased the 2013 index linked gilt and this provided a return of over 7% to the end of December.

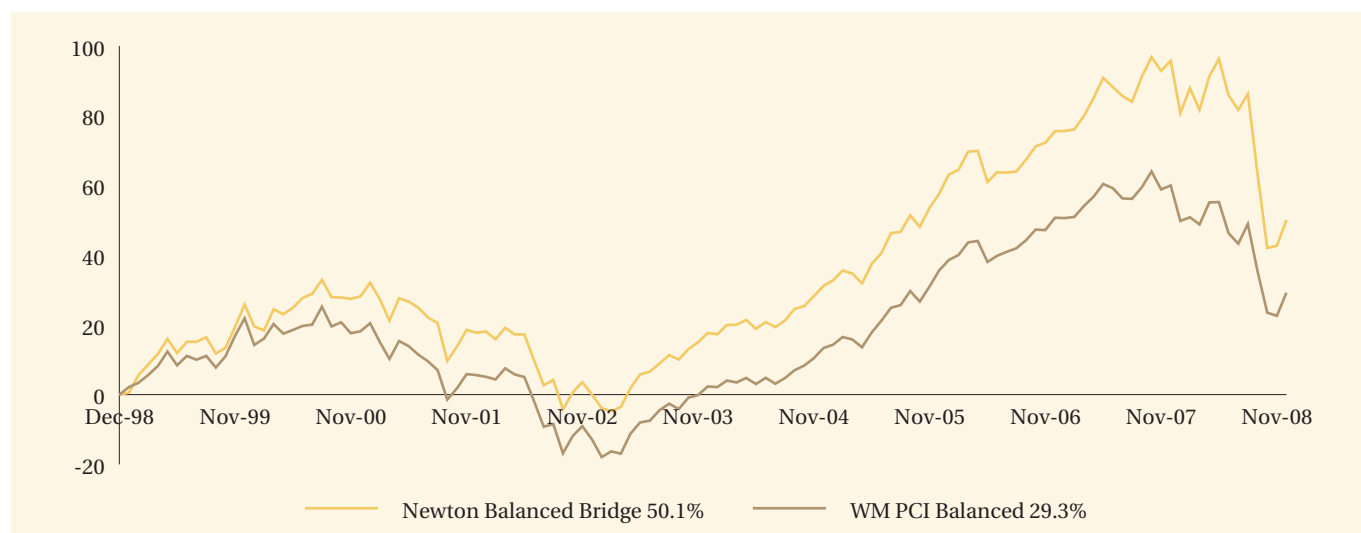
The availability of capital, for businesses and consumers, is likely to remain sparse and expensive, more so given the increased competition from governments’ funding requirements. We will continue to look across a company’s capital structure and selectively purchase investment-grade bonds whose higher yields appear to over-compensate for likely defaults. Within equity markets, we continue to seek companies with strong balance sheets and healthy cash flows which will survive the current economic downturn.

**Fund management team:**

**Caroline Lindsay and Robert Hay**

# Long-term performance

## Performance since launch



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Newton Balanced Bridge	25.1	1.8	-8.1	-15.1	17.7	11.5	20.2	11.4	11.5	-23.3
WM PCI Balanced	19.3	-3.1	-10.6	-17.5	17.5	10.8	19.6	11.1	6.1	-19.2

## Discrete past performance - percentage change

From	31/12/03	31/12/04	31/12/05	31/12/06	31/12/07
To	31/12/04	31/12/05	31/12/06	31/12/07	31/12/08
Newton Balanced Bridge	11.5%	20.2%	11.4%	11.5%	-23.3%

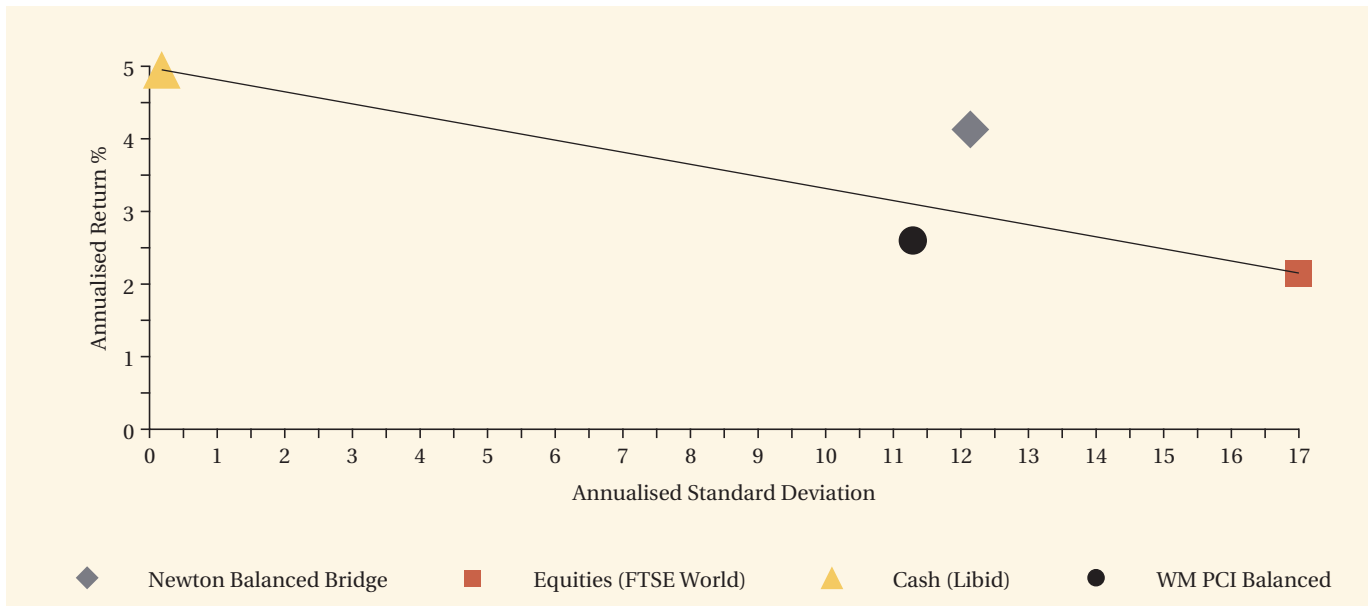
Source: Lipper, WM & Datastream, as at 31 December 2008. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

## Risk factors

This is a financial promotion and is not intended as investment advice. Past performance is not a guide to future returns. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested. The value of overseas securities will be influenced by fluctuations in exchange rates. If the portfolio invests in sub-investment grade bonds that typically have a low credit rating these carry a high degree of default risk, which can affect the capital value of your investment. If the portfolio has exposure to hedge funds, gold, private equity and property via publicly quoted transferable securities, there are additional risks associated with these sectors.

# Long-term performance - risk and reward

## Fund return and volatility since launch



This chart shows both return and volatility. The Newton Balanced Bridge Fund has given a higher return than world equities and the WM PCI Balanced Indicator but with greater volatility than that of the WM PCI Balanced Indicator. The launch date of the fund was 23 December 1998.

## Risk and return since launch

	Annualised Return	Volatility	Sharpe ratio
Newton Balanced Bridge	4.1%	12.1%	-0.1%
WM PCI Balanced	2.6%	11.3%	-0.2%

Source: Lipper, WM & Datastream, as at 31 December 2008. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

# 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.

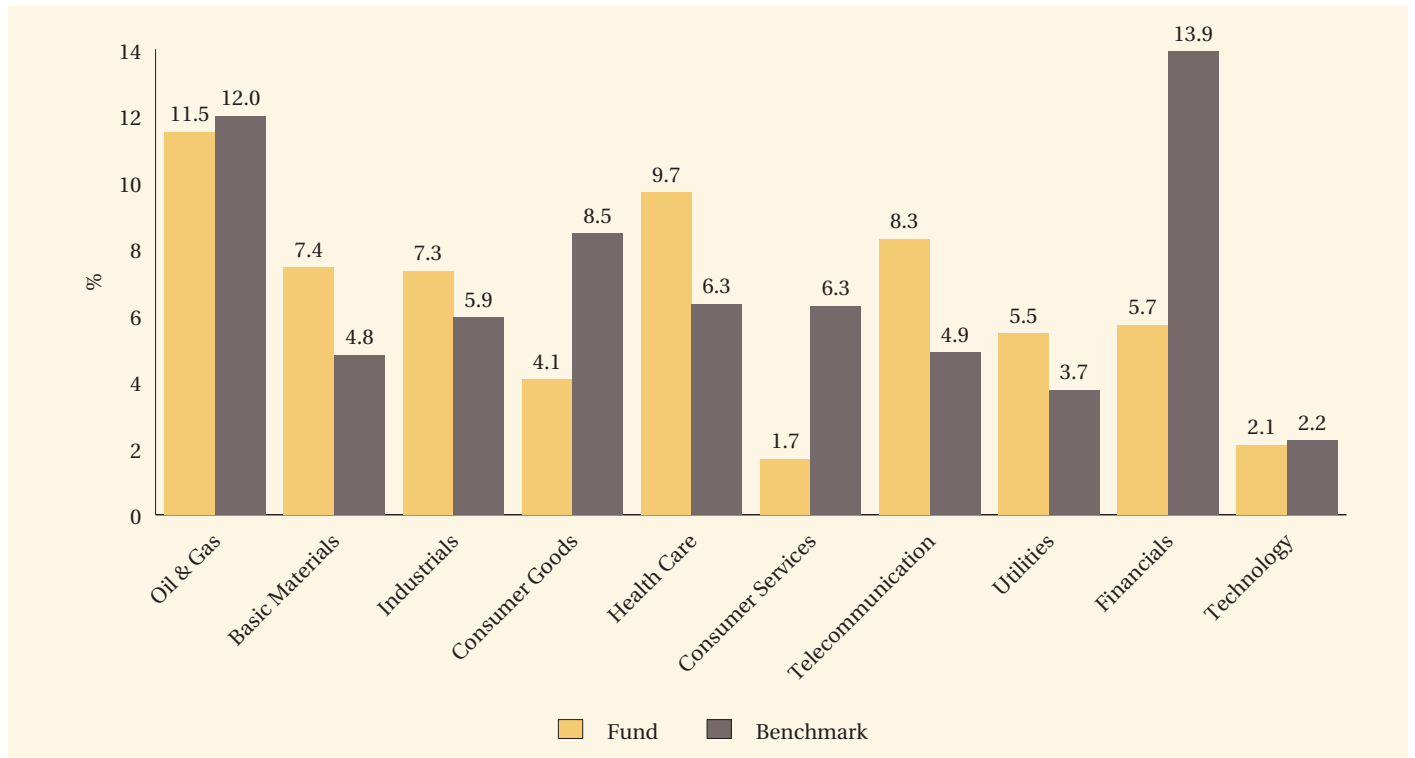
<b>Strategy groups</b>	Representatives from the strategy team, fund managers and research analysts identify global themes and formulate our economic view.
<b>Research team</b>	Global sector analysts, supported by fund managers, identify investment opportunities within the thematic backdrop.
<b>Fund management</b>	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.

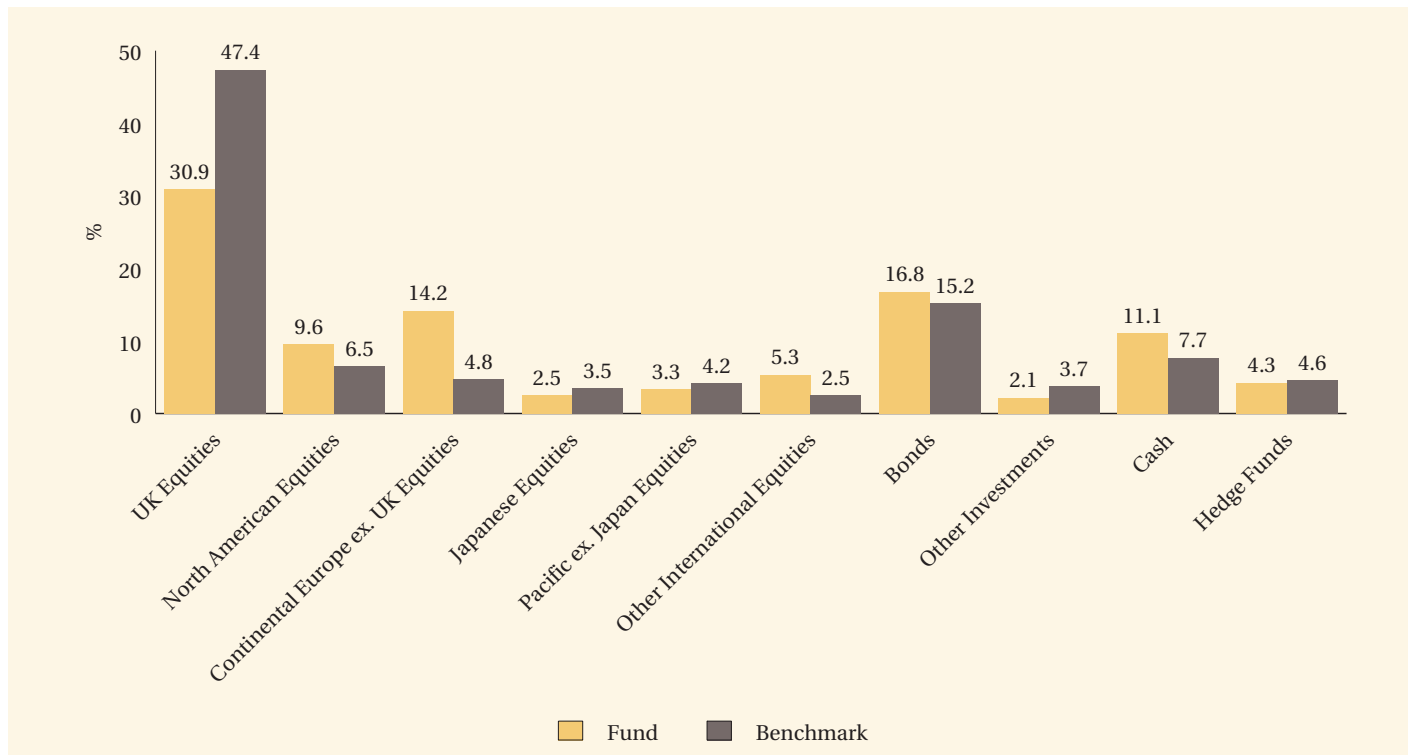
<b>Theme</b>	<b>Factors</b>	<b>Investments</b>
Earth Matters	Environmental issues have moved to centre stage in the minds of the public and policy makers. Current growth trends in the developing world suggest significant additional stress on resources and the environment.	Acciona, Bayer, Fortum, K&S, Makhteshim-Agan
All Change	The previously benign period of stable growth, low inflation, and easy credit, which allowed private sector debt and financial leverage to grow to unsustainable levels (as described in a previous theme, "Becalmed") has come to an end. When assessing investments we assume that access to credit will remain difficult, which favours companies with limited financing requirements and argues against exposure to highly-indebted customers.	Centrica, Cobham, GlaxoSmithKline, Microsoft, Reynolds American, Short dated corporate bonds, Wyeth
Networked World	Communications networks have already transformed our lives, but there is great scope for further expansion. Rapid increases in bandwidth continue to increase networks' potential, and this is driving productivity gains. The explosive growth of mobile internet, combined with innovations in sensor technology, will generate profound changes in many industries.	Cisco, Millicom, Tele Norte Leste, Telstra, Vodafone
Energy Supply	Following decades of underinvestment in oil and gas infrastructure, surplus production and refining capacity is limited. Despite weak demand currently, forecast supply of energy implies a structurally higher real oil price. This has implications for the oil industry, infrastructure, and alternative energy sources as well as significant macro effects.	Acciona, BG, Dana Petroleum, StatoilHydro, Terna Participacoes, XTO Energy

# Fund analysis

## Equity weightings by industry versus benchmark



## Regional and asset class weightings versus benchmark



Source for all charts: Newton, as at 31 December 2008.

# 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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