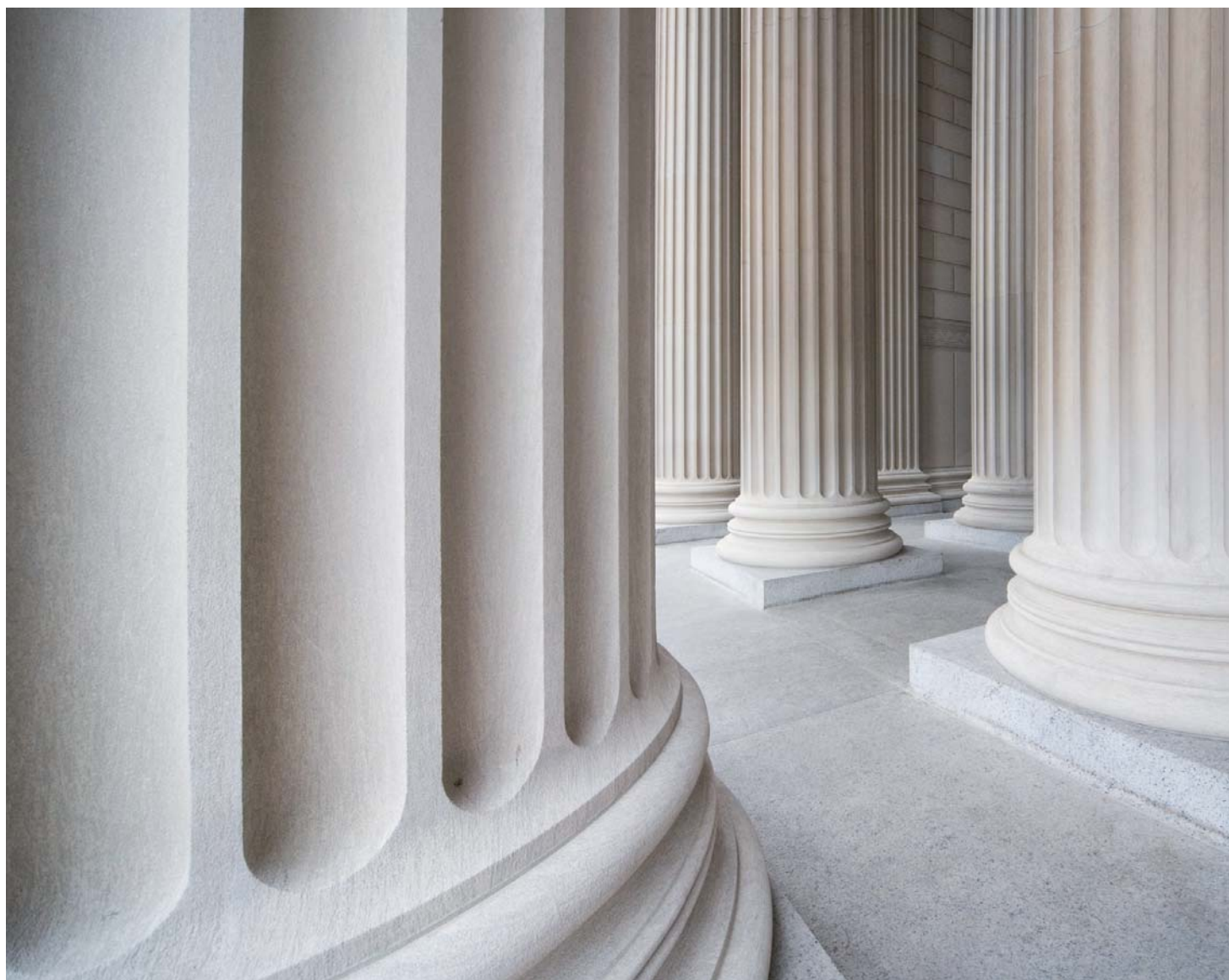


# Newton Real Return Fund

Investment Report - Fourth Quarter 2009

► 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 Real Return Fund has returned 87.9% since relaunch (31 March 2004), which is equivalent to 11.6% per annum. This is an outperformance of 3.0% per annum compared to the fund's benchmark. For more detail on the fund's long-term performance, please refer to page 4.

Prior to 30 June 2009, the Fund was called the Newton Absolute Intrepid Fund.

## Aim

To achieve capital growth in sterling terms over the long term from an unconstrained, actively managed multi asset strategy. The manager of the Fund has maximum flexibility at the asset allocation level and emphasis is placed on long term investing. The Fund is intended to have lower absolute volatility than traditional equity biased funds, but will exhibit volatility relative to its benchmark.

## 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

1 month £ Libor +4% p.a. (benchmark), ARC £ Steady Growth, IMA Absolute Return.

## Risk profile

Suitable for investors with a medium risk profile.

## Fund facts

Fund size (millions):	GBP 1,051	Ex dividend dates:	01 Jan, 01 Jul
Annual management charge:	1.0%	Pay dates:	28 Feb, 30 Sep
Total expense ratio:	1.13	Last distribution:	5.3112p per unit
Base currency:	GBP	ISIN	GB0006780323
Dividend yield:	3.2%	Sedol	0678032

# Focus on the latest quarter

## Performance over three months

<b>Newton Real Return</b>	<b>3.9%</b>				
1 month £ Libor +4% p.a.	1.1%	ARC £ Steady Growth:	2.6%	IMA Absolute Return	0.1%

Source: Lipper, WM & ARC, as at 31 December 2009. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

## Significant transactions

Acquisitions
USA Treasury Bonds 2.5% TII 15/01/2029
Scottish & Southern Energy PLC
ETFS Agriculture DJ-AIGSM 0% Secured Note (USD)
Reed Elsevier N.V.
Telekomunikacja Polska S.A.

Disposals
Treasury 2.5% Index-Linked 16/08/2013
Wyeth
Norway (Kingdom of) 6.5% 15/05/2013
FTSE 100 Index Mar10 4700 (Put Option)
Tele Norte Leste Participacoes S/A

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

## Fund manager report

### Performance factors

The Fund performed well during the second half of 2009, finishing the year ahead of the fund's stated objective, after a strong 2008. The equity portion of the portfolio delivered a large proportion of the Fund's performance as equity markets continued their nine-month rally into the year-end. However, in contrast to the two previous quarters, sector performance was more measured and broader-based in nature.

Equities exposed to commodities were amongst the top performers with **Noble Group**, the Hong Kong-based commodity trader, at the top of the list. The price of gold staged an impressive rally and breached \$1200 per ounce during November, fuelled by ongoing concerns surrounding inflation and the debasing of paper money. Another catalyst was the increase in purchases by developing world

central banks, notably India, which cited an understandable desire to diversify its reserves away from the major currencies. The holdings in gold miners, **Minas Buenaventura**, **Newmont** and **Barrick Gold**, as well as physical gold exposure via **ETFS Physical Gold**, benefited from the price improvement.

Agricultural crop prices rose in the closing months of 2009 as concerns that the late planting of crops in the US, which resulted from the heavy rain in spring, was now affected by the first snow falls, before crops have been harvested fully. Speculative trading activity during the year also showed an increase in the number of long positions as investors remarked the growing dispersion between agricultural prices and those of other commodities. The fund benefited indirectly from holdings in agricultural chemical producers, **Syngenta** and **Bayer**, as well as from direct

exposure to crop price rises via **ETFS Agriculture DJ-AIGSM**, an exchange traded fund which tracks the price of soft commodities. **Bayer** also benefited from good news flow on its blockbuster drug, Xarelto, which recorded positive results from its phase three trial and received EU approval.

Elsewhere the performance of the pharmaceuticals and the healthcare sector as a whole improved, having lagged significantly the market for most of the year. A major drag on the sector has been the threat of healthcare reform in the US, where there was concern that the government-sponsored health insurance plan would under-cut existing health care insurers and, by using its buying power, the government would procure the ultimate nationalisation of healthcare. An unamended plan would have impaired the profitability of nearly all service providers and suppliers. By the year-end the “extreme” outcome appeared to have been avoided and the bill looked relatively benign. Stocks held in the fund, such as **Medtronic**, **Amplifon**, **Smith & Nephew**, **Novartis** and **GlaxoSmithKline**, posted strong returns.

#### Review of activity

The composition of the portfolio has changed over the year to reflect both the continuing equity market rally and the investment of some of the cash into equities. The names within the equity portfolio, however, have changed very little, as we remain comfortable with core holdings in solid companies, such as **GlaxoSmithKline** and **Vodafone** which represent the best risk-reward trade-off in the current climate. The bias towards high- quality, large capitalisation companies, with sustainable cash flow and attractive dividend yields, such as **Deutsche Telekom** and **RSA**, has been maintained.

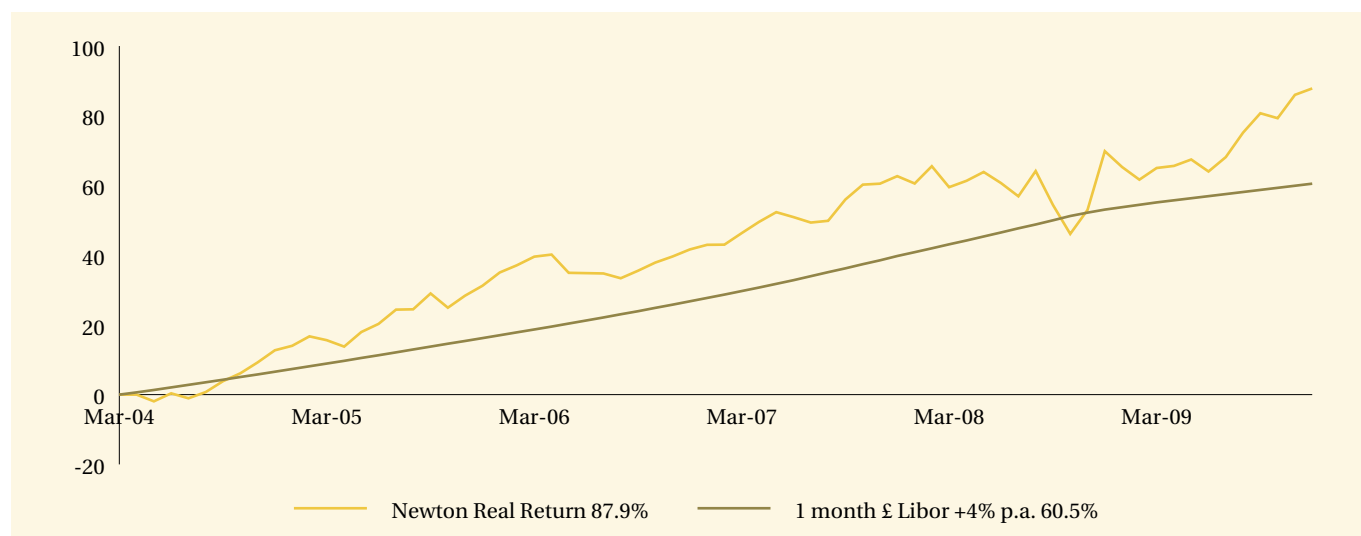
One new addition, **Scottish & Southern Energy**, like many non cyclical, stable growth companies, has not participated in the recent equity rally and the valuation fails to acknowledge potential returns likely to accrue from the current capital investment programme. The management’s commitment to dividend growth in real terms was a further attraction, since we expect income to continue to constitute a high proportion of total shareholder returns in the years ahead. Another new addition, **Polska Telecom**, was introduced because we believe the valuation fails to reflect the Polish

government’s adoption of a more constructive approach to regulation.

The bond portfolio continues to rotate lower-yielding issues into higher-yielding bonds as the spread on investment-grade issues has narrowed significantly since the beginning of the year. A new addition, **Heidelberg Cement**, rated B, is a German cement company with global operations. The company is committed to achieving investment-grade status within 18 months and the bond has already been upgraded. Asset sales will be used if necessary to pay down debt to achieve the requisite rating.

# Long-term performance

## Performance since launch



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Newton Real Return	-	-	-	-	-	16.4	8.0	14.9	4.4	10.6
1 month £ Libor +4% p.a.	-	-	-	-	-	9.0	9.1	10.3	9.5	4.9

## Discrete past performance - percentage change

From	31/12/04	31/12/05	31/12/06	31/12/07	31/12/08
To	31/12/05	31/12/06	31/12/07	31/12/08	31/12/09
Newton Real Return	16.4%	8.0%	14.9%	4.4%	10.6%

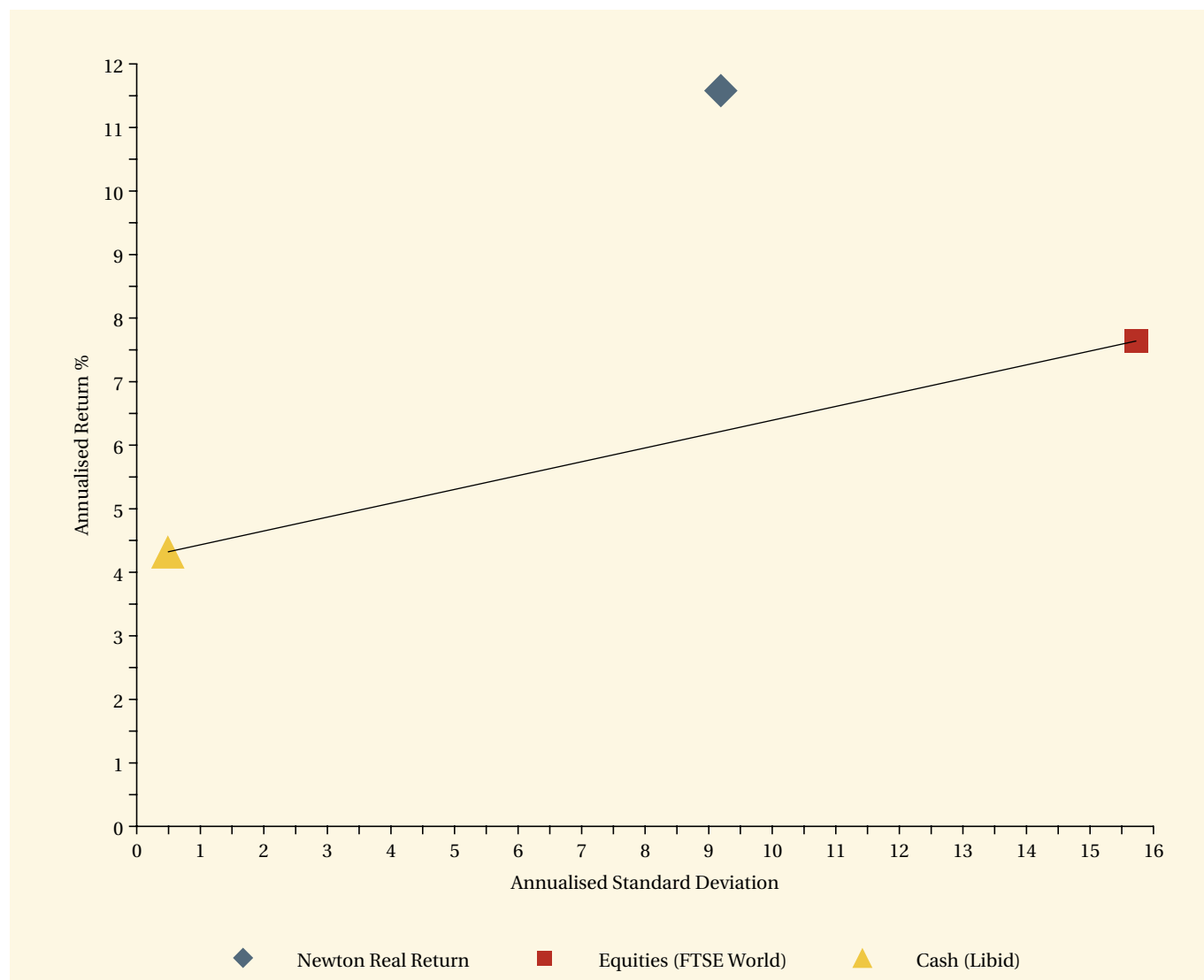
Source: Lipper, WM & Datastream, as at 31 December 2009. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

## 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 Real Return Fund has given a higher return than cash and equities with significantly lower volatility than equities. The relaunch date of the fund was 31 March 2004.

## Risk and return since launch

	Annualised Return	Volatility	Sharpe ratio
Newton Real Return	11.6%	9.2%	0.8%
1 month £ Libor +4% p.a.	8.6%		

Source: Lipper, WM & Datastream, as at 31 December 2009. 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.

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 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.	BP, GlaxoSmithKline, Roche, Vodafone
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 depend on the development of Western-style health and social security systems and will involve significant cyclical influences as well as frictions regarding trade policies.	Noble Group, Bangkok Expressway, Millicom, Tele Norte Leste Participacoes
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.	Acciona, BP, Total, StatoilHydro, Petroleo Brasileiro
More Government	The financial crisis and the recession that has followed in its wake have sharply reversed the trend of reducing the role of the state in the economy, especially in the developed world. With bigger government comes more regulation, higher taxes and the prospect, ultimately, of slower growth and higher economic volatility; local interests will take priority over global. The magnitude of the recent stimulatory policies may have sown the seeds for future inflationary pressures and the unpredictable nature of state intervention increases the risks in all asset classes.	ETFS Physical Gold, Barrick Gold, Index-Linked Bonds

# 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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