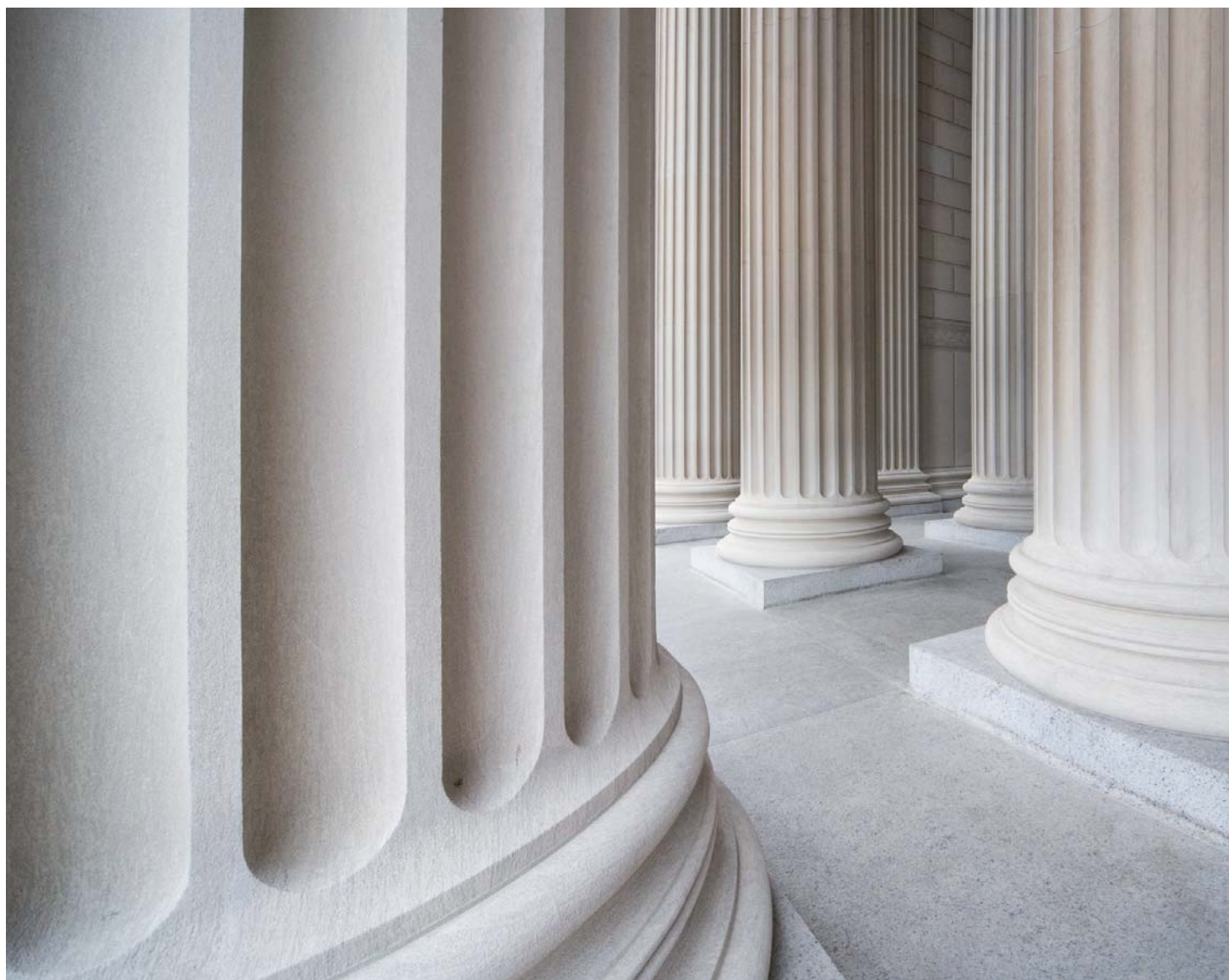


# Newton Real Return Fund

Investment Report - Second Quarter 2010

► A BNY MELLON 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 88.3% since relaunch (31 March 2004), which is equivalent to 10.7% per annum. This is an outperformance of 2.5% 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 1,892	Ex dividend dates:	01 Jan, 01 Jul
Annual management charge:	1.0%	Pay dates:	28 Feb, 30 Sep
Total expense ratio:	1.12	Last distribution:	3.6547p per unit
Base currency:	GBP	ISIN	GB0006780323
Dividend yield:	3.3%	Sedol	0678032

# Focus on the latest quarter

## Performance over three months

<b>Newton Real Return</b>	<b>-1.7%</b>				
1 month £ Libor +4% p.a.	1.1%	ARC £ Steady Growth:	-6.3%	IMA Absolute Return	-2.2%

Source: Lipper, Bloomberg & ARC, as at 30 June 2010. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

## Significant transactions

Acquisitions
GlaxoSmithKline PLC
Vodafone Group PLC
BP Capital Markets PLC-5.25% 07/11/2013
Newcrest Mining Ltd
TeliaSonera AB

Disposals
Compass Group PLC
QBE Insurance Group Ltd
Greece (Republic of)-6% Bds 19/07/2019
FTSE 100 Index-Jul10 4700 (Put Option)
Euro FX Future-Sep10 1.25 (Put Option)

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

After four quarters of consecutive and, at times, dramatic gains, global equities suffered a sharp fall during the period under review. Investors' overriding concern was the mounting sovereign debt crisis in Continental Europe, which exerted a significant influence upon both equity and fixed-interest markets. Equally troubling were signs that the nascent global economic recovery was more fragile than many investors had previously supposed. Against this backdrop no individual industrial sector posted a positive return, but there were highlights at the stock level.

The key contribution to performance during the quarter was from FTSE 100 Index put options, in place to help dampen market volatility and offset losses in the equity part of the portfolio in the event of a market fall. With the FTSE 100 Index falling

below 5000, the level at which the fund had protection in place, the fund was able to take considerable profits on exercising these contracts.

Equities detracted in aggregate from performance, but our cautious stance proved highly beneficial in this more difficult environment. The top-performing stocks included utility providers Centrica, Severn Trent and Scottish and Southern Energy. Scottish & Southern Energy received an additional uplift to its share price after withdrawing from a bid to acquire the UK distribution assets of EDF, which reaffirmed management credentials for preserving shareholder value.

The largest individual detractor from performance was BP, which experienced a dramatic collapse in its share price following the explosion and subsequent leak at the Macondo oil field in the Gulf of Mexico. These events have, undoubtedly, been

tragic but, while BP is certain to incur substantial environmental and compensation claims, we felt that the share-price fall (which wiped almost \$100bn from the company's market capitalisation) was excessive, and likely to have been the result of panic-selling.

The price of gold increased significantly during the quarter amid rising risk aversion and sustained inflation fears. The 8% gain from the holding in ETFS Physical Gold was a significant positive contributor. Furthermore, the increase in the underlying price of gold was amplified in double-digit gains from the fund's gold mining equities such as Barrick Gold, Minas Buenaventura and Newmont Mining, the three best performing holdings over the quarter.

Within the fixed-interest part of the portfolio, exposure to corporate bonds detracted as the broad increase in risk aversion prompted a widening in credit spreads. However, a positive return from holding US Treasury bonds went some way to mitigate the loss, amid the flight to 'safe haven' assets. Finally, forward currency contracts also contributed positively, offsetting the impact of the euro and US dollar depreciation on overseas assets.

#### Review of Activity

BP, was clearly a focus for investors following the catastrophic explosion and leak in the Gulf of Mexico. While the company faces considerable liabilities, we felt that investors' reaction was excessively negative; at one time nearly \$100bn was wiped from its market capitalisation. We added therefore to the equity holding and also established a position in BP 5.25% 2013 corporate bonds, on which we were able to secure a very attractive 7% yield.

Another opportunity presented by the Gulf of Mexico disaster was in Transocean, the owner of the Deep Water Horizon rig contracted by BP. Transocean has seen a large decline in both its share price and the value of its bonds, which allowed us to buy Transocean Inc 1.5% 15/12/2037 convertible bonds on a very attractive yield with upside potential from a recovery in the share price.

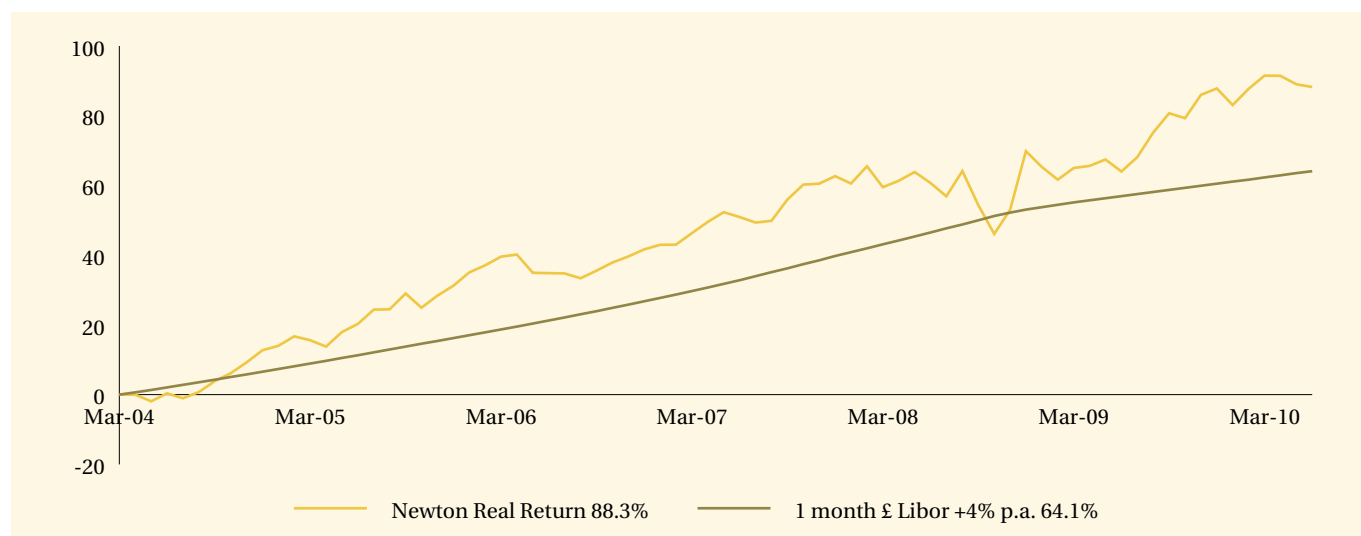
Mobile telecommunications companies have for some time been struggling with how to capitalise on the growth in mobile data usage. Newton has

been a strong advocate of putting tiered data pricing in place ahead of the exponential data growth which we see taking place in the coming years. We introduced a new holding in Teliasonera, the Swedish based telecommunications company which has pricing plans in place to benefit from mobile data growth. The stock also has an attractive yield.

We sold the holding in QBE Insurance Group in order to reduce exposure to the Australian dollar and owing to weak operational performance. Given the importance of the mining sector to the Australian economy, there has been a high correlation between the Australian dollar and commodity prices. With increased pessimism in markets and a fall in industrial metals prices, the currency looked vulnerable and we decided to reduce exposure to Australian dollar assets.

# Long-term performance

## Performance since launch



	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD 2010
Newton Real Return	-	-	-	-	16.4	8.0	14.9	4.4	10.6	0.2
1 month £ Libor +4% p.a.	-	-	-	-	9.0	9.1	10.3	9.5	4.9	2.2

## Discrete past performance - percentage change

From	30/06/05	30/06/06	30/06/07	30/06/08	30/06/09
To	30/06/06	30/06/07	30/06/08	30/06/09	30/06/10
Newton Real Return	12.1%	11.9%	6.5%	2.1%	14.8%

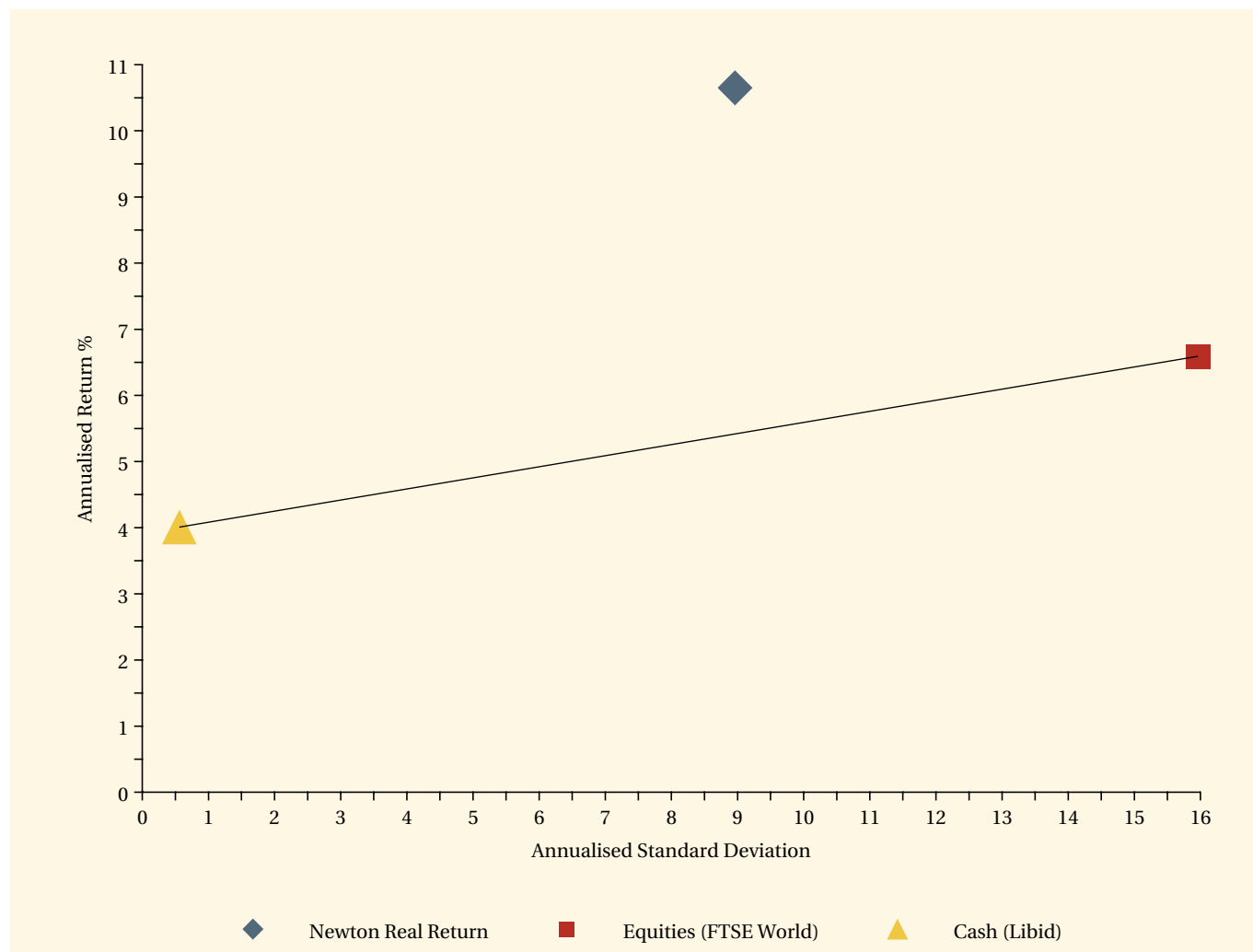
Source: Lipper, Bloomberg & Datastream, as at 30 June 2010. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

## 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	10.7%	9.0%	0.7
1 month £ Libor +4% p.a.	8.2%		

Source: Lipper, Bloomberg & Datastream, as at 30 June 2010. 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 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.	Total, GlaxoSmithKline, Roche, Vodafone, Novartis
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 Expressway, Millicom, Tele Norte Leste Participacoes, Advanced Info Service
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.	Millicom, Sprint, Vodafone, Advanced Info Service
More Government	State intervention and forms of managed capitalism hold sway over an increasing proportion of global output. With the increasing involvement of governments come more regulation, higher taxes and the prospect, ultimately, of slower growth and higher economic volatility. Local interests will take priority over global interests. The unpredictable nature of state intervention increases the risks in all asset classes.	ETFS Physical Gold, Barrick Gold, Index-Linked Bonds, Newmont Mining

# 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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