

Newton Falcon Fund

Investment Report - Fourth Quarter 2008

► A BNY MELLON ASSET MANAGEMENT COMPANYSM

NEWTON
The Power of Ideas



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Fund information

Long-term track record

The Newton Falcon Fund has returned 64.3% since launch (13 November 1998), which is equivalent to 5.0% per annum. This is an outperformance of 2.8% 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

The benchmark is 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 57	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:	1.59%	Last distribution:	1.8851p per unit (inc units only)
Base currency:	GBP	ISIN	GB0032585050
Dividend yield:	1.3%	Sedol	3258505

Focus on the latest quarter

Performance over three months

Newton Falcon Fund	-5.8%				
Benchmark	-6.2%	ARC £ Equity Risk (est)	-6.5%	IMA Global Growth	-5.3%
FTSE All Share	-10.2%	MSCI World ex UK	-2.2%		

Source: Lipper, 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	%
HSBC Holdings (underweight)	0.74
Royal Bank of Scotland Grp (not held)	0.71
Rio Tinto (not held)	0.68
ETFS Physical Gold	0.60
Wyeth	0.57

Negative	%
Sprint Nextel	-0.91
Gildan Activewear	-0.60
Aker Solutions	-0.59
Quicksilver Resources	-0.54
Subsea 7	-0.51

Significant transactions

Aquisitions
Treasury 2.5% Index-Linked 23/08/2011
Sprint Nextel Corp
XTO Energy Inc
Newcrest Mining Ltd
Smith & Nephew PLC

Disposals
Devon Energy Corp
Gold Fields Ltd
Deutsche Boerse AG
E.ON AG
Oil Search Ltd

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

Fund managers' report

In spite of a recovery from late November, equity markets produced another weak quarter to round off a miserable year for investors. We are sure that our unit holders are well aware of what has happened in the financial sector and investment markets, and any catalogue of causes and events is at risk of being out of date within a matter of weeks. For the purposes of this report we will therefore concentrate on a review of the Fund's performance in 2008 and an explanation of recent changes.

The Fund did not fare particularly well in the very tough environment of the last year, falling by 21.5% after fees, marginally less than the fall in the benchmark. Whilst the returns produced cumulatively over the last five years remain high given the circumstances, our performance deteriorated after a strong first half of the year. Decisions that benefitted the Fund included: the low exposure to banks and other financial

companies, a significant allocation to healthcare companies, a timely purchase of gold (via an ETF), and an unusually high cash balance. On the negative side, our investments in the oil and gas sector were too exposed to sharp falls in fossil fuel prices (of which more below), our agriculture-related investments gave back much of the first half's stellar performance (we realised significant profits but retained some exposure), and the Fund was also hurt by a clutch of individual investments that with hindsight were unsuited to the highly risk-averse environment that has prevailed.

In last quarter's report we explained our move out of large integrated oil companies into smaller exploration and production companies that offered more potential for production growth. We knew that this would increase the Fund's sensitivity to the oil and gas prices, and therefore reduced the overall exposure to the sector. This was not

sufficient, however, to mitigate the consequences of a very sharp fall in commodity prices during the quarter. In response to this we looked for other companies in the sector that might react better to a broad range of oil price outcomes, resulting in a switch from Devon Energy into XTO Energy, as well as the sale of Oil Search. XTO has sold forward much of its next two years of production at a price equivalent to \$120 oil, yet its share price has fallen just as steeply as other exploration and production companies. As a result we believe that the shares offer a better balance of potential risk and reward.

A broader exercise undertaken at Newton in recent months has been to review all our investments with a stricter attitude towards balance sheet strength, financing requirements, and sensitivity to a range of potential adverse developments. Sales carried out as a result of this review included Deutsche Boerse (competition and the danger of a protracted period of lower trading volume), E.ON (debt levels and commodity price sensitivity), National Express (debt levels and aspects of the East Coast mainline franchise), and the last of the Fund's holding in HSBC. Reinvestments into companies with stronger balance sheets and undemanding valuations included High Tech Computer (HTC), as described below, and a substantial addition to the holding in Smith & Nephew, the medical device company involved in orthopaedics, endoscopy, and wound management.

Having sold the Fund's shares in HTC during the third quarter, we repurchased a holding at a much lower price in December. At that point the shares were trading at approximately 9 times 2008 earnings, and offered a 9% dividend yield. HTC has no debt, and a cash balance equivalent to 20% of the company's market value. As we wrote in our last report, the consumer retrenchment may well affect sales of HTC's "smartphones", but we believe that over time the shift towards mobile phones that offer many of the internet-based features that we use at home will be a strong one. The undemanding valuation and strong balance sheet give us some comfort about the resilience of the shares in the event of possible setbacks in the underlying business.

Sprint Nextel, the third largest US mobile phone company by number of subscribers, was one of the worst performers in the Fund this quarter. The company has been under a cloud for several years,

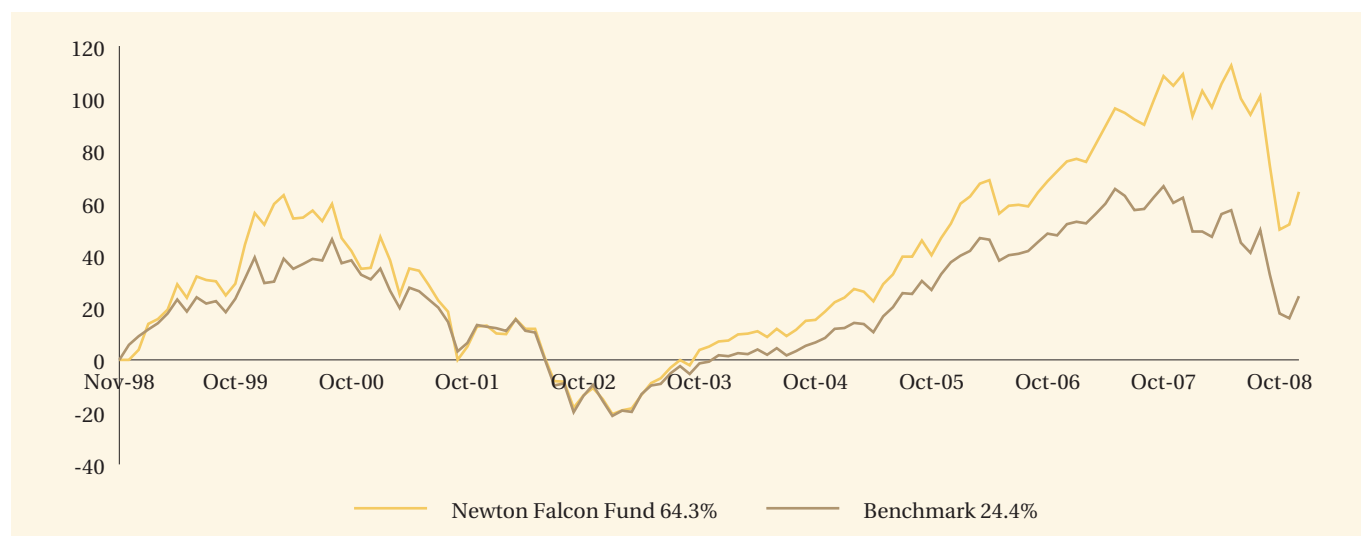
losing subscribers as a result of poor network quality and customer service. Prior to our initial investment in April 2008, Sprint had already spent a large amount to address the network and service issues, and capital expenditure had subsequently dropped back to low levels. We thought that the shares had fallen far enough earlier in the year. Unfortunately they fell further still. To provide some measure of how nervous investors had become, in December a January 2011 Sprint Nextel bond was trading at an annual gross redemption yield of approximately 20%. The new management team is focussed on generating cash and meeting maturing debt obligations, but also believes that the company's service quality is now good enough to start advertising again in earnest. Stemming the subscriber losses would go a long way to calming investor concerns, and the company still has sufficient scale to be competitive. We felt that the company's equity and the 2 year bond were trading at unnecessarily distressed levels, and bought both.

By value the largest purchase we made during the quarter was an August 2011 index-linked Gilt, as a relatively low-risk way of deploying some of the Fund's cash balance. At the price we paid, the Retail Price Index would have to deflate by more than 3.5% annually for the next two years for this bond to produce a lower return than a conventional Gilt of similar maturity. This pricing struck us as extreme, reflecting the very sharp falls in inflation expectations witnessed in the second half of the year, and represented a short-term opportunity for a modest gain.

Our theme of "All Change" is well and truly upon us. We are now paying for the excessive spending and debt accumulation of the last decade. This is unlikely to be a short process. We believe that access to capital will remain difficult and expensive, both for consumers and companies, in spite of the relief currently provided by investors' enthusiasm for corporate bonds. This expectation has driven many of the changes to the Fund's equity portfolio described above. We are also looking at opportunities in assets outside equities where an appropriate balance of risk and reward is available, as demonstrated by the investments in the Sprint Nextel bond, the short-dated index-linked Gilt, and various exposures to gold.

Long-term performance

Performance since launch



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Newton Falcon Fund	50.3	-13.4	-16.3	-24.8	26.0	14.0	24.6	15.7	19.0	-21.5
Benchmark	27.6	-6.0	-13.9	-25.2	20.8	9.9	22.8	10.6	6.6	-23.2

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 Falcon Fund	14.0%	24.6%	15.7%	19.0%	-21.5%

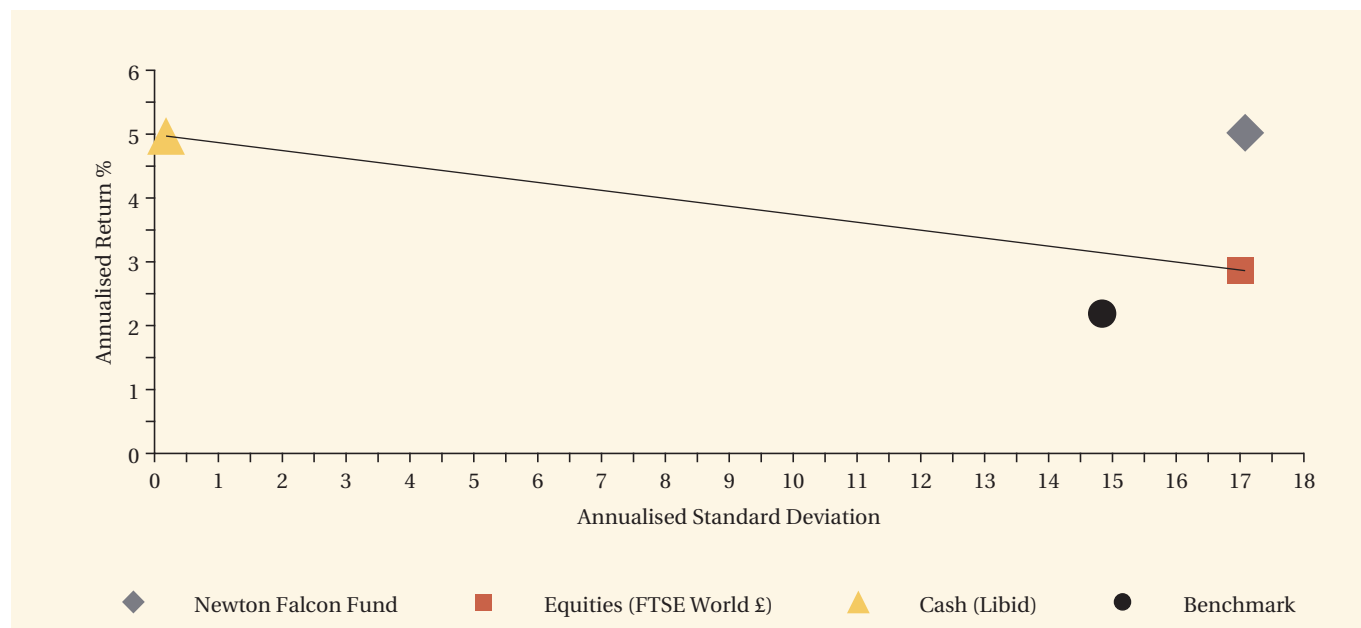
Source: Lipper & Datastream, as at 31 December 2008. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

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 Falcon Fund has given a higher return than cash, the benchmark and world equities, but with higher volatility. The launch date of the fund was 13 November 1998.

Risk and return since launch

	Annualised Return	Volatility	Sharpe ratio
Newton Falcon Fund	5.0%	17.1%	0.0%
Benchmark	2.2%	14.8%	-0.2%

Source: Lipper & 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.

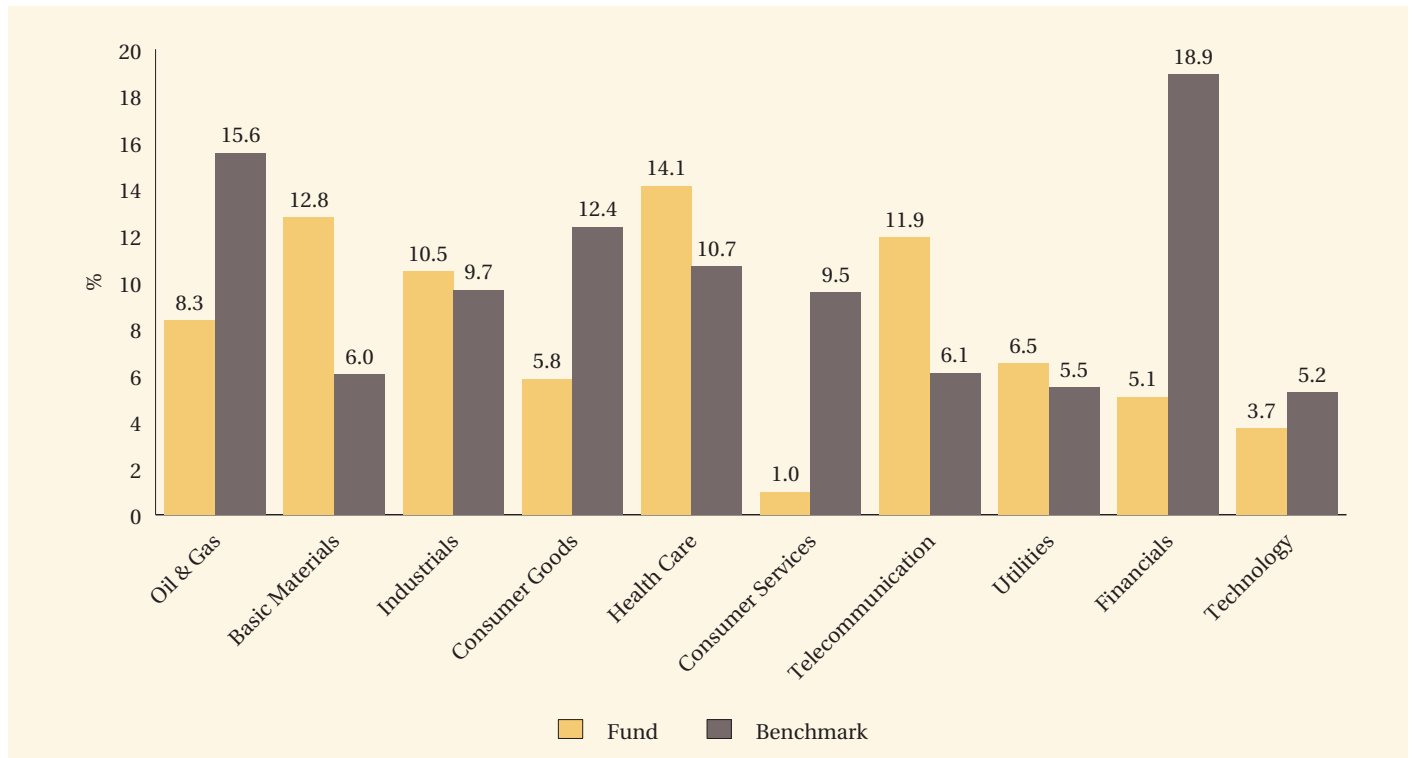
Strategy groups	Representatives from the strategy team, fund managers and research analysts identify global themes and formulate our economic view.
Research team	Global sector analysts, supported by fund managers, identify investment opportunities within the thematic backdrop.
Fund management	Fund managers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

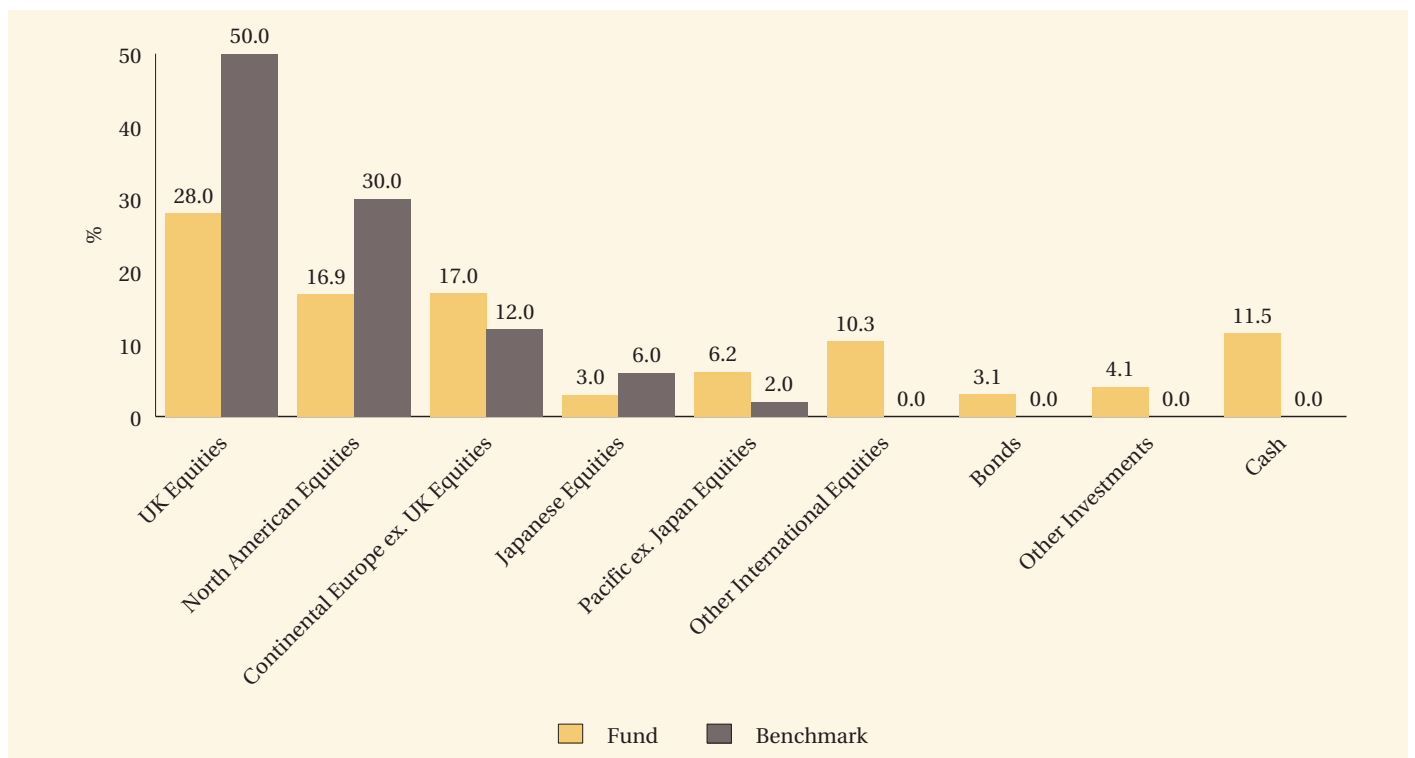
Theme	Factors	Investments
Earth Matters	Environmental issues have moved to centre stage in the minds of the public and policy makers. Current growth trends in the developing world suggest significant additional stress on resources and the environment.	Acciona, Bayer, K&S, Makhteshim-Agan
All Change	The 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, HTC, Microsoft, Reynolds American, Wyeth, no commercial banks in UK or USA, no property.
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.	HTC, Millicom, Sprint Nextel, Tele Norte Leste, 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.	BP, Petrobras, StatoilHydro, Subsea 7, 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.

Issued by Newton Investment Management Limited (NIM). The Newton Falcon Fund is an authorised unit trust operated by BNY Mellon Fund Managers Limited (BNY MFM). Registered office for NIM and BNY MFM: The Bank of New York Mellon Centre, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No.1371973 (NIM) and No. 1998251 (BNY MFM). NIM and BNY MFM are authorised and regulated by the Financial Services Authority.

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