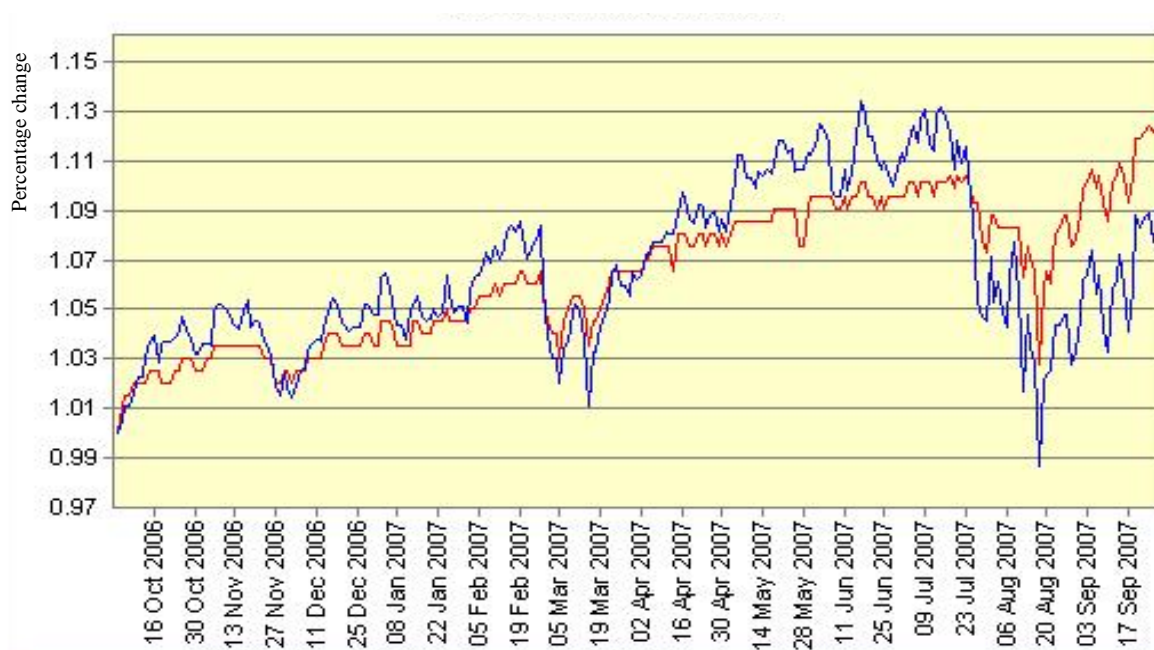


The use of structured products within the Newton Phoenix Fund (2)

In May 2007 we wrote a note on our use of structured products within the sub investment grade bond allocation of the Newton Phoenix Fund. The 'autocall' structures offer a limited upside with a much smaller chance of a larger downside. Typically, the limited upside is triggered by a stock market index rising over one year and the downside is triggered by the same index falling more than 50% (for example).

One example is the Elders (Merrill Lynch) Capital Accumulation III autocall. This promised to repay the original capital of 100p plus 11p if the FTSE index is level or above the starting level in one year (to October 2007). In the event, the FTSE index rose 9.7%. The fund therefore received a return of 11% in one year. In contrast, sub investment grade bonds gave an income of 7%, but a capital loss of 3.8% as credit spreads widened.

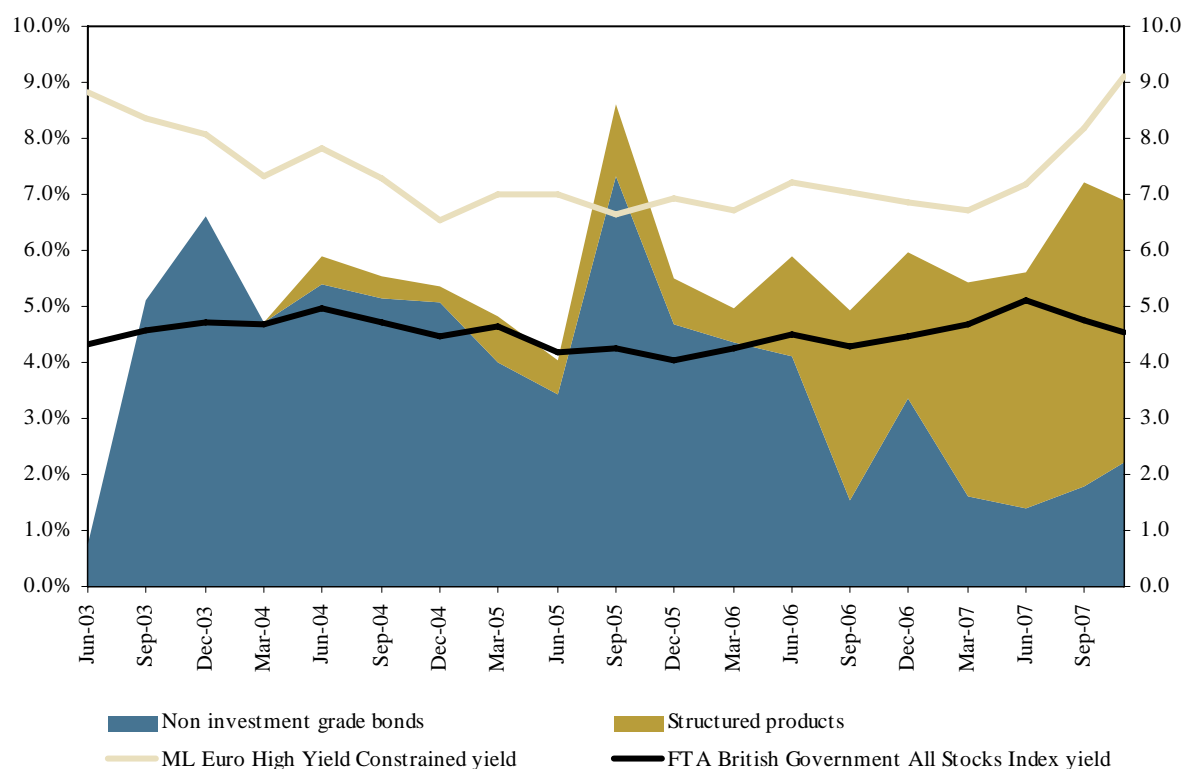
Performance of the Merrill Lynch Capital Accumulation III (red) autocall vs FTSE 100 (blue)



Source: Merrill Lynch

The chart overleaf shows the extent to which we reduced the Phoenix Fund's exposure to sub investment grade bonds over the past few years. We have overlaid two lines. The beige line is the yield of sub investment grade bonds, the other (black) is the yield of the UK gilt index. Our move away from sub investment grade bonds occurred before the increase in sub investment grade bond yields this summer.

Allocation to sub investment grade bonds and autocall structured products overlaid with the yield of the ML Euro High Yield Constrained index and FTA British Government All Stocks Index



Source: Newton, Thomson Datastream

In 2003 and 2004, the sub investment grade bonds produced double digit returns, while 2005 was a more pedestrian year. In 2006, the Phoenix Fund's bonds and structured products underperformed sub investment grade indices by 3% as credit spreads continued to narrow. The outperformance in 2007 (to end November) in excess of 6% more than compensates for this.

To date, the move has been very successful. We continue to monitor both the credit and counterparty risks within structured products. We are also conscious of both the increased equity market correlation and pricing linked to volatility levels that they bring. As value re-emerges, we will consider rebuilding our exposure to sub investment grade bonds. However, for now, with volatile equity markets and significant market worries about lower grade debt, we are very comfortable with the balance between bonds and structured products. Currently, the sub investment grade bonds offer yields between 9% and 12% while the autocall structured products offer payouts between 9% and 18% if certain conditions are met.

For the latest performance of the Newton Phoenix Fund, please ask for the latest factsheet.

Telephone: 0800 917 6594
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