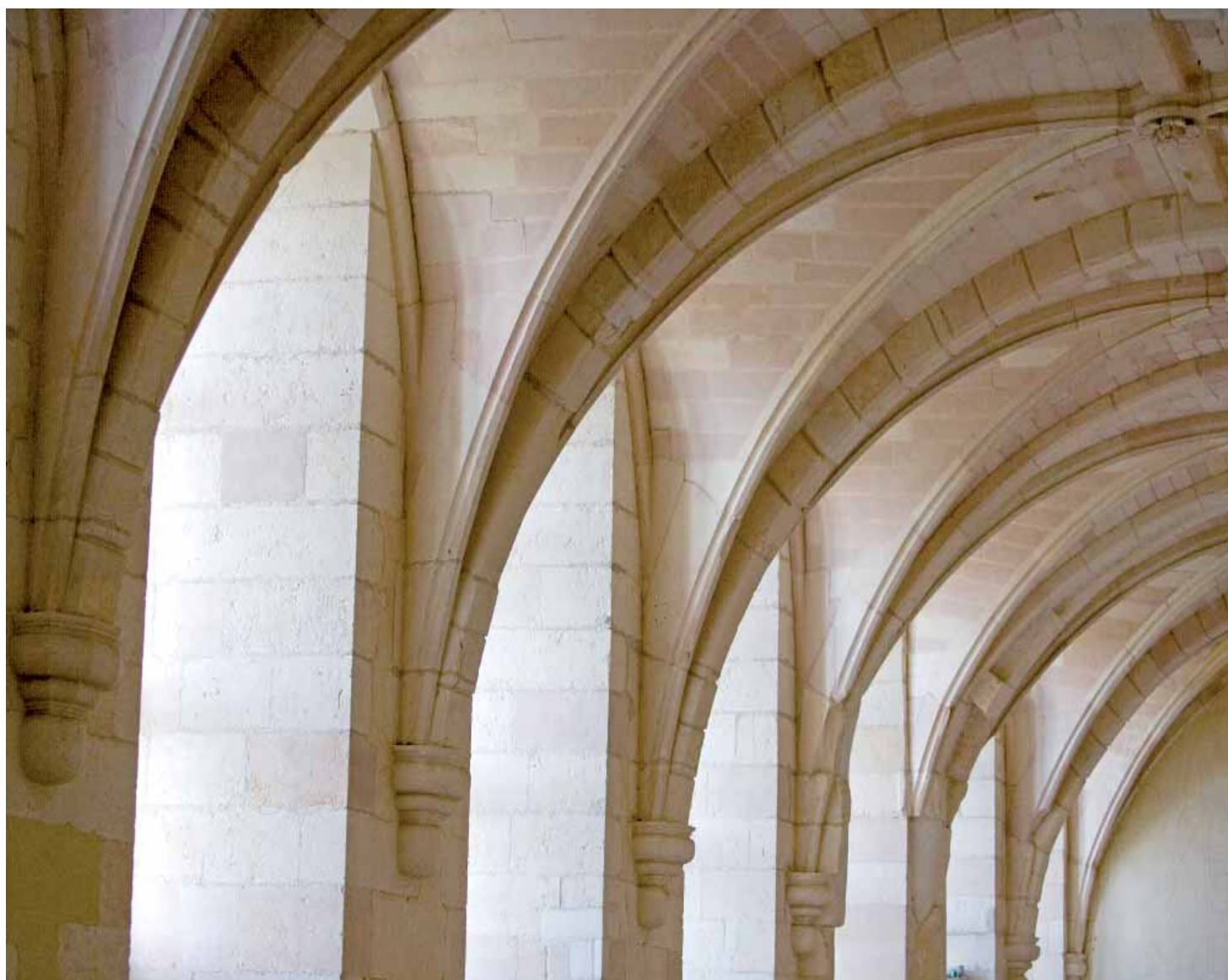


# Newton Falcon Fund

Investment Report - Second 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 Falcon Fund has returned 69.2% since launch (13 November 1998), which is equivalent to 5.1% per annum. This is an outperformance of 3.3% 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 64	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:	0.7690p per unit (inc units only)
Base currency:	GBP	ISIN	GB0032585050
Dividend yield:	1.8%	Sedol	3258505

# Focus on the latest quarter

## Performance over three months

<b>Newton Falcon Fund</b>	<b>5.8%</b>				
Benchmark	7.9%	ARC £ Equity Risk (est)	7.6%	IMA Global Growth	7.4%
FTSE All Share	10.9%	MSCI World ex UK	4.9%		

Source: Lipper, ARC & Datastream, as at 30 June 2009. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

## Major contributors to relative performance

Positive	%
Terna Participacoes	0.81
Gildan Activewear	0.66
Cia Saneamento de Minas Gerais	0.44
Millicom Intl Cellular	0.41
Subsea 7	0.25

Negative	%
ETFS Physical Gold	-0.85
HSBC Holdings (not held)	-0.62
Barclays (not held)	-0.46
Wyeth	-0.40
Deutsche Telekom	-0.34

## Significant transactions

Acquisitions
Ultra Electronics Holdings PLC
Flir Systems Inc.
China Mobile Ltd
Jardine Lloyd Thompson Group PLC

Disposals
Dana Petroleum PLC
Japan Tobacco Inc.
Gildan Activewear Inc.
Serco Group PLC

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

## Fund manager report

During the quarter global equity markets continued the sharp rally that began in March as risk appetite returned. Grounds for optimism were found in widespread evidence of a moderation in the rate of economic decline: jobs being lost at a slower rate, house prices falling less quickly, and consumers feeling less pessimistic, to name a few. In addition, conditions in the financial sector appeared to be improving: US investment banks in particular have been taking advantage of high trading volumes and wide spreads to make strong profits in their capital markets divisions; the results of the stress tests were announced without any great shocks; and some banks have even repaid the capital injections they received under the TARP programme. By most standards, however, economic activity remains weak.

Monetary and fiscal policy measures have continued to multiply, and have clearly gained

some traction. This has been perhaps most apparent in China, which has seen a surge in lending this year. The longer term effect of these measures is uncertain, and in the West they are now giving rise to concerns about the scale of required government borrowing, but in the short term they have clearly encouraged increased risk-taking, and provided some relief to the banking system.

The Fund did not keep pace with the market rally over the quarter, returning 5.8% after fees, compared to a benchmark return of 7.9%. Year-to-date, however, the result is still significantly ahead of the benchmark. Whilst we have increased the allocation to equities in recent months, we still have investments in gold and corporate bonds, which held back performance relative to equity indices. We have also allocated a significant percentage of assets to attractively valued

companies in sectors such as Telecommunications and Healthcare, which were largely ignored by investors looking to get more bang for their buck in a recovery. In sector terms, the strongest returns were to be found in the areas that had suffered most during the latter stages of the crisis, to which the Fund has relatively limited exposure: financials, mining, and industrials.

Ultra Electronics and Flir Systems, both new purchases made during the quarter, are high quality companies with sound finances, which have a record of achieving attractive returns on invested capital. Like Telecom and Healthcare companies, they have been somewhat overlooked in the rally since March, but they offer more potential for long-term growth than most of our investments in those sectors. Ultra design and support electronic systems used in the defence and aerospace industries. The company has pursued a successful and disciplined approach to growing by acquisition, and benefits from recurring maintenance revenues. Flir is the global market leader in thermal imaging equipment. The systems they manufacture have commercial as well as military applications, including night vision and energy conservation.

China Mobile, another new purchase, is the dominant mobile telecom operator in China. As we mentioned above, the authorities are putting in place policies to support domestic consumption. Only 48% of the population currently has a mobile phone, which leaves significant scope for growth in both voice and data usage. Thirteen times current earnings seems an undemanding price to pay for this potential.

Turning to the sales carried out during the quarter, we took some risk out of the Fund's Oil and Gas investments by selling the holding in Dana Petroleum, a relatively small UK exploration and production company. The shares had held up well since purchase, in spite of a very volatile environment for the oil price, and did not offer particularly compelling value.

Other sales included Gildan Activewear, a t-shirt, fleece and sock manufacturer, and Serco. Gildan shares had received harsh treatment throughout 2008 and the first two months of 2009: earnings have suffered as their distributors reduced inventories, and with hindsight it is clear that the

valuation at the start of the period left little room for disappointment. Nevertheless, the company has continued to take market share from rivals, has a sensible strategy for growth, and has very little debt. We increased the holding at very depressed levels in February and March, since when the share price has more than doubled. Following this recovery we cut the position back but still retain a holding. Serco, the UK-based public sector outsourcing group, was sold given its reasonably high valuation and disappointing cash flow generation.

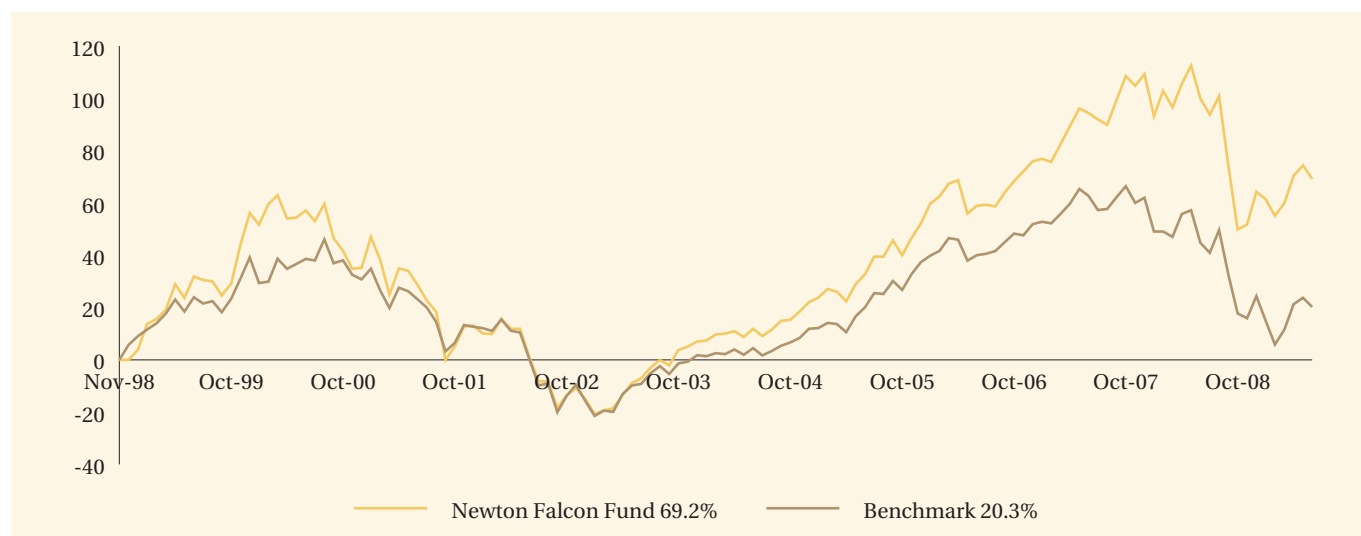
It is possible that reflationary monetary and fiscal policy will continue to provide support to financial markets. We believe, however, that given the scale of the underlying debt problem, sustained underlying economic recovery will be hard to achieve. In the Fund we are maintaining a balance between investments in less cyclical, often high-yielding shares on low valuations, more cyclical developed world companies where we are confident of the growth prospects and funding arrangements, and developing markets that do not face the same structural issues as the West.

**Fund management team:**

**Robert Hay and Ross Ciesla**

# Long-term performance

## Performance since launch



	2000	2001	2002	2003	2004	2005	2006	2007	2008	YTD 2009
Newton Falcon Fund	-13.4	-16.4	-24.8	26.0	14.0	24.6	15.7	19.0	-21.5	3.0
Benchmark	-6.0	-13.9	-25.2	20.8	9.9	22.8	10.6	6.6	-23.2	-3.3

## Discrete past performance - percentage change

From	30/06/04	30/06/05	30/06/06	30/06/07	30/06/08
To	30/06/05	30/06/06	30/06/07	30/06/08	30/06/09
Newton Falcon Fund	18.7%	19.8%	22.4%	2.8%	-15.4%

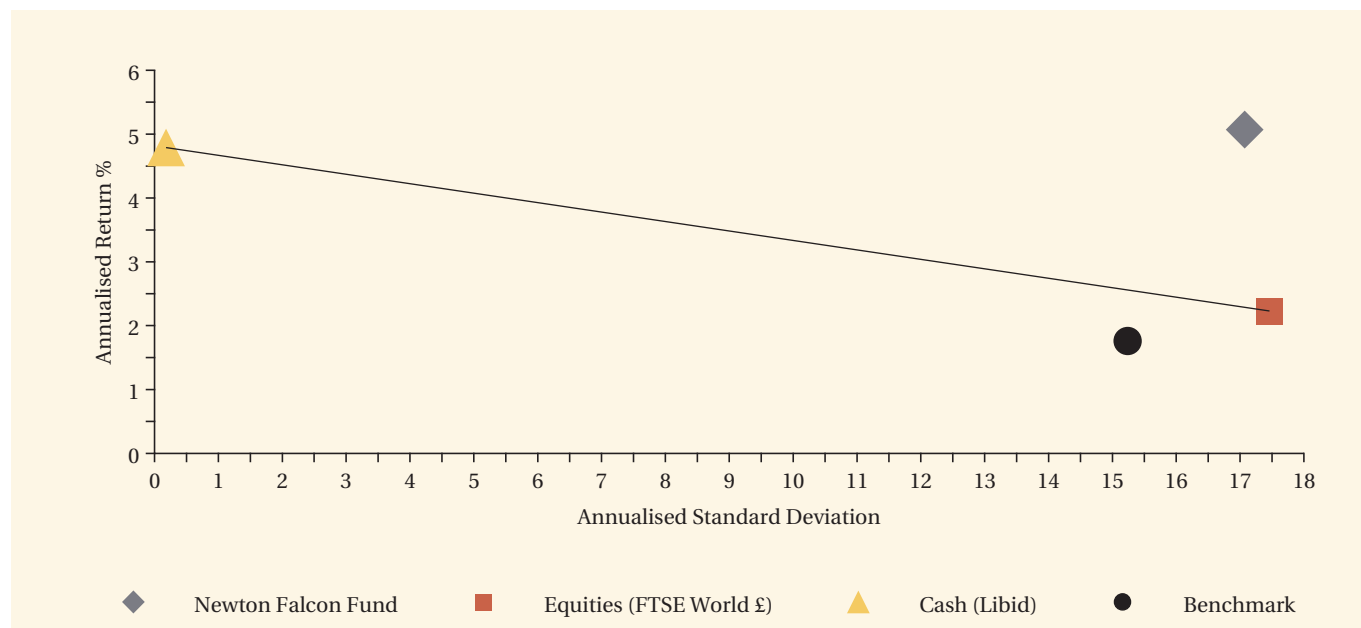
Source: Lipper & Datastream, as at 30 June 2009. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

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

## Risk and return since launch

	Annualised Return	Volatility	Sharpe ratio
Newton Falcon Fund	5.1%	17.1%	0.0%
Benchmark	1.8%	15.2%	-0.2%

Source: Lipper & Datastream, as at 30 June 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.

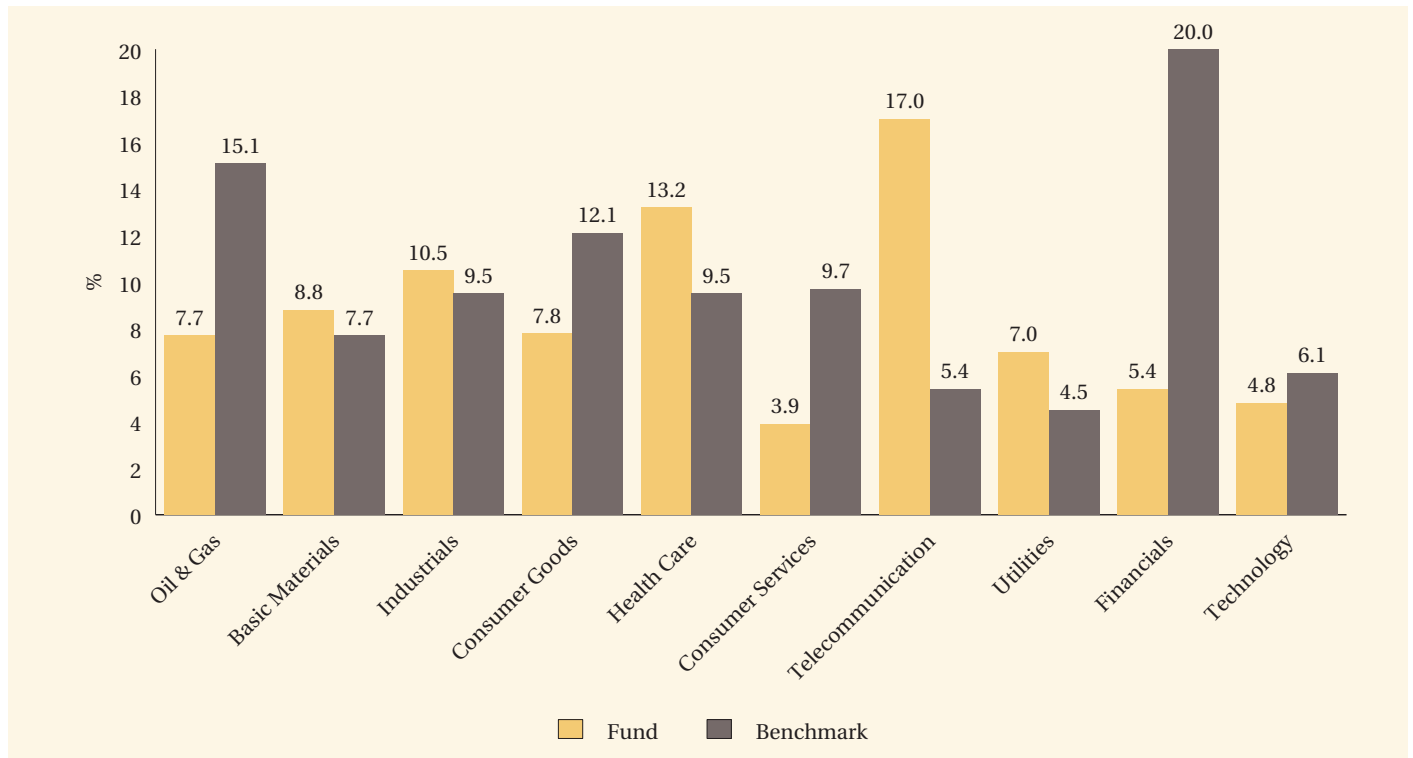
Strategy groups	Representatives from the strategy team, fund managers and research analysts identify global themes and formulate our economic view.
Research team	Global sector analysts, supported by fund managers, identify investment opportunities within the thematic backdrop.
Fund management	Fund managers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

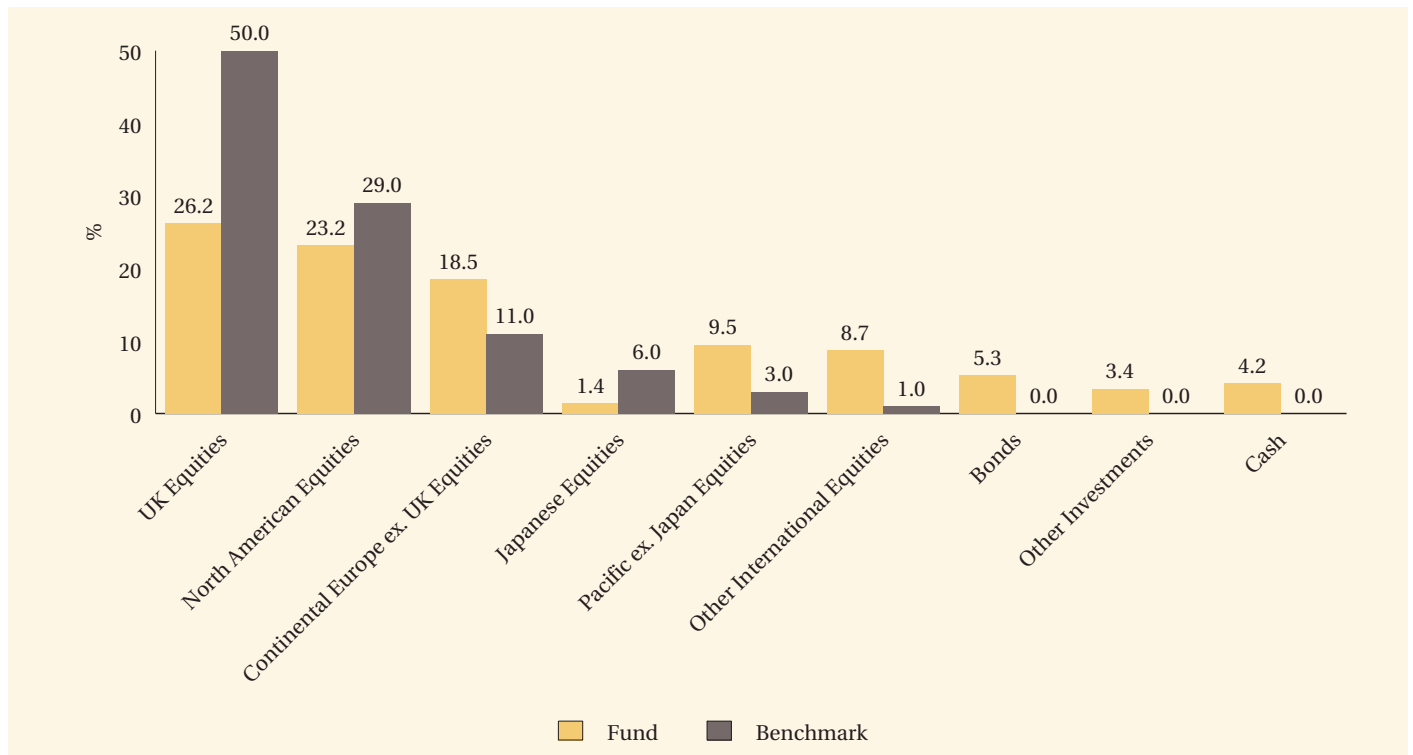
Theme	Factors	Investments
All Change	The previously benign period of stable growth, low inflation, and easy credit, which allowed private sector debt and financial leverage to grow to unsustainable levels (as described in a previous theme, "Becalmed") has come to an end. When assessing investments we assume that access to credit will remain difficult, which favours companies with limited financing requirements and argues against exposure to highly-indebted customers.	Cable and Wireless, Copasa, Flir Systems, GlaxoSmithkline, HTC, Microsoft, Nestle, Reynolds American, limited exposure to western commercial banks
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.	China Mobile, Cisco, HTC, Millicom, Sprint Nextel, Tele Norte Leste
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, Devon Energy, XTO Energy, Total
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.	Newcrest Mining, ETFS Physical Gold, Norwegian Government bonds

# Fund analysis

## Equity weightings by industry



## Regional and asset class weightings



Source for all charts: Newton, as at 30 June 2009.

# 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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Newton Falcon Fund

**Newton Investment Management Limited (NIM)**

Telephone: 020 7163 9000

Fax: 020 7163 5063

email: [privateclients@newton.co.uk](mailto:privateclients@newton.co.uk)

**NIM London**

The Bank of New York Mellon Centre  
160 Queen Victoria Street  
London EC4V 4LA

**NIM Edinburgh**

2 Festival Square  
Edinburgh EH3 9SU

**NIM Leeds**

No.1 Whitehall Riverside  
Leeds LS1 4BN

