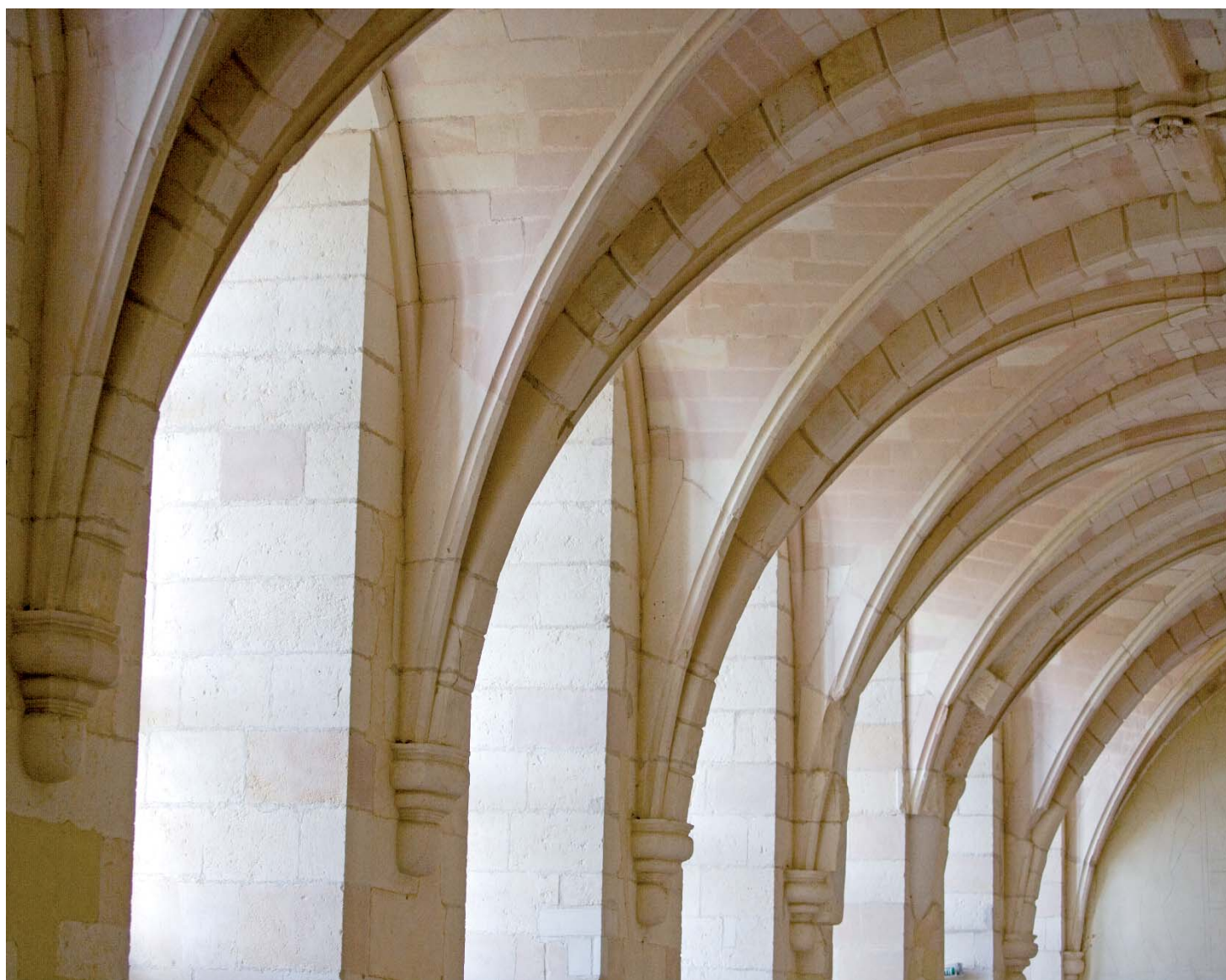


# Newton Falcon Fund

Investment Report - First Quarter 2010

► A BNY MELLON COMPANY<sup>SM</sup>

**NEWTON**  
The Power of Ideas



# Contents

Fund information	1
Focus on the latest quarter	2
Long-term performance	4
Long-term performance - risk and reward	5
Newton's investment process	6
Fund analysis	7
Glossary	8

# Fund information

## Long-term track record

The Newton Falcon Fund has returned 125.5% since launch (13 November 1998), which is equivalent to 7.4% per annum. This is an outperformance of 3.2% 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

Since 1 January 2010, the benchmark is 50% FTSE All Share Index, 50% FTSE W World ex UK Index (£). Prior to this it was 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 104	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:	2.2294p 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

<b>Newton Falcon Fund</b>	<b>7.0%</b>				
Benchmark*	8.3%	ARC £ Equity Risk (est)	6.3%	IMA Global Growth	8.1%
FTSE All Share	6.4%	FTSE World ex UK	10.3%		

Source: Lipper, ARC & Datastream, as at 31 March 2010. 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 PLC (not held)	0.50
BB&T Corporation	0.34
Bangkok Bank PCL	0.31
Principal Financial Group	0.30
Sands China Ltd	0.24

Negative	%
Cia Saneamento de Minas Gerais	-0.49
Bayer AG	-0.28
Tele Norte Leste Participacoes	-0.24
Bilfinger Berger AG	-0.23
Barclays PLC (not held)	-0.21

## Significant transactions

Acquisitions
ITT Educational Services Inc.
Eli Lilly & Co.
PTT PCL
L'Oreal S.A.
Barrick Gold Corp.

Disposals
Capcom Co. Ltd
Panasonic Corp.
ETFS Physical Gold-0% Secured Note (USD)
BAE Systems PLC
Total 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

Equity markets had a mixed start to 2010, held back by various concerns including fiscal problems in Greece and the anticipation that various extraordinary stimulus policies would be withdrawn. China in particular is taking measures to curb lending after rampant credit growth in 2009, several Asian central banks raised official interest rates during the quarter, the US Federal Reserve raised its discount rate (the rate at which banks can borrow directly from the Fed), and the Bank of England halted its "quantitative easing" programme. By the end of March, however, encouraging economic data and corporate earnings had helped markets achieve high single digit returns, which from a UK investor's point of view were flattered by the weakness of sterling.

The highest returning sectors in the benchmark were industrials, consumer services, and basic materials (a sector that is dominated by mining and

chemical company shares). Against this background the Fund underperformed, returning 7% after fees, versus a benchmark return of 8.3%. Much of this underperformance can be attributed to the basic materials and industrials sectors, in which the Fund has only limited exposure to some of the more cyclical areas that investors favoured in this environment. Our gold mining investments, for example, did not perform as well as diversified miners such as Rio Tinto, and Bayer (which is as much a healthcare business as a chemicals company) gave up its strong performance from the previous quarter amidst doubts over its drug development pipeline. Elsewhere, the investment in Copasa, a water utility in the Brazilian state of Minas Gerais, also performed poorly. The state regulator issued an adverse tariff review, which failed to give credit for the major investments the company has made in recent years. Whilst this was very disappointing, the tariff decision may be

driven more by impending state and federal elections than by a longer term view of how the company should be regulated. The shares were already cheap in our opinion, and we have retained most of the holding. On the positive side we saw strong gains in a number of our investments in the financial sector, notably from Bangkok Bank, BB&T (a US regional bank), and Principal Financial, a provider of employee retirement saving solutions to small businesses. We also saw good performance from our oil and gas investments, and within consumer services Sands China, an operator of casinos in Macau, and ITT Education made strong gains.

The share prices of the three largest new additions to the fund this quarter (ITT, Eli Lilly, and PTT) have been held back for a variety of reasons, and we are confident that their current valuations leave plenty of scope for significant gains if the main issues affecting them are resolved.

ITT is a US for-profit educational services company, offering technology-oriented degree programmes. The company achieves a high return on capital, has next to no net debt, and we believe that there remains plenty of scope for long-term growth in demand for such programmes. Concerns over proposed regulatory changes that might lead to the withdrawal of federal aid for some courses have dragged the shares down to a very undemanding valuation relative to current earnings. We believe that these concerns are overdone, and the valuation already allows for a reasonably harsh outcome.

It is well known that Eli Lilly, a US pharmaceuticals group, faces a substantial drop in profits from 2012 onwards as a number of key drugs lose patent protection. As a result the shares trade on a very low multiple of current earnings. We believe that the valuation gives no credit for a pipeline that contains some interesting products, notably for the treatment of Alzheimers. The company is also focussed on cutting costs, has ruled out large acquisitions, and pays a good dividend yield.

PTT is a Thai conglomerate, partly government-owned, with interests in a variety of oil and gas related businesses. Sentiment towards Thailand in general is poor given continued political uncertainty, and PTT has also been held back by legal challenges to a number of new projects in the

key Map Ta Phut industrial zone. Even without a contribution from these new projects, we believe that the group overall is attractively valued. This is especially evident in respect of the core gas distribution and separation business: stripping out all the stakes in quoted subsidiaries, we can derive a valuation of only 5 times our estimate for 2010 earnings, for a regulated business that is allowed to earn an attractive return. Resolution of the Map Ta Phut legal challenges and/or an improvement in the political situation would lead to substantial upside.

Amongst the larger sales we made during the quarter were two Japanese companies, Capcom and Panasonic. We sold Capcom at a good profit after a relatively short holding period. We were confident that the low valuation at the time of purchase gave us plenty of protection, but there are a number of challenges to the video game industry, notably from online gaming and cheap games available on mobile devices. We came out of Panasonic at a more modest profit, having reassessed the company's prospects. Whilst the potential for a cyclical recovery in Panasonic shares remains, the track record of the business is poor and the ability of management to improve results may be limited, given that the company operates in such competitive areas.

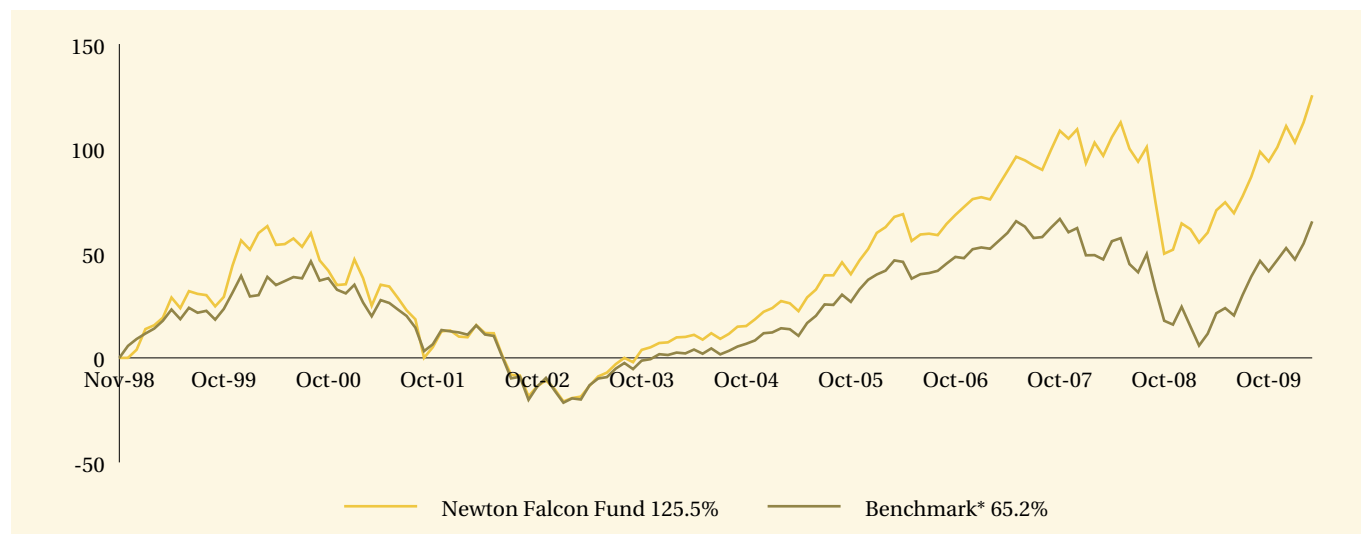
Our broad views remain very much as we described them in our last quarterly report. There is clearly ongoing improvement in the economic environment, corporate results are improving, and monetary policy remains loose for now. We believe, however, that significant risks still lurk in the background, and as a result we are taking a balanced approach within the Fund.

**Fund management team:**

**Robert Hay and Ross Ciesla**

# Long-term performance

## Performance since launch



	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD 2010
Newton Falcon Fund	-16.4	-24.8	26.0	14.0	24.6	15.7	19.0	-21.5	28.3	7.0
Benchmark*	-13.9	-25.2	20.8	9.9	22.8	10.6	6.6	-23.2	22.6	8.3

## Discrete past performance - percentage change

From	31/03/05	31/03/06	31/03/07	31/03/08	31/03/09
To	31/03/06	31/03/07	31/03/08	31/03/09	31/03/10
Newton Falcon Fund	32.8%	9.0%	7.7%	-18.7%	41.0%

Source: Lipper & Datastream, as at 31 March 2010. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

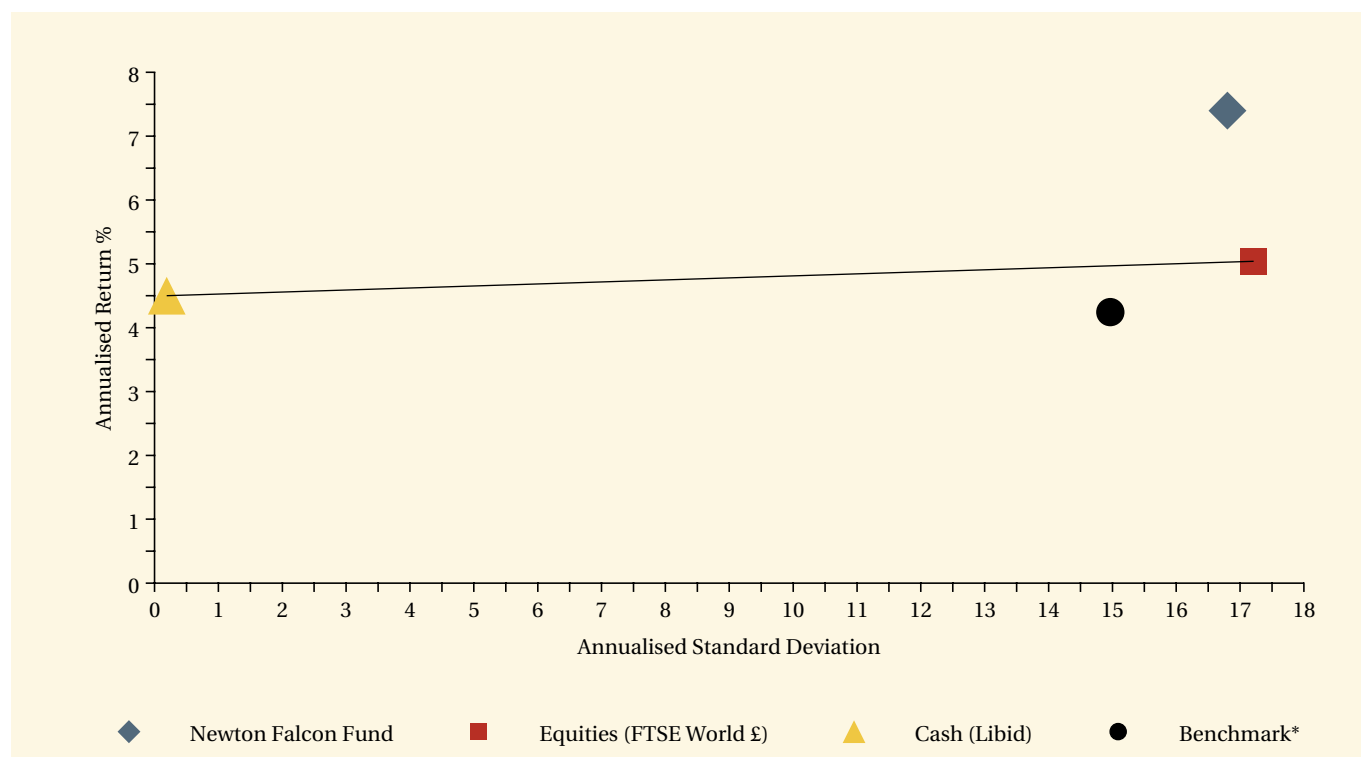
\*Since 1 January 2010, the benchmark is 50% FTSE All Share Index, 50% FTSE W World ex UK Index (£). Prior to this it was 50% FTSE All Share Index, 50% MSCI World ex UK Index (£).

## 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	7.4%	16.8%	0.2%
Benchmark*	4.2%	15.0%	0.0%

Source: Lipper & Datastream, as at 31 March 2010. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

\*Since 1 January 2010, the benchmark is 50% FTSE All Share Index, 50% FTSE W World ex UK Index (£). Prior to this it was 50% FTSE All Share Index, 50% MSCI World ex UK Index (£).

# 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.

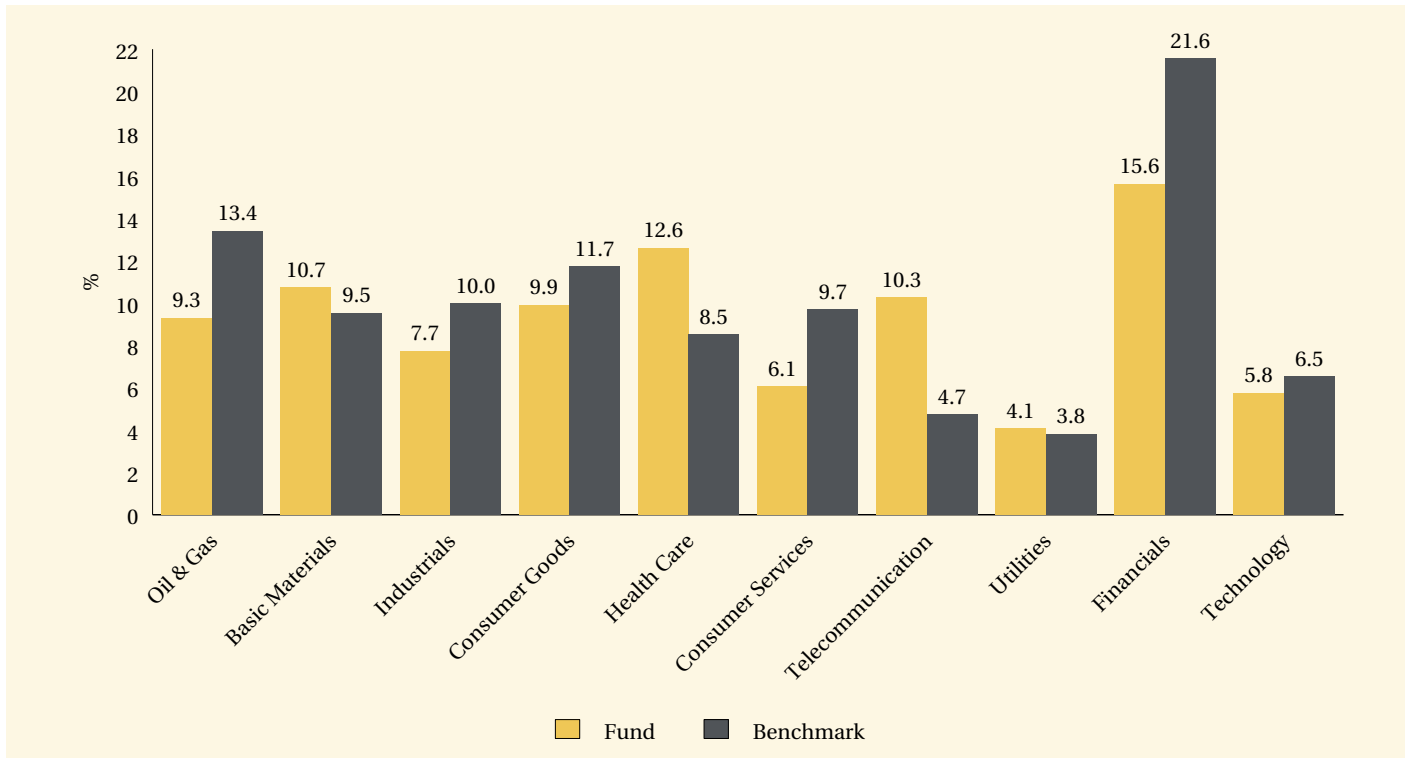
Strategy groups	Representatives from the strategy team, fund managers and research analysts identify global themes and formulate our economic view.
Research team	Global sector analysts, supported by fund managers, identify investment opportunities within the thematic backdrop.
Fund management	Fund managers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

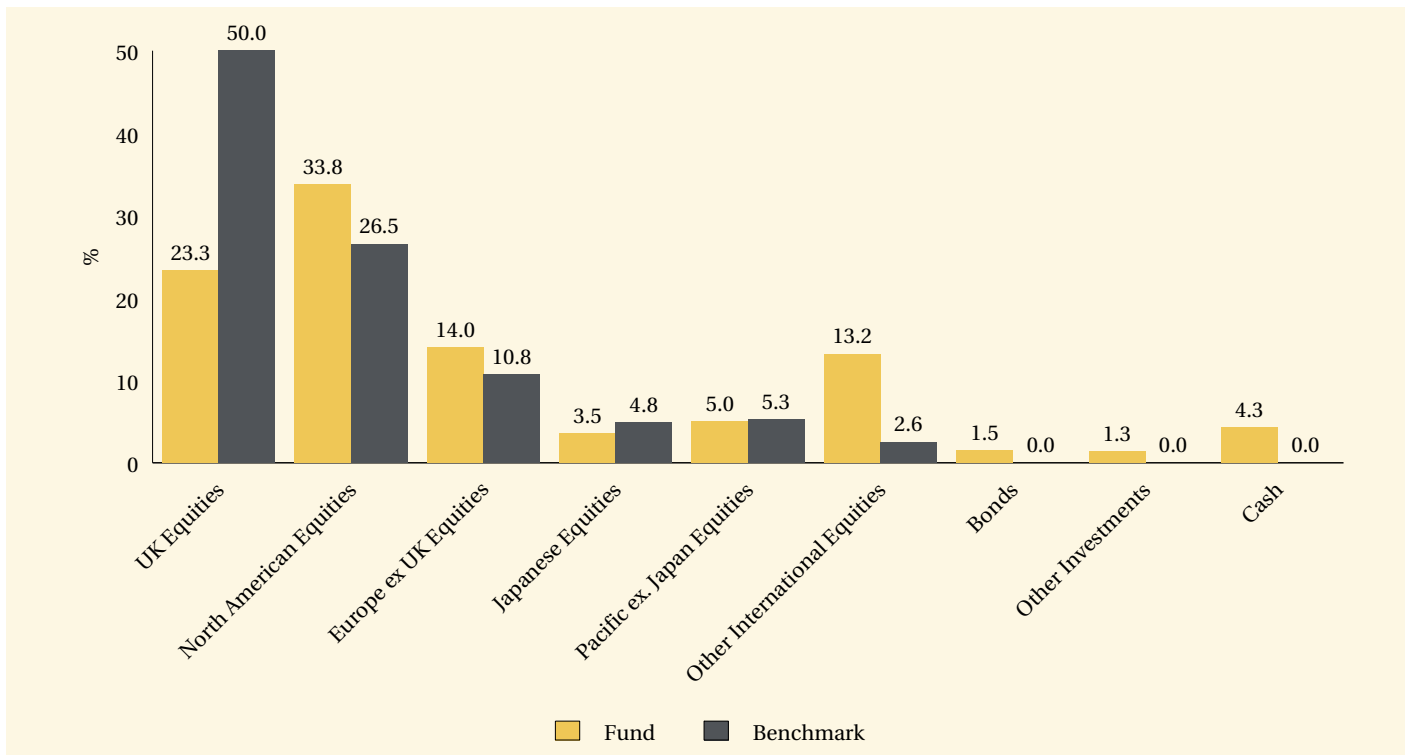
Theme	Factors	Investments
All Change	The previously benign period of stable growth, low inflation, and easy credit, which allowed private sector debt and financial leverage to grow to unsustainable levels (as described in a previous theme, "Becalmed") has come to an end. When assessing investments we assume that access to credit will remain difficult, which favours companies with limited financing requirements and argues against exposure to highly-indebted customers.	Altria, Cable and Wireless, Copasa, Flir Systems, GlaxoSmithkline, HTC, Microsoft, Nestle, limited exposure to western commercial banks
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.	Bangkok Bank, Copasa, Hypermarcas, Inpex, Millicom, Natura Cosmetics, Sands China
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.	Denbury Resources, Devon Energy, Inpex, Petrobras, Transocean
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

# Fund analysis

## Equity weightings by industry



## Regional and asset class weightings



Source for all charts: Newton, as at 31 March 2010.

# 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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