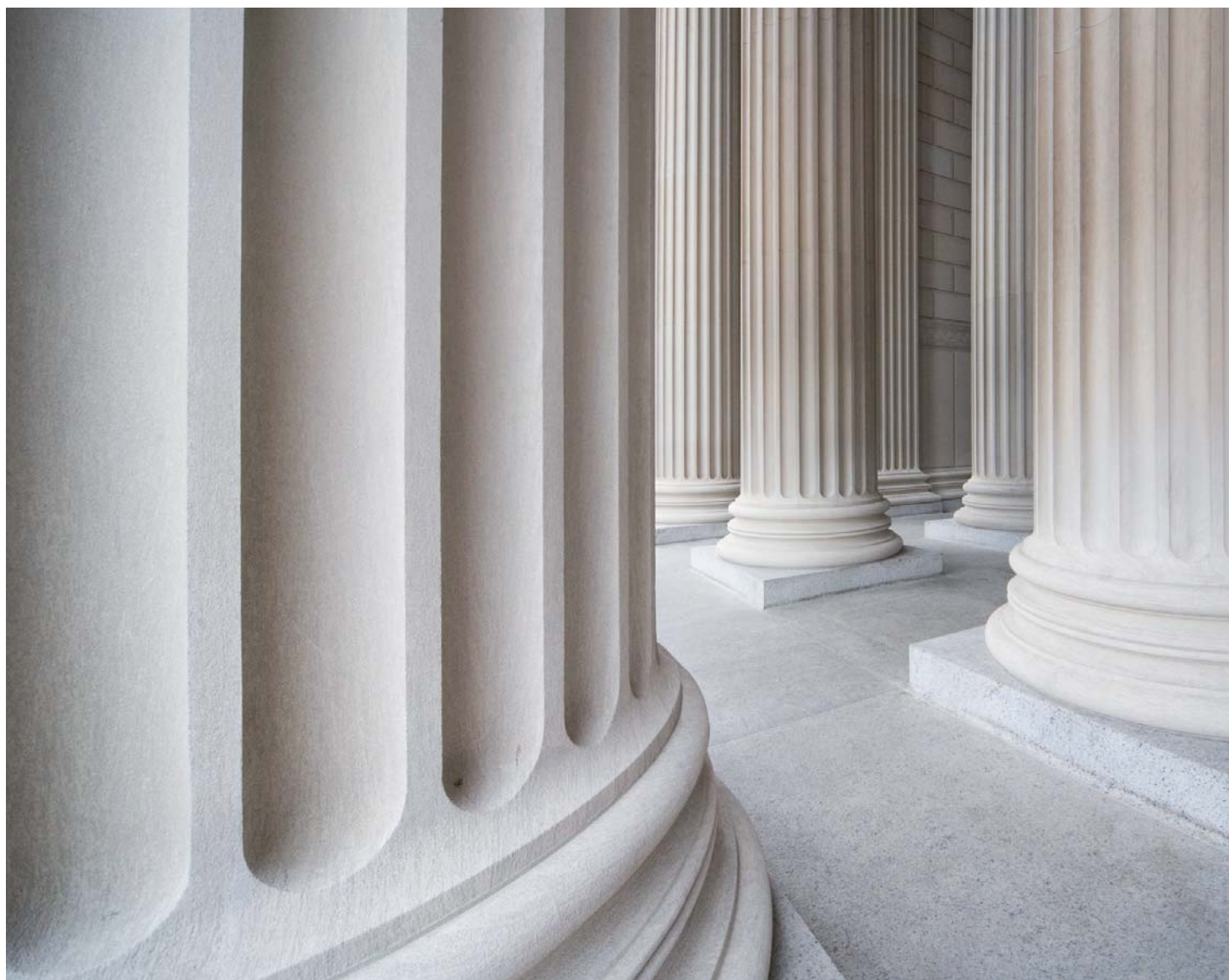


# Newton Real Return Fund

Investment Report - Fourth 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 106.1% since relaunch (31 March 2004), which is equivalent to 11.3% 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.

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 2,963	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:	2.6478p per unit
Base currency:	GBP	ISIN:	GB0006780323
Dividend yield:	3.4%	Sedol:	0678032

# Focus on the latest quarter

## Performance over three months

Newton Real Return	4.2%		
1 month £ Libor +4% p.a.	1.1%	ARC £ Steady Growth (est)	5.7%
		IMA Absolute Return	1.1%

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

## Significant transactions

Acquisitions
FTSE 100 Index-Mar11 5300 (Put Option)
Norway (Kingdom of) 4.5% Bds 22/05/2019
Inpex Corp.
British American Tobacco PLC
GlaxoSmithKline PLC

Disposals
FTSE 100 Index-Mar11 5000 (Put Option)
Vodafone Group PLC
Compania de Minas Buenaventura
ETFS Physical Gold 0% Secured Note (AUD)
Levi Strauss & Company 7.75% Bds 15/5/2018

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

The fourth quarter was both eventful and volatile for investors. Equity indices climbed higher, with accommodative monetary policy remaining a dominant factor. The backdrop was less beneficial for most fixed-interest securities; indeed, sovereign bond yields rose during the review period.

The Fund achieved a strong return. With inflation expectations on the rise, those securities held in the portfolio to provide inflation protection, reflecting our *fire risks* theme, worked well in the quarter. Gold-related equity securities **Barrick Gold**, **Yamana Gold** and **Newcrest Mining** appreciated as the price of gold bullion increased. The position in the **ETFS Physical Gold** also made strong gains. The **Agriculture ETFS**, a basket of agricultural

commodities, directly benefited from crop price rises owing to increasing imbalances between supply and demand.

Among equity holdings, **Vodafone** made one of the most notable positive contributions, following news of a likely settlement with Verizon Wireless, the US telecommunications operator in which Vodafone has a significant non-controlling stake. Orthopaedic and wound care company **Smith & Nephew** produced the top contribution to overall performance amid bid rumours.

### Review of activity

We reduced the holding of **Vodafone**, held as a beneficiary of our *networked world* theme, following its strong share-price appreciation. Much

of the proceeds were reinvested within the sector, principally in **MTN Group**, which boasts an impressive, well-diversified footprint across the growing markets of Africa and the Middle East.

We introduced a holding in **British American Tobacco**, largely on account of its attractive and sustainable dividend yield and double-digit earnings growth. BAT has been able to raise prices to offset the effects of increased taxation on tobacco products, and therefore continues to grow profitability, even as volumes in developed markets decline. In the current low interest-rate environment, we regard yield as an important contributor to the return of our core investments.

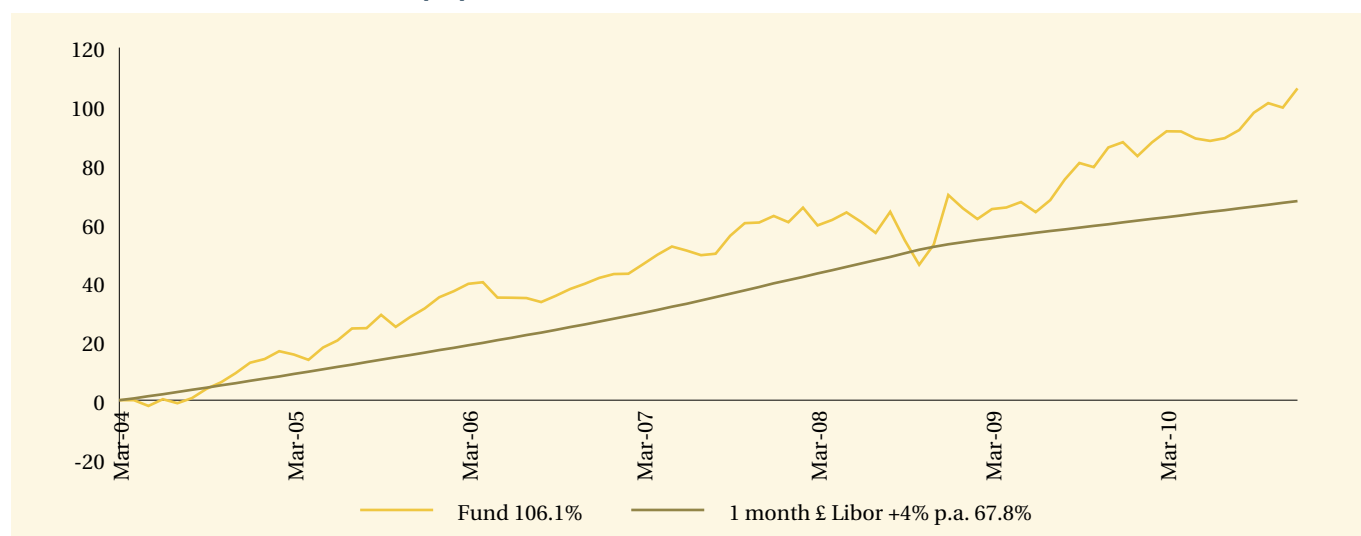
We created a new position in **INPEX**, the Tokyo-based global oil and gas exploration company; we are increasingly confident in the management's ability to deliver on the giant Ichthys liquefied natural gas offshore project in Western Australia. We added to the existing position in **Scottish and Southern Energy** as we believe the company's stable and growing earnings stream is not reflected in the market's valuation of the business. It is the second largest supplier in the UK and, despite not having exploited its full profit potential yet, its cost base rivals the market's favoured operator, **Centrica**. Increased government support for renewable energy is also advantageous, as the majority of near-term capital expenditure will be connected to this area.

Following the sharp rise in crop prices discussed in above, we decided to take some profits by reducing the Fund's holding in **ETFS Agriculture**. We continue to believe that a growing imbalance between agricultural supply and demand is likely to occur, and that this will become manifest in rising food prices; however, we feel prices may have run too far in the near term.

Following strong returns from **BP Capital Markets 5.75% 08/11/2010** and **Millicom Intl Cellular 10% 01/12/2013**, we sold these bonds. The proceeds were recycled into **Ziggo 8% 15/05/2018**, the debt of a stable, cash-generative Dutch cable company with an attractive yield. We also purchased **Clearwire 12% 01/12/2015**, a senior secured bond issued by US mobile telecommunications company Clearwire and supported by Sprint Nextel.

# Long-term performance

## Performance since launch (%)



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Fund	-	-	-	-	16.4	8.0	14.9	4.4	10.6	9.7
1 month £ Libor +4% p.a.	-	-	-	-	9.0	9.1	10.3	9.5	4.9	4.5

## Discrete past performance (%)

From	31/12/05	31/12/06	31/12/07	31/12/08	31/12/09
To	31/12/06	31/12/07	31/12/08	31/12/09	31/12/10
Fund	8.0	14.9	4.4	10.6	9.7

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

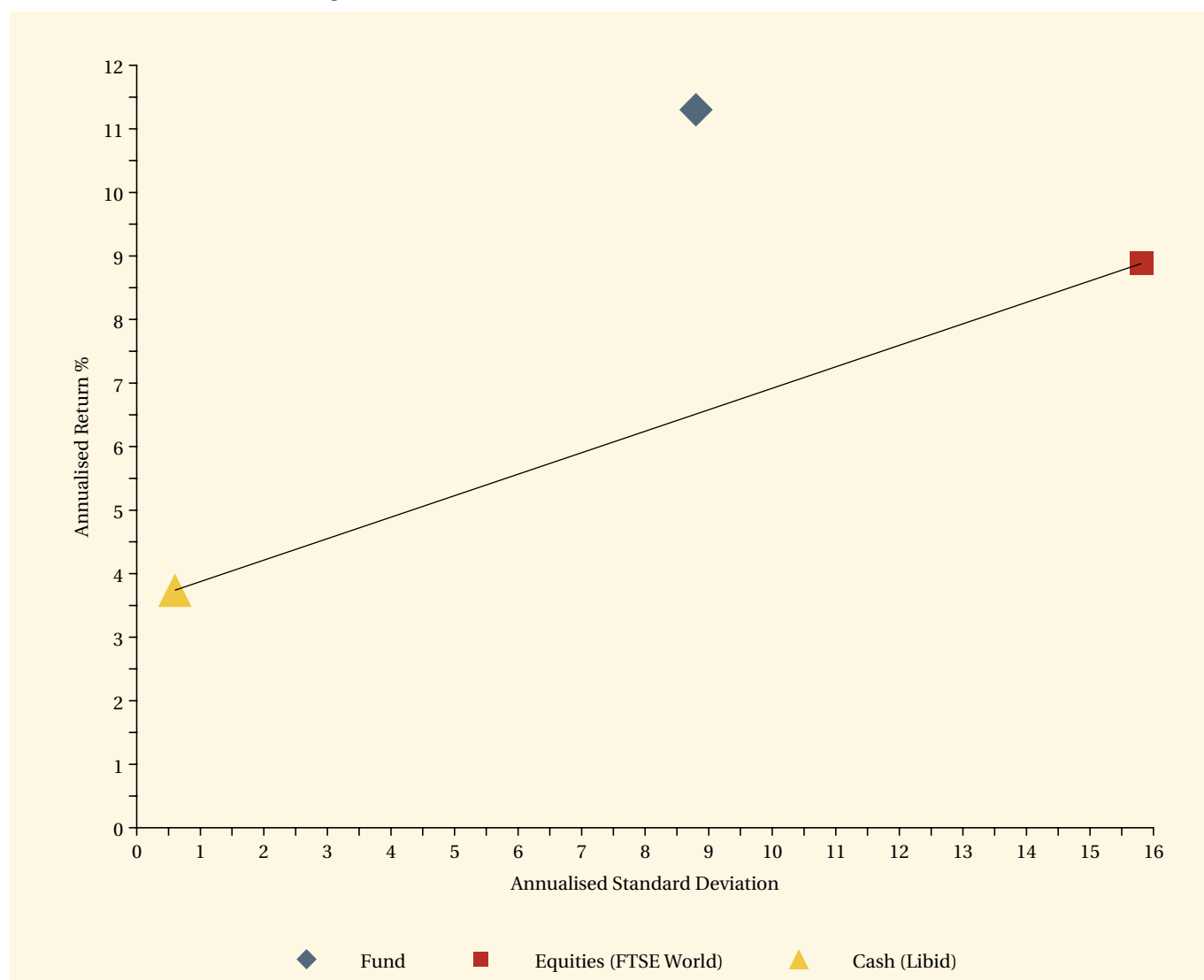
## Risk factors

The performance data shown on this report is past performance; as such it is not a guide to future performance.

Investors should remember that unit trusts should be regarded as long-term investments and that the value of units, and the income from them, can go down as well as up due to stock market and movements in exchange rates. When you sell your investment you may get back less than you originally invested. The fund may invest in emerging markets which are, by their nature, higher risk and potentially more volatile than those inherent in established markets. The value of bonds is affected by interest rate fluctuations and by changes in the credit ratings of the underlying issuer of the assets. Sub investment grade bonds, may produce a higher level of income than investment grade bonds, but carry increased risk of default on repayment. There are additional risks associated with specific alternative investments that the fund may hold such as commodities; these investments may be less readily realisable than others and it may therefore be difficult to sell in a timely manner at a reasonable price or to obtain reliable information about their value; there may also be greater potential for significant price movements. The fund may also hold derivatives. An investment in derivatives may be volatile, but the volatility of the Fund is not expected to be any greater than that of the underlying stock market.

# 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
Fund	11.3%	8.8%	0.9
1 month £ Libor +4% p.a.	8.0%		

Source: Lipper, Bloomberg & Datastream, as at 31 December 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 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.	Statoil, GlaxoSmithKline, Roche, Vodafone, Novartis, Reynolds American, British American Tobacco
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.	MTN, 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, TeliaSonera
Earth Matters	Environmental issues have moved to centre stage in the minds of the public and policy makers, and a political consensus is emerging in relation to investment in 'green' technology. It is now almost universally accepted that man-made greenhouse gas emissions are an important contributor to climate change. Current growth trends in the developing world suggest that significant additional pressure on resources and the environment is likely in the future.	ETFS Agriculture DJ-AIGSM, Bayer, Syngenta

# 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 the Investment Adviser, Newton Investment Management Limited (NIM). The Newton Real Return Fund is a sub-fund of BNY Mellon Investment Funds, an investment company with variable capital (ICVC) incorporated in England and Wales under registered number IC27. The Authorised Corporate Director of the Fund is BNY Mellon Fund Managers Limited (BNY MFM). Registered Office for NIM and BNY MFM: BNY 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.

Newton Real Return Fund

**Newton Investment Management Limited**

020 7163 9000  
privateclients@newton.co.uk

**London**

BNY Mellon Centre  
160 Queen Victoria Street  
London EC4V 4LA

**Edinburgh**

2 Festival Square  
Edinburgh EH3 9SU

**Leeds**

No.1 Whitehall Riverside  
Leeds LS1 4BN

