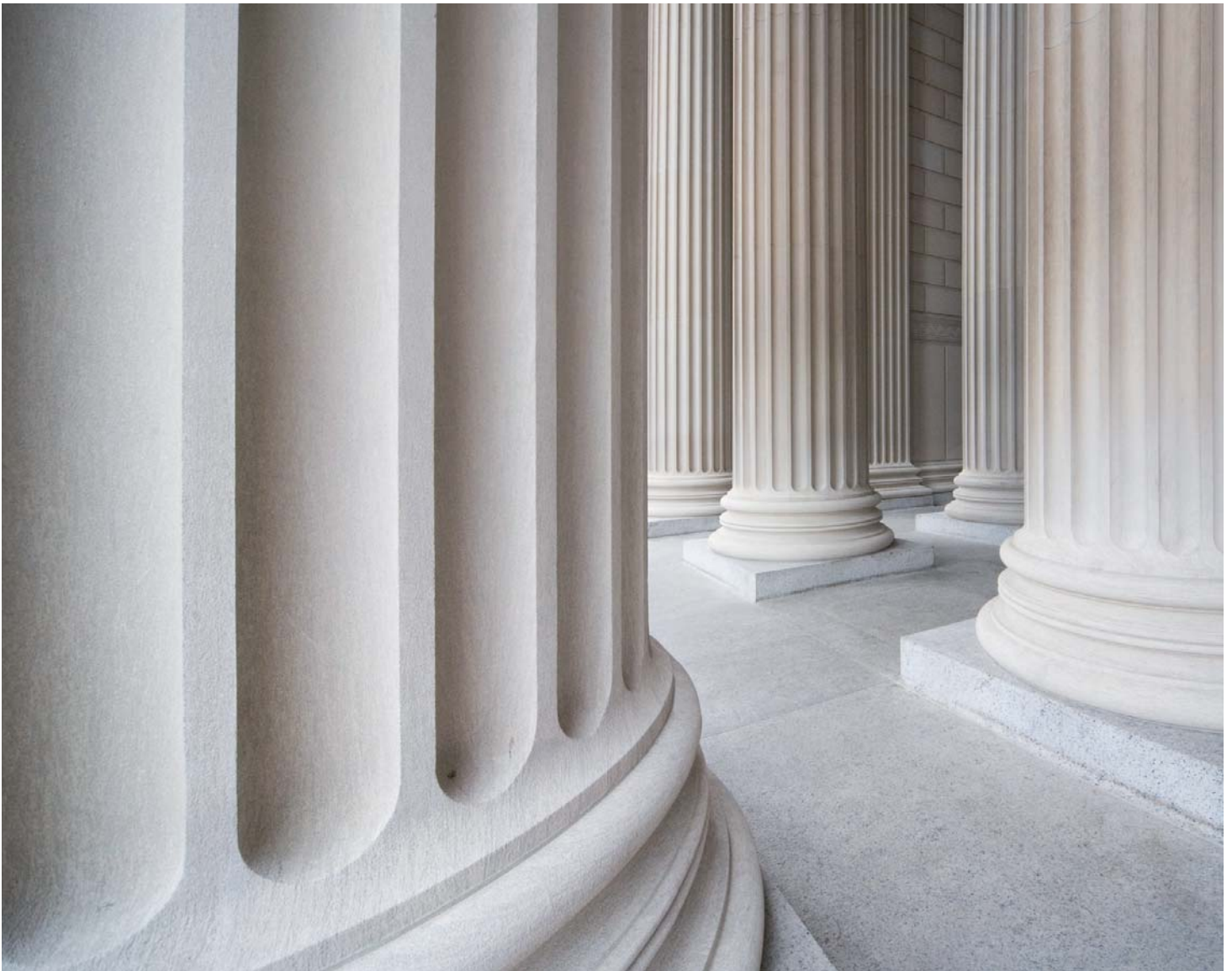


# Newton Real Return Fund

Investment Report - First Quarter 2011

► 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 108.3% since relaunch (31 March 2004), which is equivalent to 11.1% 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.

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 3,573	Ex dividend dates:	01 Jan, 01 Jul
Annual management charge:	1.0%	Pay dates:	28 Feb, 30 Sep
Total expense ratio:	1.11%	Last distribution:	3.5453p per unit
Base currency:	GBP	ISIN:	GB0006780323
Dividend yield:	3.4%	Sedol:	0678032

# Focus on the latest quarter

## Performance over three months

<b>Newton Real Return</b>	<b>1.1%</b>				
1 month £ Libor +4% p.a.	1.1%	ARC £ Steady Growth (est)	0.5%	IMA Absolute Return	0.8%

Source: Lipper, Bloomberg & ARC, as at 31 March 2011. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

## Significant transactions

Acquisitions
China Mobile Ltd
Turkcell Iletisim Hizmetleri A.S.
Reynolds American Inc.
Adaro Energy
ENI S.p.A.

Disposals
Vodafone Group PLC
Smith & Nephew PLC
Kroger Co.
BP Capital Mkts PLC 5.25% Bds 07/11/2013
BP PLC

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

Investors experienced renewed volatility during the quarter as financial markets were buffeted by a combination of macroeconomic issues, geopolitical flare-ups and the natural disasters in Japan. In spite of this backdrop, risk assets typically posted positive returns, with commodities, notably silver and oil, producing the strongest gains.

The Fund produced a modest positive return in this environment. Equities contributed the largest share of returns; the mobile telecommunications sector in particular thrived on account of renewed investor interest. Stock highlights included Deutsche Telekom, MTN Group, Advanced Info Service, Tele Norte and Millicom. Oil and gas producers were also strong, as they benefited from

the rising oil price. Inpex, the Japanese oil and gas exploration and production company, was particularly advantageous to performance. The company has a large liquefied natural gas (LNG) development off the coast of Australia, the output of which will be in high demand as Japan is forced to switch to alternative sources of energy to offset lost nuclear generation capacity. Statoil, the Norwegian state champion oil company, was similarly well placed to benefit from its status as a high-quality oil producer, located in a stable jurisdiction.

The Norwegian krone is a currency to which we have sought to maintain exposure in recent years, owing to strong state finances which are supported by oil deposits that are among the most promising in the world. Additional exposure to Norwegian

government bonds provided an attractive yield, and also enabled the Fund to benefit from the appreciation of the Norwegian krone against sterling, a relationship which is often correlated with the oil price.

Despite the modest rise in the price of gold over the quarter, most of the gold mining stocks held in the Fund experienced a decline in their share prices. The discount to which the miners trade in relation to the gold spot price is a continual source of frustration. Direct exposure to commodities was broadly positive; the return for sterling investors was, however, diluted by the weakness of the US dollar relative to sterling over the quarter.

Corporate bonds benefited from record inflows in March, which reinvigorated the market after a weak start to the quarter. Fresenius Finance 5.625% 14/8/2011 and Cemex Finance 9.625% 14/12/2017 were notable contributors.

### Review of activity

The Fund retreated from the corporate bond market in February, reflecting our view that yields were starting to become stretched. During March issuance increased providing an opportunity to invest in some interesting new names. We bought **Grohe 5.173% 15/09/2017**, a new issue from the German tap manufacturer, which has been held in the Fund before. Another new issue was **Ontex 7.5% 15/04/2018**, Europe's leading private label nappy manufacturer. An interesting purchase was made in **Cherating Capital 2% 05/07/2012**, a convertible bond issued by the investment arm of the Malaysian government. This converts into Plus Expressways shares, which are expected to be purchased by another arm of the Malaysian government in 2012.

Against the current economic backdrop we continue to place particular emphasis on Newton's *fire risks* theme, which highlights the threat of escalating inflation following a period of unprecedented monetary stimulus. This theme focuses our efforts upon hedging the risk of inflation via exposure to asset classes such as gold, but also causes us to reassess positions that may be vulnerable in such an environment, due to a lack of pricing power. Food price inflation has been particularly acute in recent months, as longer-term demand trends have been exacerbated by a combination of supply disruptions, speculation and stockpiling. While some of these shorter term pressures should moderate, we decided to sell the residual holding in **Kroger** which, due to the poor competitive structure of the US food retail industry, is likely to struggle to cope with input cost inflation.

The proceeds were reinvested in **Tesco** and **Morrisons**, which we feel are better placed to weather a period of elevated inflation on account of their relatively consolidated and rational UK home market.

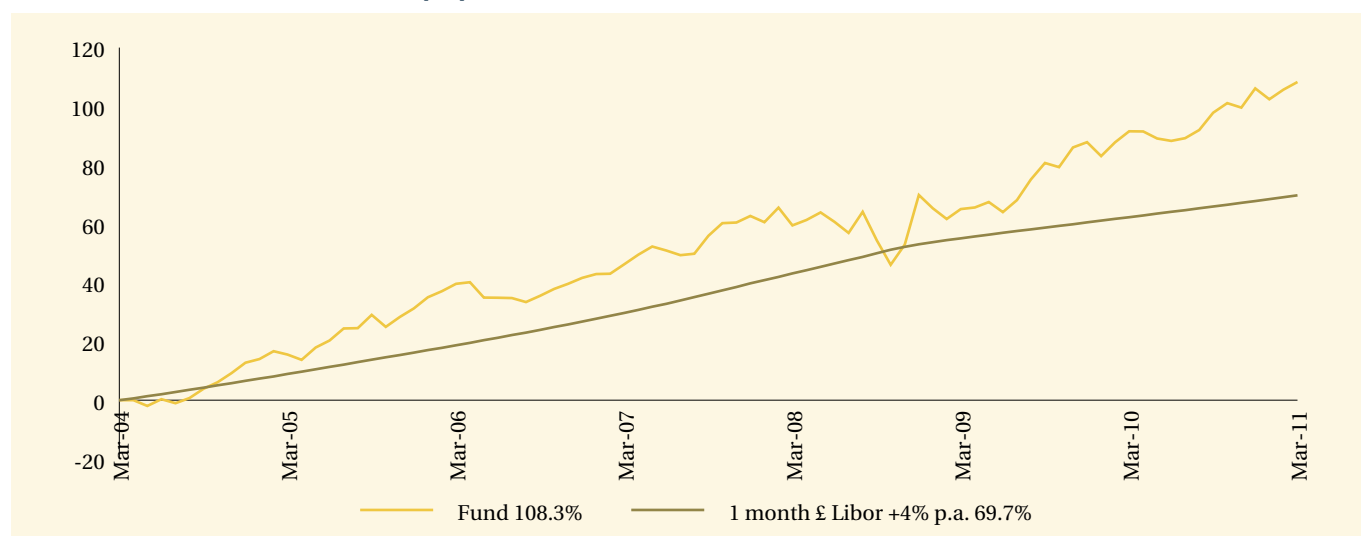
We continued to reduce the Fund's holding in **Vodafone** over the quarter, as many of the catalysts for which we had been waiting, such as a resolution with its stranded US asset Verizon Wireless, are now reflected in the share price. We continue to like the stock, but feel that such a large position is no longer justified. **Smith & Nephew**, the orthopaedic and wound care specialist, was subject to bid speculation from Johnson and Johnson. This caused the shares to run up towards our price target. We took the opportunity to realise some profits, while maintaining a position in the stock.

**Adaro Energy**, the Indonesian coal producer, was added in order to gain exposure to structural tightness within the coal market. Supply is universally constrained by infrastructure bottlenecks and project delays, while demand from China and India in particular is growing at an unquenchable rate. We took the opportunity to buy **ENI**, the major European oil company, at an attractive level, due to its exposure to Egypt. The business is diversified in nature and has strong long-term fundamentals, which lead us to believe that the share price decline, as a result of unrest in the Middle East, was an over-reaction.

Agricultural commodities have undergone a large rally over the past year, which has benefited our holding in **ETFs Agriculture**. Although we remain constructive on the longer-term outlook for agriculture, we feel a number of factors, such as short-term supply constraints from bad weather, may have exacerbated recent price movements. We are therefore taking the opportunity to recoup some profits.

# Long-term performance

## Performance since launch (%)



	2002	2003	2004	2005	2006	2007	2008	2009	2010	YTD 2011
Fund	-	-	-	16.4	8.0	14.9	4.4	10.6	9.7	1.1
1 month £ Libor +4% p.a.	-	-	-	9.0	9.1	10.3	9.5	4.9	4.5	1.1

## Discrete past performance (%)

From	31/03/06	31/03/07	31/03/08	31/03/09	31/03/10
To	31/03/07	31/03/08	31/03/09	31/03/10	31/03/11
Fund	4.8	9.0	3.5	16.0	8.8

Source: Lipper, Bloomberg & Datastream, as at 31 March 2011. Calculation basis: Sterling, total return, bid to bid, without initial charges, net income reinvested, net of management fees.

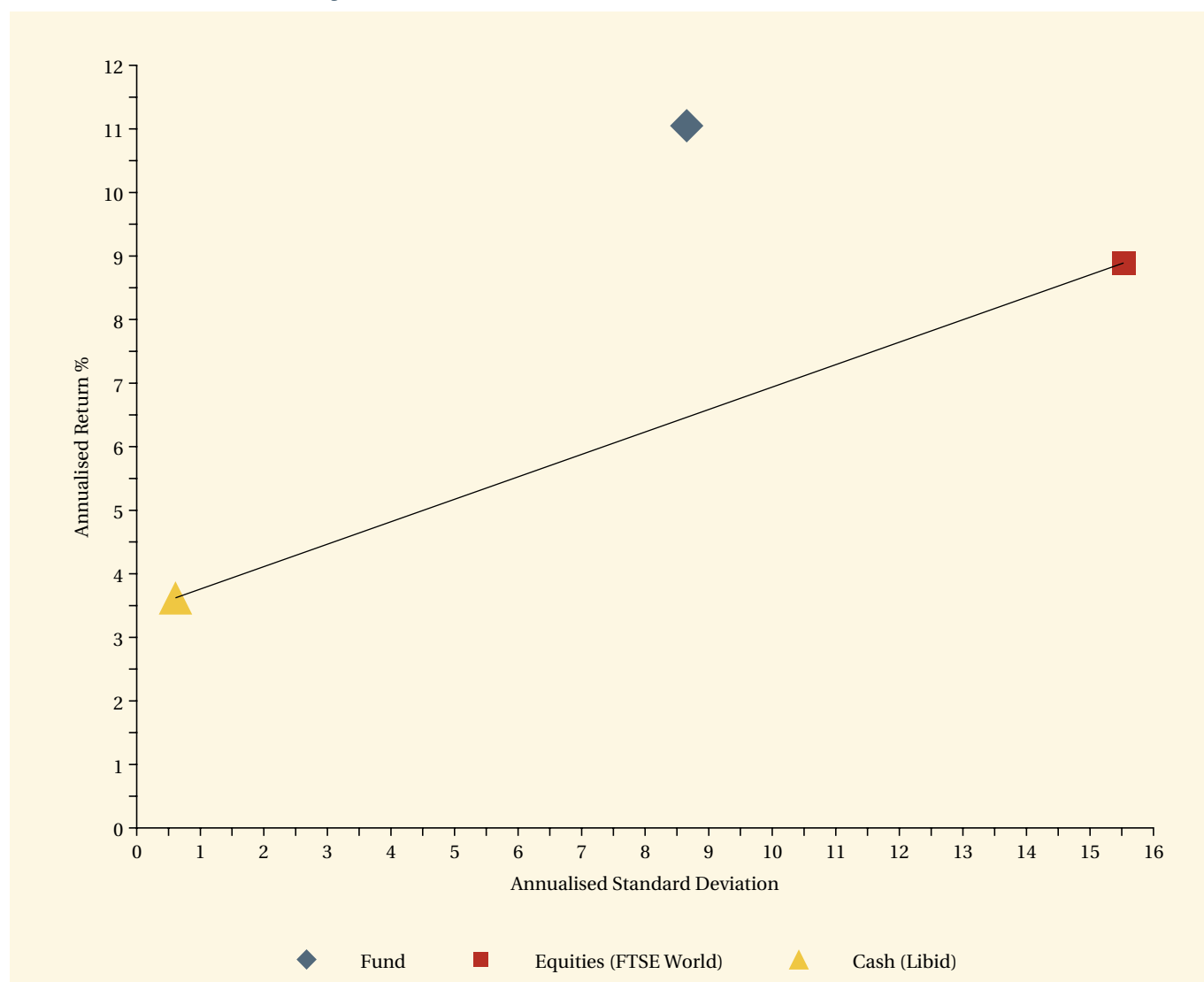
## Risk factors

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	11.1%	8.7%	0.9
1 month £ Libor +4% p.a.	7.9%		

Source: Lipper, Bloomberg & Datastream, as at 31 March 2011. 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, Scottish & Southern Energy
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, China Mobile
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.

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