



# Newton Falcon Fund

**Investment Report**  
**Second Quarter 2007**

## Contents

Your Fund	2
Fund Analysis	3
Investment Themes	5
Fund Manager's Report	6
Investment Style and Other Information	8
Portfolio Valuation	9

## Statutory Disclosure of Discrete Past Performance - Percentage Change

From To	30/06/02 30/06/03	30/06/03 30/06/04	30/06/04 30/06/05	30/06/05 30/06/06	30/06/06 30/06/07
Newton Falcon Fund	-7.9%	20.3%	18.6%	19.8%	22.4%

**Source:** Lipper, as at 30 June 2007, total return, bid to bid, net income reinvested, without initial charges, net of management fees. Lipper fund returns are based on midday prices.

## Risk Factors

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.

# Your Fund

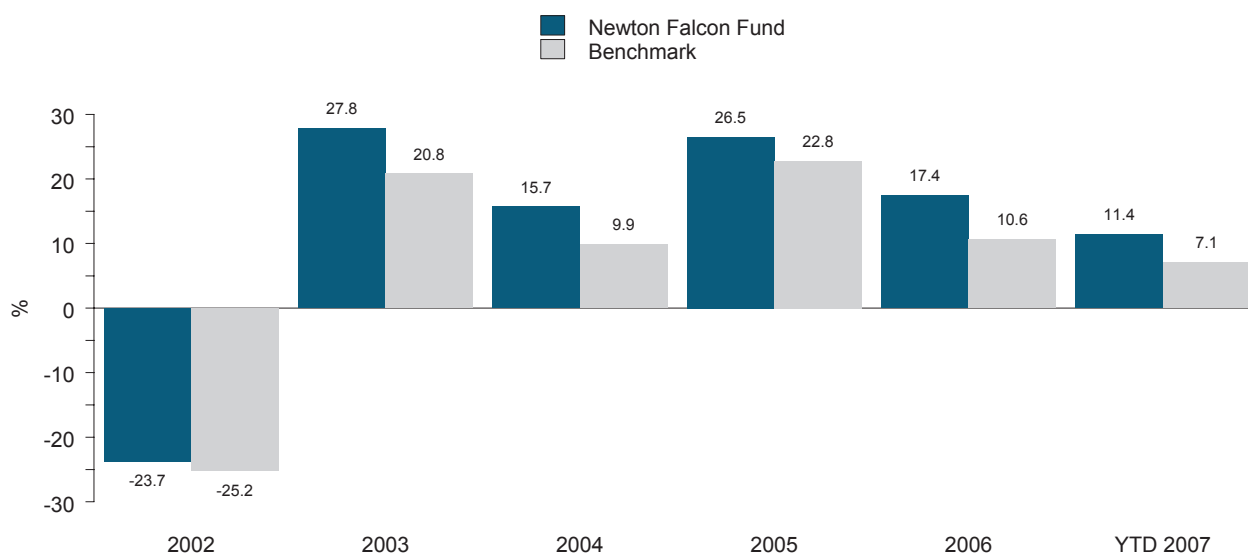
Newton Falcon Fund

## Objective

The investment objective of the Scheme is to provide long-term capital growth through investment principally in UK and international equities. The Scheme may also invest in collective investment schemes, warrants, deposits, money market instruments, fixed interest securities, derivative instruments and forward transactions.

The benchmark is 50% FTSE All Share Index, 50% MSCI World ex UK Index (Sterling).

## Performance



Please see Risk Factors and Discrete Past Performance on previous page.

	Latest Quarter (%)	Since Launch 13 November 1998 (%)
Fund Return (after fees)	6.5	94.5
Fund Return (before fees)	6.9	121.1
Benchmark	4.4	62.7
FTSE All-Share	4.5	74.3
MSCI World Ex UK	4.2	50.3

Dividend Yield: 0.6% as at 30 June 2007

|Last Distribution: 1.3284p per unit as at 31 October 2006 (inc units only)

Fund Size (millions): GBP 53.47 as at 30 June 2007

|Currency: GBP

Ex Dates: 28 Feb, 31 Aug

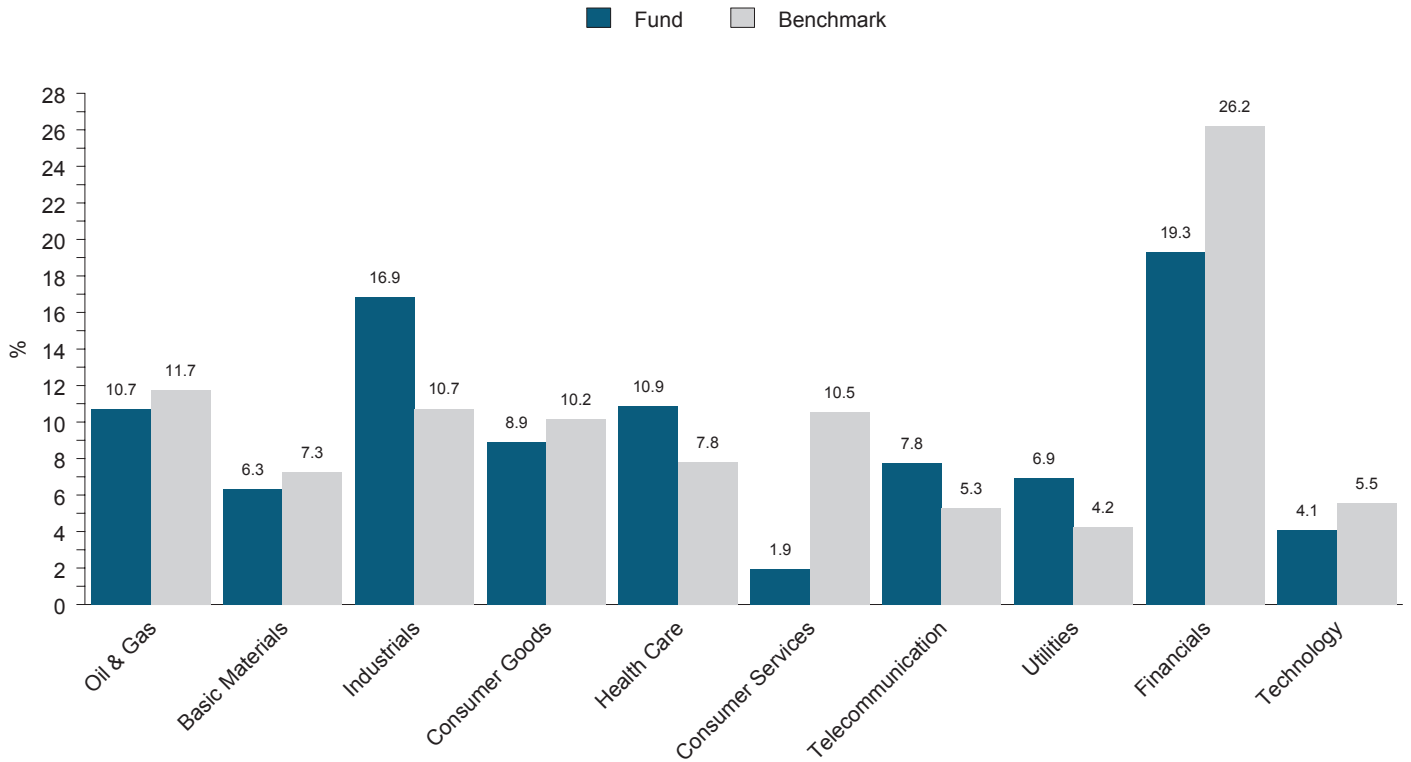
|Pay Dates: 27 Apr, 31 Oct

**Source:** Lipper, as at 30 June 2007, total return, bid to bid, net income reinvested, without initial charges, unless otherwise stated figures are gross of management fees. Lipper fund returns are based on midday prices, whereas the index is priced at the close of the relevant markets.

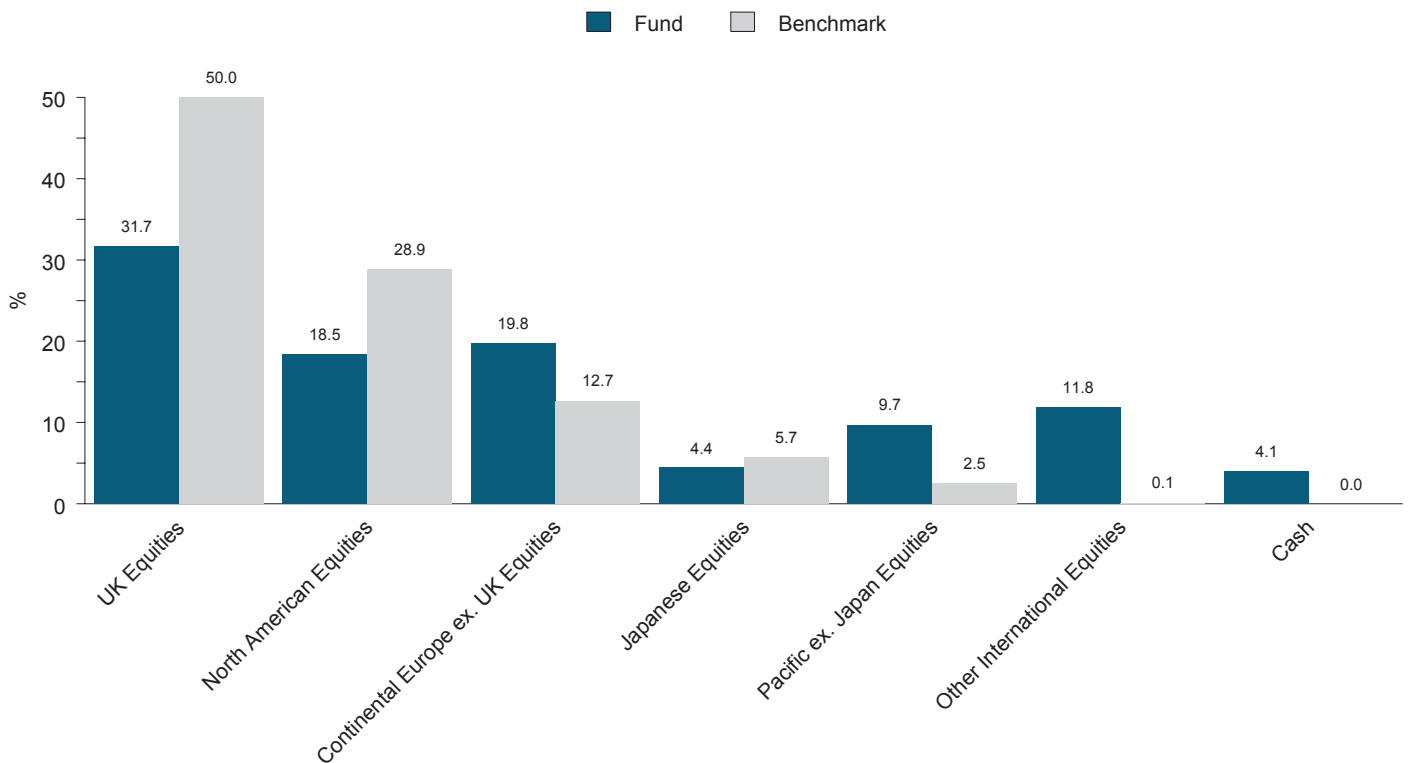
# Fund Analysis

Newton Falcon Fund

## Industrial Weightings versus Benchmark



## Regional and Asset Class Weightings versus Benchmark



# Fund Analysis

Newton Falcon Fund

## Top 10 Holdings as at 30 June 2007

<b>UK Equities</b>	<b>%</b>	<b>Overseas Equities</b>	<b>%</b>
Vodafone Group PLC	2.0	Symrise AG	2.0
GlaxoSmithKline PLC	1.9	Reynolds American Inc	1.8
Standard Chartered PLC	1.8	ConocoPhillips	1.7
BP PLC	1.7	Millicom Intl Cellular	1.7
ICAP PLC	1.6	Air Liquide SA	1.6
Bunzl PLC	1.4	Gildan Activewear Inc	1.6
Cobham PLC	1.4	Acciona SA	1.5
Scottish & Southern Energy PLC	1.4	Deutsche Post AG	1.4
Intertek Group PLC	1.3	Statoil ASA	1.4
Go-Ahead Group PLC	1.3	Japan Tobacco Inc	1.4

## Major Contributors to Relative Performance During the Quarter

<b>Positive</b>	<b>%</b>	<b>Negative</b>	<b>%</b>
Digi.Com Bhd	0.27	Royal Dutch Shell PLC (Underweight)	-0.27
Acciona SA	0.25	Rio Tinto PLC (Not Held)	-0.21
Panalpina Welttransport AG	0.23	ICAP PLC	-0.17
First Gen Corp	0.21	CFM Morant Wright Japan B	-0.11
E.ON AG	0.19	Shanks Group PLC	-0.11

## Significant Transactions

### Acquisitions

Symrise
Intertek Group
Smiths Group
Subsea 7
Shanks Group
Cia Saneamento de Minas Gerais

### Disposals

Weatherford International
Minerva
Banpu
Siam Commercial Bank
Punch Taverns

# Investment Themes

Newton Falcon Fund

The identification of global themes is a key component of our investment philosophy. Individual economies, industries or companies should not be analysed in isolation. Only by understanding events, trends and competitive pressures worldwide can investment prospects be properly evaluated. We have approximately a dozen investment themes, some of which have changed little over the past few years whilst others are fairly recent additions. A number of these themes are illustrated below with examples of individual holdings.

## Population Dynamics

A nation's demographic profile has profound implications for its ongoing economic development influencing its patterns of growth, consumption and savings, fiscal policy, healthcare regimes and competitive advantage. Industrialised economies have broadly ageing populations while some developing economies have significantly different profiles.

**Beneficiaries:** Care UK, GlaxoSmithkline, Hartford Financial Services, Old Mutual, Smith & Nephew

## Global Realignment

Stronger growth and increasing economic influence of the developing world is challenging the western industrialised nations' domination in terms of wealth, consumption of both natural resources and finished goods and market capitalisation of global stock markets. Some realignment over time is inevitable reflecting the

developing world's accumulation of foreign exchange reserves and trade surpluses.

**Beneficiaries:** Bank of Ayudhya, Bursa Malaysia, Millicom, Parkway Holdings, Standard Chartered, Terna

## Debt and Credit

The transition from high to low inflation and interest rates has triggered a super-cycle of credit growth which has boosted economic activity in the West. It has extended the economic cycle and left households, corporations and administrations increasingly highly indebted. This contrasts with a developing world where households and, increasingly, corporations are significantly less indebted. In sectors such as banking (among others), we favour companies with exposure to the developing world.

**Beneficiaries:** Bangkok Bank, DBS Group, EFG Eurobank, Standard Chartered, Unicredito Italiano

## Energy Supply

Following decades of underinvestment in oil and gas infrastructure, surplus production and refining capacity is limited. Strong current and forecast demand for 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.

**Beneficiaries:** Acciona, ConocoPhillips, Occidental Petroleum, Subsea 7

# Fund Manager's Report

Newton Falcon Fund

Equities delivered a satisfying performance over the latest quarter, with the Fund's benchmark indices delivering an aggregate return of 4.4%. This was also a good quarter for the fund: a return of 6.5% brings the total return for the first half of 2007 to 10.6% after fees, 3.5% clear of the benchmark performance.

Relative to the benchmark, the Fund benefited in particular from its exposure within the telecoms, utilities, and banking sectors. The strong performance in both telecoms and utilities was driven mainly by companies operating in Asia and Latin America, although European shares such as Cable and Wireless and E.On also played their part. The gains made in the utilities sector were in contrast to the poor showing of a number of UK companies, whose shares struggled as bond yields rose. Equally, outperformance in the banking sector was driven as much by the banks the Fund does not own (UK and US focussed banks, in essence) as by those it does. Shares such as HBOS, Royal Bank of Scotland, and Bank of America struggled, whereas the Fund's holdings in Bangkok Bank, Bank of Ayudhya, Standard Chartered, and DBS all performed respectably.

The largest purchase in value terms that we made during the quarter was of shares in Symrise. The company makes flavours and fragrances for the consumer goods industry, trades on an attractive valuation, is cash generative and requires little capital to grow. We think that there is considerable scope for the company to grow its dividend, and believe that this will be a very solid investment.

Strong cash generation is also one of the attractions of Intertek Group, a new purchase for the Fund. The company tests, inspects and certifies products and systems on behalf of manufacturers, retailers and governments, and is a natural beneficiary of growth in international trade. Intertek aims to grow both organically and by acquisition and has a good track record of generating returns on its acquisitions, which can be funded from free cash flow. The company also runs a very conservative balance sheet.

We purchased holdings in two companies, Shanks Group and GRD, which should benefit from the incentives put in place by the British government to encourage local authorities to reduce their dependence on landfill as a means of disposing of waste. Tight deadlines and the

small number of potential bidders mean that the new waste treatment PFI contracts are being offered on particularly attractive terms. Shanks and GRD are both active in this area, and the potential for GRD is particularly great: it is a small company that is diversifying away from its core business of providing services to the mining industry. Since we purchased the shares the company has received a takeover offer from Transfield Services, which may be aiming to carve up GRD's businesses with Macquarie Bank. We believe that the offer significantly undervalues the company, and will be retaining the shares.

During the quarter we also made a change to the Fund's exposure to the oilfield service sector, selling Weatherford International following good performance, and buying Subsea 7, an Aberdeen-based specialist subsea contractor, which will benefit from a large and visible order backlog. As the smallest of the four main contractors with subsea construction capabilities, it may also find itself on the right side of any consolidation within the sector.

Following the purchase of Terna Participacoes last quarter, we made an investment in a second Brazilian utility, Companhia Saneamento de Minas Gerais (Copasa). We have become more confident in the regulatory regime that governs this water utility, which allows Copasa to make an attractive 12% pre-tax real return on its assets. The state of Minas Gerais has made the improvement of basic infrastructure, including water and sewage, a key priority, and has shown itself willing to grant tariff increases that will allow Copasa to achieve its target return. On this basis we believe that the shares are significantly undervalued.

Thai equities have recovered well since the military leadership's clumsy attempt to impose restrictions on foreign investors late last year, despite ongoing uncertainty regarding the transition back to a civilian government. We recently sold the Fund's position in Siam Commercial Bank in order to reinvest in Bank of Ayudhya. The shares of Bank of Ayudhya trade at a previously well-deserved discount to Siam Commercial Bank, but we expect the quality of management to improve now that GE Capital has taken a significant stake in the company, a development that has also provided the bank with additional capital to strengthen its balance sheet. During the quarter we also sold the Fund's

# Fund Manager's Report

Newton Falcon Fund

stake in Banpu, a coal mining company headquartered in Thailand.

Lastly, we sold the Fund's stakes in two companies whose fortunes have been influenced to varying degrees by the buoyant commercial property market. The shares of Punch Taverns had been driven upwards by greater investor focus on the value of property within the pub estate, and by the potential for a takeover bid from private equity investors. We felt that the value now placed on the company already reflected much of the potential for such a bid, which would depend on the use of a high degree of leverage. Minerva is a pure property company, with a number of early and later stage development projects. The wait for value to be realised from these projects has been a frustrating one, and we took advantage of a sharp rise in the share price to exit this investment, also mindful of some concerns of overheating in the commercial property market.

It was perhaps surprising that equity markets were as resilient as they were during the quarter, given the sharp rises in bond yields and the problems suffered by investment banks such as Bear Stearns and UBS connected to hedge fund

losses linked to rising defaults on US sub-prime mortgages. It is hard to know the extent of the influence that hedge funds and private equity have had on rising equity markets. We can, on the other hand, note that the prices that private equity can pay for acquisitions are dependent on bond yields, which have risen (at times sharply) this quarter, and that investment banks provide leverage to hedge funds. It is reasonable to assume that these banks will be more circumspect in their approach to lending if losses from the sub-prime meltdown continue to mount. In combination, these influences may remove some of the support that parts of the equity market have enjoyed. As we have commented in the past, we must be diligent in seeking shares that offer genuine value, in companies whose prospects do not rely primarily on sustaining a high degree of financial leverage.

Falcon Fund Management Team

Robert Hay • Ross Ciesla

# Investment Style and Other Information

Newton Falcon Fund

There are three components of the investment process at Newton: the strategic framework, global research, and portfolio management. The basis of our investment philosophy is that no industry, market or economy can be considered in isolation. Only by understanding events, trends and competitive pressures worldwide can prospects for shares and bonds be properly evaluated. We conduct our research and invest globally.

The Falcon fund is a high risk fund that is designed to achieve long-term capital growth in sterling terms, offering the potential for higher returns over the long term than the majority of our private client funds and portfolios. For the majority of the time it is anticipated that the fund will be fully or almost fully invested in equities. We are permitted to invest in less volatile assets on a temporary basis if we believe that market conditions merit such an approach, but in spite of this the fund should always be considered high risk.

The fund may take larger positions in individual stocks and sectors than our other private client funds, and investment performance may deviate significantly from the benchmark. The benchmark has a bias towards equities quoted in the UK, and this will be reflected to an extent in the fund's composition, but there are no formal limits on how much or how little of the fund can be invested in any particular geographic region or industrial sector. The fund is nevertheless designed for sterling investors and hedging of overseas currency exposure may be implemented when we deem appropriate.

The frequency of trading within the fund is also likely to be higher than in our more typical private client funds. The fund is expected to hold between 70 and 90 securities.

# Portfolio Valuation

Newton Falcon Fund

	% WEIGHT
Newton Falcon Fund	100.00
<b>Equities</b>	<b>95.61</b>
<b>Oil &amp; Gas</b>	<b>10.70</b>
<b>Oil &amp; Gas Producers</b>	<b>9.61</b>
Anadarko Petroleum Corp	1.21
BP PLC	1.70
ConocoPhillips	1.70
Occidental Petroleum Corp	0.86
Petroleo Brasileiro SA	0.76
Royal Dutch Shell PLC	0.99
Statoil ASA	1.39
Total SA	0.99
<b>Oil Equipment</b>	<b>1.10</b>
Subsea 7 Inc	1.10
<b>Basic Materials</b>	<b>6.31</b>
<b>Chemicals</b>	<b>3.57</b>
Air Liquide SA	1.61
Symrise AG	1.96
<b>Industrial Metals</b>	<b>1.61</b>
Companhia Vale do Rio Doce	0.82
Teck Cominco Ltd	0.79
<b>Mining</b>	<b>1.12</b>
BHP Billiton PLC	1.12
<b>Industrials</b>	<b>16.85</b>
<b>Construction &amp; Materials</b>	<b>2.68</b>
Acciona SA	1.54
Cemex SAB de CV	1.14
<b>Aerospace &amp; Defence</b>	<b>2.26</b>
BAE Systems PLC	0.90
Cobham PLC	1.36
<b>General Industrials</b>	<b>1.07</b>
Noble Group Ltd	0.29
Smiths Group PLC	0.78
<b>Industrial Transportation</b>	<b>3.90</b>
Canadian Pacific Railway Ltd	1.15
Deutsche Post AG	1.40

Source: Newton

# Portfolio Valuation

Newton Falcon Fund

	% WEIGHT
Panalpina Welttransport AG	1.35
<b>Support Services</b>	<b>6.94</b>
ABC Learning Centres Ltd	1.31
Bunzl PLC	1.39
Eaga PLC	0.36
GRD Ltd	0.71
Intertek Group PLC	1.34
Serco Group PLC	1.00
Shanks Group PLC	0.82
<b>Consumer Goods</b>	<b>8.88</b>
<b>Beverages</b>	<b>1.26</b>
Diageo PLC	1.26
<b>Household Goods</b>	<b>1.14</b>
Woong Jin Coway Co	1.14
<b>Personal Goods</b>	<b>1.56</b>
Gildan Activewear Inc	1.56
<b>Tobacco</b>	<b>4.92</b>
British American Tobacco PLC	1.11
Japan Tobacco Inc	1.35
KT&G Corp	0.68
Reynolds American Inc	1.77
<b>Health Care</b>	<b>10.89</b>
<b>Health Care Equipment &amp; Services</b>	<b>5.31</b>
Beckman Coulter Inc	0.95
Care UK PLC	1.08
Medtronic Inc	1.05
Parkway Holdings Ltd	1.07
Smith & Nephew PLC	1.16
<b>Pharmaceuticals &amp; Biotechnology</b>	<b>5.58</b>
GlaxoSmithKline PLC	1.90
Lilly (Eli) & Co	1.04
Novartis AG	1.31
Wyeth	1.33
<b>Consumer Services</b>	<b>1.95</b>
<b>Media</b>	<b>0.65</b>
McGraw-Hill Cos Inc	0.65
<b>Travel &amp; Leisure</b>	<b>1.30</b>

# Portfolio Valuation

Newton Falcon Fund

	% WEIGHT
Go-Ahead Group PLC	1.30
<b>Telecommunication</b>	<b>7.76</b>
<b>Fixed Line Telecommunications</b>	<b>1.13</b>
Cable & Wireless PLC	1.13
<b>Mobile Telecommunications</b>	<b>6.64</b>
Advanced Info Service PCL	0.77
Digi.Com Bhd	1.16
Millicom Intl Cellular	1.67
Taiwan Mobile Co	1.07
Vodafone Group PLC	1.96
<b>Utilities</b>	<b>6.92</b>
<b>Electricity</b>	<b>2.64</b>
First Gen Corp	1.29
Scottish & Southern Energy PLC	1.35
<b>Gas Water &amp; Multiutilities</b>	<b>4.28</b>
Cia Saneamento de Minas Gerais	0.81
E.ON AG	1.32
Terna Participacoes SA	1.20
Veolia Environnement	0.93
Veolia Environnement EUR5 (Sub Rights 27/06/2007)	0.01
<b>Financials</b>	<b>19.32</b>
<b>Banks</b>	<b>8.62</b>
Bangkok Bank PCL	1.02
Bank of Ayudhya PCL	0.86
Barclays PLC	0.57
DBS Group Holdings Ltd	1.25
EFG Eurobank Ergasias SA	0.84
HSBC Holdings PLC	1.10
Standard Chartered PLC	1.83
Unicredito Italiano SpA	1.15
<b>Nonlife Insurance</b>	<b>2.43</b>
Allianz SE	1.22
Hartford Financial Services Gp	1.21
<b>Life Insurance</b>	<b>2.27</b>
Old Mutual PLC	1.10
Prudential PLC	1.17
<b>Real Estate</b>	<b>2.14</b>
Deutsche Wohnen AG	0.48

Source: Newton

# Portfolio Valuation

Newton Falcon Fund

	% WEIGHT
IRSA Inversiones Y Representca	0.90
Japan Real Estate Inv Co	0.49
Mapletree Logistics Trust	0.27
<b>General Financial</b>	<b>3.86</b>
Bursa Malaysia Berhad	1.11
Deutsche Boerse AG	1.16
ICAP PLC	1.60
<b>Technology</b>	<b>4.07</b>
<b>Software &amp; Computer Services</b>	<b>0.52</b>
VeriSign Inc	0.52
<b>Technology Hardware &amp; Equipment</b>	<b>3.55</b>
Canon Inc	0.64
Cisco Systems Inc	0.97
High Tech Computer Corp	0.88
High Tech Computer Corp GDS (Rep 4 Ord TWD10)(Reg'S)	0.23
Samsung Electronics Co Ltd	0.82
<b>Unitised / Structured Investments (Equities)</b>	<b>1.95</b>
<b>Japan</b>	<b>1.95</b>
Capita Financial Managers Morant Wright Japan B (Acc)GBP	1.26
Elders (Merrill Lynch Intl) Japan Accel Growth II 25B	0.69
<b>Cash</b>	<b>4.06</b>
<b>Derivative Instruments</b>	<b>0.33</b>
<b>Options</b>	<b>0.33</b>
FTSE 100 Index Dec 07 UKX 6125 PBT (Put Option)	0.23
FTSE 100 Index Sep07 UKX 6325 PBT (Put Option)	0.11

## Risk Factors

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.

Issued by Newton Investment Management Limited. The Falcon Fund is an authorised unit trust operated by Mellon Fund Managers Limited. Newton Investment Management Limited and Mellon Fund Managers Limited are authorised and regulated by the Financial Services Authority and are members of the IMA.

Registered office for Newton Investment Management Limited (NIM) and Mellon Fund Managers Limited (MFM), Mellon Financial Centre, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No 1371973 (NIM) and No. 1998251 (MFM). Authorised and regulated by the Financial Services Authority.



---

Newton Investment Management Limited (NIM)  
Mellon Financial Centre  
160 Queen Victoria Street  
London EC4V 4LA

Mellon Fund Managers Limited (MFM)  
Mellon Financial Centre  
160 Queen Victoria Street  
London EC4V 4LA

**Telephone: 020 7163 9000**  
**Fax: 020 7163 5063**  
**e mail: [privateclients@newton.co.uk](mailto:privateclients@newton.co.uk)**  
**[www.newton.co.uk/pim](http://www.newton.co.uk/pim)**

Registered office for NIM and MFM: Mellon Financial Centre  
160 Queen Victoria Street, London EC4V 4LA  
Registered in England No.1371973 (NIM) and No.1998251 (MFM).  
Authorised and regulated by the Financial Services Authority.

*A Mellon Financial Company<sup>SM</sup>*

**NIM Edinburgh**

2 Festival Square  
Edinburgh EH3 9SU

**NIM Leeds**

No. 1 Whitehall Riverside  
Leeds LS1 4BN