

**James Harries**  
**Global Higher Income Update**

Word Count : 1151

**The case for equity income**

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Hello, my name's James Harries and I'm the manager of the Newton Global Higher Income strategy. This is a strategy that's designed to give investors the opportunity to invest for income from a group of global equities. We think income is a very important part of an overall return from an equity portfolio and the strategy aims to give investors both a high and sustainable income yield as well as capital growth over the longer term.

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It's been shown in recent months (and years perhaps) that many sources of income have been of questionable provenance. We think, therefore, that a transparent, understandable and non-g geared source of income for investors in a variety of currencies in a diverse global portfolio makes a great deal of sense.

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Now we've seen a number of dividend cuts around the world and we'd expect this to continue. In the same way that many business models and investment strategies were predicated upon an unrealistic cost of debt, we believe that many companies' dividend distribution policies were also predicated upon an unrealistic cost of debt and, as that cost has gone up and is unlikely to reduce in the near term, we would expect further cuts.

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We think it's very important therefore to continue to invest in robust businesses that are well financed, and by that we mean do not have too much debt, and should therefore continue to be able to pay dividends to shareholders.

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**Positioning for strategy in the current market**

The relevance of this point is the banking sector, where we remain underweight and which is currently enjoying quite a strong rally. I'll go on to talk about how we remain sceptical with regard to the prospects of the banking sector but, no matter what one thinks, it remains the case that in terms of income, banks are unlikely to pay growing dividends in years to come, and are therefore unlikely to be a fertile source of income investment in the medium term.

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We're currently enjoying a strong rally in world equity markets, led by both the financial and more cyclical areas. Those are parts of the economy that would generally be expected to benefit from an improving economic environment.

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The question remains, therefore, whether we expect such a cyclical recovery, and whether we are positioning our strategy to benefit from that. The answer is, broadly, no.

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According to our *all change* theme, we think the so-called credit 'crunch' is a step change in world markets, in the investment environment, in capital structure, in business investment and in consumer behaviour. Therefore, we are sceptical that a normal cyclical recovery should be expected. We therefore think that many economies, including the US and the UK, have more structural difficulties which will take some time to work through.

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Specifically, we think that the over-indebtedness that we see at the consumer and corporate level, most focused in the banks, is unlikely to be cleared by normal cyclical recovery, and we therefore do not anticipate one to be forthcoming any time soon.

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Having said that, we do think that other parts of the world are in a more favourable position but that they have been overwhelmed by the intensity of the cyclical downturn we are currently experiencing. We would put in that category many parts of Asia and specifically, Brazil. We maintain exposure to both those parts of the world within the fund.

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**Investment Outlook**

We actually think the outlook is likely to be characterised by three distinct phases. The first is the current, more optimistic tone within markets which is really as a result of the fact that the news from markets and from companies is not getting worse. We know that the global economy had somewhat of a heart attack in the fourth quarter of 2008, largely driven by the collapse of Lehman Brothers and the problems in the financial markets that that caused.

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The point is that to extrapolate the very poor negative numbers that we saw from the global economy in Q4 of 2008 is dangerous, and that therefore some form of recovery driven by either the

rate of decline decelerating or by some form of restocking is to be expected, and this is what is indeed driving markets currently.

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But we think equally that this is unlikely to be a sustainable recovery for the points I made before; and therefore that investors shouldn't be getting too excited that we have reached the bottom and that markets can now form a sustainable upward trajectory.

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More likely, we think, is that we are moving into a period of more deflationary forces where the banking sector will continue to have difficulties and those companies that will produce the best returns are those that are relatively uneconomically cyclical and not dependent upon a strongly improving economic environment. We think that this deflationary period will last for some time.

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We do feel, however, that the inevitable consequence of the policies being put in place by governments more broadly will ultimately be inflation and that we should expect this to return, potentially with a vengeance, in time to come. We will be positioning the strategy to benefit from those sorts of trends.

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In terms of positioning, therefore, the fund has been very overweight more defensive sectors and that remains the case. In anticipation of this market recovery we're currently experiencing, we did reduce somewhat our telecommunications exposure in favour of financials, both in terms of insurance and also in market exchanges.

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Having therefore enjoyed this recovery, we're now more minded to move back to being more defensive, and that will include again repurchasing some of the telecommunications holdings that have underperformed in the rising market as well as potentially holding some cash.

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In broad terms, the portfolio remains largely unchanged; we are overweight Asia and Brazil within the emerging markets and underweight the US economy.

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In terms of income, I've mentioned that we expect dividend cuts to continue to be a feature of world markets, but we are striving to maintain the income yield this year and we think we can do that by investing in both robust businesses and also by having some exposure further up the capital structure in the form of convertible bonds and preference shares.

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### **Performance**

The running yield on the fund is currently around 6% and we expect that to be maintained this year.

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The performance in 2008 was marginally ahead of world markets and in the first quarter of 2009 we have performed largely in line with world markets. We think that the world economy and the backdrop for investments will remain troubled, but we continue to find areas which have attractive valuations and sustainable dividend yields which will help the fund maintain its objective overall in the medium to long term.

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Thank you very much.

(End of talk)