

Newton Webcast Filming
 James Harries – Newton Global Higher Income
 31/3/11

Time Code	Transcription
00:00:00	<p>We like companies that pay income, pay a real cash dividend for a number of reasons. The idea behind the strategy is to give investors a total return but with a focus on income-generating companies. Companies that pay a regular cash dividend tend to be a little more careful with your capital: they tend not to over-gear the balance sheet, they have to generate cash to pay the dividend and they generally have a controlling influence on the capital allocation decision of management. In addition to that, a dividend is a very important contributor to overall total return in the current market that we are seeing, which is characterised by quite a high degree of indebtedness in the developed world, no interest rates, and quite an uncertain outlook in many ways. The relative certainty that a dividend gives you in terms of contributing to the total return is attractive. And finally, you can use the dividend as a way of timing purchases and sales of shares by obviously paying companies, or buying companies that are out of favour and selling them again when they are rather more in favour, and therefore their dividend has reduced somewhat.</p>
00:01:17	<p>The overarching theme at the moment we have is called <i>all change</i>. <i>All change</i> is the idea that there is a high degree of indebtedness in the developed world. We expect a fairly sluggish outlook in terms of economic growth from here as a result of the credit crunch that we have all experienced, meaning that the ability to take on further debts is likely to constrain activity and lead to a slower economic outlook than we would have otherwise might think. In addition to that, the ability of the authorities to dampen and lengthen the cycle by collapsing interest rates and encouraging greater indebtedness is less strong than it used to be. We think, therefore that you should be relatively cautious, you should concentrate on companies that are relatively dependable or predictable and aren't dependent upon an ongoing global strong economic backdrop. So that main theme very much speaks to income investing, and in addition to that there are two further themes we think are important. The first is <i>networked world</i>. We think it is a genuine growth area for people to use handheld devices, the explosion of data across networks. We can access that through investing in telecoms companies, in some technology companies and so on. And secondly we like <i>medical technology</i>. We in the west are unfortunately getting older, the east is getting richer and we think therefore that the spending on health care generally and pharmaceuticals is unlikely to decline in the years to come. And yet this sector looks very attractive in terms of valuation. So the telecoms and health care sectors are well represented in the strategy and we think this is appropriate given the investment backdrop that we see.</p>
00:03:07	<p>As I mentioned before, the dividends that companies pay tend to be a constraining influence on managements in terms of their capital allocation. And therefore companies that pay a regular cash dividend tend to be higher quality, if you like, they tend to be well financed, management tend to not overstretch</p>

	the balance sheet and so on. And so generally we are drawn towards companies that have a high free cash flow yield, that are well financed, that are sensibly managed, if you like, and that have a sustainable or dependable franchise and that can dependably grow capital through time. And therefore, generally speaking, our portfolio would be less volatile than many others and the companies within it would have a higher degree of predictability.
00:03:58	The <i>all change</i> backdrop that we foresee essentially means that the economic outlook for a number of years is likely to be constrained. The credit crunch we think is a process rather than an event, we are still in it. And that means that for a number of years the investment backdrop is likely to be characterised by sluggish growth in the global economy. In addition to that we think that the business cycle is likely to be shorter and more volatile than it used to be and finally currently the cyclically adjusted P/E, the valuation of the broader equity market, is up twenty three or twenty four times, which is towards the top end of its historical valuation range. We would therefore expect fairly low returns from equities in general, however we think there are pockets within it, particularly those which are characterised by high yielding high quality companies at the moment, that look attractive in absolute terms and that should generate reasonable returns for shareholders, and an important contributor to that will be the dividends that the companies are investing in and paying.

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