

Newton Webcast Filming
Tineke Frikkee – Newton Higher Income
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Time Code	Transcription
00:00:00	Hello. My name is Tineke Frikkee and I am the lead manager of Newton's UK equity income strategy. First we'd like to share our investment outlook with you. During the 20-year period from 1980 to 2000, investors have enjoyed strongly rising asset returns, with relatively long cycles and relatively low volatility. We believe this is unlikely to continue. Drivers behind this "great moderation" were the significant declines in inflation and bond yields and the significant increases in debt. US inflation was 10% in 1982 and 1.5% in 2010. The 10-year US bond yield was 15% in 1982 and 2.5% in 2010. US total debt as percentage of nominal GDP was 160% in 1982 and 350% in 2008. US household debt to personal income was 65% in 1982 and 118% in 2010. We believe these drivers are unlikely to repeat themselves in the medium term. Even though global bond yields and inflation may stay relatively stable, Western households are already de-gearing and developed economies have plans in place to reduce their borrowings.
00:01:32	As a result, we believe it is sensible for investors to expect a more modest, but still positive return on their assets. We are likely to see more volatile volatility and shorter cycles. In this environment, we believe going down less than the market in downturns may prove key to generating above market returns in the long run. Investing in high yield equities could well prove attractive given their greater downside protection.
00:02:01	Let's just explore this a bit more. On the far right you see close to 16 years worth of annualised total returns from the FTSE All Share in yellow and the FTSE 350 High Yield in red. We have split these performance numbers by periods that the FTSE All Share rises - on the left - and that it falls - in the middle. What you can see is that the high yield index has kept up reasonably well when taken all rising markets together. During falling markets though, the high yield index did not go down as much. This greater downside protection was the main driver for the outperformance of high yield equities for the whole period.
00:02:45	Saying that, during the two years to the end of 2010, UK high yield equities have underperformed dramatically. Even though the FTSE 350 High Yield index is up a respectable 26%, the low yield index is up 74% during these two years. The main driver behind this has been the significant rise in the low yield mining sector, which has gone up nearly 180% during this time. We believe this has left the High Yield index looking attractively valued. It is now rated at a P/E multiple of 10 times, even though it was trading at a 14 times P/E 6 years ago. A P/E of 10 times also looks attractive in a longer-term context.
00:03:37	From a sector point of view, our UK equity income strategy is diversified across more defensive sectors, like utilities and tobacco, but also more cyclical parts of the market, such as selected asset managers, retailers and pubs. Low-yielding

	sectors like mining and banks are largely excluded. At a company level, we look for characteristics such as relatively stable end-demand, strong balance sheet, good cash flow management, sensible company strategy, clear dividend policy at an attractive valuation. Other areas of interest could include more structural growth opportunities in fragmented or immature markets and "self-help" through efficiency programmes or delivery of synergies.
00:04:30	Even though the UK economy itself is likely to only deliver modest growth during the next couple of years, UK companies make around two-thirds of their sales outside the UK. We also see this reflected in our UK equity income strategy. We do have some pure domestic investments, such as utilities and supermarkets, but we also have US exposure in media, engineering design and flight support stocks. Emerging market exposure is widely found in tobacco, pharmaceuticals and food producers. Some companies focus more on continental Europe, be it tour operators, specialist lenders or work wear and mat suppliers. That brings me to the end of this webcast. We believe high yield UK equities may be able to provide greater downside protection in the more volatile investment environment we are likely to be in already. This strategy can be well diversified across sectors and end-markets. Thank you for listening and good luck.

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