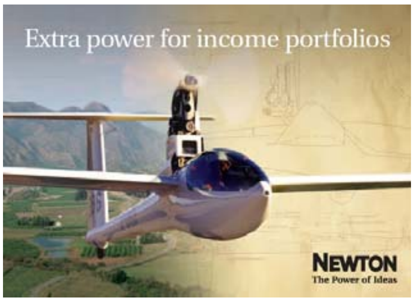


# Monthly Manager Commentary
# Newton Higher Income Fund

## December 2007

STANDARD &POOR'S A FUND MANAGEMENT RATING

obsr RATED A

**Tineke Frikkee**

For Professional Investors Only

**Newton Higher Income Fund Commentary** **December 2007**

## Economic and market developments

UK equity markets finished 2008 by posting marginally positive gains for December however, the factors affecting money markets are far from reaching normality.

Interest rates in the UK were cut by 25 basis points (9-0 vote) to 5.5% as the Bank of England warned that slowing growth in the industrial world was already apparent and that substantial monetary loosening may be required despite the threat of high and rising oil prices to inflation. UK house prices suffered their largest one-month drop since the early 1990's as the effects of the credit crunch begin to impact the wider market.

In the US, the Federal Reserve cut interest rates by 25 basis points and followed this with a liquidity injection, offering to auction short-term money in conjunction with other leading Central Banks to ease the crisis in money markets over the year-end period. To ease the strain on the voting public President Bush announced plans to prevent interest rates increasing on re-set mortgages for those that could not afford the higher payments.

The ECB offered substantial amounts of liquidity to markets and were successful in reducing short-term Libor rates markedly, though they kept the euro rate on hold, more concerned about inflation than their global counterparts.

Investments by sovereign wealth funds to shore up the capital bases of the leading investment banks continued, with UBS no longer offering a cash dividend to shareholders. In this environment the oil and gas sector and the defensive tobacco and mobile telecom sectors performed well and the banks, mining and retail sectors performed poorly.

## Fund performance

In December the FTSE All-Share Index returned 0.26%. Large caps outperformed, with the FTSE 100 Index returning 0.45%, whereas FTSE 250 and FTSE 350 indices were returned -0.69% and 0.29% respectively. The Fund outperformed in December, returning 0.67%. This placed the Fund in the second quartile over one month, six months, one year and five years, first quartile over three months and third quartile over three years. The Fund's interim dividend as at 31st December grew by 10% on last year's. All figures are in sterling terms.

Our large holding in **BAT** performed well as investors continued to seek out reliable earnings streams and our holding in **Tui Travel** recovered from weakness as the market rewarded solid current trading. Weakness in the mining sector was positive for our relative performance, given our yield-driven void in the sector, as **Anglo American** and **Rio Tinto** underperformed. Our underweight position in the banking sector continued to be positive and our holding in **Emap** performed well as the long-awaited restructuring and sale of the company emerged.

Oil price strength resulted in a strong performance from low yielding **BG** where we are under represented. Our holding in **Rexam** performed poorly as management warned that commodity and currency issues would negatively impact profits. Holdings in **Smiths** and **IMI** were also weak and **FKI** fell substantially after warning that US retailers may delay orders for some of their products.

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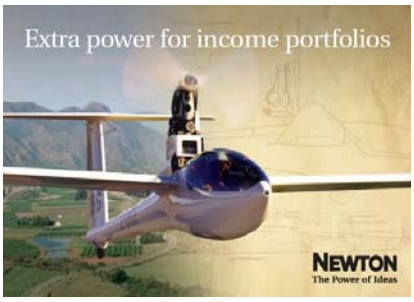


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## Fund activity

We introduced a new position in water company **Severn Trent** during the month. The company operates under a regulatory environment and has stable cash flows, the floods witnessed in the UK over the summer underlined the need for investment in the UK water infrastructure and this, coupled with the effect the credit crunch has had on borrowing costs, should be reflected in the regulators allowed return. We believe the company should therefore continue to be able to pay an attractive and growing dividend to shareholders.

We also increased our position in **BT**, as the stock had been weak on concerns surrounding broadband competition and global services margins. We believe the valuation fully reflects these concerns and that a recovery in global services margins is achievable. We continued to build our holding in **Sage** reported last month and also in **Marks and Spencer** into price weakness, as we believe that the company can weather the current poor consumer environment.

In the mid cap area we are beginning to see some opportunities thrown up by market weakness. We are building positions in **BBA Aviation** and also in **FKI** which has more than halved since the failure of buyout talks earlier in the summer.

We completed our yield-driven exits of **Scottish and Newcastle** and **Unilever** from the Fund and reduced our holdings in the life assurance sector as, despite attractive valuations, we believe it may be some time before these are recognised.

## Outlook

Our outlook moving into 2008 remains little changed. We continue to believe that the second round effects of the credit crunch have yet to be fully recognised and that contagion into the wider economy is likely. We expect market volatility may continue for some time as these effects arise and we will continue to seek out the opportunities that this market environment inevitably presents.

**T Frikkee, December 2007**

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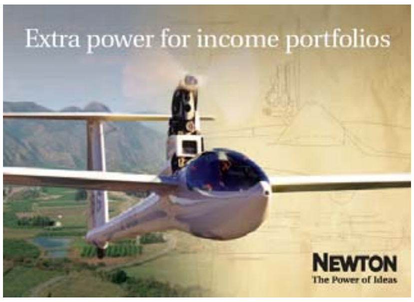


# Monthly Manager Commentary
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## Sector group weightings as at 31 December 2007

| Sector Group | Portfolio % | FTSE All Share % | Active % | Last Month Active % | Active change % |
|---|---|---|---|---|---|
| Oil & Gas | 14.0 | 17.4 | -3.4 | -3.1 | +0.3 |
| Basic Materials | 0 | 9.9 | -9.9 | -10.6 | -0.7 |
| Industrials | 9.5 | 6.9 | 2.6 | 2.4 | +0.2 |
| Consumer Goods | 12.9 | 10.2 | 2.7 | 3.3 | -0.6 |
| Healthcare | 6.4 | 6.6 | -0.2 | -0.4 | -0.2 |
| Consumer Services | 11.9 | 10.9 | 1.0 | 0.2 | +0.8 |
| Telecommunications | 14.6 | 7.1 | 7.4 | 7.5 | -0.1 |
| Utilities | 13.3 | 4.4 | 8.9 | 8.5 | +0.4 |
| Financials | 15.3 | 25.7 | -10.4 | -9.3 | +0.9 |
| Technology | 2.2 | 0.9 | 1.3 | 1.0 | +0.3 |

## Top ten holdings against FTSE All Share as at 31 December 2007

| Stock | Yield %* | % of Portfolio | % of FTSE All Share | Active % |
|---|---|---|---|---|
| National Grid | 4.1 | 4.8 | 1.2 | 3.6 |
| British American Tobacco | 3.8 | 5.1 | 1.6 | 3.5 |
| Centrica | 4.2 | 4.1 | 0.7 | 3.4 |
| Vodafone Group | 3.9 | 8.2 | 5.5 | 2.7 |
| Scottish & Southern Energy | 3.7 | 3.2 | 0.8 | 2.4 |
| Cable & Wireless | 4.3 | 2.6 | 0.3 | 2.3 |
| BP | 3.5 | 8.8 | 6.4 | 2.4 |
| BT | 6.1 | 3.4 | 1.2 | 2.2 |
| Smiths Group | 3.8 | 2.3 | 0.2 | 2.1 |
| Tui Travel | 4.1 | 2.1 | 0.1 | 2.0 |

**Consensus forecast dividend yield next financial year.*
*Portfolio holdings are subject to change at any time and without notice.*

## Performance (%) as at 31 December 2007

| | Yield** | 1 Month | 3 Months | 6 Months | 1 Year | 3 Years | 5 Years | Fund Size |
|---|---|---|---|---|---|---|---|---|
| Newton Higher Income Fund | 4.4 | 0.67 | 0.47 | -3.26 | -0.69 | 39.40 | 105.98 | £3.4bn |
| IMA UK Equity Income Average | 3.4 | 0.27 | -1.55 | -4.90 | -1.30 | 40.78 | 100.14 | ~ |
| FTSE All Share (total return)* | 2.8 | 0.26 | -0.35 | -2.11 | 5.32 | 50.04 | 104.65 | ~ |

*Source: Lipper Hindsight 5. Basis: total return in GBP, no initial charge, net annual charges, net UK income reinvested.*

*** Yield date 31/10/2007. All yield figures that are used are calculated on the basis of dividing the last 12 months dividends by the current price. Current yields are not indicative of future yields.*

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