



# Monthly Manager Commentary Newton Higher Income Fund

January 2008



Tineke Frikkee

For Professional Investors Only

## Newton Higher Income Fund Commentary

January 2008

### Economic and market developments

January witnessed one of the worst starts to the year for global equity markets for quite some time, with the UK markets down 8.7% over the month. Continued fear of defaults in the financial sector, as Monoline insurers became the focus of investors due to rating downgrades in the US, led to heavy market falls mid month. Fears of a recession in the US and heavy losses from a rogue trader at Société Générale all added to the market malaise.

The Fed responded with an emergency 75 basis point cut in rates intra meeting, citing a weakening in economic outlook and increasing downside risks to growth. While this produced some relief, markets continued to fall and further monetary easing followed with a further 50 basis point cut following the Fed's usual meeting taking the cut to 125 basis points in two weeks. Fiscal packages were also announced to ease the pain on the US economy as unemployment breached 5% and the economy recorded its first job losses for more than four years.

The Bank of England left rates unchanged in January as inflation remained above target however rates are likely to be eased over the short term given global market events and the availability and pricing of debt in the UK economy.

Despite concerns about global growth, merger and acquisition activity in the mining sector ensured it was the best performing sector in the month. Real estate was also strong as rate cuts provided some relief for the interest rate sensitive sector and the market had already priced in weak markets. Oil and gas stocks were the worst performers in the market in January, having had a strong end to 2007 and despite a temporary recovery from rate cuts, Banks face tremendous headwinds following the credit squeeze and HSBC and Royal Bank of Scotland dragged on market returns.

### Fund performance

In January the FTSE All-Share Index fell by 8.67%. Large caps underperformed, with the FTSE 100 Index declining by 8.90%. The FTSE 350 Index matched the UK market, returning -8.67%. The FTSE 250 Index outperformed in January, although it was also firmly in negative territory, returning -7.15%. The Fund returned -10.6%. This placed the Fund in the fourth quartile over one month, third quartile over three months, one year and three years and second quartile over five years. All figures in sterling terms.

Our defensive stance continued to lend support to the Fund in January, with beneficial contributions from **Smiths**, **BT** and **Vodafone**. **Tate & Lyle** was also strong following its weakness last year and **Emap** and **Rexam** also held up well relative to the falling market. Other contributors to relative performance included those that were not owned, or in which the Fund was underweight relative to the index. This included **SAB Miller** that announced lower than expected quarterly beer volumes and was affected by issues in the South African economy and a weaker rand. Our underweight position in the banking sector continued to be supportive, with notable positive contributions from our void in **Royal Bank of Scotland**, and underweight position in **HSBC**. Our modest underweight position in **Royal Dutch Shell** was positive, although the overweight in **BP** weighed on the portfolio, given the underperformance of the UK oil majors.



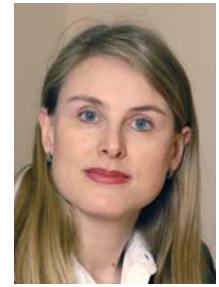
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The worst performing stock was **Premier Foods** which was buffeted by ongoing concerns about input cost inflation and high debt levels. A debt factoring arrangement was taken particularly negatively with the market in unforgiving mood. **Yell** also suffered from its high debt levels, exposure to the US economy and negative broker sentiment. Having been a strong performer in 2007, **Cable & Wireless** was impacted in January amid concerns about its International division and the effect of the potential disposal of its pension fund. We continue to be positive, given more favourable dollar-sterling rates, management incentives, and its tendency to under promise and over-deliver. **TUI Travel** underperformed in January, as the market persists in disbelieving the merger synergy potential and its ability to hold up well in a consumer downturn, despite historical trading behaviour. We think that the bearish stance presents an investment opportunity and continue to maintain our holding in the stock.

Yield-driven voids in miners **Xstrata** and **BHP Billiton** once again weighed on performance. This was driven by bid speculation surrounding the former and supply constraints following floods in Australia and South Africa. Demand for commodities continues to be strong, especially from China.

## Fund activity

We continue to add to larger holdings, with defensive exposure and stable earnings generation through the cycle. Additions included **AstraZeneca**, **Severn Trent**, **BT** and **Scottish & Southern Energy**. We also increased the weighting in oil major **BP** on price weakness.

We are beginning to see some value in more cyclical names that have suffered relatively weak performance and we are selectively adding small positions in names with strong market positions such as **GKN**, **Renishaw** and **BBA Aviation**.

We continue to reduce our exposure to financials, including **HSBC**, **Aviva**, **Provident Financial**, **Jardine Lloyd Thompson** and **Barclays**. We took profits on **Emap** and on yield grounds started reducing **Imperial Tobacco**. The latter was very volatile during the month and as a result, we continue to be holders.

## Outlook

The large move in US interest rates underlines the seriousness of the issues facing the US and the global economy over the short term. While this monetary policy may give some relief to markets, we believe that a slowdown is unlikely to be averted and expect market volatility to persist.

In this environment, we remain holders of stable, defensive companies with the capacity to generate secure income streams for investors and will selectively add those companies where we believe the market has become overly cautious of their prospects.

T Frikkee, January 2008



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## Sector group weightings as at 31 January 2008

Sector Group	Portfolio %	FTSE All Share %	Active %	Last Month Active %	Active change %
Oil & Gas	13.3	16.6	-3.3	-3.4	-0.1
Basic Materials	0.0	10.3	-10.3	-9.9	+0.4
Industrials	10.0	6.9	3.1	2.6	+0.5
Consumer Goods	12.2	10.1	2.1	2.7	-0.6
Healthcare	7.3	6.8	0.5	-0.2	+0.3
Consumer Services	11.6	10.8	0.8	1.0	+0.7
Telecommunications	15.4	7.3	8.1	7.4	+0.7
Utilities	14.4	4.5	9.9	8.9	+1.0
Financials	12.2	25.8	-13.6	-10.4	+3.2
Technology	2.6	0.9	1.7	1.3	+0.4

## Top ten holdings against FTSE All Share as at 31 January 2008

Stock	Yield %*	% of Portfolio	% of FTSE All Share	Active %
National Grid	4.2	5.0	1.2	3.8
British American Tobacco	4.4	5.3	1.6	3.7
Centrica	4.1	4.3	0.7	3.5
Vodafone	4.3	8.7	5.6	3.1
BT	6.5	4.2	1.3	2.9
Scottish & Southern Energy	3.9	3.6	0.8	2.8
BP	4.2	8.7	6.1	2.6
Cable & Wireless	4.5	2.6	0.2	2.4
Smiths Group	3.9	2.6	0.2	2.4
Tui Travel	4.2	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 January 2008

	Yield*	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	Fund Size
Newton Higher Income Fund	5.5	-10.60	-14.08	-10.41	-11.62	21.60	103.07	£2.9bn
IMA UK Equity Income Average	4.1	-9.40	-13.91	-10.84	-10.79	24.69	97.15	
FTSE All Share	3.3	-8.67	-12.78	-7.51	-3.57	35.26	105.34	

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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