

# Newton Real Return strategy

An actively-managed multi-asset strategy which takes an unconstrained approach to targeting absolute returns

➤ A BNY MELLON ASSET MANAGEMENT COMPANY<sup>SM</sup>

**NEWTON**  
The Power of Ideas





# Performance

Newton exists primarily to increase the wealth of its clients by delivering strong and transparent investment performance.

# Perspective

Newton uses a distinctive global, thematic approach to maintain perspective and to generate strong and durable investment ideas.

# Teamwork

Newton is successful in varied market conditions by using a coherent, collaborative and enduring team-based investment approach.

# Consistency

Newton seeks to achieve consistent and stable growth in its business by maintaining strong investment performance and managing portfolios that are appropriate to the fulfilment of clients' objectives.

# Newton Real Return

Newton Real Return<sup>1</sup> is an actively-managed multi-asset strategy which takes an unconstrained approach to targeting absolute returns of cash (1-month Libor) +4% per annum over rolling 3-5 year periods. It invests in 'conventional' assets (global equities, bonds and cash) and 'alternatives'. The strategy utilises derivatives to gain exposure to a particular asset, to hedge investment risks (in relation to markets or currencies for example) and to generate additional income. The strategy does not borrow in order to leverage or sell stocks 'short'.

The strategy has an absolute return target, but its broader objective is to generate an attractive real return for investors over the long term with significantly less volatility than is experienced in equity investing alone. It also has a strong emphasis on capital preservation.

Our guiding principle at Newton has always been to enhance the real wealth of our clients and, to that end, our multi-asset approach has consistently been managed with absolute, as well as relative, returns in mind. The Newton Real Return strategy harnesses our long-standing strength in global, multi-asset investment management and takes a more opportunistic approach to achieving its performance target than is the case with a 'traditional' multi-asset strategy.

<sup>1</sup> Until 1 July 2009, Newton Real Return was known as Newton Absolute Intrepid. The Newton Real Return strategy is available via the Newton Real Return Fund (part of the Newton range of pooled funds within the BNY Mellon Investment Funds ICVC) or, to investors with over £50 million to invest, in a segregated arrangement. In this document we use the Fund to illustrate the performance and positioning of the strategy. Dollar and Euro versions of the strategy are available.

During the last two decades of the twentieth century, equity markets enjoyed some significant tailwinds; inflation and interest rates fell rapidly and share prices rose strongly. Today, the investment environment has changed and equities appear to have less scope for further re-rating, with interest rates having fallen to historic lows. We believe that investors now need to moderate their expectations about investment returns and re-evaluate in a lower return world, the absolute as well as relative, nature of those returns.

We believe that multi-asset funds, and particularly those which target absolute returns have a prominent role to play in meeting the aspirations of both defined benefit and defined contribution pension scheme trustees. By combining investments in a single, holistic portfolio, investors are well-placed to benefit from our continuous appraisal of the relative value available in different asset classes. The single-portfolio approach allows our clients to strike a better balance between risk and return than is available typically from an approach which divides investments between a range of 'specialist' managers.

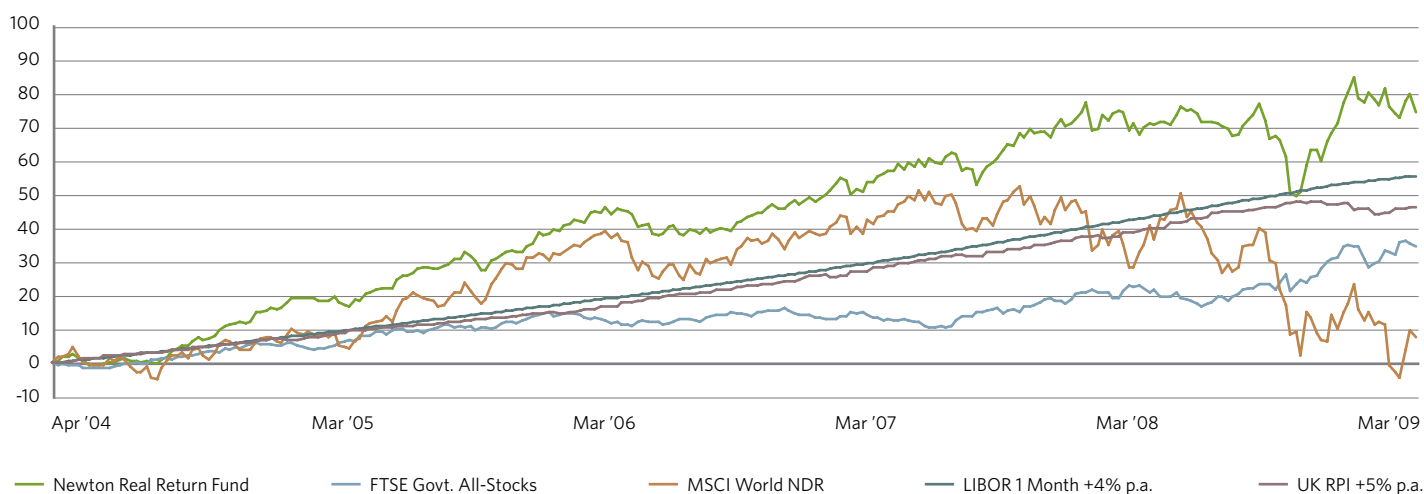
Taken with the significant value that our global, thematic perspective adds to our management of multi-asset funds, the unconstrained nature of the Newton Real Return strategy provides the flexibility which is key to providing a decent real return in an increasingly volatile world.

By combining investments in a single, holistic, portfolio, investors are well-placed to benefit from our continuous appraisal of the relative value available in different asset classes.

# Performance

The Newton Real Return Fund achieved an 11.8%p.a. return between its 1 April 2004 inception\* and the end of March 2009, versus the target return of 9.2%p.a. This is a particularly impressive track record when the market background across this 5 year period is considered – for example, it was not possible to achieve this target through buying the UK bond market (UK Gov All Stocks Index 6.1%p.a.) or the global equity market (MSCI World NDR Index 1.5%p.a.).

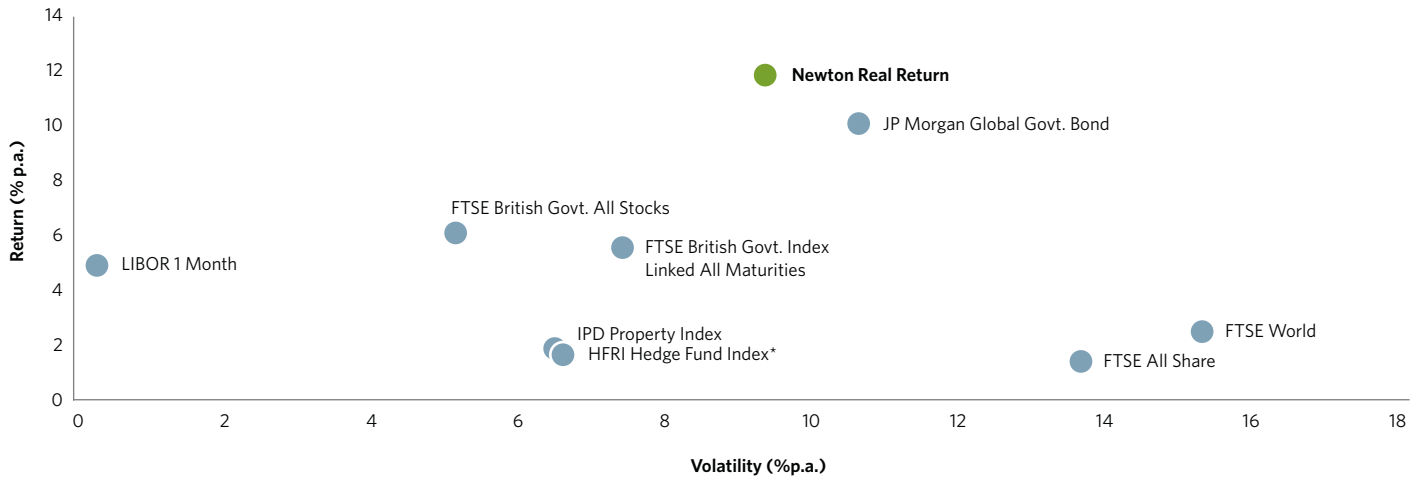
## RETURNS OVER FIVE YEARS



Figures are based on sterling returns. Past performance is not a guide to the future. Please remember that the value of shares and the income from them can fall as well as rise and investors may not get back the full amount originally invested. Source: Newton, weekly data, total return, gross of management fees, gross income reinvested.

In short, the Newton Real Return Fund has captured significantly more equity upside than downside, indicating the effective risk control inherent in its management. Both observed and forward-looking measures of risk indicate that the Fund delivered its performance with relatively low volatility. Over the last five years, the Fund's observed volatility has been 9.7%p.a. compared with historic global equity market volatility of 17.9%p.a. and UK bond volatility of 5.6%p.a. (source: Lipper). As at 31 March 2009, the expected volatility of the Fund was 9.1%p.a. compared with prospective global equity and UK bond market volatility of 16.9%p.a and 6.9% respectively. (source: APT).

## RISK/RETURN OVER FIVE YEARS



\*Net of fees. Figures are based on sterling returns. Past performance is not a guide to the future. Please remember that the value of shares and the income from them can fall as well as rise and investors may not get back the full amount originally invested. Source: Newton, weekly data, total return, gross of management fees, gross income reinvested, to 31/03/09.



# Methodology

The starting point of Newton's investment process is the identification of investment themes which represent our ideas about the likely forces of change in the world. A global, thematic approach allows us to gain long-term perspective on global financial markets and economies, to anticipate how the world will change and to identify the beneficiaries of such change. The advantage of this approach is that it directs analysts and fund managers towards profitable investment opportunities across the world, highlighting attractively priced securities with the right characteristics.

Our 'holistic' approach to multi-asset investing – using single seamlessly constructed portfolios rather than 'fund of funds' – allows us to be fully aware of the risks in the investments we make. Using our 'macro' outlook, our thematic framework and the output of our in-house research analysts, the Real Return strategy team compares the relative attractiveness of different stocks, sectors, regions and asset classes in a dispassionate manner.

In the internet age, there is no shortage of information, but information without perspective is inadequate in seeking to fulfil investment objectives. A central tenet of Newton's approach, which dates back to the inception of the firm, has been that 'change leads to opportunity'. The world is constantly changing and an investment strategy if it is to prove successful, needs to be dynamic. In short, because themes are about change, our approach is unlikely to be caught out by change in the way that many model-driven approaches which rely on backward-looking data, have been.

Too much emphasis is placed on short-term 'noise' when the underlying trends are much more influential drivers of return. Using longer-term themes to generate perspective enables us to identify areas of opportunity and risk across the various asset classes on the investment landscape. In the context of that philosophy and process, we buy fundamentally researched securities on a global basis.

We also gain perspective from being based in one location. The collaborative nature of our approach allows the team responsible for the Real Return strategy to draw upon an array of expertise, including that of our career global industry analysts, specialist fixed income and equity investment managers, strategists and 'alternative' investment specialists.

Maintaining perspective has been important in recent years and led, for example, in our benchmark aware/relative return funds, to our holding significantly underweight positions in Western financial and consumer sectors during the credit crisis which began in 2007. Those positions proved to be particularly fruitful, but the perspective that gave rise to them had been in place for several years. We firmly believe perspective will be vital looking forward in the 'all change' environment.

The ability to focus (on opportunities and risks) and the flexibility (to respond to changing market conditions) afforded by our holistic approach are simply not available to the typical fund-of-fund manager. Multi-specialist portfolios suffer from a lack of control over underlying portfolio positions and are more likely to end up index-centric. Focus and flexibility are key attributes of the Newton Real Return strategy, which is entirely unconstrained in seeking to meet its cash (1-month LIBOR) +4% per annum target over rolling 3-5 year-periods.

Over the longer term we expect the greater part of the strategy's overall return to come from a core of return seeking investments, such as particular equities, corporate bonds and other assets. Portfolio volatility is managed through good security selection, by downside protection via derivatives and by asset-class diversification.

The team responsible for the Real Return strategy assess and control a number of areas of risk, not simply 'investment' risk (volatility). Cash holdings, for example, are subject to a rigorous set of controls and are diversified via money market funds and providers approved by Newton's fixed income team. The team also takes advantage of the work of our counterparty risk group to ensure that appropriate measures are in place to control the risk inherent in the use of counterparties. The seamless single portfolio approach is a significant positive in this regard as it enables the various investment and operational risks inherent in portfolio management to be readily assessed.

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#### PORTFOLIO IDEAS COME FROM ACROSS THE HOUSE



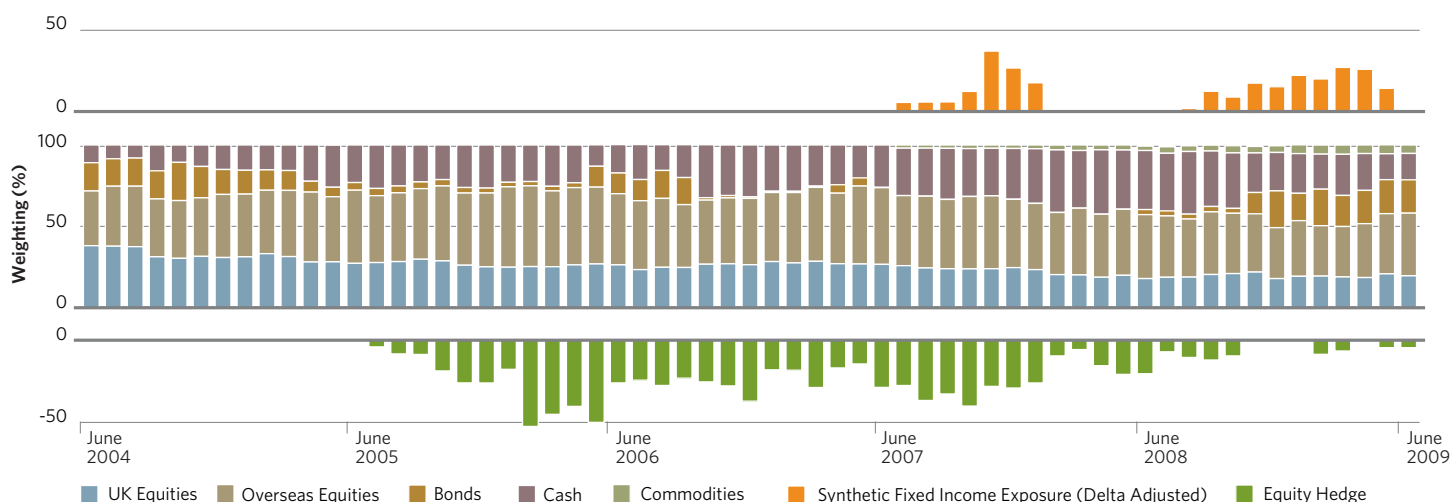
# Positioning and contribution analysis

Investment flexibility is fundamental to the success of the Newton Real Return strategy. Aside from conventional assets, the Real Return strategy gains exposure to other types of asset indirectly (through exchange – traded funds and unitised vehicles) such as commodities, real estate and currencies where appropriate. It has total flexibility at the asset allocation level, subject to the restriction that no more than 20% may be held in any global sector. At the security level, weightings reflect our conviction about each holding i.e. the composition of a company in market indices is irrelevant. In order to control volatility, no more than 5% is purchased in any one company (debt and equity combined).

Decisions about the asset distribution of the strategy are not a function of macro-economic predictions, but rather the result of a process of constant comparison of relative risk and reward. Only those investments with attributes that correspond to our thematic view of the world and which we believe are capable of delivering a strong absolute return or hedging against certain risks, will be held at any particular time.

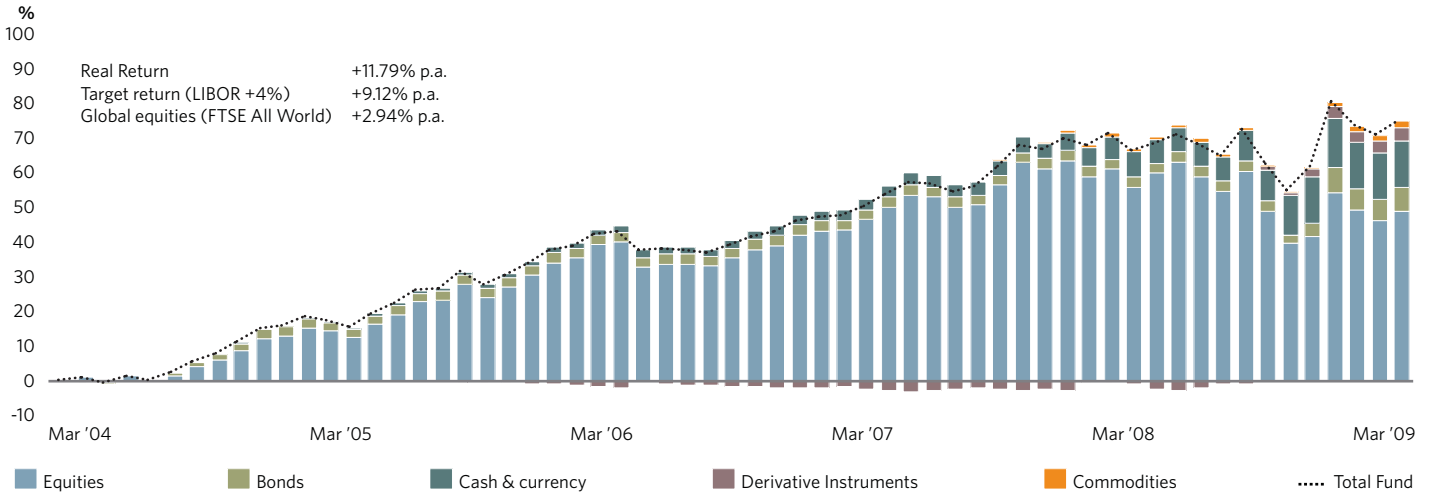
The chart below illustrates changes in asset allocation since the Real Return Fund's inception on 1 April 2004. For illustrative purposes, delta adjusted equity market option exposure is shown below the main body of the chart, to demonstrate the extent to which downside protection has been utilised over time. Similarly, synthetic bond positions (bond options) have been highlighted above the main body of the chart to illustrate clearly the different bond exposures – via options and physical positions. Importantly, the strategy does not borrow to implement derivative strategies and risk controls exist to prevent exposing the strategy to open-ended losses.

## ANALYSIS OF FUND POSITIONING OVER FIVE YEARS



Over the very long-term, we would anticipate the majority of performance to come from the equity content of the strategy. The chart below shows the contribution of each asset class in the Fund to overall performance over the last five years, demonstrating this point.

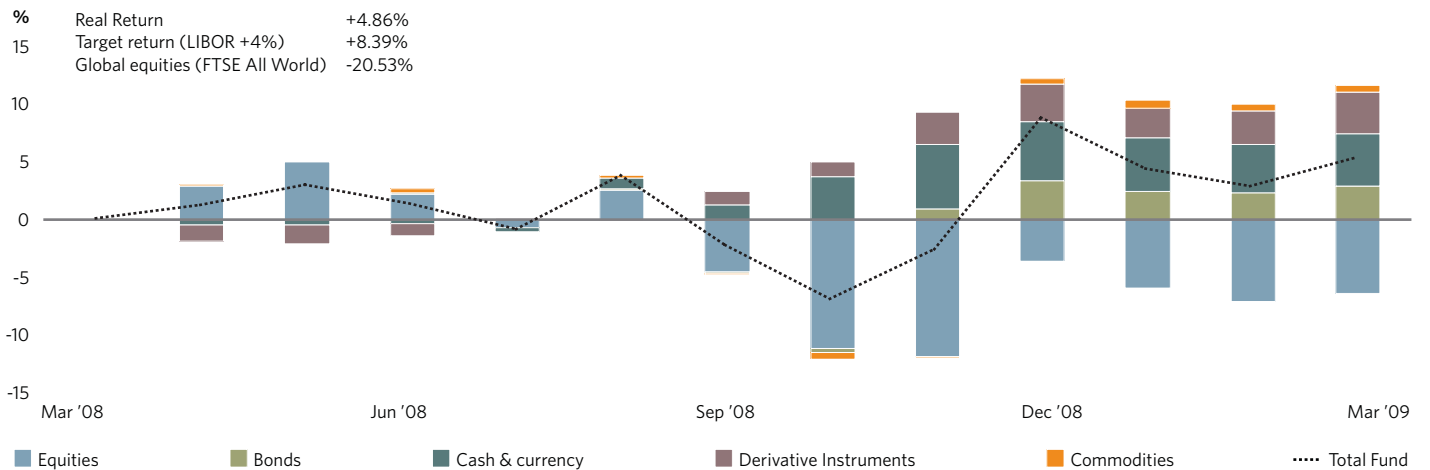
**PERFORMANCE CONTRIBUTION BY ASSET CLASS OVER FIVE YEARS**



Source: Newton, gross of fees, to 31/03/09

Over shorter-term periods we would anticipate greater potential for wider contributions from other asset classes. The chart below illustrates the cumulative contributions to performance over the 12 months to 31 March 2009, a period which saw global equities fall -20.53%. The chart highlights the positive effect of bonds, commodities, cash and derivative positions which helped the Fund return a positive 4.86% despite the weak contribution from equities.

**PERFORMANCE CONTRIBUTION BY ASSET CLASS OVER ONE YEAR**



Source: Newton, gross of fees, to 31/03/09

# Portfolio management team



## **Iain Stewart**

Iain is a member of Newton's global team and is lead manager of the Real Return strategy for sterling-based investors; he has managed the strategy since inception in 2004. Iain specialises in managing multi-asset mandates for pension fund clients. He joined Newton in 1985 and has been the manager of the Newton Exempt Fund (Newton's flagship pooled balanced fund) since 1992. He is a member of our strategy team, with particular responsibility for co-ordinating the development of our global investment themes. He holds a doctorate from the Ministry of Agriculture, Fisheries and Food.



## **James Harries**

James is a member of Newton's global team and is alternate manager of the Real Return Fund for sterling-based investors. He manages both global equity and multi-asset mandates and is lead manager of the dollar and euro versions of the Real Return strategy as well as the Newton Global Higher Income strategy. He joined Newton in 1995 and worked initially as a portfolio manager in the Private Investment Management department. Following a year at Veritas Asset Management, during which he established and managed a global income fund, he rejoined Newton in 2005. James graduated from Bristol University with a BSc in Politics and completed a year of military service before joining Newton. He also holds a Masters Degree in Finance from the London Business School in 2004.



## **Matthew Brown**

Matthew is a member of Newton's global team. He manages both multi-asset and global equity mandates and is alternate manager on segregated Real Return mandates. He joined Newton in 2000 having graduated from the University of Bristol in 1999 with a degree in History.

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