

A Fund Manager's view

In the last issue of The Shareholder we recommended a Fund from the Newton Investment Management stable. Now Ben Russon, Fund Manager of the Newton UK Opportunities Fund, tells us how his long term share picking decisions are based on an award-winning, in-house process.

At Newton, we have two key strengths to our investment management process that we have followed since inception: a global thematic approach to investment and a team of in-house analysts that conduct all our primary research. Our Macro Strategy group develops the global investment themes (Outsourcing, Security, Population Dynamics etc.) that represent the long term trends which are our interpretation of forces that drive change. This gives an overarching structure that guides our analysts into the areas most worthy of investigation. Our analysts then put their core sector recommendations into their 'UK research recommended list' and it's up to the fund management teams to consider those recommendations and to construct the portfolios.

Initially, we build a UK Model portfolio ('the Model') which acts as a blueprint for all the UK funds. The Model brings together the best ideas from the analysts' research, the macro economic viewpoint and our strategic thematic overlay. I then select the Newton UK Opportunities Fund portfolio based on the analysts' conviction for the relevant companies in the Model. The Newton culture ensures that all our investment personnel work in close proximity so the process is driven by both individual thinking and interaction across the team. This investment approach – which can not be replicated by individual investors – has been recognised with over 100 investment awards in the past two years.

The Fund is unconstrained and unbenchmarking so we don't use the All Share Index as a starting point for investment; we only hold shares because our analysts think they will represent value over the long term (18 months – 2 years). All our analysts are career analysts that have built up a sector

“As long as you're happy with your long term position, you can sleep at night with your short term issues: it's all about getting your long term where you want it to be.”

knowledge base over many years and have established trusted company management relationships and business understanding through longevity of contact. This allows them to make an educated judgement on the quality of a company's management and the accuracy of a company's forecasts. There are no capitalisation limits, but because of our Model based process all the companies in the portfolio need to be investable across the range of Newton UK funds. They therefore tend to be focused in the FTSE 350 to get the required level of liquidity.

The Newton UK Opportunities Fund ('the Fund') was devised as a vehicle to provide undiluted exposure to the Newton investment process. As the name implies, the Fund invests predominantly in UK companies, although it does have the capability to invest overseas when appropriate. Overseas investments currently account for 6% of the Fund. Our analysts take a global view and occasionally present an idea that can't be played through a UK name or could be more effectively played through an overseas name. For example,

we hold TNE, which gives us exposure to the under penetrated mobile market in Brazil. This investment ticks lots of boxes: emerging markets, a growing market, a growing share of the market and the prospect of a more efficient consolidated market.

The Fund currently has 37 positions each weighted at approximately 3%. Because of the low number of holdings we need to take committed rather than neutral positions. When we decide to invest in a company, we take an initial holding of around 1½%. As the investment story unfolds, further investment may be triggered. If the share price rises but we have increasing conviction in the end valuation then we are happy to buy more at a higher price because the risk/reward profile has changed. If a share price falls significantly, we don't make a knee jerk reaction, we follow our investment process and often meet with the company's management to reach a considered opinion of what's changed, why it's changed and what impact that has on the share price. If the investment case hasn't changed, that can be a prompt to increase the size of our holding.

We take an absolute, stand-alone approach to long term company valuation, regardless of what's happening in the wider market. This valuation may then vary as the investment case develops. We sell to zero when the share price approaches our valuation or if there is downside risk. We then take a fresh look at the current ideas in the Model; if no convincing opportunity presents itself we hold the position in cash.

If there is still value in a share we keep running it. Care UK has been in the Fund for over 2 years. It runs residential care homes on behalf of the NHS and fits two



Ben Russon
Fund Manager,
Newton UK Opportunities Fund

Ben joined Newton in 1999, having read Economics and Geography at the University of Edinburgh. Based in Newton's Leeds office, Ben assisted in the management of UK equity portfolios on behalf of institutional and retail clients. This function was complemented with research responsibility for the Global Food Retail Sector.

Ben is now lead manager on the Newton UK Opportunities Fund, along with two segregated mandates. He is also lead manager on the Newton Osprey Fund.

At a glance

- The Newton Process:
Global thematic approach to investment.
- Primary research conducted by core analysts.
- We only take committed positions.
- We only hold shares that represent long term (18 months-2 yrs) value.
- We sell to zero when the share price approaches our valuation.

Investment decisions should be intellectual, long term decisions arrived at by research and process.

of our core themes: outsourcing and population dynamics. It's a win/win situation as Care UK runs the homes more efficiently than the NHS and gets to build their business through the opportunities that provides.

Sometimes an event occurs in a company that triggers an investment decision. Atkins is a UK engineering outsourcing company associated with everything from landmark football stadia to oil refinery harbours and fits with our themes of outsourcing and infrastructure. We liked the company, its infrastructure business and its growth, but it held a 20% stake in Metronet which made us reluctant to get involved. Once Metronet was put into administration, it became a viable investment for us.

The UK has just enjoyed one of the longest periods of uninterrupted economic expansion, but is now experiencing a financial liquidity crunch. We've had a cautious macro outlook for some time based on the indebtedness of the UK consumer and the prospects for the housing market. We therefore have very few banks, no general retailers and favour non-cyclical, more defensive opportunities e.g. support services, tobacco and pharmaceuticals.

In such volatile markets, investors need to be vigilant and to be confident in a company's forecasts and their underlying assumptions. The worst thing you can do if your investment performance drops is to panic, make short term moves and change the way you do things. Ignore market noise: investment decisions should be intellectual, long term decisions arrived at by research and process.

We believe in the Newton process, the thematic approach and the team based culture that adds value over the long term. Our Fund performance is in the top quartile of the IMA UK All Companies

sector and compares favourably against the FTSE All Share Index. We aim for consistent performance and constantly reassess our portfolio and our conviction in longer term positions. We don't chase short term opportunities; we find the core high quality shares which we think represent good value over the long term and let the investment case play out through time.

Newton UK Opportunities Fund	
30/06/06 - 29/06/07	21.8%
30/06/05 - 30/06/06	15.9%
30/06/04 - 30/06/05	18.2%
30/06/03 - 30/06/04	24.7%
28/06/02 - 30/06/03	0.7%

Performance details are based on total return, including annual charges but exclude initial charges, income reinvested net of tax.

This interview took place on 18 September 2007. Newton Investment Management is a subsidiary of Bank of New York Mellon.