NEWTON
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a new world order

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The days when the UK 'ruled the waves' for equity income are long gone - now there is a whole world of high yielding investment opportunities from which to choose, says James Harries, manager of the Newton Global Higher Income Fund.

The UK's reputation as a leading source of dividend yield once attracted the interest of investors from around the world. However, recent times have seen the developing markets of Asia and Latin America, not to mention the mature markets of continental Europe surging ahead in their attempts to attract a wider investment audience through the delivery of true shareholder value.

It was Newton's cognisance of this emerging trend that was one of the key drivers behind its launch of the Newton Global Higher Income Fund in December 2005. The other was the recognition that, as a result of the UK's former hegemony in dividend payments, the average UK equity income investor was heavily over reliant on their domestic market as until then, opportunities to diversify more widely had been few and far between.

Newton was quick to recognise that a number of factors had converged helping to create a new paradigm in global equity markets. One was the TMT boom of the mid to late 1990s. At the time, valuation multiples such as P/E ratios for lower yielding stocks rocketed from around 20x to close to 60x before starting an even faster decline. Investors across the world learned an important lesson as a result - as did listed companies - and this event, probably more than anything else, helped launch the period of sustained shareholder value that we have seen since the turn of the millennium. Importantly the same period has coincided with the huge progress made by the BRIC economies (Brazil, Russia, India and China) to become more integrated into the global economy. While the growth enjoyed by these and similar economies may be long overdue, the result has been nothing less than a sea change within their domestic equity markets with local companies now moving rapidly toward a more 'Anglo Saxon' model by committing themselves to the financial rigours that the payment of high and rising levels of dividend demand.

The impact of these developments is illustrated in chart 1, which shows the steadily rising trend in the number of companies yielding more than 3% over the last decade. Crucially it also shows that over 90% of the stocks in the FTSE World Index that yield more than 3% now lie outside of the United Kingdom.

Back in 2005, Newton was the first recognised equity income specialist to launch such a fund. Since then, by targeting companies across the globe that can demonstrate a high and rising level of dividend and strong levels of free cashflow, the fund has delivered an enviable net yield of 3.6% (estimated) while returning more than twice the FTSE World Index over the period and leaving the average fund in the IMA Global Growth sector trailing far in its wake (see chart 2).

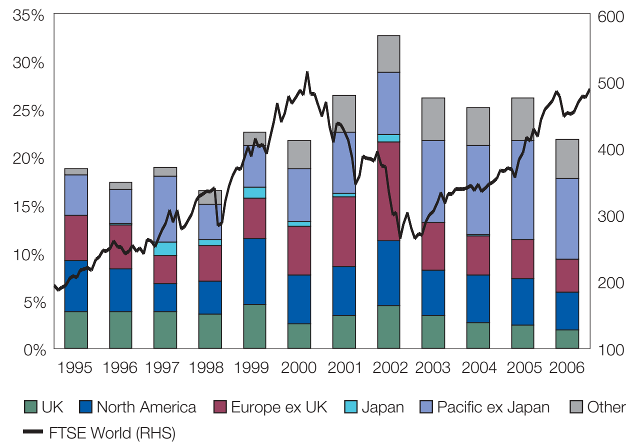
dividend and conquer

The extent of the Newton Global Higher Income Fund's outperformance within its sector helps to underline the continuing strength of equity income investment strategies when compared to more growth-oriented approaches.

Like all of Newton's equity funds, the Global Higher Income Fund draws upon

chart 1

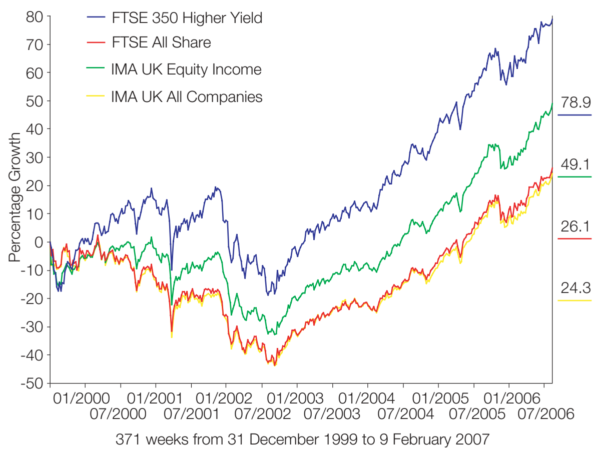
Percentage of FTSE World Index yielding greater than 3%



Source: FACTSET, Datastream January 2007. Past performance is not a guide to future performance.

chart 2

Percentage growth total teturn, tax UK net, charges applied, in GBP



Source: Lipper. Percentage growth total return, net of UK taxes and annual charges. Initial charges not included. Past performance if not a guide to future performance.

Newton's thematic research process, but, as in other Newton equity income funds, all prospective holdings are subject to a strict yield criteria. For inclusion in the portfolio any stock under consideration must have a prospective yield 50% greater than the FTSE World Index while any holding whose yield falls below a 25% premium to the index is immediately sold. While this approach enables the fund to participate fully in continued global growth, its emphasis on dividend income provides an uncommon level of downside protection during periods of market volatility. The result is a genuinely innovative fund that has pioneered the concept of income investment in the context of a global portfolio.

Importantly, it is the fund's strict yield criteria, which drives stock selection and so dictates its geographic allocation. As a result, the fund is significantly overweight in Asia, Latin America and Europe where levels of dividend yield continue to improve. By contrast, the US and Japanese markets, where levels of yield remain more muted, are both significant underweights relative to the benchmark.

The fund's truly global sector approach leads to companies that are thematically attractive, have sound fundamentals and which offer a substantial yield. Because of this the portfolio contains a concentration of stocks with high free cashflow yields, higher returns on equity, higher levels of potential earnings growth and lower P/Es than those of the broader market. As a result, the fund's current sector emphasis includes a mix of high yielding sectors and those that offer strong growth potential such as financials, resources, industrial transport, tobacco or mobile telecoms. Currently these include positions in oil and gas producers such as Petrobras of Brazil or Statoil of Norway and the mobile telecom stock Digi.com of Malaysia. Elsewhere, the banking sector is represented by material positions in stocks such as DBS Group of Singapore or KBC, the thriving Belgian concern.

Of course, should any of these stocks see their yield levels fall as a result of strong price performance, the fund's yield discipline will result in it booking all of the profits - even while competing funds may be restrained by index considerations - and recycling the proceeds into more attractive positions. With signs that global growth could face significant headwinds from here as interest rates continue to rise; such yield discipline might be just as well. In this sort of environment, dividend income will keep client portfolios aloft far longer than occasional gusts of investor sentiment.

Past performance is not a guide to future performance. The Newton Global Higher Income Fund is available through Skandia's Life, Pension, MultiSA, MultiFUND and MultiPEP fund ranges. The Skandia fund will not mirror the performance of the underlying fund because of Skandia Life fund charges, taxation adjustments (if appropriate) and the Skandia Life investment process.