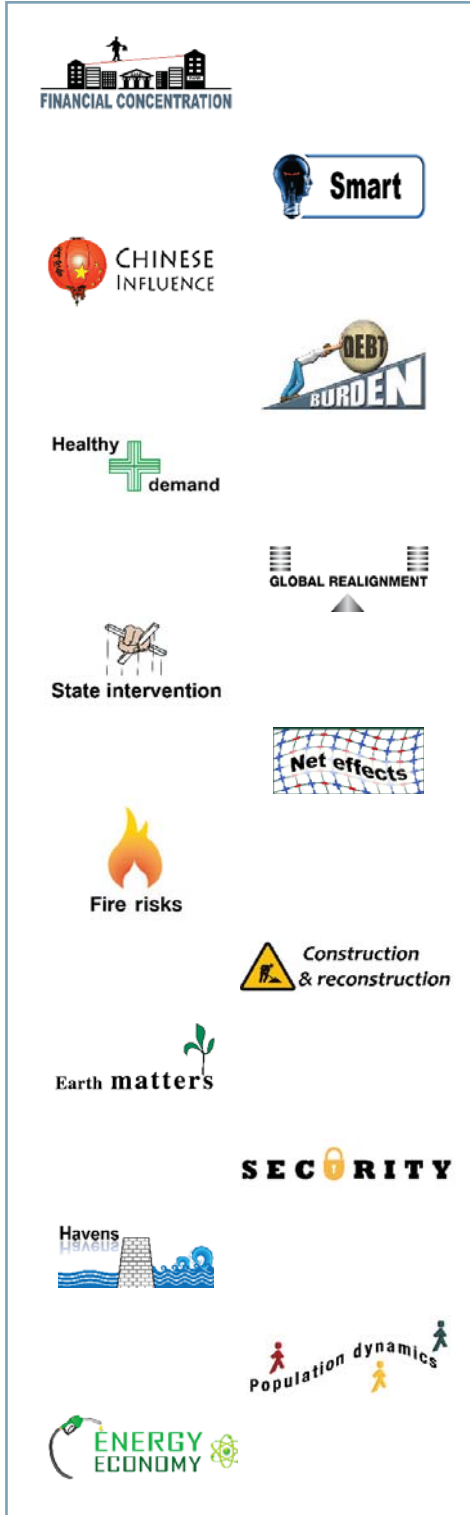




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## Thematic investing - an update



At Newton, we continue to expect investment returns to be much lower over the coming years than they were during the period of the 'great moderation', and we think investors face a rocky ride in seeking to meet their objectives amid heightened volatility in asset prices. Against this backdrop, it is essential to maintain perspective on financial-market opportunities and risks.

To achieve that perspective, we use a dynamic framework of global investment themes. In this article, we provide an update on our current themes and explain how they have evolved.

Our global themes evolve to capture the long-term developments that are driving change in the world around us. They help us to identify and interpret the trends that are likely to shape investment opportunities and risks in the years ahead, and to determine the necessary characteristics for investment candidates to benefit from these trends. They promote an active and flexible approach across all of our strategies.

As investors, we could spend a great deal of time contemplating the many economic, financial, geopolitical and social variables that are likely to shape investment prospects, and we could try to 'predict' the future. However, the outlook is so complex that it is impossible to foresee exactly how these variables will interact.

Instead, we seek to prepare for a range of outcomes, and to ensure that we focus upon investments and assets which have the potential to withstand, over the long term, a variety of economic and financial-market conditions. It is in this respect that themes are so important to us at Newton. They encourage us to focus on long-term ideas, give us perspective, and help us to block out the 'noise' and look beyond the short-term distortions that exist in markets today.

### Theme hubs

We have organised our themes into four main 'hubs', which capture the main areas of change in the world:

- (i) debt, crisis and policy
- (ii) innovation
- (iii) energy, environment and infrastructure
- (iv) geopolitics and demographics

Within the first hub, we continue to explore a number of key themes, including *debt burden*, *fire risks* and *state intervention*.



*Debt burden*, in particular, which replaced *deleverage*, is an important theme for us as we seek to anticipate the implications of debt in developed economies.

With the credit bubble having left many economies carrying levels of debt which materially impair their prospects, and authorities broadly reluctant/unable to accept the consequences of debt reduction, we anticipate an extended period of relatively low growth and heightened economic volatility. The scale of accumulated public and private debt means that the timing and means by which deleveraging occurs (via repayment, default, restructuring or forgiveness), and the effect of offsetting policies, will be critical for all aspects of the investment outlook



Fire risks

Our *fire risks* theme reflects our concerns about the potential for inflation in the global economy and financial markets, as monetary policy measures which were intended as temporary means to tackle post-credit-crisis conditions have become entrenched. *State intervention* examines the ever-greater involvement of policymakers in economies.



State intervention

Elsewhere, we continue to identify other attractive areas for investment, among them innovative health care and information technology companies which are creating new sources of growth. In the energy sector, the challenges created by high oil prices and the depletion of traditional energy sources bring about required improvements in productivity, technology, infrastructure and conservation. These features are captured by our *energy economy* theme, and should continue to create a variety of opportunities across many sectors. Meanwhile, our *Earth matters* theme guides our thinking in the agriculture, energy and utilities sectors.



Earth matters

Each of the four hubs above brings together some of our global analysts, credit analysts and investment managers to identify the opportunities and threats which relevant themes suggest. The output of the theme hubs provides our investment team with the context to look for 'winning' stocks.

### A new theme - *havens*

We believe economic output, inflation, commodity prices and financial markets are all likely to be more volatile as the ability of authorities to manipulate economic activity wanes. A challenging backdrop is likely to lead to divergence between the fortunes of the 'strong' and the 'weak'. This should favour active investment over passive, as the slower growth environment undermines some business models and places greater emphasis on the attractions of specific security characteristics. The theme identifies clear opportunities, not simply among 'defensive' companies, but among those with attractive growth prospects too, both as a result of innovation and via reduced competition as weak businesses struggle. In volatile and distorted capital markets, investors may pay a premium for stability. However, financial-market participants must beware of 'value traps', of overpaying for haven characteristics, and of assuming that an area which has provided refuge will necessarily continue to do so.



Havens

### The evolution of an existing theme - *net effects*

In the course of the last decade, the expectation of a *networked world* (our previous theme in this area) has become a reality following the exponential growth in connected entities. The enormous improvements in technological capability enable the creation, capture and analysis of unprecedented amounts of data. This is transforming lifestyles and traditional business. Innovative companies are using this connectivity and data to adapt their business practices, create sustainable competitive advantages, and challenge less agile incumbents across diverse sectors. As such, not only does this generate new opportunities, but the pace and extent of change that is occurring may create significant risks for established companies across many sectors.



Net effects

### A retired theme – large cap laggards

Amid the sporadic mispricing of risk in financial markets, our *large cap laggards* theme had previously identified attractive investment prospects among larger companies whose balance sheets were generally robust and whose end demand was relatively stable. Given that many former laggards have performed strongly (thereby eroding the valuation opportunity they had presented), and that those which have lagged include financial and cyclical stocks which we see as less attractive, we have discontinued the theme.

### Conclusion

With significant changes taking place in the world, heightened volatility in financial markets is likely to be accompanied by considerable market ‘noise’. Such noise can compound the risks which investors face in seeking to meet their investment objectives. However, at Newton, we believe that change, if properly understood, can lead to significant opportunity.

In seeking to balance risks and opportunities, maintaining perspective is crucial. We continue to believe that our evolving thematic framework provides that perspective and allows us to make sense of a volatile and complex world.

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