Generating alpha from thematic investing

Peter Hensman, CFA

Prepared for professional investors only
Introduction

- The Bank of New York Mellon Corporation

- BNY Mellon Asset Management

- BNY Mellon Asset Management – specialist asset managers
The Bank of New York Mellon Corporation

**Strong market positions in high-growth businesses**
- The leading global provider of securities servicing with more than US$23.1 trillion in assets under custody and administration
- A leading global asset manager with more than US$1.1 trillion in assets under management
- The leading provider of corporate trust, depositary receipt and shareowner services
- The leading provider of clearing services
- A leading provider of wealth management with 80 offices in the US, UK and Asia
- A leader in US cash management and global payments
- Leading client service scores in all major businesses

**Extensive global expertise**
- Locations across 6 continents, in 34 countries

BNY Mellon Asset Management

A multi-boutique asset management model encompassing investment skills of world class specialist asset managers

- Institutional grade asset management, innovation and market leading intelligence
- Each asset manager has its own proprietary investment processes
  - No ‘house view’ is imposed: there is no overall Chief Investment Officer
  - Each asset manager retains complete investment autonomy
- An entrepreneurial, focused approach is encouraged
  - Each asset manager focuses solely on investment management
- A great breadth and depth of expertise in every major asset class and sector
  - Nearly 300 institutional asset management product offerings

Leading market positions globally

- A top 15 global asset manager
- A top 10 US asset manager
- 7th largest asset manager active in European marketplace

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1 Pensions & Investments, Sep 2007 (based on AUM as at 31 Dec 2006)
2 Institutional Investor, Jul 2007 (based on AUM as at 31 Dec 2006)
3 Investments & Pensions Europe, Jun 2007 (based on AUM as at 31 Dec 2006)
BNY Mellon Asset Management – specialist asset managers

Depth and breadth in every sector and asset class

<table>
<thead>
<tr>
<th>Company</th>
<th>Description</th>
<th>AUM (US$bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alcentra</td>
<td>Focused on sub-investment grade debt capital markets in Europe and US</td>
<td>18.0</td>
</tr>
<tr>
<td>BNY Mellon ARX</td>
<td>Specialists in Brazilian equities, hedge fund and fixed income strategies</td>
<td>5.1</td>
</tr>
<tr>
<td>Boston Company</td>
<td>Active fundamental equity manager, core, growth and value styles</td>
<td>45.6</td>
</tr>
<tr>
<td>Dreyfus</td>
<td>One of the world’s foremost money market specialists</td>
<td>234.4</td>
</tr>
<tr>
<td>EACM Advisors</td>
<td>Fund of funds manager specialising in alternative funds and traditional long-only products</td>
<td>5.9</td>
</tr>
<tr>
<td>Franklin Portfolio</td>
<td>Benchmark-driven structured US portfolio specialist; quantitative approach</td>
<td>24.4</td>
</tr>
<tr>
<td>Hamon Investment Group</td>
<td>Asian specific growth specialist manager</td>
<td>2.1</td>
</tr>
<tr>
<td>IVY Asset Management Core</td>
<td>Global manager specialising in fund of hedge funds</td>
<td>13.3</td>
</tr>
<tr>
<td>Mellon Capital Management</td>
<td>Fundamentally-based global quantitative strategies</td>
<td>212.6</td>
</tr>
<tr>
<td>MGA</td>
<td>Fund of hedge funds manager specialising in event driven and relative value strategies</td>
<td>1.7</td>
</tr>
<tr>
<td>Newton</td>
<td>The Power of Ideas Active stock and bond selection within a global framework</td>
<td>75.8</td>
</tr>
<tr>
<td>Pareto</td>
<td>Specialists in currency and risk management</td>
<td>51.9</td>
</tr>
<tr>
<td>Standish</td>
<td>Specialist fixed income and absolute return manager</td>
<td>157.3</td>
</tr>
<tr>
<td>Urdang</td>
<td>Investors in, and managers of public, private, global and US real estate investment</td>
<td>3.5</td>
</tr>
<tr>
<td>WestLB Mellon Asset Management</td>
<td>Active manager with structured investment processes, focused on European and Emerging Markets</td>
<td>51.4</td>
</tr>
</tbody>
</table>

Total AUM US$1.1 trillion


BNY Mellon Asset Management International Limited distributes the capabilities of its specialist asset managers

See disclosure statement in important information
Generating alpha from thematic investing

- Forecasting is difficult

- Thematic investing

- Some current themes

- Results
“Prediction is very difficult especially if it's about the future” – Nils Bohr

“Who the hell wants to hear actors talk?”

H. M. Warner, Warner Brothers, 1927

“I think there is a world market for maybe five computers.”

Thomas Watson, chairman of IBM, 1943

“Stocks have reached what looks like a permanently high plateau.”

Irving Fisher, Professor of Economics, Yale University, 1929

“As long as the music is playing, you’ve got to get up and dance….We’re still dancing.”

Chuck Prince, former CEO of Citigroup on role as provider of financing for leveraged buyouts, July ’07
Equities work...

Annualised decade excess returns versus cash

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Decade to end 2007 % pa</th>
<th>1990s % pa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equities</td>
<td>3.3%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Bonds</td>
<td>-0.9%</td>
<td>-9.4%</td>
</tr>
<tr>
<td>Commodities</td>
<td>0.4%</td>
<td>-6%</td>
</tr>
<tr>
<td>Property</td>
<td>5.5%</td>
<td>-3.7%</td>
</tr>
</tbody>
</table>

Source: Datastream, Newton as at Mar 2008
...especially if active sector selection is adopted

Technology versus mining sector performance comparison

Source: Datastream, Newton as at Mar 2008
Idea generation
Themes efficiently focus Newton's research

- Themes are Newton's interpretation of key forces that drive change
- Themes provide a stimulus for debate at the widest level
- Themes continually evolve prompting a stream of new ideas

Themes make us better stock pickers
Newton's investment team structure

... The key is to create a structure that encourages idea generation, communication and implementation...

**Newton's structure encourages creative thinking fluid communication and effective implementation**

**Newton**

The Power of Ideas

**Traditional structure**

- Hierarchical
- Isolated specialist groups
- Regionally focused
- Asset allocation

**Newton's structure**

- Flat structure
- Single multidisciplinary team
- Co-located, global perspective
- Trend / theme / macro framework
Strong investment team positioned for core area growth

Notes
Chart illustrates primary responsibilities. Regional fund management teams combine portfolio management with regional research responsibilities

1 Combined Global Research/Portfolio Management roles; 2 Corporate Governance; 3 Socially Responsible Investment considerations; 4 Special situations research
* Private Investment Management
Thematic stock selection

Ideal stocks exhibit

- Thematic view
- Strong fundamentals
- Appropriate value

Ideal candidates
Thematic stock selection – an example…

Standard Chartered Bank versus Royal Bank of Scotland

Source: Datastream, Newton as at Apr 2008
Investment process
Overview

- Themes provide long term orientation
  - ‘Big picture’ to avoid short term focus
- Career research analysts split by global sector
- Research Recommended Lists act as stock menus
- Single location essential
  - Enables rapid idea generation and implementation
- Communication culture
- Directly invested, seamlessly constructed portfolios
- Commonality is naturally occurring
  - Model portfolios
  - Client portfolios exceed 95% commonality
- Quantitative assessment by Portfolio Analytics Team

London based, performance oriented
All change!

Overleveraged economies

Northern Rock Nationalised
“We had to intervene here, because if we let this bank fail there was every chance... The problems would have spread into the wider British banking system.” he [Chancellor Alistair Darling] said

Reuters, 17 Feb 2008

Federal Reserve staff move into offices of investment banks to monitor activities
The Fed argues that if it is to act as lender of last resort to the securities firms, it should keep a closer eye on their activities

The Times, 4 Apr 2008

Source: Datastream, Newton as at May 2008
All change!

Volatility returns

Source: Datastream, Newton as at May 2008
Emerging and developed countries compared

- Population
- Land mass
- Foreign Exchange reserves
- Energy consumption
- GDP at PPP
- Exports
- GDP at Market rates
- Market cap

- Underpinnings for developing world expansion
- Income
- Population
- High savings
- Economic structure
- Reforms
- Currency appreciation
- Shift to domestic demand
- 'Westernisation' of tastes
- Urbanisation

Source: IMF, Bloomberg, Datastream, Newton as at Dec 2007
Near-term threats?

Valuation – Dividend yield comparison

Inflation a near-term risk?

...but theme unlikely to have played out until widespread current account deficits?

Source: Datastream as at May 2008
Number of internet sites

Source: isc.org, The Microfinance Gateway as at May 2008

Text banking notice from the Philippines

YouTube consumes as much bandwidth as the entire Internet in the year 2000.  
Barrons, January 2007
Portfolio construction
Representative Global Equity Fund vs. MSCI World (as at 31 March 2008)

**Key sector positions compared to the MSCI World (%)**

<table>
<thead>
<tr>
<th>MSCI Sector</th>
<th>Portfolio</th>
<th>MSCI World</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecommunication Services</td>
<td>14.4</td>
<td>4.6</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>14.7</td>
<td>9.0</td>
</tr>
<tr>
<td>Materials</td>
<td>12.3</td>
<td>7.8</td>
</tr>
<tr>
<td>Cash</td>
<td>3.8</td>
<td>0.0</td>
</tr>
<tr>
<td>Energy</td>
<td>10.9</td>
<td>11.1</td>
</tr>
<tr>
<td>Health Care</td>
<td>7.7</td>
<td>8.8</td>
</tr>
<tr>
<td>Utilities</td>
<td>3.4</td>
<td>4.7</td>
</tr>
<tr>
<td>Financials</td>
<td>18.2</td>
<td>22.1</td>
</tr>
<tr>
<td>Industrials</td>
<td>7.4</td>
<td>11.8</td>
</tr>
<tr>
<td>Information Technology</td>
<td>4.3</td>
<td>10.4</td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>2.9</td>
<td>9.7</td>
</tr>
</tbody>
</table>

**Relative position to benchmark (%)**

- **underweight**
  - Telecommunication Services: 5.7
  - Consumer Staples: 4.5
  - Materials: 3.8
  - Energy: -0.2
  - Health Care: -1.1
  - Utilities: -1.3
  - Financials: -3.9
  - Industrials: -4.4
  - Information Technology: -6.1
  - Consumer Discretionary: -6.8

- **overweight**
  - Telecom Services: 9.8
  - Consumer Staples: 5.7
  - Materials: 4.5
  - Energy: 3.8

*Stock selection driving allocations*

*Portfolio holdings are subject to change at any time without notice and should not be construed as investment recommendations*

*Source: Newton as at 31 Mar 2008*
Strong and consistent investment performance

Relative outperformance against the benchmark

Source: Datastream, Newton as at Mar 2008. Total Return, gross of fees in GBP
Please see appendix for GIPS compliant composite disclosure
Summary

- The future is difficult to forecast

- Long term themes and trends can help frame investment backdrop

- Considered, well researched active sector, stock selection can add to returns

- Current themes
  - All change!
  - Global rebalancing
  - Networked world
Newton Global Equity Institutional Composite contains fully discretionary equity portfolios that invest in global equities including emerging markets, which may include stocks that do not form part of the benchmark and for comparison purposes is measured against the FTSE World and MSCI World indices. Returns include the effect of foreign currency exchange rates.

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The Pound Sterling is the currency used to express performance. Further information regarding the exchange rates used is available upon request. Returns are presented gross of management fees and include the reinvestment of all income. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. The fee schedule appropriate for this presentation starts at 0.25% per annum subject to a minimum of £100,000, however, individual fees are negotiated on an account by account basis. The annual composite dispersion presented is an equal-weighted standard deviation calculated for the accounts in the composite the entire year.

Carve-outs are included in this composite and performance reflects required total segment plus cash returns using a pro-rated cash allocation. Carve-outs from composite 720001 comprise 2.8% of this composite at the end of 2006.

The Newton Global Equity Institutional Composite was created 3Q00.

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<table>
<thead>
<tr>
<th>Year End</th>
<th>Total Firm Assets (millions)</th>
<th>Composite Assets</th>
<th>Annual Performance Results</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sterling (millions)</td>
<td>% of Firm Assets</td>
<td>Number of Accounts</td>
</tr>
<tr>
<td>2006</td>
<td>35,610</td>
<td>2,891</td>
<td>8%</td>
</tr>
<tr>
<td>2005</td>
<td>28,758</td>
<td>1,573</td>
<td>5%</td>
</tr>
<tr>
<td>2004</td>
<td>21,739</td>
<td>1,008</td>
<td>5%</td>
</tr>
<tr>
<td>2003</td>
<td>21,129</td>
<td>73</td>
<td>Less than 1%</td>
</tr>
<tr>
<td>2002</td>
<td>18,659</td>
<td>52</td>
<td>Less than 1%</td>
</tr>
<tr>
<td>2001</td>
<td>21,295</td>
<td>56</td>
<td>Less than 1%</td>
</tr>
<tr>
<td>2000</td>
<td>22,159</td>
<td>61</td>
<td>Less than 1%</td>
</tr>
<tr>
<td>1999</td>
<td>18,404</td>
<td>64</td>
<td>Less than 1%</td>
</tr>
<tr>
<td>1998</td>
<td>13,220</td>
<td>46</td>
<td>Less than 1%</td>
</tr>
<tr>
<td>1997</td>
<td>10,732</td>
<td>58</td>
<td>Less than 1%</td>
</tr>
<tr>
<td>1996</td>
<td>10,305</td>
<td>38</td>
<td>Less than 1%</td>
</tr>
</tbody>
</table>

N.A. – Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

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