



October 2011

BNY MELLON INVESTMENT FUNDS - NEWTON HIGHER INCOME FUND

Sub-fund of UK-authorized Oeic; Ucits III

Fund owner: BNY Mellon Fund Managers

Fund manager/adviser: Newton Investment Management Ltd

Named portfolio manager/adviser(s):

Tineke Frikkee (since April 2004)

Peer group: UK Equity Income

Location: London

Launch date: May 1987

Fund size (September 2011): £2.56bn

Contact group: +44 500 66000 or

www.bnymellonam.com

Further information on S&P's fund coverage can be found at www.FundsInsights.com

Investment style

	Value	Blend	Growth
Large-cap			
Mid-cap			
Small-cap			

Performance statistics

	Three years
Fund	21.3%
Standard & Poor's peer median	23.4%
Index**	22.8%
Fund rank	155/248

** FTSE All-Share GBP! (The Industry Classification Benchmark is a joint product of FTSE International Limited and Dow Jones & Company, Inc. and has been licensed for use.)

Note: returns are cumulative

Risk characteristics

	Three years
Maximum monthly drawdown (%)	-8.6
Volatility	15.2
Correlation	0.9
Beta	0.8

Income record

Year	Pence/unit	% Change
2006	2.74	-
2007	3.25	18.61
2008	3.37	3.69
2009	4.66	38.28
2010	3.88	-16.74
2011 YTD	3.04	-

Calendar-year decile ranks



Decile ranking in discrete annual periods. First decile shown as rank 10, second decile as rank nine with tenth decile as rank one.

Performance Data Source - © 2011 Lipper inc. All rights reserved. All statistical data on this report has been run to 1 August 2011 on NAV to NAV basis, with gross income reinvested, in GBP.

Please see page three for required research analyst certification disclosure.

Standard & Poor's opinion (September 2011)

This fund has a history of providing a high yield and a growing distribution, but market conditions and the already high income payment have made this growth requirement increasingly difficult to achieve. As a result, Newton has decided to reduce the income payment by 20-25% over the next year, before targeting sustainable future growth.

This change will allow the manager much more flexibility to make investment decisions based on maximising total return rather than focusing on achieving income growth. The yield requirement at the stock level (minimum 115% of the FTSE All-Share yield) remains in place and defines the stock universe, and, as a result, wholesale changes to portfolio holdings are not expected. What is likely, however, is a re-weighting of stock positions towards those with greater growth prospects as well as greater freedom for the manager to buy and sell holdings irrespective of ex dividend dates.

The manager continues to conduct significant work on prospective dividend yields and forecasting portfolio income, and makes good use of the analyst team in discussing stock recommendations and the prospects for higher-yielding names that would not be of interest to the wider group.

Performance from the product has been weak over recent years as higher-yielding names have been out of favour, the generally defensive stance of the group has been unhelpful and the manager has been forced to focus on income growth. With the latter issue removed, there is scope for improved future performance and as a result the fund retains its S&P A rating.

Fund manager & team

Newton's UK equity team comprises seven fund managers split between London (Tineke Frikkee, Richard Wilmot, Paul Stephany and a junior manager) and Leeds (Simon Nichols, Ben Russon and Robert Shelton).

The team draws heavily on the research of the 17 global sector analysts, who have UK equity research responsibilities. It can also use input from strategists, credit analysts and SRI specialists.

Frikkee and Nichols specialise in the income mandates and control assets of around £2.8bn.

Tineke Frikkee - health sciences (Heerlen University, Netherlands), MBA (City University, London), joined insurer UNUM in 1995 as a risk management analyst, before moving to Newton in 1998.

Simon Nichols - chartered accountant, CFA, joined Newton Investment Management's UK team in 2001. He worked at Wilton Investments from 2000 as a financial accountant. Before that he worked for five years at leading accountancy firms.

Management style

The fund aims to rank in the top quartile of the UK equity income sector on a rolling three-year basis while growing the income distribution (paid quarterly).

The portfolio is constructed bottom up with a focus on dividend yield. It invests only in stocks with a prospective yield of 115% of that of the FTSE All-Share index at purchase. Investments yielding less than the market are sold.

Frikkee draws on the UK model portfolio where possible, using the house themes to focus idea generation. However, due to the high yield focus, commonality with the model is only about 50%.

Other important criteria include cash dividend cover, the management's commitment to the dividend and the potential for its future growth. Stocks are often bought against consensus and held for the long term.

The portfolio may differ substantially from the benchmark at both stock and sector level. Stock positions may not exceed 10%, but major index constituents are not held if they do not meet the yield requirement. Sector positioning is also influenced by macroeconomic views.

Bonds are not held and covered calls may be written to generate income. The fund is run fully invested, across 55 to 75 holdings.

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Portfolio & performance analysis (August 2011)

While this fund has a history of providing a high yield and a growing distribution year-on-year, this has become increasingly difficult in the current environment and the decision has been taken to cut the distribution by 20-25% over the coming year. This re-basing of the income payment will allow the manager far more flexibility in her investment decisions.

It is anticipated that changes will be gradual as Frikkee opportunistically decreases her weighting in high yielders to allow more exposure to lower yielding names offering more attractive growth prospects.

Importantly, the investment process in terms of individual stock yield requirements is not changing and the overall yield from the fund will remain high relative to peers. Currently the yield stands at close to 8%, but this is now likely to fall closer to 6%, assuming the fund's unit price is at the same level on 30 June 2012 as it was on 30 September 2011.

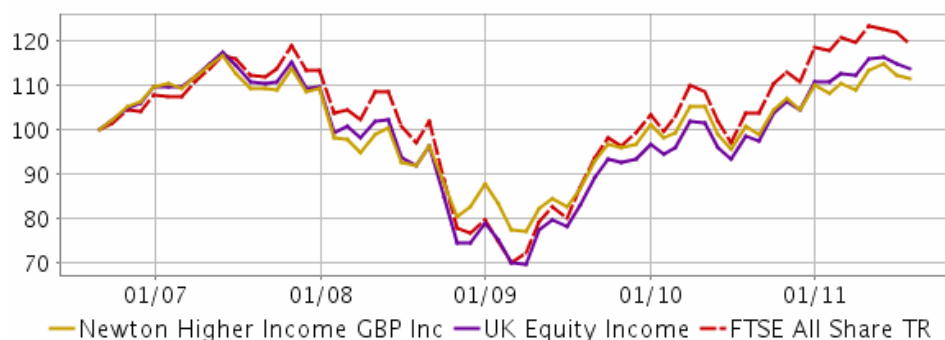
Covered calls continue to be used to enhance income, with 5% of the portfolio currently having calls written on it.

Fund positioning reflects the yield requirements and the reasonably cautious current views of the manager and house. Utilities, healthcare and consumer services are the main overweights at the expense of oil & gas and materials.

Following relative weakness over recent years, the fund now stands below the peer-group median over three and five years.

Over the 12 months to September 2010, underperformance was seen against benchmark and the peer group. Attribution shows stock selection in oil & gas and consumer services, plus the (forced) underweight to materials as the main detractors. After some further weakness relative to peers and the benchmark at the end of 2010 and into 2011, the fund showed some better relative returns in Q2. Relative to the index, success was seen from the holdings in Glaxo, BAT, and Berendsen, while positive contributions also came from various stocks that were excluded from the fund on yield grounds.

Cumulative performance



Calendar year performance

	2007		2008		2009		2010		YTD August 2011	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
Fund	-0.2	99/211	-19.9	36/239	15.2	221/254	9.1	273/284	1.2	192/299
Index**	5.3		-29.9		30.1		14.5		0.7	
Median	-0.8		-28.0		22.8		14.3		2.3	

** FTSE All-Share GBP! (The Industry Classification Benchmark is a joint product of FTSE International Limited and Dow Jones & Company, Inc. and has been licensed for use.)

Fund benchmark: FTSE All-Share index

Share class screened: GB0006779218 (Ord)

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FUND MANAGEMENT RATING

Portfolio characteristics (September 2011)

No. of holdings	81
% in top 10	53
Turnover ratio (%)	42
Estimated gross yield (%)	7.10

Top 10 holdings

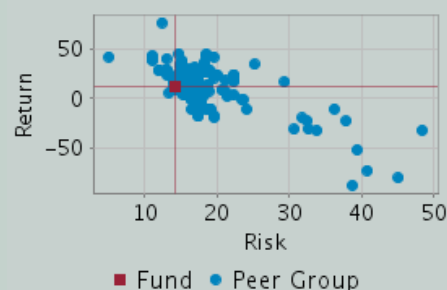
GlaxoSmithKline *	9.3
Royal Dutch Shell *	6.4
HSBC Holdings *	6.2
BP *	5.5
British American Tobacco *	4.2
AstraZeneca *	3.8
Tesco *	3.5
Vodafone Group *	3.3
Scottish & Southern Energy *	3.0
Imperial Tobacco Group *	2.9

* In top 10 holdings a year ago

Sector allocation

Basic materials	0.0
Consumer goods	11.8
Consumer services	15.8
Financials	19.5
Healthcare	13.1
Industrials	10.1
Oil & gas	11.8
Technology	0.9
Telecommunication	5.2
Utilities	10.6
Cash	1.2

Risk return (standard deviation) over five years



STANDARD & POOR'S

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Symbols and Definitions

Long-only fund ratings

- AAA The fund demonstrates the highest standards of quality in its sector based on its investment process and management's consistency of performance as compared to funds with similar objectives.
- AA The fund demonstrates very high standards of quality in its sector based on its investment process and management's consistency of performance as compared to funds with similar objectives.
- A The fund demonstrates high standards of quality in its sector based on its investment process and management's consistency of performance as compared to funds with similar objectives.

Fund-of-hedge-funds ratings

Absolute return fund ratings

Specialist fund ratings

- AAA The fund demonstrates the highest standards of quality based on its investment process, risk awareness and consistency of performance relative to its own objectives.
- AA The fund demonstrates very high standards of quality based on its investment process, risk awareness and consistency of performance relative to its own objectives.
- A The fund demonstrates high standards of quality based on its investment process, risk awareness and consistency of performance relative to its own objectives.

Ucits III flexible beta fund ratings

- AAA The fund demonstrates the highest standards of quality based on its investment process, risk awareness and consistency relative to its own objectives and relative to comparable flexible beta funds.
- AA The fund demonstrates very high standards of quality based on its investment process, risk awareness and consistency relative to its own objectives and relative to comparable flexible beta funds.
- A The fund demonstrates high standards of quality based on its investment process, risk awareness and consistency relative to its own objectives and relative to comparable flexible beta funds.

All fund ratings

- Not Rated (NR) Funds designated as Not Rated currently do not meet the requisite performance standards and/or the minimum qualitative criteria to achieve a fund rating.
- Under Review (UR) Ratings are placed Under Review when significant management changes occur at the fund manager or fund management team level and Standard & Poor's Fund Services has not had the opportunity yet to evaluate their impact on the qualitative appraisal.
- (New) Signifies where a major event has occurred for which there is no fund-specific track record available. This includes: funds recently launched, the implementation of a new investment process or mandate and may include structural changes within a fund team.
- Tenure Review (TR) The fund manager/team involved in the management of the fund does not currently have the minimum 12 months relevant investment management experience required to be eligible to be considered for a rating.
- Long-term fund management rating The fund has been rated in the A/AA/AAA fund rating band for five consecutive years or more, and continues to hold a rating.

Bond fund volatility ratings

The bond fund volatility rating is our current opinion of a fund's sensitivity to changing market conditions. Volatility ratings evaluate the fund's sensitivity to interest rate movement, credit risk, investment diversification or concentration, liquidity, leverage and other factors. For V1-V4 categories, risk is considered relative to a portfolio composed of government securities and denominated in the base currency of the fund.

- V1 Bond funds that possess low sensitivity to changing market conditions. These funds possess an aggregate level of risk that is less than or equal to that of a portfolio comprising government securities maturing within one to three years, and denominated in the base currency of the fund. These funds possess an aggregate level of risk that is less than or equal to that of a portfolio comprising the highest quality fixed income instruments with an average maturity of 12 months or less. Within this category, certain funds are designated with a plus sign (+), indicating extremely low sensitivity to changing market conditions.
- V2 Bond funds that possess low to moderate sensitivity to changing market conditions. These funds possess an aggregate level of risk that is less than or equal to that of a portfolio comprising government securities maturing within three to seven years, and denominated in the base currency of the fund.
- V3 Bond funds that possess moderate sensitivity to changing market conditions. These funds possess an aggregate level of risk that is less than or equal to that of a portfolio comprising government securities maturing within seven to 10 years, and denominated in the base currency of the fund.
- V4 Bond funds that possess moderate to high sensitivity to changing market conditions. These funds possess an aggregate level of risk that is less than or equal to that of a portfolio comprising government securities maturing beyond 10 years and denominated in the base currency of the fund.
- V5 Bond funds that possess high sensitivity to changing market conditions. These funds may be exposed to a variety of significant risks including high concentration risks, high leverage, and investments in complex structured and/or less liquid securities.
- V6 Bond funds that possess the highest sensitivity to changing market conditions. These funds include those with highly speculative investment strategies with multiple forms of significant risks, with little or no diversification benefits.

Absolute return fund N ratings

The N rating is Standard & Poor's indication of a fund's potential capital stability in normal markets. It is a qualitative rating but is based on annualised weekly downside deviation. N1 is the most stable and N9 the least.