NEWTON
Investment
Management

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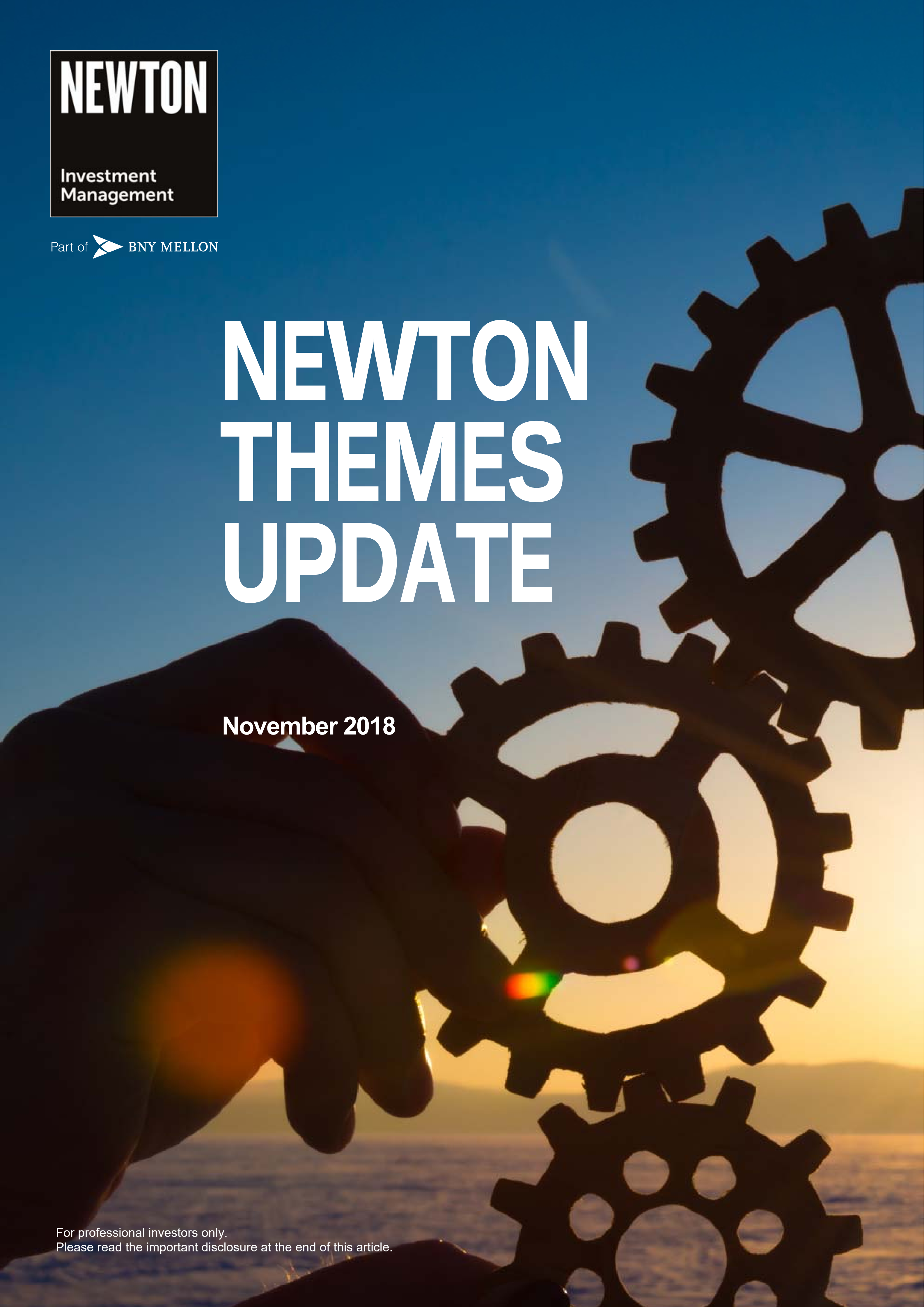
NEWTON THEMES UPDATE



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Please read the important disclosure at the end of this article.

NEWTON THEMES UPDATE – Q4 2018

At Newton, we believe there are certain key factors that will be instrumental in shaping the investment landscape over the coming years, and we capture them in a number of themes which help inform our investment decisions.

We see these factors, which include the disruption from technological change, the increasing power of consumers, the impact of climate change, and the influence of China, as indicative of long-term, structural trends which are likely to persist for some time.

Themes are used throughout Newton's investment process, facilitating both our top-down and bottom-up idea generation process. From initial, high-level research prioritisation to portfolio construction, themes and sub-themes play an essential part in helping to shape our investment outlook and positioning. Employing themes in our investment process not only alerts us to potential opportunities, but also serves to highlight possible risks.

In seeking to decipher opportunities from risks, investors have a very large universe to look at, and it is unrealistic for an investment manager to analyse the whole of it (and the almost infinite influences upon it).

Our themes are intended to provide perspective and allow our global research analysts and portfolio managers to focus their time on areas of greatest importance. They:

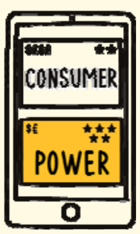
- represent the first stages of idea generation and risk management
- identify drivers of long-term change
- provide a dynamic framework for investment thinking
- afford a longer-term global perspective on a volatile world

We review our thematic framework regularly, and, following our most recent review, we are making some changes. We are condensing our previous 14 themes down to nine, in order to hone in on what we believe are the most significant factors for investors. We are consolidating six of our existing themes into our remaining themes, with our *fire risks* and *debt burden* themes being subsumed into *financialisation* for example, while our thinking around *construction and reconstruction* has been incorporated into our *state intervention* theme. We are also adding one new theme, *consumer power*, which encapsulates crucial consumer trends.

This leaves us with nine core themes: *net effects, smart revolution, Earth matters, financialisation, state intervention, China influence, consumer power, population dynamics* and *healthy demand*.

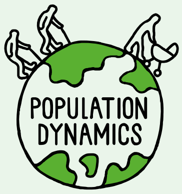
EARTH MATTERS

Increasing levels of economic activity have created significant stress across the world's environmental resources. At present, there is pressure and intent among individuals, businesses and governments to bring about positive change in this area. *Earth matters* covers a wide array of environmental concerns, including climate change, pollution and resource depletion and innovation across a range of industries. It also analyses cost and affordability constraints, as well as the growing risks of non-compliance with laws in both financial and reputational terms. Companies and policymakers are becoming more proactive as a result, which creates opportunities, but can also accelerate disruption.



CONSUMER POWER

Increasing internet use has changed the consumer landscape, leading to increased choice and price transparency. Consumers can access and compare product information, as well as online reviews and influencer preferences, and as a result consumer companies no longer control the narrative. The rise of the emerging-market 'middle class' will present further opportunities for consumer companies to capture more spending. The onus is therefore on companies to navigate this shifting landscape through differentiation – be it through offering experience, pricing, convenience, authenticity or personalisation.



POPULATION DYNAMICS

Populations are shifting significantly – with unprecedented ageing occurring in mature economies, and income growth driving changes in developing economies. This creates structural growth opportunities in certain areas together with risks from growing fiscal burdens. Changing patterns of labour participation such as education later in life and the growing proportion of women in the workplace also contribute. Increasing consolidation of populations around large urban centres is another feature of developed and emerging markets, and will help drive demand for infrastructure and housing.

CHINA INFLUENCE

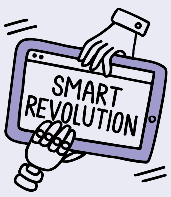
The influence of China on the global economic and capital-market outlook is far greater today than in the past. This is evident in the country's consumption share of a range of commodities, the increasing impact of Chinese political views, and the competitive threat from Chinese businesses. China's robust growth rebound through the global downturn was facilitated by a state-inspired credit expansion of unprecedented scale, which exposed the economy to higher levels of leverage and risk. The ability to secure consumption-led growth is of great global significance. Rebalancing will not be easy, but is likely to present attractive investment opportunities as well as pitfalls.

NET EFFECTS

The expectation of a networked world has become a reality following the exponential growth in connected entities. The enormous leaps in the capabilities of the technologies behind this advance enable the creation, capture and analysis of unprecedented amounts of data. This is transforming lifestyles and traditional business. Innovative companies are using connectivity and data to adapt their business practices continuously, create sustainable competitive advantages, and challenge less agile incumbents across diverse sectors. As such, as well as generating new opportunities, the pace and extent of change that is occurring can create significant risks for established companies across many sectors.

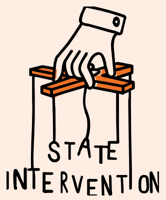
HEALTHY DEMAND

Growing incomes and changes in lifestyles in the developing world, combined with ageing populations and severe budgetary constraints in mature economies, drive stronger demand for affordable health-care solutions. At the same time, an increase in out-of-pocket health-care spending fuels growing consumerisation of health care. The increasing adoption of Western-style diets globally, and a recognition of the role of diet in disease, point to potential changes in patterns of chronic disease, food consumption and government policies.



SMART REVOLUTION

A range of technologies are making networks, systems, processes and products of all kinds increasingly responsive and intelligent. 'Smart' entities have the potential to enhance efficiency and productivity radically. Smart technologies can cause disruption across sectors and societies as a greater range of tasks emerge in relation to which machines are able to replace human workers. This has the potential to exacerbate income inequalities and drive population dynamics. It is also likely to influence policy choices as authorities intervene and seek short-term fixes.



STATE INTERVENTION

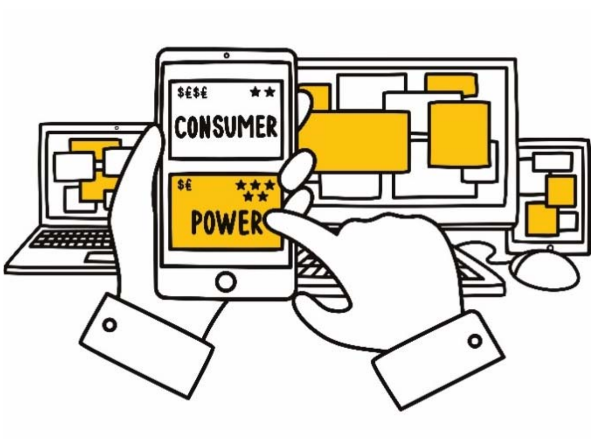
Structural challenges are set to render the pace of global economic growth more moderate than in recent decades, which will, we think, only intensify electorates' growing disillusionment with the political and corporate establishments. Against this backdrop, we envisage incumbent governments and their associated monetary authorities being forced to maintain a level of state intervention which is elevated compared to the decades preceding the global financial crisis. While central-bank stimulus, the dominant form of state intervention since 2008, is presently being withdrawn, a reversal, and indeed the potential deployment of even more extreme forms of monetary intervention, are realistic prospects during the next cyclical downturn. However, given the apparent lack of traction that policies such as quantitative easing (asset purchases) have had upon the 'real' economy in recent years, this is likely to be accompanied by, and possibly intermingled with, fiscal policy in future.

FINANCIALISATION

The scale, complexity and interconnectedness of global financial markets has mushroomed, with modern financial architecture increasingly built on complex financial instruments which depend on liquid and continuous markets. Further impetus has come from inflationary monetary policies, and from the dominant central-bank belief in not clamping down on financial excess. Moreover, while overall debt levels have decreased in relative terms post-2008, in absolute terms debt continues to rise, adding a further burden to government balance sheets. Strong vested interests, weak regulatory control and complicit politicians have allowed finance to dominate rather than to serve economies. One consequence is that, despite some improvements in capital, funding and regulation, the scale of global finance remains much as it was in the run-up to the credit crisis. As a result, financial flows continue to overwhelm real economic activity, leaving market and economic changes extremely sensitive to small swings in investor sentiment.

While each of our themes helps to frame our idea generation and investment decisions, we focus on three particular themes in more detail below.

CONSUMER POWER



Our new *consumer power* theme touches on parts of our outgoing *abundance* theme. It explores the way in which abundance operates from a consumer perspective, as technological advances change the nature of commerce and the role of the customer. Before the internet, brands controlled the narrative, and scale was everything. Only the biggest brands could afford far-reaching advertising like TV advertisements, making it difficult for smaller, newer businesses to upset a few firms' market dominance in a host of consumer sectors. The internet has shifted power away from brands, and over to the consumer. Consumers can now straightforwardly compare prices themselves, and find smaller businesses offering the same products. This has increased competition and allowed smaller companies to compete more evenly.

The *consumer power* theme looks at a number of key factors within the scope of these broader ideas. Over recent years, there has been a notable shift, for example, towards experiences instead of material goods, which has changed spending patterns considerably, and is likely to have positioned the travel, fitness and food industries, among others, to thrive.

This trend towards experiences has reduced the amount of disposable income available for spending on material things, making low costs key to physical goods manufacturers. Low-end and luxury businesses seem likely to be beneficiaries of consumer trends, while the 'middle' may suffer.

Luxury goods are likely to remain profitable as authenticity becomes a prominent consideration for consumers. Aspirational, natural, personal products and experiences will become more desirable, and we believe that companies with this in mind are poised to grow as spending patterns shift.

Consumers are also increasingly expecting convenience, so firms with multi-channel delivery networks and an understanding of how to locate their target market effectively should continue to expand.

Moreover, with a growing percentage of the world's population residing in emerging markets, and forecasts suggesting that hundreds of millions of people in emerging markets will be moving into the 'middle class' over the forthcoming decades, the consumer sector is likely to encounter notable disruption from shifting demographics. This will present new and vast opportunities for companies able to capture these developing markets.

While these trends have been active for a while, we believe they provide strong potential for growth among a range of companies.

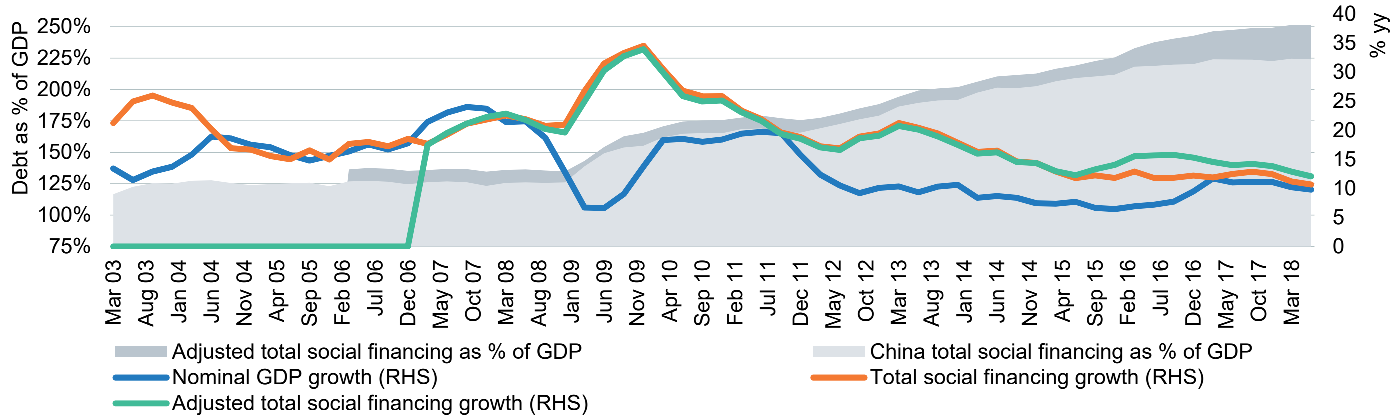
CHINA INFLUENCE

Our *China influence* theme remains especially relevant, given that the influence of China on the global economic and capital-market outlook has grown exponentially since the economy last had an official recession in the 1990s. Now that China has emerged as a significant global economic player, it is no longer a country that investors can ignore. China's role in geopolitics remains highly significant as its growing influence on regional and global politics mounts a clear challenge to US hegemony.

The 'One Belt, One Road' initiative is intended to develop transport infrastructure not only on the Eurasian continent, but also in Africa and Latin America, and aims to promote mutual trade and economic development, as well as increase China's soft power and strategic manoeuvrability. This may result in opportunities across the transport and infrastructure industries, along with an associated economic boost to other countries which stand to benefit from the initiative.

Given that China makes up such a significant proportion of global GDP, the country's unprecedentedly large recent credit boom poses a clear risk to both domestic and global financial stability if mishandled. Both the speed of expansion and the extent of 'off-balance sheet' credit growth are concerning, although this risk is tempered slightly by the scope of the government to coordinate banks' actions.

Debt bubble: China credit growth, debt as % of GDP



Source: China National Bureau of Statistics, Thomas Reuters Datastream, Q1/July 2018.

The impact this could have on the rest of the world makes it an important area of focus, along with the potential implications for a number of Chinese industries and businesses. In the aftermath of such a credit boom, there is now the need for economic rebalancing – for the country to move away from its reliance on investment, manufacturing and exports to consumption-led activity. Given this, the importance of the Chinese consumer is increasing, and, equipped with rising incomes and a more discerning attitude towards consumption, they will contribute toward the country's shifting current-account surplus, as domestic consumption growth exceeds that of its trading partners. This will be a major shift for the Chinese economy, not least in the consumer sector where there are likely to be continued attractive investment opportunities, and may be characterised, among other things, by greater social care provisions (to free up more disposable income) and a transition to being more dependent on capital inflows, which would reduce authorities' policy freedom.

EARTH MATTERS

The world is going green. Climate change is in the headlines with increasing frequency, and many corporations and governments are starting to engage seriously with environmental issues. As much of the world moves away from fossil fuels, there are likely to be opportunities for those offering competitive, scalable and environmentally sustainable energy sources. Considering alternative sources of energy is especially relevant at the moment given that oil prices have been rising.

There is also a distinct push towards developing electric vehicles (EVs). In the past, Tesla cornered the EV market, but now almost all major car manufacturers are joining in, owing to the implementation of new CO_2 regulations.

Reducing the use of plastics and increasing recycling are also becoming more prevalent, meaning that those capable of remedying outdated, harmful and unpopular means of production and distribution may be poised to prosper. The growing adoption of EVs has implications for a number of sectors beyond the automotive industry, including chemicals, mining, metals and technology.

There are also a number of environmental considerations as populations increase, including increased food production, water delivery and waste removal. With Asia's population becoming wealthier, these levels are likely to increase, creating opportunities for companies that can operate in a more environmentally friendly manner.

Given the significant stress on the world's environmental resources, combined with intent from individuals, businesses and governments to address these issues and enact real change, we believe companies that can facilitate a greener, more sustainable way of living modern life or solve a key environmental challenge are likely to offer attractive investment opportunities in the years ahead.

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