BNY Mellon UK Income Fund

INVESTMENT MANAGER

NEWTON
Investment Management

Newton Investment Management: Newton pursues a distinctive global thematic investment approach and provides added value from extensive proprietary research.

FUND RATINGS

RSMR RATED FUND

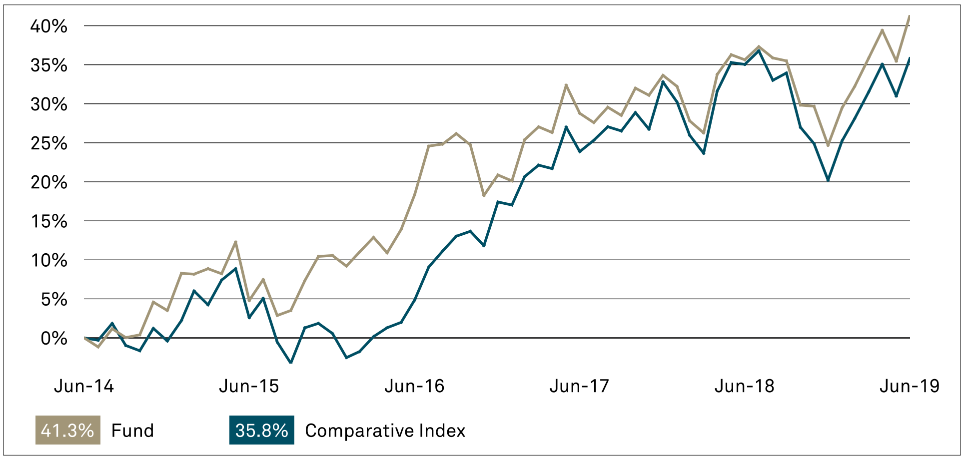
PERFORMANCE DISCLOSURE

Past performance is not a guide to future performance. The value of investments can fall. Investors may not get back the amount invested. Income from investments may vary and is not guaranteed.

QUARTERLY HIGHLIGHTS

- Performance: The Fund produced a positive return, net of fees, ahead of its comparative index.
- Activity: We reduced the Fund's holding in Royal Dutch Shell and established a position in Total. We increased the holding in Imperial Brands and introduced Philip Morris to the Fund.
- Outlook & Strategy: We are not particularly positive on the outlook for economic growth, so have balanced the Fund's exposure to international companies, which could benefit if the UK economy struggles.

5 YEAR CUMULATIVE PERFORMANCE (%)



PERFORMANCE SUMMARY (%)

	1M	3M	YTD	1YR	2YR	Annualised 3YR	Annualised 5YR
Institutional Shares W (Acc.)	4.32	4.02	13.34	4.19	4.76	6.09	7.16
Comparative Index	3.67	3.26	12.97	0.57	4.71	9.00	6.31
Sector	2.52	1.89	10.63	-2.72	1.63	7.23	5.25
No. of funds in sector	86	85	85	84	82	77	73
Quartile	1	1	1	1	1	3	1

	2014	2015	2016	2017	2018
Fund	6.40	6.81	9.33	10.56	-6.70
Comparative Index	1.18	0.98	16.75	13.10	-9.47

Source for all performance: Lipper as at 30 June 2019. Fund Performance for the Institutional Shares W (Accumulation) calculated as total return, including reinvested income net of UK tax and charges, based on net asset value. All figures are in GBP terms. The impact of an initial charge (currently not applied) can be material on the performance of your investment. Further information is available upon request.

Effective 10 June 2019, the Fund name changed from Newton UK Income Fund to BNY Mellon UK Income Fund.

BNY MELLON INVESTMENT MANAGEMENT EMEA LIMITED - CLIENT SERVICES

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PERFORMANCE COMMENTARY

The FTSE All Share Index returned +3.3% in the second quarter of 2019. The UK equity market was beaten by world ex-UK equities, but outperformed corporate bonds and gilts. Over the first six months of 2019, the FTSE All Share Index had the best first six months for the index since the first half of 1998.

HOLDINGS IN RELX AND SMURFIT KAPPA CONTRIBUTED, WHILE IMPERIAL BRANDS AND BRITISH AMERICAN TOBACCO WERE AMONG THE DETRACTORS

The rally in global equities was underpinned by three factors. The first was the switch to a dovish monetary stance by the US Federal Reserve (Fed), aided by accommodative policies from central banks in Europe, Japan and China. The second factor is that these policies are designed to underpin a global economic recovery. China's economy now appears likely to avoid a hard landing. The third factor is a possible resolution to the China-US trade dispute. The US and China, the world's two largest economies, account for 40% of global output and given the global, inter-linked nature of the UK market this has a critical impact upon many UK companies.

In April, President Trump said: "Tariffs are beautiful" and threatened to impose a 25% tariff on all Chinese imports. At the end of June, however, an apparent truce in US-China trade talks took place at the G20 summit with Trump indefinitely suspending planned tariffs on Chinese imports, China purchasing US farm products and Trump allowing US companies to sell products to Chinese technology company Huawei. As a result, the Dow Jones Industrial Average had its best June since 1938 and the S&P 500 index had its best June since 1955.

In the UK, the political circus continued with Theresa May's resignation as prime minister prompting a Conservative leadership challenge, with Boris Johnson the frontrunner. Both Boris Johnson and his rival Jeremy Hunt have suggested they will maintain the 31 October 2019 Brexit deadline even in the event of a no-deal scenario. The market is attaching a 50% probability of a UK interest rate cut by the end of 2019 and the UK 10-year gilt yield has fallen to 0.7%, below the central bank's benchmark rate for the first time since 2008.

The UK manufacturing purchasing managers' index hit its lowest level since February 2013, affected by the unwinding of pre-Brexit stockpiling. There has also been a reduction in output and new orders have fallen. However, 44% of companies predict that output will be higher in a year's time compared to only 14% forecasting a contraction.

Some parts of the consumer sector are depressed. Auto demand has weakened since the Brexit vote. When consumers are uncertain about the future, they maintain essential day-to-day spending but typically avoid big, expensive purchases. Where households go, the economy usually follows given consumption makes up nearly 70% of UK GDP (gross domestic product). We believe a 'hard' Brexit presents a significant risk to the outlook for domestic consumption and the broader UK economy.

The Fund produced a positive return in the second quarter, ahead of its comparative index. RELX was among the top contributors, after the information and analytics provider issued a reassuring first-quarter trading update, and investors continued to assign value to the company's steady, defensive earnings stream. Packaging company Smurfit Kappa performed well with full-year results revealing revenue and earnings growth, plus widening margins. Engineering conglomerate Smiths cheered investors with the appointment of a chief executive to its medical division, as part of its plan to spin out the struggling unit. The Fund's relative performance was helped by not holding mining company Glencore, which reported weak production figures and is facing a new corruption inquiry.

The Fund's tobacco stocks Imperial Brands and British American Tobacco were the largest detractors, as the sector continued to struggle in response to negative news flow. We viewed this as an opportunity to increase the Fund's weighting (see activity review).

Within financials, the ongoing Brexit saga was not conducive to positive share-price performance for Royal Bank of Scotland, and the resignation of Chief Executive Officer Ross McEwan was taken negatively by the market. This was swiftly followed by an underwhelming set of results for the first quarter, with income falling short of expectations. Not holding Standard Chartered and the underweight in HSBC was also a negative, with both banks beneficiaries of China's plans to open up its US$44 trillion financial sector to the world. Losses were partly offset by the holdings in Prudential and Zurich Insurance, which both outperformed.

ACTIVITY REVIEW

There were a number of changes to the portfolio. We increased the Fund's tobacco holdings by nearly 3% – making us significantly overweight the comparative index – by expanding the size of the holding in Imperial Brands and adding a new position in Philip Morris.

WE ADDED TO THE FUND'S TOBACCO HOLDINGS BY EXPANDING THE IMPERIAL BRANDS POSITION AND ADDING PHILIP MORRIS

Imperial Brands was trading at its lowest valuation in over a decade on concerns it will no longer be able to offset declining volumes with higher prices. Conversely, we believe Imperial has strong pricing power and scope to grow earnings, and it is developing products such as 'myblu'. Philip Morris has the market-leading IQOS heat-not-burn tobacco product we believe could power long-term sales growth.

We used the proceeds from a reduction in the Royal Dutch Shell holding to establish a position in its French peer, Total. Total is an oil major with a global presence across both upstream and downstream. Total's downstream operation is world class and produces high returns after years of cost focus and rationalisation. We believe Total can sustain low single-digit top-line growth (and cash flow) while maintaining the dividend and undertaking modest share buybacks.

We added a new position in Centrica. After reducing our expectations for profit margins over the next few years, and being cautious about growth rates, we believe the stock has significant upside potential. The increasing risk of a dividend cut is deterring investors, and this has provided us with an attractive entry point. With a dividend yield of nearly 13%, Centrica could halve its dividend and still offer an attractive yield for a UK income fund. We also initiated a position in Persimmon, which constructs affordable residential homes throughout the UK excluding London. We believe it has potential for capital appreciation and value its highly attractive, well-covered dividend yield.

Valuation discipline drove our decision to sell Dutch publisher Wolters Kluwer and medical equipment manufacturer Smith & Nephew, and significantly reduce alcoholic beverages company Diageo. Their respective dividend yields had all fallen to levels, which were no longer making a meaningful contribution to the portfolio.

INVESTMENT STRATEGY AND OUTLOOK

The near-term outlook for financial markets largely hinges on the outlook for monetary policy. We believe any significant slowdown of the global economy would probably lead to fresh stimulus in the form of interest-rate cuts or a return to quantitative easing.

WE HAVE BALANCED THE EXPOSURE TO OVERSEAS AND INTERNATIONAL COMPANIES THAT COULD BENEFIT IF THE UK ECONOMY STRUGGLES

The market is already expecting the US Fed to cut rates later this year. We believe while support from central banks around the world is most likely to prevent asset prices falling too far, it is difficult to be particularly positive on the outlook for economic growth, especially when faced with the possibility of rising US-China trade tensions.

Turning to the UK, in our view political risk is clearly elevated, and investors face a particularly challenging variety of outcomes. It is difficult to hypothesise what the final form of Brexit will look like. In addition, the outcome of Brexit negotiations continues to raise the chance of a snap general election, and that brings with it the risk of a Corbyn-led government which, in our view, could have significant implications for investors. The market has reacted to this uncertainty by rerating large-cap stocks with high overseas earnings while selling domestically focused companies. This divergence in fortunes has left nearly 30% of the FTSE 350 Index trading very cheaply, on a P/E (price-to-earnings) ratio below 10 times. In view of this uncertainty, we have balanced the Fund's exposure to overseas and international companies, which could benefit if the UK economy struggles, with some attractively valued domestic companies that already price in a poor outlook for the UK economy.

Our thematic framework sharpens our focus on the long-term investment landscape. Guided by our 'state intervention' theme, we have a positive view on defence spending. Encouraged by President Trump, Nato's (North Atlantic Treaty Organisation) European members have committed to increase defence spending this year and the portfolio has meaningful exposure to businesses that we see as beneficiaries of this trend.

TOP 10 HOLDINGS (%)

	Fund
Royal Dutch Shell PLC	6.0
GlaxoSmithKline PLC	4.3
BP PLC	4.0
RELX	4.0
Prudential PLC	4.0
British American Tobacco PLC	3.9
Diageo PLC	3.8
BAE Systems PLC	3.6
Imperial Brands PLC	3.6
Smiths Group PLC	3.3

INDUSTRIAL ALLOCATION (%)

	Fund	Comp. Index
Consumer Services	13.2	11.5
Industrials	14.0	11.5
Health Care	9.4	8.5
Utilities	4.1	2.6
Technology	1.6	1.2
Basic Materials	3.0	8.2
Oil & Gas	12.0	14.3
Telecommunications	3.8	2.4
Financials	20.2	26.1
Consumer Goods	15.8	13.9
Cash	2.7	0.0

QUARTERLY ATTRIBUTION BY INDUSTRY

	Total Fund Return	Total Index Return	Stock Selection	Asset Allocation	Net Effect
Consumer Services	10.17	3.16	0.79	0.01	0.80
Industrials	8.87	7.24	0.21	0.07	0.29
Health Care	5.42	3.44	0.23	-0.02	0.21
Utilities	2.15	-1.90	0.15	-0.03	0.12
Technology	15.32	9.88	0.08	0.03	0.10
Basic Materials	9.28	4.21	0.15	-0.05	0.10
Oil & Gas	5.32	4.50	0.10	-0.02	0.09
Telecommunications	-7.81	-6.43	-0.06	-0.15	-0.21
Financials	3.74	4.50	-0.18	-0.06	-0.24
Consumer Goods	-4.66	-1.41	-0.50	-0.05	-0.55
Cash	0.80	0.00	0.02	-0.12	-0.11

Source: BNY Mellon Investment Management EMEA Limited

KEY RISKS ASSOCIATED WITH THIS FUND

- There is no guarantee that the Fund will achieve its objectives.
- The Fund primarily invests in a single market which may have a significant impact on the value of the Fund.
- Derivatives are highly sensitive to changes in the value of the asset from which their value is derived. A small movement in the value of the underlying asset can cause a large movement in the value of the derivative. This can increase the sizes of losses and gains, causing the value of your investment to fluctuate. When using derivatives, the Fund can lose significantly more than the amount it has invested in derivatives.
- The Fund takes its charges from the capital of the Fund. Investors should be aware that this has the effect of lowering the capital value of your investment and limiting the potential for future capital growth. On redemption, you may not receive back the full amount you initially invested.
- The insolvency of any institutions providing services such as custody of assets or acting as a counterparty to derivatives or other contractual arrangements, may expose the Fund to financial loss.
- A complete description of risk factors is set out in the Prospectus in the section entitled "Risk Factors".

INVESTMENT OBJECTIVE

To generate distributions over an annual period together with long term capital growth.

GENERAL INFORMATION

Total net assets (million)	£ 1,280.87
Historic yield (%)	4.15
Active Share (%)	58.9
Comparative Index	FTSE All-Share TR
IA Sector	UK Equity Income
Lipper sector	Lipper Global - Equity UK Income
Fund type	ICVC
Fund domicile	UK
Fund manager	Team approach
Base currency	GBP
Currencies available	GBP
Fund launch	01 Jun 1987
Distribution dates	28 Feb, 31 May, 31 Aug, 30 Nov

DEALING

09:00 to 17:00 each business day
Valuation point: 12:00 London time

INSTITUTIONAL SHARES W (ACC.) SHARE CLASS DETAILS

Inception date	04 Sep 2012
Min. initial investment	£ 10,000,000
ISIN	GB00B7M90R07
Bloomberg	NEWHIWA
Sedol	B7M90R0
Registered for sale in:	CL, GB

INSTITUTIONAL SHARES W (ACC.) COSTS AND CHARGES (%)

Ongoing Costs	0.79
Management fee	0.75
Other costs & charges	0.04
Transaction costs ex ante	0.36

Source: BNY Mellon Investment Management EMEA Limited
Any views and opinions are those of the investment manager, unless otherwise noted.

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