

# Industries of the Future Fund



“Whilst we appear to have made considerable progress since markets reached their nadir in the early months of last year, as 2010 starts to take shape, global economies still remain far from being in good health. We will soon be entering a sustained period when growth is scarce and investors will be prepared to pay a premium for companies that can demonstrate ‘sustainable’ growth – in all senses of the word.”

**Tim Dieppe,**

Manager of the Henderson Industries of the Future Fund

## Key aspects of our investment process

- This is a global multi-thematic fund invested entirely in our 10 Industries of the Future Themes: five environmental and five social. This results in structural sector biases such as being very underweight compared to the fund’s benchmark in sectors such as financials, telecoms and resources, and also being under-exposed to mega-cap stocks (i.e. those companies with a market capitalisation greater than US\$20 billion).
- The ten themes each have strong growth characteristics and regulatory or demographic and technological reasons why they should continue to grow faster than the market in future. Hence this fund has a strong ‘growth’ bias in its style of investing.
- The fund is global in its exposure with regional geographic weightings kept close to those of its benchmark the MSCI World Index.

## 2009: A Rollercoaster Year

Following the historic and generation-defining events of 2008, 2009 proved something of a rollercoaster ride for investors. It is worth revisiting some of our comments from the review of 2008:

*“By any standards, 2008 was a truly momentous year in world economic history. This was the year that saw US\$720 billion in write-downs and losses by financial institutions, US\$30 trillion wiped off market valuations, the semi-nationalisation of the international banking system, the biggest bankruptcy in history, the unveiling of what is likely the biggest fraud in history, the collapse of Iceland, and multiple bailouts or takeovers of failing financial institutions.”*

Last year began in a similarly dramatic vein with the UK base rate forced to a 300 year low, government debt hitting record peacetime levels, and quantitative easing launched on a major scale. At the start of 2009 the market was thoroughly depressed and indeed entertaining the possibility of an economic depression. Sentiment changed in March, however, as several US banks announced that they were seeing profitable starts to the year. With equity markets oversold at that point, this set the stage for a multi-month rally led by banks, automobile manufacturers and mining companies. By June, industrial company managements were reporting that they had been through the worst and the market moved to anticipate recovery into 2010 and beyond.

The MSCI World Index rose by 16.5%\* in sterling terms in the twelve months to the end of 2009. The Henderson Industries of the Future Fund outperformed this benchmark by 1.6%\* in the year. The annual figures mask a notable level of volatility, including a decline of 22%\* in the benchmark to early March, followed by a rally of 46%\* to the end of the year. The strength of the British pound also masks the strength of the rally which approached 70% in US dollar terms – one of the strongest rallies in stock market history.

During 2009, the fund was defensively positioned with high levels of exposure to the **Health** and **Knowledge** themes. This served the fund well for the first two months of the year, and by the end of February it was approximately 6% ahead of the benchmark\*. The subsequent recovery in markets was very much led by companies within the financials sector and cyclicals, such as mining stocks, where the fund lacks exposure because of its thematic approach. This formed something of a headwind for the fund and made it hard for the fund to maintain its outperformance compared to the rest of the market. All things considered, we were pleased to have closed the year with some outperformance in spite of it being such a challenging market for thematic investors.



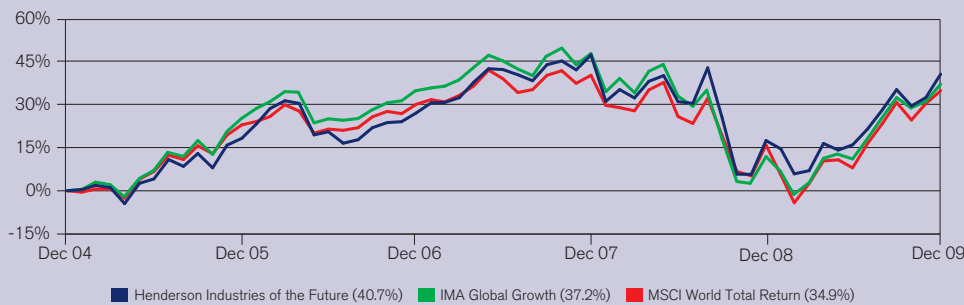
# Industries of the Future Fund



## Fund Performance

### The Henderson Industries of the Future Fund

#### Henderson Industries of the Future – 5 year performance review \*



- The Fund returned 19.7% year to date, outperforming the MSCI World Index benchmark by 1.6%. Over three years the Fund has outperformed the benchmark by 6.9%.
- The Fund received a 'highly commended' award within the Best Climate Change fund category of the 2009 Climate Change Awards.

Fund performance is based on daily nav-nav pricing. Please remember that past performance is not a guide to future performance. The value of an investment, and the income from it, can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested.

#### Henderson Industries of the Future Fund \*

% Annual Returns	Dec 08- Dec 09	Dec 07- Dec 08	Dec 06- Dec 07	Dec 05- Dec 06	Dec 04- Dec 05
Henderson Industries of the Future Fund	19.7	-20.3	15.8	7.5	18.3

\*Source: at 31 Dec 09, ©2010 Morningstar. All rights reserved, nav-nav, UK sterling net income reinvested.

### Theme Contribution to Performance

Industry of the Future theme	Total contribution to gross performance (%)
Water Management	+1.37
Safety	+1.32
Environmental Services	+1.31
Health	+1.26
Efficiency	+0.17
Social Property & Finance	+0.16
Cleaner Energy	-0.36
Sustainable Transport	-0.63
Quality of Life	-0.63
Knowledge	-1.23

**Total 2.74**

Source: Factset, 2010

Over the course of 2009 we saw positive contributions from six out of our ten Industries of the Future themes: **Water Management, Health, Environmental Services, Safety, Efficiency**, as well as **Social Property & Finance**.

Water Management was the top contributing theme. Industrial water treatment company **Nalco** recovered from oversold levels at the start of the year to rise by over 70%\*\* in the year, becoming the fund's top positive stock contributor. We expect a continued growth in demand for Nalco's services, especially as water is likely to become an increasingly political issue in the next few years. The theme of Environmental Services added to positive fund performance during 2009, aided by a strong performance from waste water treatment company **China Everbright**. The stock rose over 100%\*\* from extremely oversold levels earlier in the year. There were several cyclical names in this theme that benefitted from the market recovery and contributed positively in the year.

Efficiency was another strong theme for the fund, and an area containing some of the more cyclical names within the portfolio, therefore benefitting from the market rally in the year. Testing and measurement company **Agilent** was among the top contributors, having experienced a strong recovery in orders combined with improvements in profit margin. The Health theme contributed positively in spite of its more defensive characteristics. Neonatal and paediatric physician care company **Mednax** was a top

contributor: reporting strong trading figures, while expanding profit margins, stabilisation of payer mix, and made accretive acquisitions. The share price of eyecare company **Alcon** also performed well after falling heavily at the start of the year, due largely to anticipation of Novartis taking a majority holding at the end of the year.

Knowledge was the worst contributing theme for the year as defensive stocks and those companies demonstrating counter-cyclical qualities (moving out of favour with the economic cycle) fell out of favour with investors. US education provider **Apollo** was also plagued by regulatory concerns causing it to perform particularly poorly. Japanese education service provider **Benesse** also struggled because of weak sales of its language learning products.

The negative contribution from the Sustainable Transport theme was caused by poor performance from Japanese companies **Shimano** and **East Japan Railway**. It is worth noting that the Japanese market was the worst performing major market in 2009, underperforming the MSCI World Index by over 15%\*. Bicycle parts manufacturer **Shimano** performed in line with the Japanese market over the year though still contributed negatively relative to the MSCI World. **East Japan Railway** was hit by weak passenger numbers and concerns about the impact of swine-flu on rail travel. On the positive side, we saw a strong contribution from video conference equipment manufacturer **Polycom** as demand for its products continued to be strong.



## The transition towards a sustainable economy continues to influence investment markets

Looking back on 2009 the poor outcomes from the December Copenhagen climate negotiations were a source of disappointment. However, it is easy to focus too much on the failed negotiations during the year and miss the very real progress that was made across the sustainability agenda.

In retrospect, perhaps the most encouraging development was the central role that 'green growth' came to play in economic stimulus packages that were announced by governments around the world. Central to many of these programmes was the realisation that there were real economic and environmental 'win-wins' in accelerating economy-wide energy efficiency programmes – something that was given further impetus as oil prices climbed over the course of 2009 to stay north of US\$70 a barrel for most of the second half.

Given the scale of the downturn at the beginning of the year, several commentators had suggested that sustainability commitments would be put on hold in 2009. In fact, the year saw a continued focus on key issues and important new announcements from many large corporations. **Wal-Mart**<sup>†</sup>, **Nestlé**<sup>†</sup>, **Cadbury's**<sup>†</sup> and **Tesco**<sup>†</sup> for example engaged in significant new initiatives on

issues ranging from climate change to toxic chemicals and supply-chain standards. Their moves have major ramifications for sustainability because of the significant influence they have on supply-chains.

In other sectors too we have seen radical shifts in business strategies including within the automobile industry, which has now placed significant investment in the development of plug-in hybrid and full electric vehicles. Even the meeting in Copenhagen itself, while clearly failing to deliver a legally binding treaty, still catalysed the development of significant new climate change targets in countries around the world.

Reflecting back on 2009, it is important to be reminded that the movement towards sustainable forms of economic development is – and always was – a long-term transition. Short-term disappointments such as Copenhagen are inevitable. However, it is clear that the long-term trajectory is still sound and that 2009 can be viewed overall as a good year in seeing more – and deeper – commitments to sustainable and responsible business.

<sup>†</sup>Note: highlights companies not approved for the fund.

### 2009 team highlights

- The launch in January of an Industries of the Future Fund for the European market, which later in the year attained the Novethic SRI Label, and received a special award for 'ESG indicators'
- The SRI team welcoming Gwen Rutta as a new member of the SRI Advisory Committee
- Henderson sponsorship of the UK's National Ethical Investment Week campaign for the second year running
- The SRI team launching a blog

### Corporate and strategic engagement

In 2009 we significantly increased our company engagement activities. Our focus has been to work with companies on key environmental, social or governance (ESG) issues where there is business risk or opportunity that in our view is not being effectively managed.

- Convinced **ABB** (Efficiency theme) to exit from its remaining business activities in Sudan, including its involvement in a controversial dam project.
- Having previously refused to respond, successfully encouraged five companies to provide comprehensive responses to the Carbon Disclosure Project ([www.cdproject.net](http://www.cdproject.net)).
- Secured the support of several companies for a new initiative (the CEO Water Mandate) aimed at tackling water use as a strategic issue for companies in key sectors.
- Worked with the solar power sector to improve supply-chain standards on social and environmental issues resulting in **Yingli Green Energy** (Cleaner Energy) a key holding for the fund, achieving independent certification (SA8000) for the quality of its supply-chain management.
- Convinced Chinese rail equipment manufacturer **ZhuZhou CSR Times Electric** (Sustainable Transport) to sign up to the UN's Global Compact initiative.
- Secured a commitment from a wide range of companies including **Eurofins Scientific** (Safety), **NBTY** (Quality of Life), **Spectris** (Efficiency) and **Verbund** (Cleaner Energy) to improve the quality of their disclosure on sustainability issues.
- Ultimately not succeeded in convincing **Idex Corporation** (Efficiency) to prioritise key aspects of its sustainability programme. Subsequently took the decision to sell the stock.



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## 2010 Outlook

Having witnessed a remarkably strong rally in global markets since their lows in March 2009, it is hard to expect markets to continue to post strong returns in 2010. Global economies still have to contend with several concerning issues, including increasing unemployment, massively increased government borrowing and continued debt defaults. Government intervention has been successful in avoiding, or at least postponing, a depression, but just how far government spending can prop up economic growth, and for how long, remains to be seen.

At our request, HSBC reviewed the scale of global economic stimulus packages launched in 2009 and concluded that

US\$1.2 trillion (nearly 40% of the total) is allocated to areas captured by our ten Industries of the Future themes. We estimate that around 20% of this has been spent so far and the bulk of spending will occur during 2010. Many of our investments are therefore well-placed to benefit from this inflow of capital and should see orders come through as a result.

Our key investment themes continued to be supported by the economic policies undertaken by most countries around the world. Consequently, we have been adjusting the portfolio to gain greater exposure to high growth companies that fit into our Industry of the Future Themes.

## Fund strategy & thematic positioning

- Increasing weighting in the **Efficiency** theme due to growth opportunities created by stimulus spending and the introduction of new regulation. New holdings at the end of last year in this theme include Swiss high voltage electrical equipment company **ABB**, and Spanish IT software solutions company **Telvent**.
- Relief that there are some highly undervalued companies in sectors that the market considers to be defensive, but are displaying growth characteristics, including companies in structural growth areas such as in the **Knowledge** theme. The Industries of the Future Fund is positioning itself for these stocks to recover.
- Once the debate surrounding US healthcare reform is finally settled, expectation that this will remove investor concerns about possible outcomes for companies and should leave the **Health** theme in a strong position. High growth medical technology companies within this theme are particularly attractive as they have continued to demonstrate growth even despite the difficult economic background.
- Currently monitoring the fund's **Cleaner Energy** theme with regards to timing an increase in weighting. Belief that market frustration over short-term difficulties should lead to a discounting of the longer-term opportunities.

## Contact us

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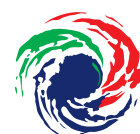
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### Important Information

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