January 2025
taml.co.uk

Responsible Investment Report N°·15

Generation Sober? Exploring Youth Drinking Habits

As many of us swap cocktails for mocktails during Dry January, it's a fitting moment to explore the shifting dynamics of the alcohol industry and what they might mean for our investment in the sector.

Alcoholic beverages are an attractive and resilient consumer category. For instance, Diageo has delivered a ~9% compound annual return since Troy first purchased shares in the company in 2005. Troy also has holdings in Pernod Ricard and Heineken. The companies we favour in the alcohol sector align with the premiumisation trend in drinking behaviours, reflecting a shift towards quality over quantity.

Profits and principles

The sector does however raise questions for responsible investors. The industry profits from the sale of a psychoactive substance that, if abused, poses health and societal challenges. Consumers, investors, and regulators have long known misuse can be harmful. Recently, the US Surgeon General has called for warnings on alcohol bottles. Alcohol misuse is estimated to contribute to 5% of the global disease burden, according to the World Health Organization.

How does investing in alcohol sit within Troy's responsible investment framework? We are careful to balance risks against opportunities to achieve our investment objective of delivering attractive risk-adjusted returns. Our focus is on the integration of material environmental, social or governance considerations into our investment analysis, this includes staying live to changing consumer preferences and government policymaking.

We do not deem it our role to be the moral arbiters for our investors' capital. We leave that decision to you by offering alternative portfolios. Our Ethical fund range screens out companies deriving more than 10% revenue from the sale of alcohol. The ethical exclusion criteria of our Ethical portfolios also screens out certain investments in armaments, fossil fuels, gambling, high-interest rate lending, pornography and tobacco.[1]

Moderation Matters

"The social licence to operate is not granted by governments or regulators but by the communities and stakeholders impacted by a company's operations."

– Ian Thomson, Author

Despite the health-related consequences of excessive alcohol consumption, alcohol remains deeply ingrained in cultural traditions, celebrations, and social connections. Referring to it as a "social lubricant" might raise a few smiles, but anyone who has attended an office party during the festive season can likely appreciate the sentiment. Some may argue that without it, things might get a bit... well, dry.

Notwithstanding this, we believe it is important for alcohol companies to stay vigilant around the risks associated with overconsumption. Failing to do so can harm brand equity and invite regulatory scrutiny. We prefer companies that focus on promoting responsible drinking and thoughtful marketing, which enhances consumer trust and the long-term sustainability of their business models.

The alcohol companies in Troy portfolios focus on premium spirits or beers, prioritising quality over quantity. This strategy creates brand integrity and naturally avoids associations with excessive consumption. Despite this, social risks remain. This prompted us to conduct a focused analysis in 2023 to evaluate how our portfolio companies, Diageo, Pernod Ricard, and Heineken, manage these risks. We summarise their approaches to responsible drinking in the table below, with a focus on marketing practices.

[1]For further information on the specific requirements of the ethical exclusion criteria can be found at www.taml.co.uk.

Responsible Drinking Campaings	
DIAGEO	As part of Diageo's 'Society 2030 Spirit of Progress' plan, the company is committed to promoting changes in attitudes towards excessive consumption, drink driving and underage drinking. Diageo have launched a number of education platforms such as DRINKiQ to promote moderation.
Pernod Ricard	Pernod Ricard launched a cross-market digital campaign: "Make Memories, Not Hangovers". The company has a goal to roll out at least 12 campaigns in strategic brands to promote responsible drinking behaviour amongst their consumers by 2027.
HEINEKEN	Heineken has made a commitment to invest 11% of its annual marketing budget to support responsible consumption programmes (to reach 1.2 bn unique customers a year) via digital media. Heineken 0.0 (zero alcohol) has seen significant success. Low and no alcohol beers comprise a growing proportion of Heineken's sales.

While individual choices matter, alcohol companies play an important role in promoting responsible drinking. We regularly discuss their progress in this area, recognising that addressing social impacts is vital to maintaining their licence to operate.

Secular Decline or Shifting Patterns?

The alcoholic beverages sector has fallen out of investor favour lately, caused by a slowdown in volume growth. This is in stark contrast to the period of exceptional growth seen during and the pandemic, when lockdowns saw consumers 'pantry-loading' and up-trading, leading the premium spirits brands to do particularly well. When the world returned to normality, the industry also benefited from a period of 'revenge conviviality', as the former Campari CEO called it. This coincided with significant price increases to cover the additional costs of higher input cost inflation and supply chain disruption.

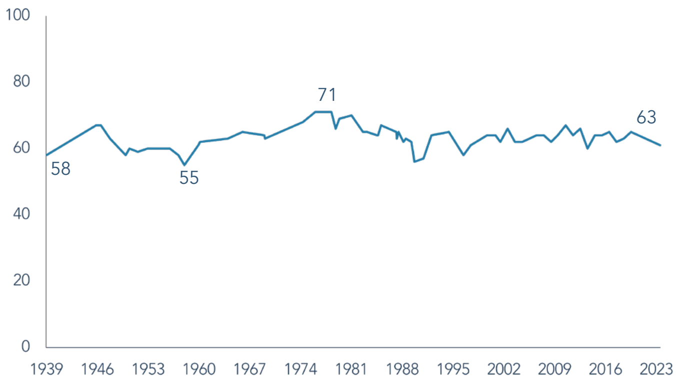
We are now experiencing a hangover from super-normal growth. This softness in quarterly volume figures has led some to extrapolate the effects of what we consider to be a more cyclical slowdown. Many have speculated that depressed volumes is partly caused by a structurally reduced appetite for alcohol consumption by younger consumers and the popularity of GLP-1 weight-loss drugs.

We find that the relationship between trends in alcohol consumption and the growth of GLP-1s is inconclusive. Controlling for other variables, academic studies do not show a clear association between alcohol and obesity. To put it more bluntly than an academic might, obese people aren't necessarily the biggest drinkers. Furthermore, studies find that two-thirds of patients stop GLP-1 therapy within 24 months and regain over half of their lost weight. Whatever their impact on consumption in the near term, the longer-term impact may be modest unless adherence to these drugs significantly improves. It is ultimately too soon to tell what the long-term impact on demand will be, but early indicators do not suggest that alcohol's concentrated consumption puts it at an outsized risk from the rise of GLP-1s.

The question of youth drinking habits is also intriguing. If it is true that Gen Z (those born between the late 90s and early 2010s) are drinking less, the alcohol industry may face structural decline. Having researched this topic, we have found that younger demographics are drinking the same quantity of alcohol as generations prior, but they are taking up the habit at an older age than previous generations. The percentage of US adults who drink has consistently fluctuated around the ~60% mark since 1939 and is unchanged in the last 20 years. While it is true that Gen Z drinkers are generally more experimental, more willing to try flavoured spirits and ready-to-drink mixers, for instance, they are not drinking less alcohol.

The data also shows that alcohol consumption for 18–25-year-olds has declined but after reaching 25 and transitioning into working adulthood, consumption reverts to historic trends. Drinking prevalence among 25-30-year-olds has remained stable at ~70% since the 1980s, with per capita drinking quantities also staying relatively constant over time.

FIGURE 1: PERCENTAGE OF U.S. ADULTS WHO DRINK, TREND SINCE 1939



1939-1970 results are based on adults aged 21 and older.
1971-2023 results are based on adults aged 18 and older.

Source: Gallup, December 2023

We suspect the modest decline in consumption for 18–25-year-olds is largely because of the growing economic burden faced by Gen Z. Young Americans graduating with a bachelor's degree today have a debt-to-income ratio of ~65% compared to ~40% 15 years ago. Additionally, more adults are living at home for economic reasons, leading to fewer opportunities to socialise. Consumer confidence for this demographic is also at an all-time low as this cohort struggle disproportionately with higher costs of living.

Clamping Down on Underage Drinkers

Another notable trend is the reduction in underage drinking. Between 2002-2021, the National Institute on Alcohol Abuse and Alcoholism found that prevalence of alcohol use in the past 30 days among 16 and 17-year-olds dropped by 58%, and by 69% for 14 and 15-year-olds.

This downward trend can be attributed to several factors, including increased awareness of alcohol's negative effects on adolescent brain development, stricter enforcement of minimum legal drinking age laws, and more effective prevention programmes. In addition, the COVID-19 pandemic contributed to this decline, as school closures and reduced social interactions limited opportunities for underage drinking.

The substantial reduction in underage drinking represents more than just a statistical achievement. While this demographic cohort contributes minimally to alcohol sales, the real victory lies in safeguarding young people until they can make better informed decisions about alcohol consumption when they reach legal age.

Adaptability Wins

While younger demographics exhibit shifting drinking patterns—delaying the start of alcohol consumption and experimenting with newer categories—they are not abandoning alcohol altogether.

These trends underscore the importance of adaptation. Companies that embrace premiumisation, focus on responsible marketing, and anticipate changing preferences are well-positioned for long-term success.

Many of our alcohol companies have launched low and no-alcohol variants, which has been an important source of growth in recent years. Heineken's low and no-alcohol beers represent over 3% of their global beer volume, whilst Diageo's Guinness 0.0 has become the UK's bestselling alcohol-free beer.

The premiumisation trend also has further to go. Authenticity and aspirational consumption remain deeply embedded in consumer behaviours and will continue to shape the industry's evolution.

The alcohol industry is far from being in structural decline; rather, it is navigating a period of post Covid excess and redefinition. By balancing these issues carefully, we believe the sector can continue to generate attractive returns over the long term.

Whether and whatever you may be drinking this month, we raise a glass to you and wish you a Happy New Year.[2]

Sian-Azilis Evans — January 2025

[2] Data included in this report is from The University of Michigan Monitoring the Future, The Substance Abuse and Mental Health Services Administration and Bernstein Research.

Responsible Investment at Troy

UK STEWARDSHIP CODE

Signatory of:

PRI Principles for Responsible Investment

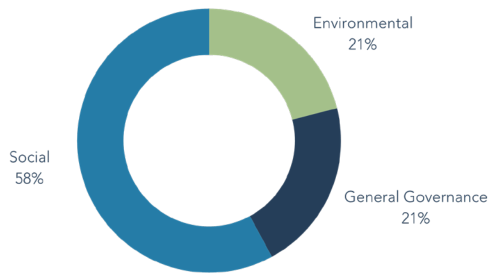
NET ZERO ASSET MANAGERS INITIATIVE

Voting

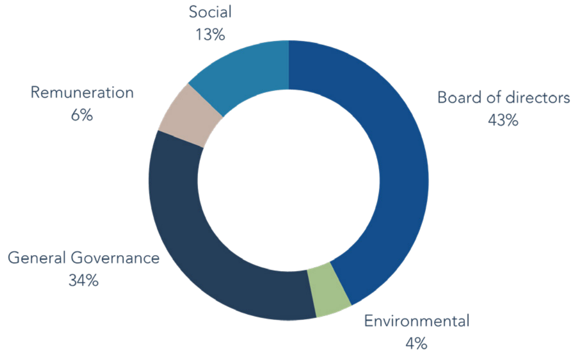
	2023	2024
Meetings Held	98	100
Meetings voted	100%	100%
Meetings with at least 1 vote Against Management*	48%	35%
Management Resolutions		
Total management resolutions	1,618	1,554
Votes against management resolutions*	8%	5%
Votes against ISS recommendations	10%	6%
Shareholder Resolutions		
Total shareholder resolutions	79	70
Votes in favour of shareholder resolutions	43%	27%
Votes against ISS recommendations	24%	16%

Source: ISS. *This may include abstentions.

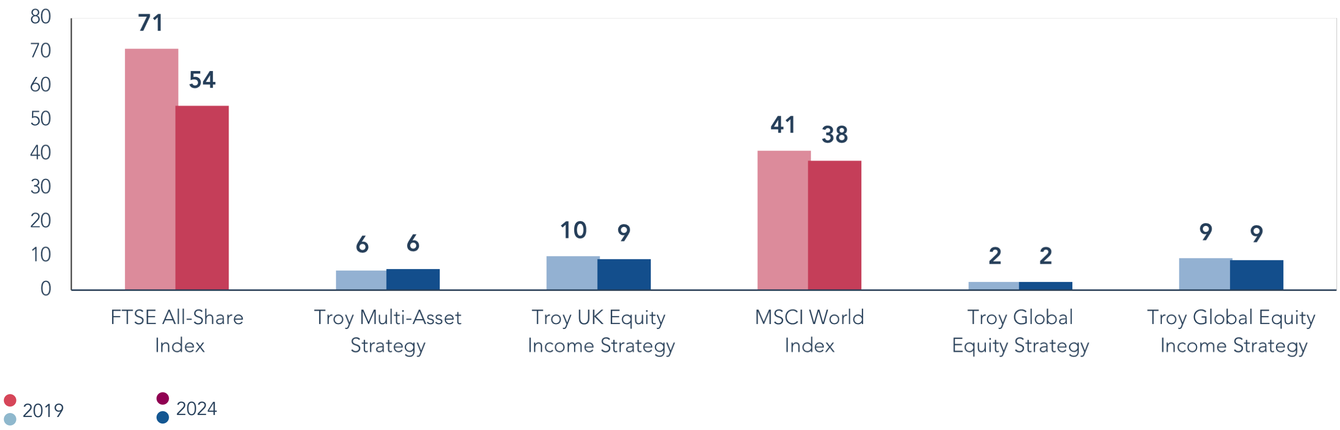
VOTES IN FAVOUR OF SHAREHOLDER RESOLUTIONS – 2024



VOTES AGAINST MANAGEMENT RECOMMENDATIONS - 2024 (BOTH MANAGEMENT AND SHAREHOLDER RESOLUTIONS)

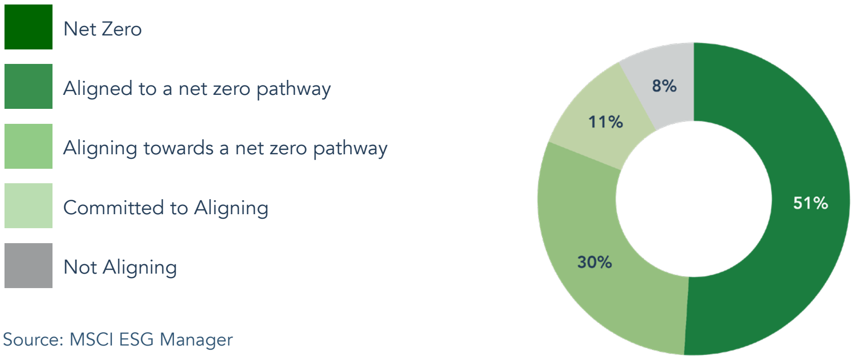


Portfolio Carbon Footprint (Tons CO2e / $M Invested)*



*Carbon footprint calculated using market capitalisation.
Source: MSCI ESG Manager, portfolio holdings as at 31 December 2024. Asset Allocation subject to change. The information provided is based on calculations relating to corporate securities only. Where the fund holds other asset classes, such as cash or government bonds, these are excluded from the portfolio. The information shown relates to a mandate which is representative of, and has been managed in accordance with, the relevant Troy Strategy. Past performance is not a guide to future performance. All references to benchmarks are for comparative purposes only.

Current Alignment of our Holdings with Net Zero by 2050

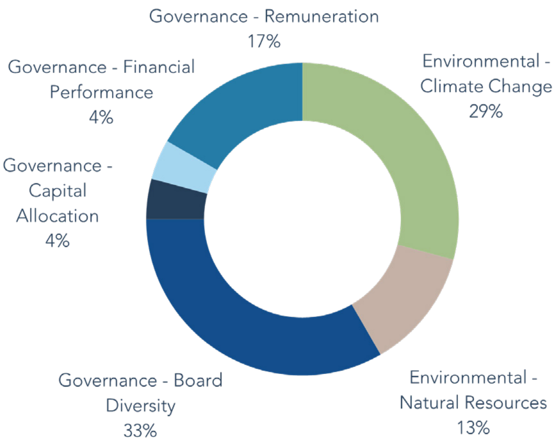


Source: MSCI ESG Manager

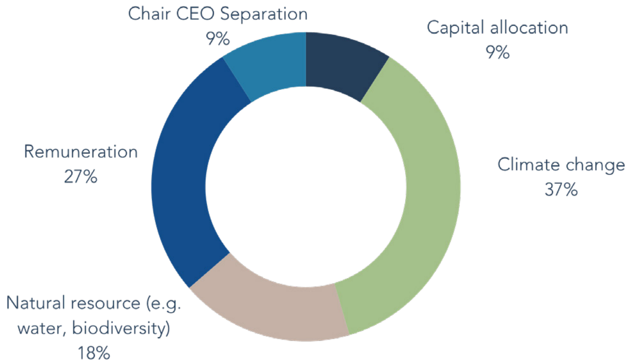
Troy has categorised all equity holdings along an alignment maturity scale in accordance with the Institutional Investors Group on Climate Change's (IIGCC) Net Zero Investment Framework methodology. This reflects our commitment under the Net Zero Asset Managers initiative to ensure our investments are on track to meet global ambitions of net zero emissions by 2050 or sooner. We currently have engagements underway with all holdings deemed 'not aligning', our goal is to move all holdings along the climate maturity scale with the ultimate objective of achieving net zero. For further information please see Troy's Climate Change Mitigation Policy.[2]

Engagements

2023 - 23 ENGAGEMENTS WITH 18 COMPANIES



2024 - 11 ENGAGEMENTS WITH 10 COMPANIES



Source: Troy Asset Management, 31 December 2024. [2]This policy outlines the consideration of climate risk in our investment decision-making process for mandates which meet the criteria under Article 8 of the European Union's Sustainable Finance Disclosure Regulation

Disclaimer

Further information relating to how ESG integration is applied to the fund can be found in the fund prospectus and investor disclosure document. For further information relating to Troy's approach to company voting and engagement, please see Troy's Responsible Investment and Stewardship Policy available at www.taml.co.uk.

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