Trojan Income Fund

Protect and grow

"Never change a winning game..."

The quote came from the late, great American tennis pro, Bill Tilden, and was often repeated to me as a budding player. If you are on to a winning strategy, stick with it. I have found the same wise words apply in investment. While evolving and improving are a must, there is little logic in changing a sound and successful approach.[1]

Since its launch in September 2004, the Trojan Income Fund has judiciously balanced capital growth and income to provide investors with market-beating returns and shallow drawdowns, as well as the lowest volatility in the Investment Association (IA) UK Equity Income sector.[2]

The Fund has delivered an annual return of c.8% over these 17 years. Annual volatility has been some 35% below the FTSE All-Share Index and IA UK Equity Income sector. We aim to deliver a resilient total return and lower-than-average volatility by investing in strong businesses capable of generating real cash flow and dividend growth. While our processes have evolved and improved, our fundamental aims and core investment principles have not changed. If anything, our experience has only strengthened our resolve and we look forward to investing this way for the next 17 years.

Resilience in tough markets

We have always believed that income investing is a natural home for investors' more cautious equity allocations. For us, the best income-paying companies are well-established, growing businesses financing dividends by generating surplus cash flow. We seek out companies with consistently growing sales and attractive business models that are well placed to grow their dividends year in, year out. The businesses in which we invest have proven to be resilient, as has the Fund itself.

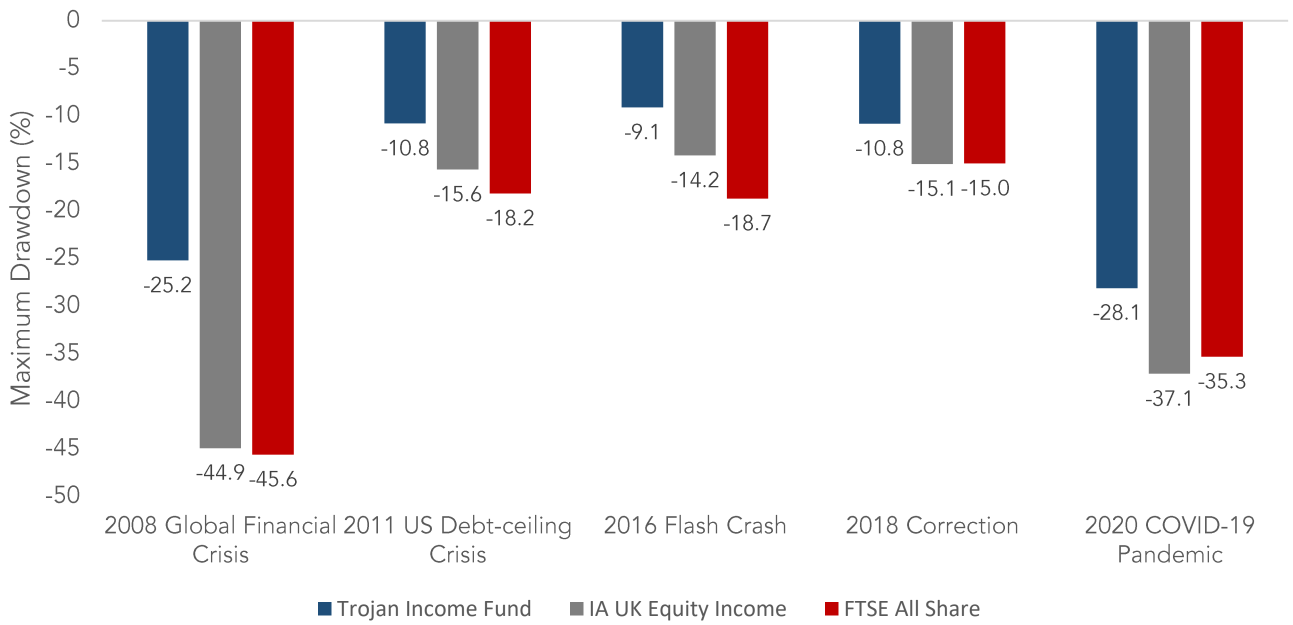
Figure 1 (below) charts the five most significant UK equity market drawdowns since the Trojan Income Fund's inception. This starts with the Global Financial Crisis and ends with the onset of the COVID-19 pandemic.

With the Trojan Income Fund represented in dark blue, readers can see the more resilient profile of the Fund in each period of stress, in comparison with the FTSE All-Share and the IA UK Equity Income sector. The return profile of the sector in grey is also noteworthy; while capital invested was protected slightly better than the rest of the market in the earlier drawdowns, this was not the case in either 2018 or 2020. Clearly there are different approaches to equity income investing but given Troy's clear preference for resilience and reliability, the increasingly cyclical nature of much UK equity income investing does not sit naturally with us. We will always take our own approach rather than follow the crowd.

[1] "Far From The Finishing Post – Playing To Your Strengths For Sustainable Income Growth" https://www.taml.co.uk/Podcasts-Webinars/

[2] Drawdown is the peak to trough decline over a particular period of time. Volatility measured as standard deviation of annual returns

Figure 1 – Trojan Income Fund, Maximum Drawdown



Past performance is not a guide to future performance

Source: Factset and Lipper – O Income shares total return net of fees since launch 30 September 2004 to 31 July 2021. All references to benchmarks are for comparative purposes only

Investing with an absolute mindset

Indeed, the Fund's resilience stems from our unwavering philosophy and approach, and our absolute, rather than relative mindset to investing. At Troy, we do not worry about what the index is doing; we invest freely, purely interested in finding the best prospective returns consistent with our investment objectives. Our investors want absolute, cash-on-cash returns to preserve and grow their wealth, and this is what we target.

Taking a relative approach to investing is beset by several risks. Perhaps the greatest is that we would be pushed to invest in companies and sectors inconsistent with our investment beliefs and objectives. This is particularly clear in the UK, where some of the largest and highest yielding stocks in the FTSE All-Share (such as banking, oil exploration and mining companies) are those most incompatible with our approach. We do not like the combination of high cyclicality and capital-intensity in these industries; our natural habitat is companies capable of consistently and sustainably growing free cash flow and therefore dividends.[3]

We also take an absolute approach to income, prioritising growth in dividends in pounds and pence, rather than a certain yield or yield relative to a specific index.

This may be at odds with the requirements of the IA UK Equity Income sector, which requires funds to at least match the yield of the FTSE All-Share. To remain in the sector, we would have to chase the market's weighted-average yield, irrespective of how sustainable we judge this to be, or what targeting such a yield might mean for our ability to protect capital. We would end up with the proverbial tail wagging the dog.

[3] Free cash flow is the cash generated by operating activities after capital expenditure that can be used for dividends, share re-purchases, repayment of debt or to fund acquisitions

The Fund currently has a dividend yield of 2.5%, a healthy and realistic yield for today's environment. This is below that of the FTSE All-Share. Unless the IA UK Equity Income sector is redefined, the Trojan Income Fund is likely to move out of the sector.

Our approach to income investing is clear. We see yield as the output of a sensible, bottom-up portfolio construction process that reflects the most relevant opportunities rather than an input. We target companies with growing cash flow and dividends per share, which will translate into real income growth in pounds and pence for investors.

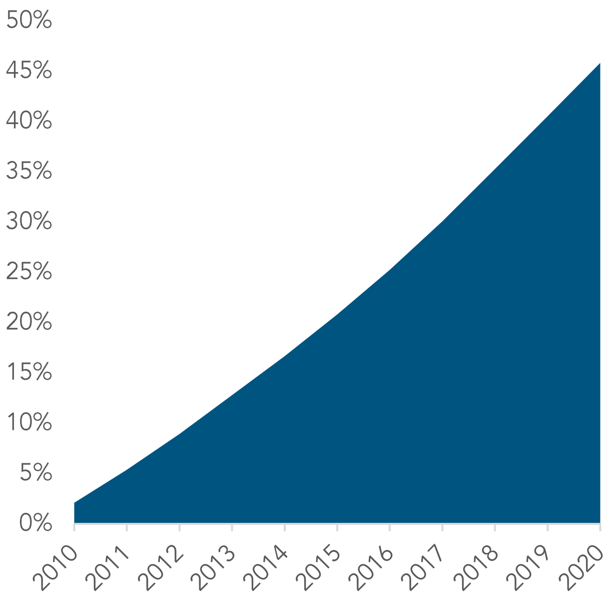
Growing capital and income

A good example is Croda, a leading speciality chemicals company that supplies key ingredients in products ranging from anti-ageing cream to mRNA COVID vaccines.

While its chemicals typically account for a tiny fraction of each product's volume, they are crucial in terms of science and value. In other words, Croda supplies the magic ingredients. This gives it pricing power, and in turn, strong gross margins. The company's R&D informs product development at thousands of businesses in growing and relatively non-cyclical sectors such as personal care and life sciences. Underpinned by science, rather than heavy manufacturing, the business is capital light, enabling Croda to reinvest and pay a sustainable, growing dividend. We have been impressed by the long-standing management team and its approach to capital allocation.

Having grown the dividend for 29 consecutive years, including during the financial crisis and the pandemic, this is a high-quality income growth stock, even though the current yield of c.1.4% is considerably lower than the market.

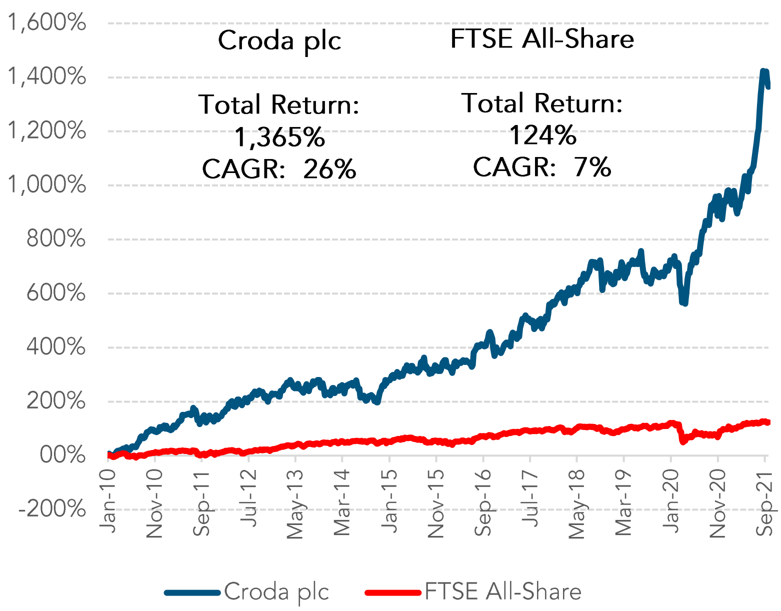
Figure 2 – Croda, cumulative dividends received as a % of 2010 share price



Income generated may fall as well as rise and past performance is not a guide to future performance.

Source: Bloomberg, 31 December 2020.

Figure 3 – Cumulative Total Return 2010-2021 YTD



Past performance is not a guide to future performance

Source: Bloomberg, 31 December 2009 to 30 September 2021.

An investor who bought shares in 2010 would by 2020 have already received close to half the original investment back in income alone (Figure 2), whilst also earning a handsome total return (Figure 3).

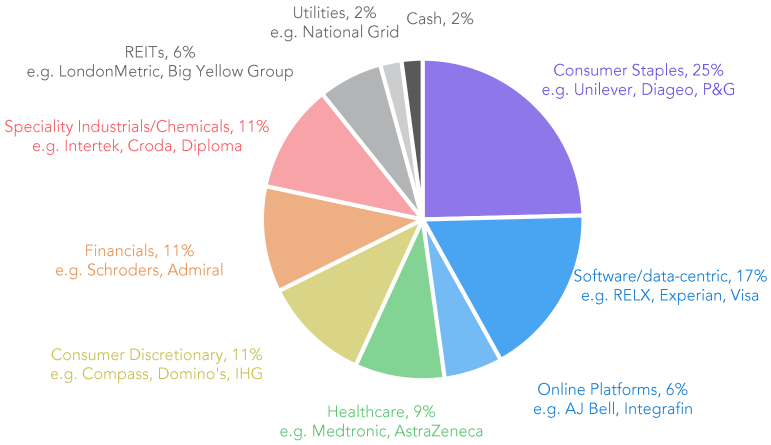
As the chart in Figure 2 shows, Croda 'only' yielded slightly more than 2% back in 2010, as it did when we bought shares last year. And yet the annual dividend has more than doubled since 2010, reflecting an average annual growth rate of +10%, compared with just +0.5% for the FTSE 100. Crucially, Croda's dividend has been paid out of excess cash flow, after consistent reinvestment into future growth. The result has been strong share price performance which, when combined with the dividend track record, has generated an annual total return of +26%, compared with the FTSE All-Share's +7% (Figure 3). As such, stock bought in 2010 would today yield over 5% on the original share price. Rather than overlooking stocks such as these, because of their relatively low yield, I believe companies such as Croda are the bedrock of an income fund, providing sustainable income and capital growth for patient investors.

In future newsletters I am looking forward to exploring some of the traits of resilient, world-class UK companies which we believe will achieve strong capital and income growth for years to come.

Blake Hutchins

October 2021

Sector Breakdown (custom definition by Troy)



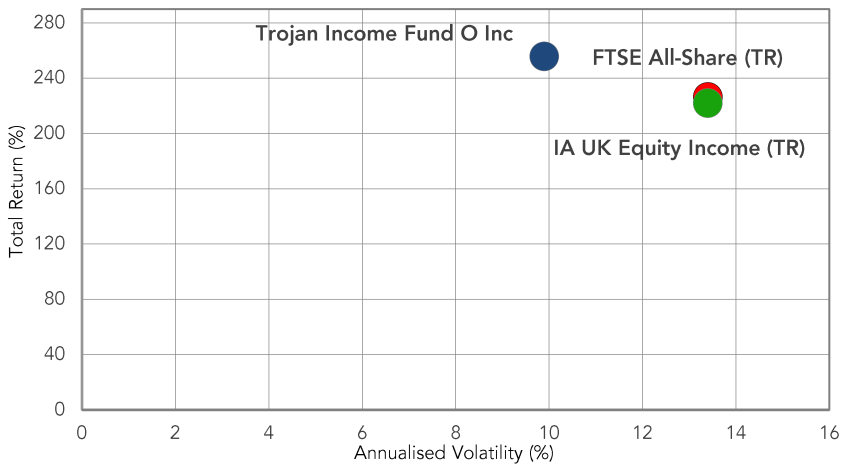
Source: Troy Asset Management, 30 September 202. Asset Allocation and holdings subject to change.

Top 10 holdings

Diageo	Croda International
Experian	Paychex
RELX	AstraZeneca
Unilever	Nestlé
Reckitt Benckiser	GlaxoSmithKline

Total top 10	45.4%
Other 30 holdings	53.0%
Cash	1.6%

Source: Factset. Holdings subject to change



Source: Lipper, 30 September 2021. **Past Performance is not a guide to future performance**

Fund Ratings

For information on how to invest, please visit
www.taml.co.uk/Funds/How-To-Invest

ESG

Troy achieved the following scores from the UN PRI (July 2020) in relation to Direct and Active Ownership of assets.

Score	Topic
A+	Listed Equity – Incorporation
A	Listed Equity – Active Ownership
A	Fixed Income – SSA (Sovereign, Supranational and Agency)

Troy UK Income team

Francis Brooke Blake Hutchins Hugo Ure Fergus McCorkell Aniruddha Kulkarni

Troy Asset Management became a signatory to the Net Zero Asset Managers Initiative in July 2021 and the drive towards achieving net zero greenhouse gas emissions by 2050. The initiative is backed by a total of 128 signatories with over $43 trillion assets globally.

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