



Investment Report N°69

www.taml.co.uk

July 2021

Our aim is to protect investors' capital and to increase its value year on year.

Dedicated to
Jeremy Lyon
1942-2021

Stock Jobber and Stock Broker for 62 years

Legends

Back in the late 1990s, as an aspiring fund manager at GEC Pension Fund, I read *Money Makers* by Jonathan Davis. The book is somewhat dated now but in its time it provided a wonderful insight into the life and times of eight great UK-based fund managers including Anthony Bolton, Nils Taube, Mark Mobius, and Michael Hart of Foreign & Colonial (who was an early inspiration for my co-director Francis Brooke). *Money Makers* appealed to me because it demonstrated two axiomatic insights into investment management. Firstly, there are plenty of different ways to succeed in investing; everyone has a style to best suit their temperament and talents. The second, perhaps less obvious lesson, is that clients have different needs and desires as well. Not everyone is seeking to 'beat the market' over every time frame. Some are seeking a different experience to all the thrills and spills the equity market has to offer. I was drawn to one fund manager's approach which particularly appealed to me because it combined a big picture, macro view with bottom-up stock picking. He was Ian Rushbrook, described by Davis as "a stock market impresario". I soon became a shareholder in his investment trust, Personal Assets Trust, and the rest, as they say, is history.

Money Makers totally changed the way I looked at investing. It advocated for an approach which was long-term, which focused on avoiding the drawdowns of markets, and

which unapologetically relinquished the dogma of returns relative to an index. While the FTSE All-Share, MSCI World or the S&P 500 indices may be the correct target for certain institutions, are they appropriate for *all* investors? Private investors, academic research has shown, tend to be whipsawed by buying high and selling low. For most people the goal of capital preservation is the absolute priority. Similarly, charities never know when they will require access to their reserves. The last thing a trustee needs to see is the value of a charity's portfolio collapsing when the funds are needed most. Case in point, the pandemic required many charities to dip into their reserves in the teeth of the crisis. This coincided with the collapse in stock markets and the freezing of traditional fundraising due to lockdowns. A fully-invested equity portfolio is not always suitable for such eventualities.

Investing is about more than maximising upside or beating indices over short time periods. Many would prefer to avoid the slings and arrows of red-blooded equity market volatility but still, over the longer term, see their investments grow ahead of inflation and compound at a consistently attractive rate. We believe this is possible with patience and the acceptance that short-term returns may lag when markets are at their most ebullient.

Twenty years of winning by not losing

At the end of May, we celebrated 20 years of Troy's multi-asset strategy which began with the launch of the Trojan Fund and now includes Personal Assets Trust amongst other mandates. In this report I reflect on the experience of the past two decades,



considering the evolution of our investment process.

I have said before that this mandate, more than anything, is about 'winning by not losing', a phrase coined by Charlie Ellis in his book *Winning the Loser's Game*. In it, Ellis compares investment to playing lawn tennis. You win, not from hitting spectacular winners, but by keeping the ball in play and by making your opponent hit one more shot. Wimbledon fans will be all too familiar with this. During the Championships we watched Novak Djokovic grind down his opponents by keeping the ball in play and staying in the game.

What this means, in investment terms, is 'staying in the game' by avoiding the permanent capital loss suffered from torpedoes in your portfolio – the losers. Within equities, these tend to be weak businesses that are highly cyclical, geared or both. They may tempt us with the prospect of a short-term recovery or be buoyed by a temporary pick-up in demand. Over the long term, however, they bring with them the downside that accompanies poor competitive positions and low returns on capital. These are 'wasting assets' which we seek to avoid.

What I have learnt over 20 years of managing the Trojan Fund is that an equity approach which prioritises quality is more suitable (and a lot less stressful) than attempting to trade the ups and downs of lesser businesses. Equity investing is about participating in future cash flows delivered over the course of years and decades. It is not about riding on next quarter's earnings puff or hanging onto the glories of yesteryear. Looking back at the constituents of the S&P 500 20 years ago informs us of the harsh Schumpeterian reality of business. There are few survivors. For the S&P 500, Microsoft is the only company to remain in the top ten from May 2001, when we

launched the Trojan Fund. If you had invested in the top ten companies back then you would have lost money in seven of them despite the stock market's rising tide. In the case of two of these stalwart 'blue chips' of 20 years ago - General Electric and AIG – you would have lost more than 75% of your capital. We believe steering clear of such losses is the primary aim of any long-term investment plan.

Low turnover, not no turnover

Over 20 years, change is inevitable. We recognise that portfolio turnover is a tax on investment returns and not just because of the direct costs of trading shares. There is also rich reward for patience from the positive compounding of returns. The average equity holding period for our multi-asset portfolios today is around seven years. But whilst we believe in low turnover, we do not believe in no turnover. Episodes of heightened activity at junctures like 2008 or 2020 are to be embraced, in the knowledge that they will often be followed by prolonged periods of calm. Our *modus operandi* has always been to be proactive and to treat the portfolio as a living animal, not something set in aspic.

Since Troy's foundation, the quality threshold for the businesses in which we invest has risen and our hit rate has improved. In that time, we have invested in 98 companies. During the first decade, 81% of stocks made a positive contribution to returns; that figure rose to 86% in the second. Of the 82 stocks that have left the portfolio, eight received takeover bids. Our track record is a function of a number of things. Perhaps most important is our highly selective filter at the time of purchasing any stock. Next comes patience. This is afforded by our mandate's time horizon, but it also requires a certain temperament and is bolstered by a conviction, borne of thorough research, in each investment that we make.



Patience does not, however, mean refusing to alter our course when new information comes to light; 'buy and hold' is not 'hold forever'. The majority of our sell decisions are made following a period of positive returns and are driven by our identification of increasing risks to the business or better opportunities elsewhere. There are also, thankfully less frequent, instances where investment decisions transpire to have been wrong with the benefit of hindsight. When the facts change, we change our minds; we are not wedded to any holding in the portfolio.

The improvement in the quality of our holdings can be seen through portfolio-level metrics. Looking at the aggregate free cash flow margin of our equity holdings, this has always been in excess of the average stock market constituent but it has improved over the past decade by over 10 percentage points (see *Figure 1*). It is now well above market levels, illustrating the huge financial productivity of the companies we favour. Compare this to the price to free cash flow¹ which is still broadly in line with that of the MSCI World, an indicator that we resist overpaying for superior cash margins.

Evolution, not revolution

In my first investment report in July 2001, I stated that, "*We intend to invest in UK and US equities*". Part of the strategy's evolution pertains directly to its geographical make-up. Prior to the financial crisis in 2008, we held c.80% of our equity investments in the UK, with the balance overseas. Over the past decade this has reversed, so that today the equity portion of our multi-asset portfolios is c.80% invested overseas (predominantly in the US) and the remainder in the UK. This international shift has nothing to do with any 'top-down'

view on the UK market, nor its valuation. Instead it is a function of finding better companies elsewhere from a 'bottom-up' perspective. We have always found incredible depth of world-class businesses in the US. This is true across a broad range of sectors from software to healthcare, and the breadth of opportunity has only improved over the past decade.

We will continue to be guided by where the best opportunities lie. For us, companies must have exceptionally strong governance to match an outstanding business model, and that will often determine the jurisdictions in which we are happy to invest. However, that still means doing the homework on areas which may not be investable today. Getting to know businesses in geographies such as China is paramount to understanding the global opportunity set. You will be reassured to hear that, having founded Troy as a one-man-band, I am now ably supported by a very talented team of fund managers and analysts, all of whom are focused on identifying the best businesses in the world. We retain an open mind when it comes to opportunities further afield, whilst maintaining that high bar set for capital preservation.

Seeking Absolute Returns

"Our aim is to protect investors' capital and to increase its value year on year"

This quote from Lord Weinstock has featured at the top of this report since its first edition. We hasten to clarify that we do not consider the Trojan Fund or Personal Assets Trust to be 'absolute return' mandates, even though we endeavour to deliver attractive absolute returns over the long term. True absolute

¹ Price to free cash flow is the share price divided by the free cash flow per share



return funds target positive returns over all time periods. We recognise that we are long-only investors with a mandate that intentionally eschews shorting - and for good reason. Shorting is an entirely different investment discipline and one which incurs the threat of unlimited liability.

Our long-only approach does not entail the use of stop losses; on the contrary, in weaker markets we lean into risk, increasing equity exposure as we did in the first quarter of last year. In more benign conditions, where risk appetite and investor complacency are high, we are prepared to stand back from markets and reduce our exposure. This approach has been stress-tested over market cycles from the dotcom bust to the global financial crisis, and more recently the pandemic.

Diversification

What of the other parts of the portfolio? While equities have been the driver of over 60% of the returns achieved in two decades, fixed income (including index-linked), gold and currencies have contributed strongly to overall performance. Furthermore, they have provided crucial diversification and protection in times of market stress. They also offer valuable liquidity for us to deploy into equities when valuations become more attractive.

Gold bullion continues to serve an important role when it comes to protecting capital. It has generated returns of over +11% per annum (in £) since we first invested in 2005, and continues to provide a rare store of value in the form of an alternative currency that cannot be printed. Gold has proven its credentials over millennia. Currency debasement is nothing new and we retain gold as insurance against the eroding purchasing power of modern money. We remain open minded as to whether the current surge in consumer prices

will be transient or sustained. Over the past 12 years from 2009-2021, a saver holding cash has earned a mere +6% on their savings, which compares to UK RPI of +39% over the same period; a -24% devaluation of sterling in real terms. This is the definition of financial repression. In the years to come, given the current level of nominal interest rates, we suspect that this will remain a persistent problem for savers.

Preserve and grow

What of the next decade? Our aim is still clear: to protect and grow the capital of our investors. This objective remains constant and just as relevant today as it was 20 years ago. There is no doubt that the next ten years will be very different but some things never change. The laws of compounding are most certainly intact. If you lose less on the downside, and still manage to compound steadily on the upside, your long-term returns will be better and the ride will be considerably more comfortable.

We are under no illusion that despite these constants, we must adapt. After 13 years, the unorthodox monetary policy of Quantitative Easing and low interest rates seem to be here to stay, with profound implications for asset prices and volatility. The means through which we fulfil our mandate will continue to evolve, but our principles are steadfast. We must steer a course that can deliver for investors on those same things that mattered when Troy was founded at the turn of the millennium. Look after and preserve what is there. Turn off the siren sounds of market noise and euphoria and instead, tune in to opportunities which will play out over the long term, where patience is rewarded. We thank our investors and shareholders for their continued support.

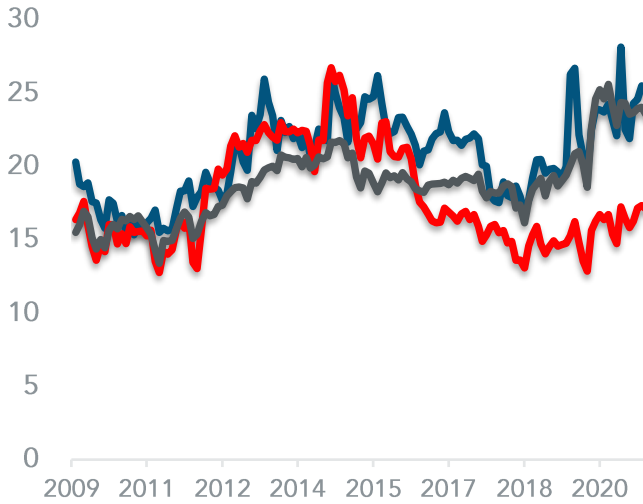
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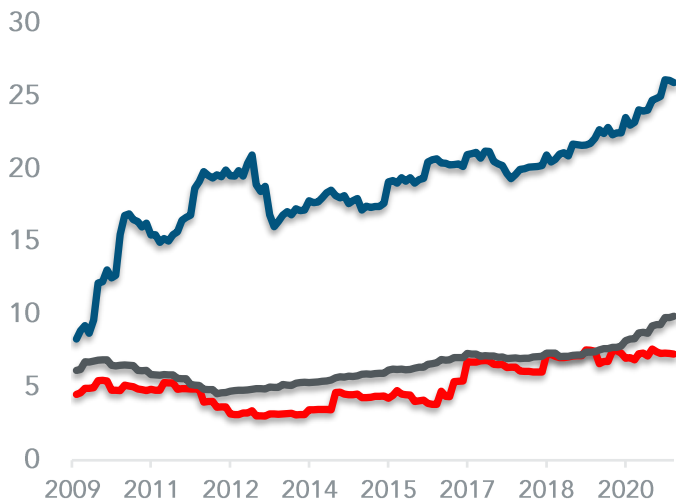


Figure 1 - Equity Holding Characteristics

Price to Free Cash Flow



Free Cash Flow Margin (%)



— Trojan Fund — FTSE All-Share — MSCI World — Trojan Fund — FTSE All-Share — MSCI World

Source: Factset and Troy Asset Management Limited, 31 December 2009 - 31 May 2021.

Free cash flow represents the cash a company generates after accounting for cash outflows to support operations and maintain its capital assets.

Free cash flow margin is the free cash flow a company generates divided by its revenues.

Price to free cash flow is the share price divided by the free cash flow per share.

Past performance is not a guide to future performance

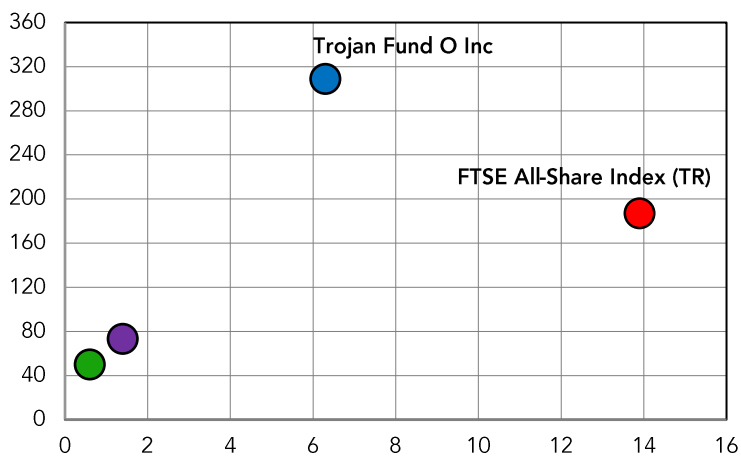


Figure 2 - Troy Multi Asset Strategy Track Record

| Total Return to 30 th June 2021 | *Annualised Return Since Launch | *Since Launch | 15 years | 10 years | 5 years | 3 years | 1 year | 6 months |
|--|---------------------------------|---------------|----------|----------|---------|---------|--------|----------|
| Trojan Fund O Inc | +7.3% | +308.9% | +160.2% | +67.1% | +30.3% | +24.5% | +8.3% | +6.1% |
| UK Official Bank Base Rate | +2.0% | +49.9% | +20.6% | +4.7% | +2.1% | +1.4% | +0.1% | +0.0% |
| UK Retail Price Index | +2.8% | +73.3% | +52.1% | +28.4% | +14.7% | +7.2% | +3.1% | +2.2% |
| FTSE All-Share Index (TR) | +5.4% | +186.9% | +131.0% | +85.5% | +36.9% | +6.3% | +21.5% | +11.1% |

*Trojan Fund launch date 31 May 2001

Source: Lipper – O Income shares total return net of fees since launch 31 May 2001 to 30 June 2021



| Risk analysis | Trojan Fund O Inc | FTSE All-Share Index (TR) |
|-----------------------|-------------------|---------------------------|
| Total return | +308.9% | +186.9% |
| Max drawdown | -13.7% | -45.6% |
| Best month | +8.9% | +12.7% |
| Worst month | -4.7% | -15.1% |
| Positive months | +66.8% | +58.9% |
| Annualised Volatility | +6.3% | +13.9% |

Source: Lipper – O Income shares total return net of fees since launch 31 May 2001 to 30 June 2021

Past performance is not a guide to future performance



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