TROY ASSET MANAGEMENT LIMITED
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TROJAN FUND

Quarterly No.10

The aim of the Fund is to protect investors' capital and to increase the value of the Fund year on year.

New Investment Director

Troy Asset Management is delighted to announce the appointment of Francis Brooke who joins from Merrill Lynch Investment Managers (1997-2004) where he was a Director with responsibility for managing £1.5 billion of UK equities for major clients. He was a member of MLIM's Asset Allocation Committee and UK Sector Strategy Group. Prior to that he was a Director of Foreign & Colonial Management Ltd and specialised in UK equity portfolios (1989-97). Francis is a highly experienced investment manager with a distinguished track record and a deep knowledge of equity markets. He will be responsible for managing the new Trojan Income Fund due to be launched at the end of September.

Trojan Income Fund

Troy has consistently espoused the benefits of investing for income and we believe that a number of existing unitholders in the Trojan Fund, as well as new clients, will be interested in the Trojan Income Fund. This Fund will generate a higher and more regular income than the Trojan Fund which targets total returns and not income. The management fees will be the same as for the Trojan Fund but, where possible, costs will be charged to capital rather than income. If you are interested in the Income Fund, please contact Francesca Davies on 0207 499 4030. Like the Trojan Fund, investors will have the option of choosing either income or accumulation units.

Going Nowhere

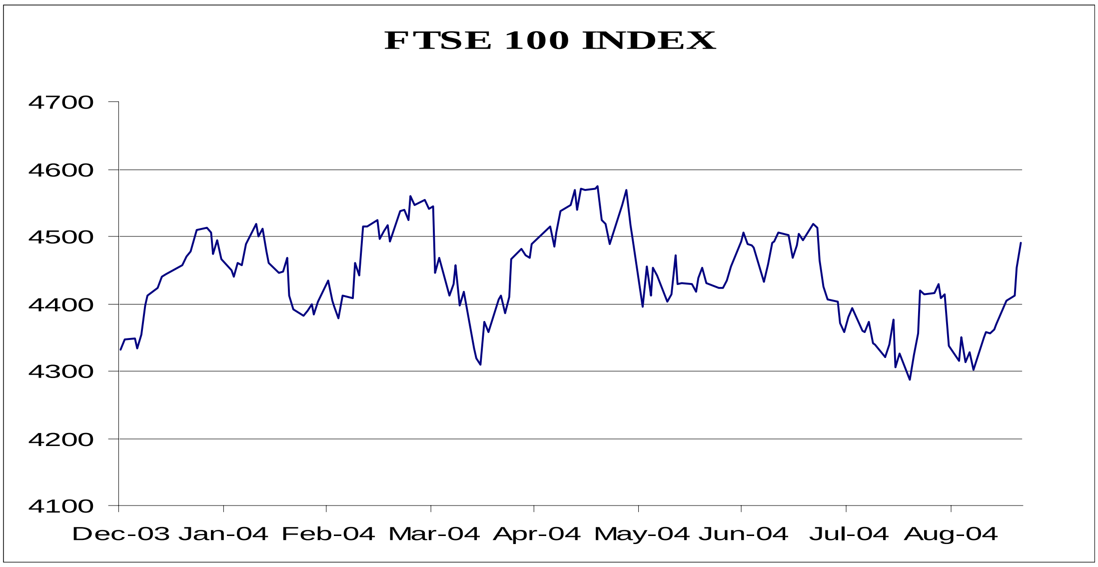


Figure 1 *Source: Bloomberg*

The lack of activity in the equity market is beginning to frustrate those investors who are seeking short term returns. This is far and away the fastest growing and most active part of the market and they thrive on volatility. In contrast, as long term investors, directionless markets are less of a problem for us. We are happy to be patient. It is not just the last quarter that was dull. The UK equity market has traded sideways for almost forty weeks in a range of only 7%. This is reminiscent of the "*flatliner*" market of October 2001 to May 2002 which lasted 34 weeks (see Quarterly No.3) and preceded the sharp fall in markets in the summer of 2002. High risk takers have not been rewarded. In contrast to last year, the higher the risk taken, the lower the reward. The high beta trades of mining, technology and emerging markets are down year to date. Our proverbial traveller emerging from six months in a tropical rainforest with no access to information would briefly look at current market levels and dismiss them with a yawn.

Flatliner

After the bull markets of the 1980s and 90s and the bear market that followed, investors are not used to such lack of volatility; but markets can go sideways for a long time. Memories are generally short when it comes to investing, but we recently came across an old sage who had been investing for a highly regarded Scottish investment house since the early 70s. He reminded us that after the bull market of the 1960s the Dow Jones traded between 600 and 1000 for 15 years (see Figure 2). He recalled the celebrations each time the Dow hit 1,000, only for hopes to be dashed. It took a patient investor (merely living off dividend income) to await any capital return. This may not be different to the next few years as corporate earnings catch up with valuations. Good stock picking, active asset allocation (in and out of equities) at the right time, and a focus on dividend income will add value. Our investment approach should thrive in such an environment. Although we advocate low portfolio turnover, there will be times to be active. Index tracking fund management (the investment fashion of the 1990s), may be less appealing after such a prolonged period of range trading.

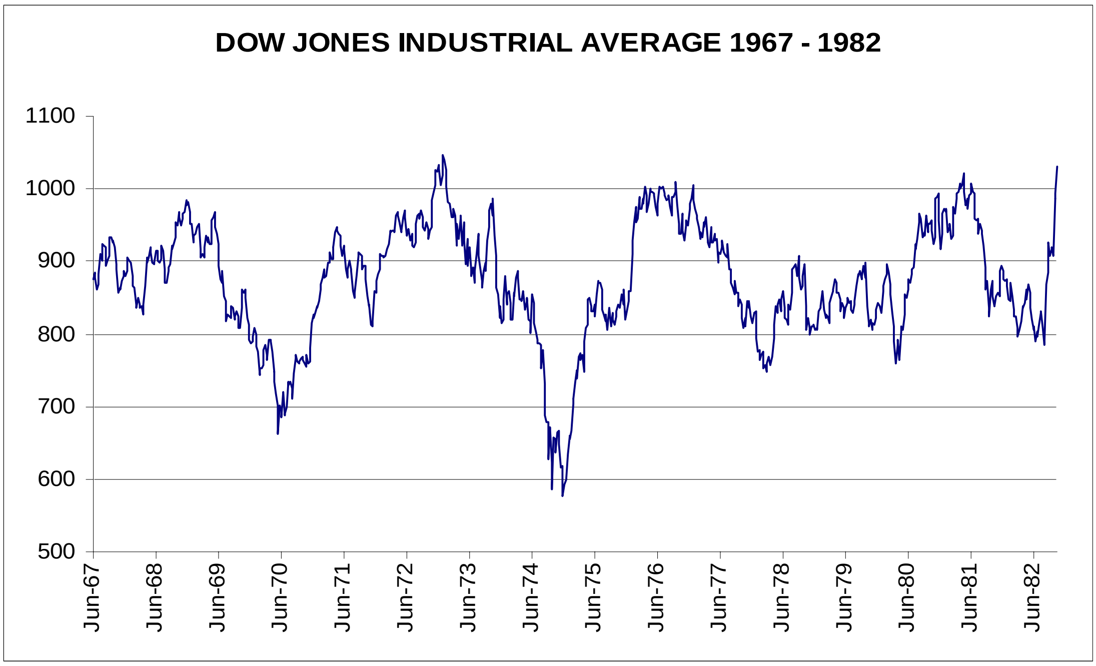


Figure 2 *Source: Bloomberg*

Boredom Trades

In quiet summer markets the temptation to do something is always there. Investors are mistaken in believing activity generates returns. More often than not, the opposite is the case. One of our highly regarded contacts from a large US investment bank told us of boredom trades. These are positions that traders put on amid the summer lull (with little or no conviction). This is often done just to be seen to be doing something. Invariably, in these low volume months, it is easy to get caught out by a sharp change of direction. The natural instinct is to cover ones losses quickly and move on to the next trade. More often than not, boredom trades lose money.

Notwithstanding all this lack of excitement, we have added one new holding to the Fund over the summer which was not taken due to your managers' lack of anything better to do while yearning for the beach! Reynolds American has just completed a merger with Brown & Williamson, BAT's US subsidiary. The cost savings of over $550m have been revised upwards and should come through next year. The company is committed to a payout ratio of 75%, putting the shares on a prospective dividend yield of over 9%. This looks like a good return to us. The stock has risen from the $66 we paid to $76 today. We hope that this investment will prove to be an exception to the rule.

Crisis, what crisis?

The old chestnut of long term savings has reared its head again recently but in a most unlikely situation. Usually, the mention of pension funds meets with a collective glazing over of anyone but David Willetts, the Conservative party pensions spokesman. We wrote about this topic a while ago in the context of companies needing to contribute more into their defined benefit schemes which guarantee pension payments to employees based on their final salaries. This is important for investors because a pension fund deficit is ultimately a creditor to the company. Higher contributions will continue to impact on corporate earnings growth. We also highlighted the trend away from schemes investing in equities in favour of bonds. In contrast to life assurance companies, most of whom have already made this switch, pension funds have been more glacial, attempting to finesse markets more adeptly than selling out at the bottom. However, the process is far from complete with pension funds expected to reduce equities from about 60% of their portfolio to nearer 40% in the next few years. Moreover, companies are putting pressure on trustees to take less equity market risk in order to avoid further nasty surprises which might increase pension deficits. Longevity, which will increase liabilities further, is only just beginning to be taken into account. As pension funds are one of the UK equity market's largest investors, this adds a headwind we could all do without. Governments are not prepared to tackle the issue of long term savings for fear that the main provider of economic growth, the consumer, will inevitably spend less if encouraged to save.

Poison Pills

The implications of poorly funded pensions are spreading further, into the field of mergers and acquisitions. In the last quarter, two attempts by private buyers to take over public companies were thwarted, at least in part, by trustees of the target companies' pension fund. These were, Philip Green's audacious approach to Marks & Spencer (although a formal offer for the company was never made) and Permira's bid for WH Smith. In both instances the trustees expressed concern that, if the proposed bid succeeded, the buyer would increase the company's indebtedness by gearing up the company's balance sheets. They insisted that company's pension fund contributions would need to be higher in order to take account of this risk. Martin Taylor, Chairman of the WH Smith's trustees quoted in the *Financial Times* said that "a pension fund deficit amounts to a loan to the company by the members of the pension scheme. It is my view that a bunch of little old men and ladies are inappropriate providers of corporate debt". Understandably, trustees, seen as a rather dry lot, are like any other creditor, keen to ensure their sponsor remains sufficiently solvent to keep paying contributions to the fund. Thanks to those little old men and ladies, the highly leveraged public to private takeover bids, which have kept the M&A activity going in the last few years, may be a thing of the past. Investment bankers, hoping for a return to the 1990s takeover boom, are in for a long wait. It may take years to realise that this was a once in a generation phenomena.

Relative investing

Love him or loathe him, in the heat of the battle for Marks and Spencer, Philip Green expressed some interesting views on the fund management industry with which we agree. Mr Green pointed out that a number of institutional investors that had not held M&S at 280p, before he made his approach to the company, could not resist buying at 360p, after the announcement, in order to *neutralise* their portfolios from further underperformance. This was just in case a bid went ahead and the share price rose still further. By purchasing an index weighting in the stock, these managers would be indifferent as to whether the bid went ahead or lapsed. It would not affect their *relative* performance. However, when Mr Green decided to walk away from the deal, the share price fell, leaving the investors with a loss. These managers' relative performance to the index was unchanged because the fall in the shares would be reflected by a fall in the index, but they had lost money for their clients. This approach of sell low, buy high is no path to riches and, while it may still be the industry standard, it is not a path we intend to follow.

Outlook

We have not changed our views about the economy and markets. Bill Gross, the highly regarded manager of Pimco's bond funds, described the global economy as "treading a tightrope between deflation and reflation". With the outcome so uncertain, the Fund's asset allocation and stock selection reflects this. The holding in bonds and preference shares will benefit from slower growth and disinflation, the cash and short-dated gilts give us the flexibility to exploit market squalls and protect capital while our equity holdings are biased to consumer goods stocks and utilities that should perform respectably in either a deflationary or inflationary scenario.

Arguably, equities do not look too expensive against 2005 forecast earnings, but forecast earnings are rarely accurate. On a historic basis, markets do not look cheap. After an unusually long period of sideways trading, there is less discernible bullishness and bearishness and more a common complacency. This attitude, at a seasonally difficult time for markets, could prove to be a triumph of hope over experience. We believe the Fund is in good shape to face that uncertainty.

Administration

We now deal weekly (at noon on Thursdays) and on the last working day of the month. If you would like to participate, application forms are available from Francesca Davies on 020 7499 4030, or from Capita Financial (Tel: 020 7556 8800). Please note that the income units are ex-dividend by 1.496p pence per unit. From early August accumulation units as well as income units were available.

Sebastian Lyon
Troy Asset Management Limited
September 2004

Trojan Fund

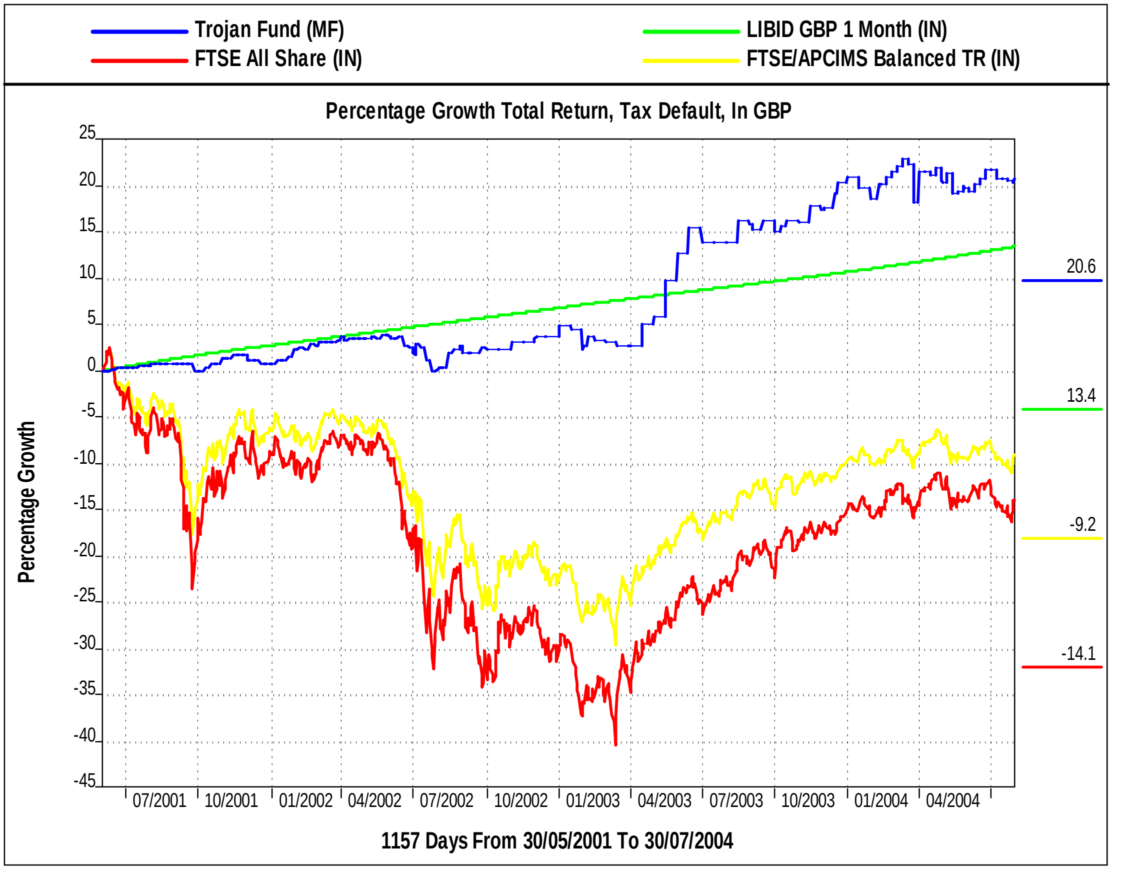
As at 31 July 2004

Unit Price £1.12 **Fund Size** £69.94m

Investment Objective

The investment objective of the Fund is to achieve growth in capital and income in real terms over the longer term. The Trust's policy is to invest substantially in UK and overseas equities and fixed interest securities.

The aim of the Fund is to protect investors' capital and to increase the value of the Fund year on year



PRESERVATION

CONSISTENT RETURN

EXPENSE

Performance
As at 31 July 2004

	Since Launch 30.05.01	3 years 31.07.01	1 year 31.07.03	3 months 30.04.04
Trojan Fund[1]	+20.6%	+19.9%	+6.0%	+0.24%
FTSE All Share Index[2]	-14.1%	-9.4%	+10.6%	-1.5%
APCIMS Balanced[2]	-9.2%	-6.9%	+7.1%	-1.31%
LIBOR	+13.4%	+12.4%	+4.0%	+1.11%

Currency Exposure
As at 31 July 2004

	% Fund
USD	0.6
JPY	0.0
EUR	0.0
AUD	0.0
GBP	99.4
Total	100.0

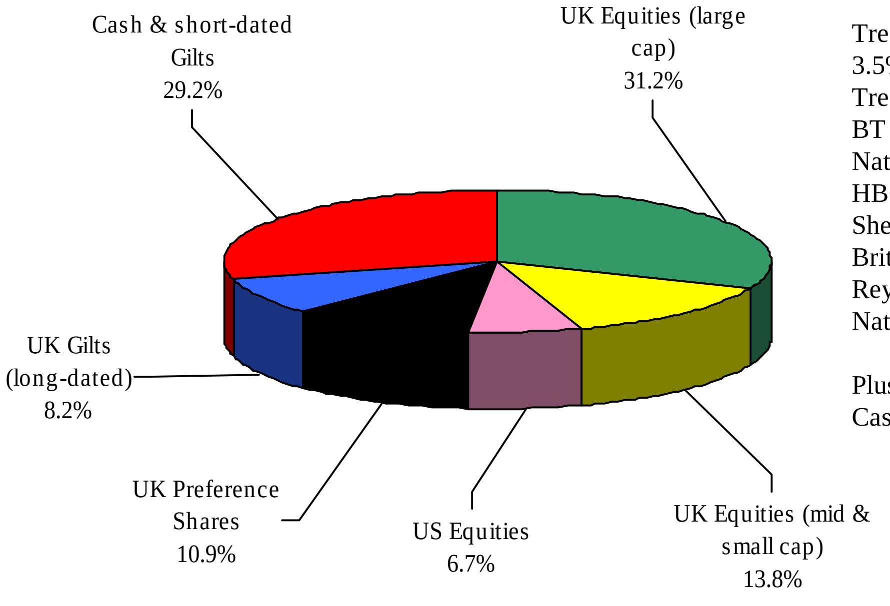
[1]Bid to bid, net income reinvested Source: Lipper Hindsight
[2]Total return indices Source: Bloomberg

The Trojan Fund is an absolute return fund. Any comparisons against equity indices are for illustrative purposes only

Trojan Fund

As at 31 July 2004

Asset Allocation



Top 10 Holdings

	% Fund
Treasury 5% 2008	12.3
3.5% War Loan	6.3
Treasury 7.5% 2006	4.6
BT	4.2
NatWest 9% Pref	3.9
HBOS 9.25% Pref	3.3
Shell T&T	3.2
British American Tobacco	2.7
Reynolds American	2.6
National Grid Transco	2.5
Plus 24 other holdings	42.0
Cash	12.4
Total	100.0

Authorised Corporate Director (ACD)
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15 St Botolph Street
London EC3A 7HH

Investment Adviser
Troy Asset Management Ltd
13 Albemarle Street
London
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020.7499.4030

Enquiries
Capita Financial
020.7556.8800

Registrar
Capita Financial Administrators Ltd

Depository
State Street Trustees Ltd

Auditors
Ernst & Young LLP

Dealing
Weekly – Thursday at 12 noon and month end

Denominated Currency
GBP

Management Fees
Standard fee: 1%

Launch Date
30 May 2001

Dividend
Paid annually
ex date 02.02.04
Final 2.824p
payment 31.03.04

Bloomberg
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