



Trojan Global Income Fund

5 Year Anniversary

Our Aim

When the Trojan Global Income Fund was launched in November 2016 our aim was to offer investors a Fund that was true to Troy's investment principles. To provide both income and returns that were above average but with below average volatility over a full market cycle.

Now, as then, we live in a world where income is scarce. In the meantime, valuations across capital markets have become richer still implying low expected returns and putting capital at risk of material, if not permanent, loss. More recently inflation has become more of a concern. We remain open-minded as to whether or not these worries are misplaced.

The combination of scarce income and low expected returns, to us, means Troy's focus on absolute returns and the quality of the underlying businesses in which we invest is more important than ever. We are acutely aware that many of our underlying investors have irreplaceable capital and are dependent, in part, on the income we produce. We are therefore keen to avoid substantial drawdowns.

This, in turn, informs our attitude to risk and guides our distinctive approach. Our primary focus is on generating absolute returns which gives us a clarity of purpose, a steer on valuation and helps us frame what returns might reasonably be expected. Competition for capital is driven by a continuous process of seeking the right balance of income, quality and growth to achieve our objective

rather than relative to a benchmark. Inherent in this idea is that standard relative approaches to risk fail to account for the fact that the benchmark itself may be risky. Given current valuations as well as the pace of change in the global economy we firmly believe this to be the case currently.

This approach requires a willingness to diverge from the returns of the broader markets by some margin on occasion as we demonstrated in the teeth of the pandemic as well as more recently. It is an inevitable outcome of our method. While our process has historically delivered a return with lower volatility, we make no attempt to manage the return relative to a benchmark.

We acknowledge that this approach requires a level of tolerance from our investors, our investment team and ultimately Troy to weather periods of underperformance. This is necessary to ensure the attributes outlined above remain embedded in our portfolios. Patience and faith in the process are required and a willingness to lag when markets are strong and led by companies we consider to be low quality. To paraphrase an old Scottish expression – *you can't have the rainbow without the rain.*

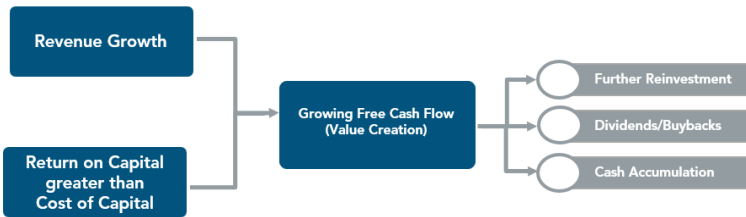
The private ownership of Troy allows for a culture rooted in the long term by aligning investment with persistent value creation, rather than by short term relative performance concerns. Such a stable, aligned ownership structure results in high staff equity ownership which, in turn, drives a stability of intellectual capital from low staff



turnover. From personal experience the benefits of this are hard to overstate.

Process

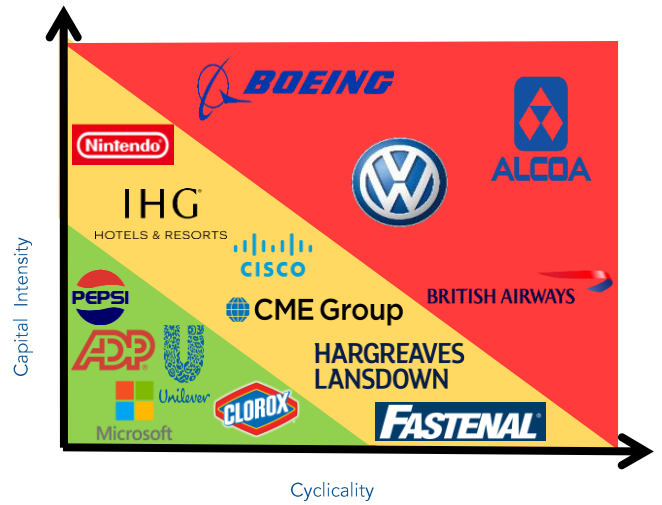
We confine ourselves to a relatively limited number of companies and sectors that we think can sustain high returns, grow, deliver income and that are resistant to both technological and increasingly environmental disruption. Further we favour companies that generally do not require large amounts of capital to grow. This is crucial as it 'squares the circle' between 1) being comfortable that a business generates sufficient predictable cash flow to re-invest to entrench their competitive advantages and 2) paying a dividend.



Source: Troy Asset Management, 31 October 2021

Capital-light businesses also cope better with inflationary environments as they are able to raise prices without having to increase capital expenditure commensurately. This may be more valuable in the next 5 years than it has been in the past. This group of companies, which have been built up over 20 years or so make up our investment universe. An example of portfolio holdings as well as businesses which we avoid is shown in the chart to the right.

This clear but distinct focus means the risks we concentrate on are related to the sustainability of returns and the opportunities for growth and income rather than what is considered to be risk by much of the industry.



Source: Troy Asset Management, 31 October 2021

There are plenty of things we do worry about such as a better competing product, a loss of patent, a dependence on a single product or brand – unless exceptional, a lack of visibility in the business or certainty of demand, regulatory risk if not priced in, underinvestment, an insufficient focus on returns on capital and poor management incentives or capital allocation.

Equally there are other factors that we worry less about such as tracking error – or positioning and performance relative to a benchmark, missing out on the latest fad/new thing or short term macro-economic or speculative noise. It is crucial, in our view, not to fixate on the short-term movement in share prices driven by news flow but on the sustainability of the competitive advantages a business enjoys.

We do, however consider the overall valuation of markets which themselves can impact on the prospects for particular businesses as well as, of course, expected returns. We aim to control this valuation risk by not overpaying for our companies.



Similarly we do not aim to morph the portfolio to capture the beneficiaries of perceived phases of the business cycle which seem to drive so much noise and activity in our industry. Our longer-term holding periods preclude this. Once we have established the portfolio we are reluctant to interrupt its development unnecessarily in order to aim to maximise the compounding of these high-quality businesses. With 9.4% annual turnover on average in the Fund over the last 5 years, it suggests we have holding periods of 10+ years. This is longer than most full economic cycles, let alone phases therein. Ironically perhaps, the current one appears to be a notable exception.

The outcome

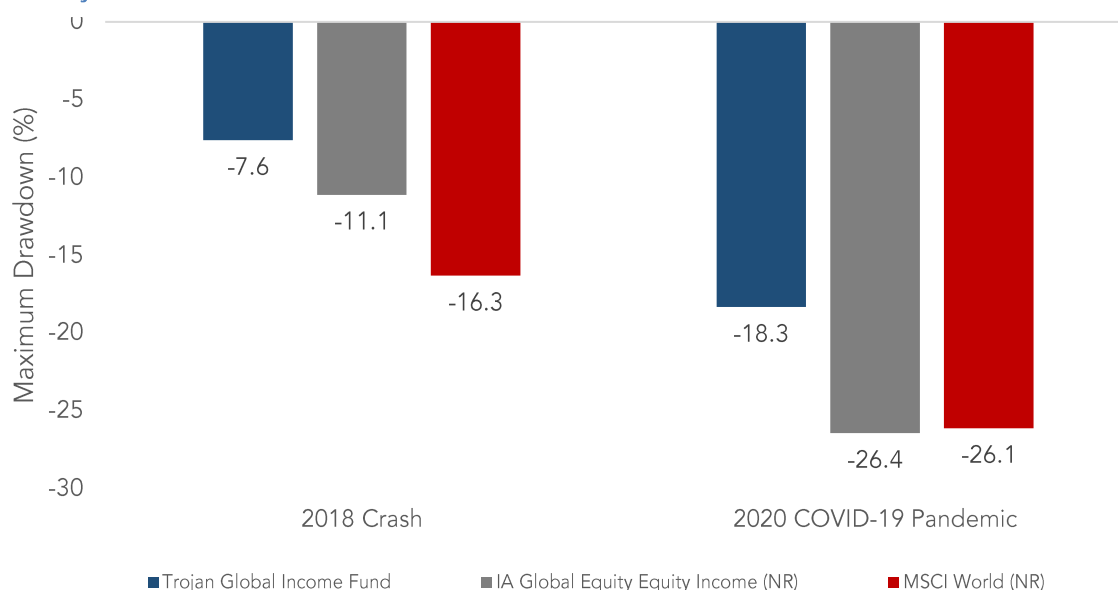
Over the 5 years since launch the Fund has compounded capital at 7.9% with a volatility of 10.3%. This compares to our peers¹ who have managed 8.2% with a volatility of 11.7%. As such we have produced a decent return, with lower volatility, relative to our

peer group and are well placed should the current buoyant market become less benign.

Further we have demonstrated that this Fund is likely to protect capital in the event of a marked drawdown consistent with Troy's investment approach.

Figure 1 also highlights a remarkable fact. In the 5 years since the Fund was launched there have been only two drawdowns of more than 10% (albeit that the COVID related sell off was sharp if short). The jury is still out as to whether the trauma and related policy response of COVID has kickstarted a new cycle rather than extended the current one. Our view is that given we have not seen a credit event we are still in the same cycle that started in 2008/9 and continues to this day. Given our relative performance tends to be best when times are tough we may need to wait until this cycle completes to fully demonstrate, once again, the value of our approach.

Figure 1: Trojan Global Income Fund Maximum Drawdown (%)



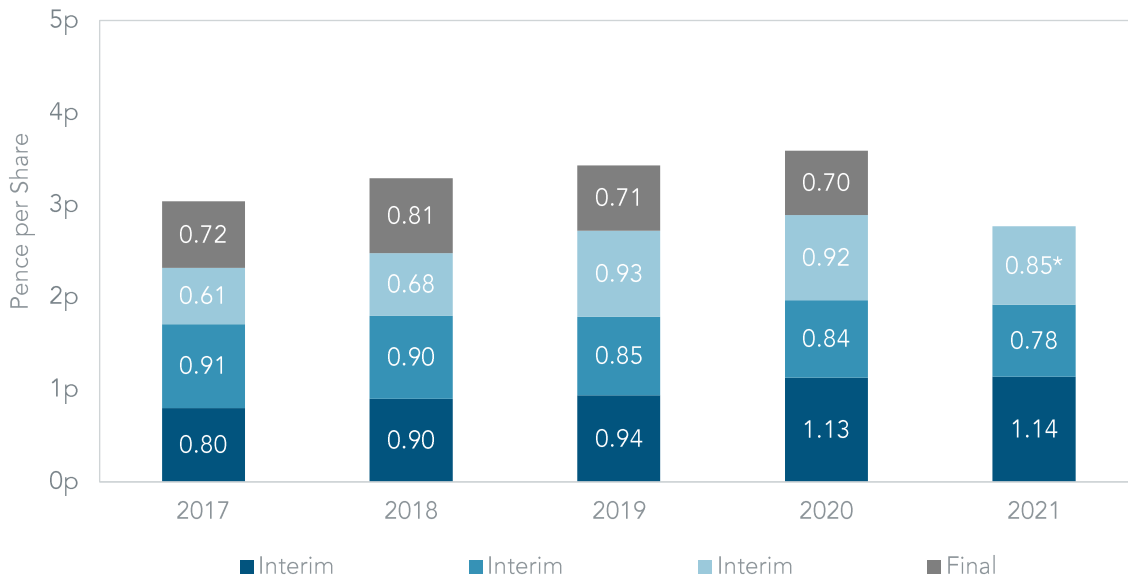
Past performance is not a guide to future performance.

Source: Factset and Lipper – O Income shares total return net of fees since launch 01 November 2016 to 30 September 2021. All references to benchmarks are for comparative purposes only.

¹ IA Global Equity Income Sector



Figure 2: Trojan Global Income Fund dividend history



Past performance is not a guide to future performance.

*Estimated. All data based on Trojan Global Income Fund O Inc share class. Income generated may fall as well as rise. Source: Link Asset Services, 31 October 2021.

Figure 3: Underlying Ratios

| Trojan Global Income Fund | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | MSCI World Index (NR) 2021 |
|---------------------------|------|------|------|------|------|------|----------------------------|
| ROIC [#] | 13.4 | 11.6 | 14.2 | 13.6 | 14.5 | 16.3 | 8.1 |
| FCF Margin | 15.1 | 17.1 | 19.6 | 20.5 | 22.4 | 22.7 | 10.0 |
| Operating Profit Margin | 21.0 | 22.5 | 25.1 | 24.5 | 26.3 | 27.8 | 12.8 |
| Dividend Cover | 1.7 | 1.7 | 1.8 | 1.6 | 1.5 | 1.6 | 4.3 |
| Net debt/EBITDA* | 1.8 | 1.9 | 2.0 | 2.2 | 2.2 | 2.1 | 1.6 |

Past performance is not a guide to future performance.

[#]Return on invested capital. *Earnings before interest, tax, depreciation and amortization. Source: Factset, 30 September 2021. All metrics shown excluding Financials, except *Dividend Cover*. All references to benchmarks are for comparative purposes only.



We have also delivered a robust, growing income, including in 2020, when many dividends around the world were cut (Figure 2).

Moreover over the 5 years we have sought to continuously improve the quality of the portfolio without compromising the income. This we have done (Figure 3).

It must be acknowledged that global income bearing strategies have generally lagged those that do not seek to provide income. This is demonstrated by the extraordinary recent divergence between the broader global index and our peer group (as proxied by the MSCI High Dividend Yield Index (Figure 4). Over the last 20+ years the two indices have largely tracked each other. Indeed from 2000 (which admittedly is a favourable start point as it coincides with the peak in the last technology boom) until recently, the MSCI High Dividend Yield Index had done slightly better. Since the COVID low this has changed.

This in part reflects the reality that in times of strong market returns the dependability and relative attractiveness of income is overlooked as being uninteresting and of little proportional value. In our experience this rapidly changes when returns are harder to come by and investors become more focussed on meeting outgoings without drawing down on depleted capital. But there is a deeper, fundamental driver of this phenomena. COVID accelerated a number of pre-existing trends of which technological change was especially profound. This disruption is rendering many business models challenged or even obsolete. At the same time innovative and fast-growing newer businesses are appearing. The former tends to pay dividends whereas the latter tend not to. This is real and makes it vital that a Fund that is tasked with producing both income and capital growth recognises this long-term threat as well as opportunity to growing cash flows. It must be part of our investment

Figure 4: MSCI World (NR) and MSCI World High Yield (NR) Total Return

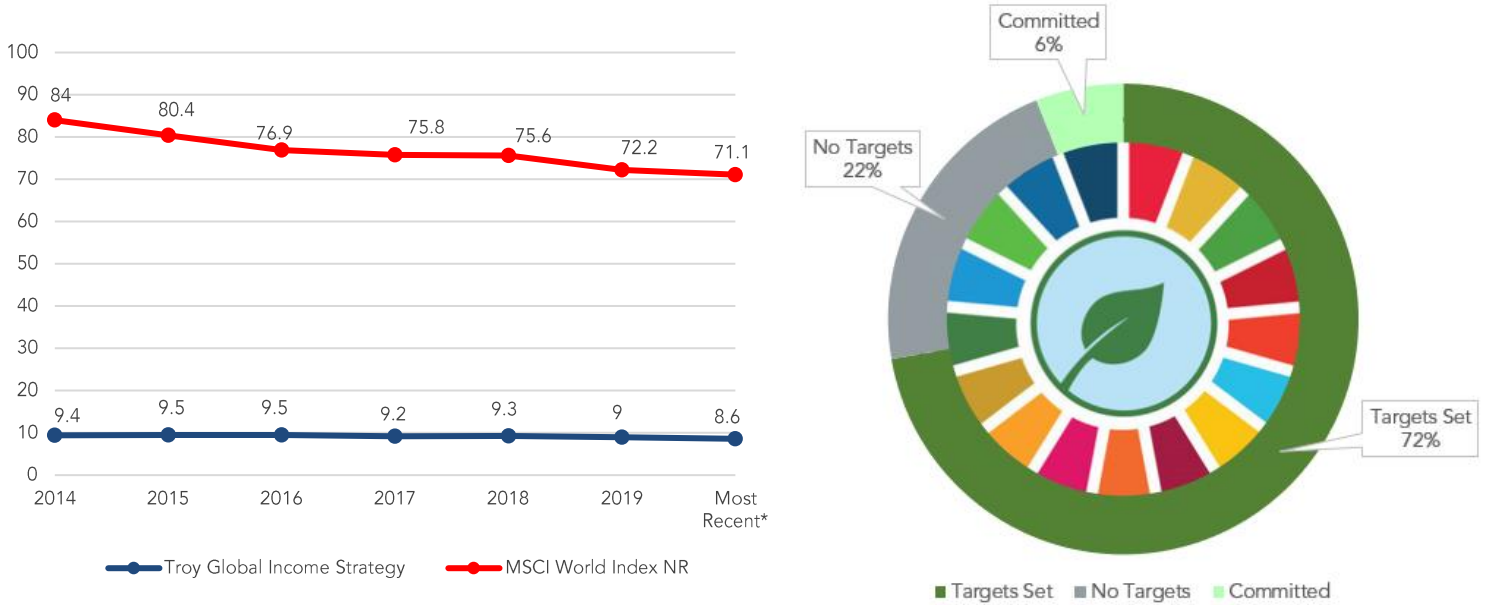


Past performance is not a guide to future performance.

*Reflects the most recently available data for each company prior to 30 June 2021. Source: MSCI ESG Research, 31 August 2021. All references to benchmarks are for comparative purposes only. Asset Allocation and holdings subject to change.



Figure 5: Weighted average carbon intensity trend of current holdings



Source: Bloomberg, 31 October 2021. All references to benchmarks are for comparative purposes only

process. To us this means that we will have no exposure to the racier new issues or the non-yielding technology companies. But equally we will not hold companies that we deem are subject to the disruptive forces these companies are creating. We consciously favour the prosaic and robust over the novel.

A further challenge is the increasing pressures faced by companies to validate their licence to operate both with regard to carbon emissions and negative externalities. We at Troy have integrated these considerations into our investment process in a number of ways. We have always been strongly focussed on the governance of businesses both internally and in our investee companies. As social and environmental concerns have increased we have also had a commensurate increase in our focus on these areas. This is both with regard to changes in consumer and investor behaviour and its likely influence on demand and the cost of capital a business pays.

Specifically on climate change, we have a portfolio that has a materially lower carbon footprint than the broader market reflecting our concentration on high quality, capital-light businesses. This modest output is also expected to decline as our companies strive to align with the Paris Agreement.

Nearly all our companies either have science based targets or net zero commitments and we are engaging with those that do not. Further we have engaged with a number of businesses on specific topics which we see as impactful.

In a wider context the obvious outlier is our holdings in tobacco companies. In this regard we would draw a distinction between ethical considerations and ESG. We understand that some investors wish to exclude certain sectors and we are happy to accommodate this. To that end we recently launched an ethical version of this global income strategy to be managed by Tomasz Boniek and I. Where there are no restrictions, we view these companies as available for



investment. We also see them as agents of change given that they are enabling the c.1bn people around the world who wish to consume nicotine to do so in a less harmful way.

We believe that it will not be too long before the tobacco moniker will be seen as redundant and they will be known as nicotine consumer goods companies. Meanwhile they represent an outstanding, resilient, high quality and very keenly priced asset for an income growth investor. They command a position in the portfolio. This is especially the case while the broader market remains fully priced.

The outlook

Despite the challenges we face in terms of the lack of available income, elevated valuations and rapidly shifting profit pools we believe we have a resilient, high quality and good value portfolio. The largest 5 current holdings make up 24.1% and exemplify our desired combination of quality, income and growth:

Paychex (5.0%)

Paychex is an enterprise software business that is the leading provider of payroll, human capital management and insurance serving small and medium sized enterprises primarily in the US. Established in 1979 its services over 710,000 clients and pays 1 in 12 US private sector workers. As the management of human capital becomes more complex the impetus to outsource grows. The range of services Paychex offers, including benefits administration, attendance software as well as insurance broking, leads the company to become embedded with their clients which represents a powerful barrier to switching. The company trades on an unlevered 3%

free cash flow yield funding a 2.1% dividend yield. Limited capital requirements and a fragmented market mean the company should continue to grow cash flows for years to come.

British American Tobacco (5.1%)

British American Tobacco (BAT) is a global consumer goods company selling a range of tobacco and nicotine products. Although traditionally this was predominantly cigarettes it is increasingly a suite of reduced harm products including vapour brands, heated tobacco brands as well as traditional and modern oral products. Following an ill-timed part-acquisition of Reynolds American the company has suffered from an overburdened balance sheet and suppressed returns on capital. This led them to lag their rival (Philip Morris) in rolling out the new less harmful portfolio. This is now changing. The new portfolio is beginning to gain traction and net debt to EBITDA² is approaching 3x. This should allow the company to generate resilient growth in free cash flow and restart a program of share buy backs. On a forward-looking basis, owing to the very attractive valuation of an 11% free cash flow yield funding an 8.6% dividend yield, we believe that the shares are well placed to deliver excellent returns.

Philip Morris International (4.8%)

Philip Morris International (PMI) is the other leading international consumer goods company selling a range of tobacco and nicotine-containing products. The company enjoys exceptional returns on capital. It is the legacy custodian of the Marlboro brand globally outside the US. PMI has aggressively invested behind its heat not burn product, branded iQOS, which has

² Earnings before interest tax depreciation and amortization

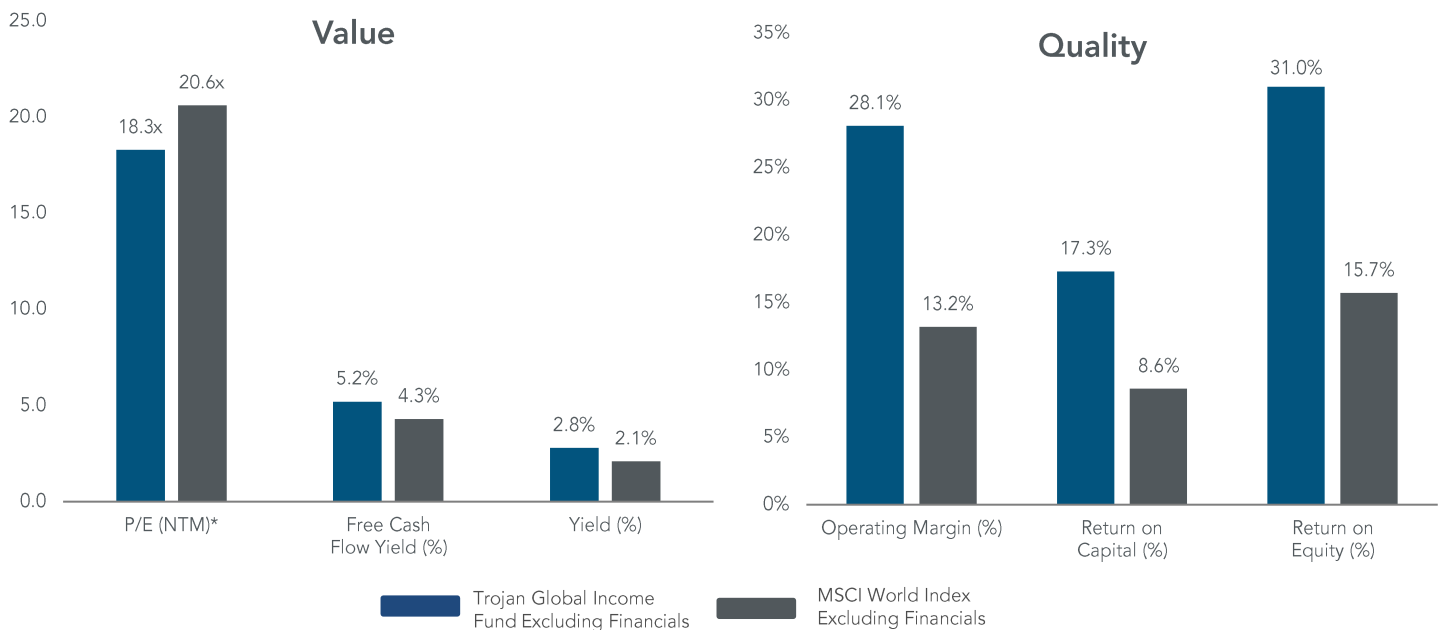


allowed it to establish the device as the leading premium product in this category. As consumers switch from more to less harmful products PMI is well placed to manage this transition. IQOS is growing strongly and now represents c.30% of the business. The combination of growing demand, margin expansion as IQOS scales and share buy backs means the company is guiding to a very credible and respectable 13-14% EPS³ growth. Despite this the shares trade on a 7.1% free cash flow yield funding a 5.3% dividend yield with a modest level of debt.

Unilever (4.7%)

Unilever is currently somewhat under a cloud which allows us to have a material weighting in an excellent business at an attractive valuation. The company sells a range of goods in personal products, home care and packaged foods. It has a number of storied brands including Hellman’s mayonnaise, Lipton tea and Dove skin products. This line up combined with an extensive emerging markets footprint has allowed the company to generate excellent returns on capital and growth for decades, funding an attractive and growing income stream. Some recent concerns including management communication, lacklustre share gains in some markets, underinvestment and a lack

Figure 6: Valuation and Returns



Past performance is not a guide to future performance.

*Price to Earning Ratio Next 12 Months

Source: Factset, 31 October 2021. Characteristics are shown excluding financials. All references to benchmarks are for comparative purposes only. Asset Allocation is subject to change.

³ Earnings per share



of portfolio innovation has driven the valuation down to a historically attractive level. COVID has also been disruptive. We view these concerns as ultimately fixable but acknowledge it may require increased investment and a shake-up of the company which may take some years. The shares are now on a 6.3% free cash flow yield funding a 3.7% dividend yield.

Reckitt Benckiser (4.4%)

Another business that has had a few problems has again allowed us to establish a position, over time, in a company that we believe is inherently attractive and is good value. The company makes a variety of household and personal care products such as Dettol, Lysol, Finish and Durex, many of which have number 1 or 2 positions in their categories. Such brand strength in these categories confers the ability to raise prices. Investors have been concerned that underinvestment has led to unsustainable margins, and a disappointing acquisition of Mead Johnson led to both an over-indebted balance sheet and a distracted management team. The company has also been disrupted by COVID. We think the new management team are now fixing these problems which do not challenge the structural attractions of the business. The shares are trading on a 4.1% free cash flow yield funding a 2.9% dividend yield.

At the portfolio level the Fund offers a 5.2% free cashflow yield funding a 2.8% dividend yield (figure 5). This is supported by a high quality and predictable group of companies that are compounding capital at an attractive underlying rate. Thus, we have confidence that we have embedded in the Fund an attractive expected return balanced between income and growth.

Inflation

It is no secret that inflation is once again a key concern for equity investors (if less so for fixed income investors it would seem). We are keeping an open mind. We acknowledge that demand is currently strong driven by both policy and selective pent-up spending at a time when supply is struggling to respond.

Balanced against this are the structural factors that kept inflation low which have intensified. Debt levels have exploded, populations have aged and technological disruption continues apace.

It is impossible to know the outcome of this complex conundrum. As such we are not managing a portfolio based upon an inflation forecast.

What we can be more convinced about is that interest rates cannot rise too much as there is simply too much debt. This leaves us with two possible outcomes. Either inflation dissipates or it remains persistent, but in both cases interest rates remain low. In the first instance, as supply disruptions normalise and inflation expectations peak, input costs will likely moderate. This will benefit our portfolio.

In the second instance, if inflation is more persistent, but interest rates remain low, we will face an ongoing negative real interest rate environment (as inflation continues to exceed the level of interest rates). This favours an index-linked security or, dare I say it, a portfolio of high-quality businesses that will likely be able to raise prices over the longer term.

This ability to raise prices stems from the same competitive advantages that allow for high returns on capital. In this scenario we believe that we are once again well placed.



Although many of the sorts of business in which we invest are considered nominal bond proxies, in the sense that over short periods they are correlated with interest rates, over the longer term they are much more akin to an index-linked bond.

When viewed in this way the portfolio appears very good value.

Conclusion

It remains our aim to be seen as *the* high quality, low volatility, global income strategy that offers a decent and growing income yield together with capital growth. We look forward to the next 5 years and beyond and thank our investors for their support so far.

James Harries

30th November 2021



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