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Trotting ahead of the big beasts

Fund focus

Troy AM's income fund is cautious by nature but effective in action, writes Oliver Shah

Having just breached £100m (€110m, \$160m) under management this month, Troy Asset Management's Trojan Income fund is something of a minnow in a pond dominated by the likes of Invesco Perpetual and Newton Investment Management.

But big is not always best, as income-focused investors in Trojan Income will have discovered over the past year.

While many of the IMA UK Equity Income peer group's star managers have announced distribution shrinkage, Troy managers Francis Brooke and Sebastian Lyon quietly delivered a July interim dividend of 2.3p, 4.5 per cent larger than 2008's first-half payment.

Mr Brooke says he is on track to deliver a final dividend "at least in line" with January 2009's figure of 2.9p at the start of 2010.

However, its capital growth has been less remarkable since March's cyclical rallies. Year to date, the FTSE All-Share is up 24.4 per cent, which would have added £244 to a £1,000 investment, while Trojan Income would have added £93 through a 9.3 per cent return.

The fund's warlike name belies its cautious mandate. Mr Brooke and Mr Lyon insist they will not own highly leveraged or structurally risky companies, instead preferring liquid blue-chip names such as Unilever and British American Tobacco.

Although the portfolio holds just 41 names, its mandate also restricts the managers from putting more than 6 per cent into any one share, meaning performance is damper when markets are driven by small clusters of companies.

Unsurprisingly, Mr Brooke and Mr Lyon are keen to see companies with above-average dividend yield and whose business models will sustain dividend payments over time. Like other UK equity income managers they place heavy emphasis on fundamental analysis, taking a strong interest in

firms' balance sheet strength and free cashflow per share.

The portfolio's 3 per cent stake in Tesco, 2.9 per cent stake in Diageo and 2.9 per cent stake in BAT may offer only modest upside, but Mr Brooke describes their average price-to-earnings ratio of 13 times as "undemanding" given they yield between 3.1 per cent and 4.7 per cent and offer healthy dividend cover.

Mr Lyon says the Bank of England's gilt repurchasing programme, and 14-fold rise in government debt issuance to £203bn in 2009/10, have created "an artificial

credit market", making medium-term economic prospects unpredictable.

"The FTSE 250 index has increased in value from a price-to-earnings ratio of nine times five months ago to more than 22 times today," he adds. "These companies need a huge recovery in profits to justify such valuations. The rally has been based on increased liquidity rather than an improvement in fundamentals."

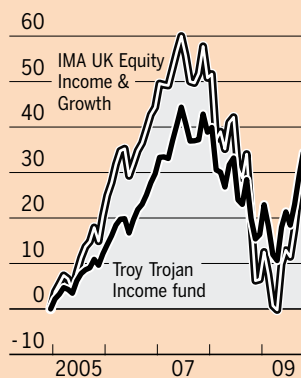
Mr Lyon argues further waves of recapitalisation will make larger, slower-moving companies safer places to be as shareholders in more volatile stocks are likely to see stakes diluted.

Annualised turnover is about 30 per cent. Mr Brooke and Mr Lyon sell shares when they believe a valuation exceeds fundamentals, or when a company's structure changes significantly for the worse.

Recent additions to the portfolio include Coca-Cola, bought on a p/e of 16 times, and retail baker Greggs, which was bought on a p/e of 12. Mr Brooke hopes for double digit dividend growth from both.

Troy Trojan Income fund

Total return indices (rebased)



Source: Morningstar

Oliver Shah is a reporter on Investment Adviser