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AS Troy Fund

Quarterly Report No. 7

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

Sugar Rush

The US economic recovery just refuses to lie down but we still believe that it will prove unsustainable. The potent combination of fiscal laxity, the lowest interest rates in half a century and the partial resolution of hostilities in Iraq were bound to reinvigorate the economy, but annualised GDP growth of 8.2% in the third quarter of 2003 has taken many by surprise (ourselves included). Once again George W Bush and Alan Greenspan have combined forces to bribe US consumers to bring forward purchases. This time, the shot in the arm of tax rebates received in July and August took up the slack from mortgage refinancing that ground to a halt soon after bond markets peaked in June. The question is, how will consumption hold up without further incentives over the next six months? It is too early to say, but personal spending in October showed no growth at all and the mounting evidence will be watched with interest. We anticipate that the 8.2% economic growth figure proves to be the peak of activity - written off as a temporary burst of enthusiasm. By bringing forward spending once again, this latest surge in activity will fizzle out, leaving the prospect of much more modest growth in future.

A jobless recovery

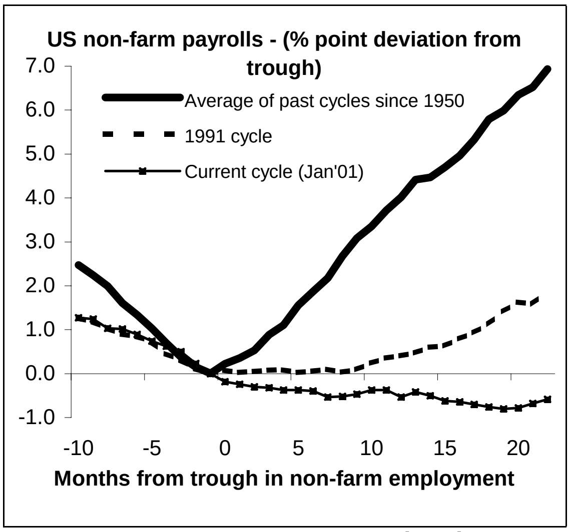


Figure 1 *Source: Independent Strategy*

Like Troy, the US Federal Reserve remains unconvinced, refusing to comment on when they plan to raise interest rates. Not in 2004, is our guess. The highest consumer debt and lowest job creation (*Figure 1*) in any post war recovery, combined with low corporate pricing power and slow wage growth (US average earnings grew by 0.8% in the year to September, the lowest rate for twenty years), are hardly preconditions for economic take off. As with all downturns, consumer deleveraging will happen sooner or later, it is just a case of when.

Inflation is stuck at depressed levels. The US consumer price index (CPI) rose 1.3% year on year in September, the lowest since 1966, while the UK's Retail Price Index excluding mortgages (RPIX) rose 2.7%, and Gordon Brown's newly introduced pro-

European harmonised index of consumer prices (HICP) increased a mere 1.4%. As one savvy fund manager pointed out to us recently, "without the biggest credit boom for decades in the UK and the US, where would inflation be?"

The recent short-term surge in economic activity has not helped to constrain global economic imbalances, particularly the US current account and budget deficits. The American economy has grown, funded by increased government expenditure, further household borrowing and tax cuts. Consequently, international investors are becoming increasingly wary of the US dollar. Even Warren Buffett recently admitted to purchasing foreign currency for the first time in seventy-two years. The Fund's US dollar exposure has remained hedged (even at £/$1.70) since June 2002, saving over £1.3m to date.

Thrifty Mervyn

Unlike the United States, the Bank of England has decided to raise short-term interest rates. We are not convinced that this is an effort to stave off inflation. Instead, the UK central bank has become increasingly concerned about the level of consumer indebtedness. Sensibly, the new Governor, Mervyn King, is concerned about a sharper economic slowdown that would result from a collapse in the housing market. Rather than an attempt to slow economic growth, which is hardly racing away at an annual 2% growth rate, this was a shot across the bows for UK consumers who are borrowing far too much (*Figure 2*). The rise in rates to 3.75% is a reverse of the cut too far in July of 0.25%, as opposed to the beginning of a series of rises. Money markets are currently discounting 5% rates by the end of 2004 while some forecasters are pencilling in 6%.

Borrowing for Britain

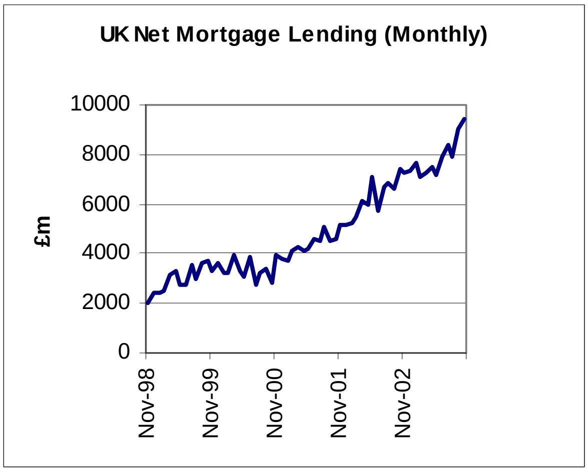


Figure 2 *Source: Bloomberg*

These expectations will, we believe, prove wide of the mark. An interest rate rise of such magnitude (+71% from the low), would be equivalent to John Major's "*if it isn't hurting, it isn't working*" rate rises in the early 1990's. Mervyn King is attempting the opposite. But this latest manoeuvre illustrates the tightrope he walks between discouraging the consumer from borrowing more, while keeping the economy moving forward.

The contrast with US monetary policy is palpable. While Alan Greenspan appears to have fed asset bubbles, whether in equities or property, the Bank of England is attempting to deflate the UK housing bubble, and thereby avert a larger crisis in the future.

Bangalore calling

Unemployment remains at record lows in the UK, but unlike many economists concerned about capacity constraints we remain sanguine. The labour market is becoming more global, as witnessed by the lack of recovery to date of jobs in the US. HSBC and BT recently announced back office and call centre outsourcing to India. A presentation by Tom Glocer, Chief Executive of Reuters, demonstrated the benefits of outsourcing jobs to the sub-continent and the Far East. English language support staff cost £30,000 a year in the US compared with £7,000 in Bangalore. While, software quality improvement professionals cost £80,000 a year in the US compared with £14,000 in Bangkok. Not surprisingly the number of Reuters' employees in these cities is forecast to grow exponentially to the detriment of American and British employees.

Portfolio changes

The Fund made slow progress during the quarter as the rise in equities was partly offset by falls in the value of our bond holdings. We have made few changes to the Fund during the period. As we suggested we might in our previous quarterly (No.6), we have added to our fixed interest exposure by increasing the Fund's holdings in 2½% Consols (UK) and French and Australian government bonds – all at yields over 5%. The consensus view is that the bond market bottomed in June but, once consumers begin to reduce their debts, bond yields may fall further.

The 1980's and the 1990's were an aberration in the history of capital returns from equity markets (Figure 3). We are convinced that dividend income will remain a key part of investors' returns in the future. In this vein, we have added two new holdings of Gallaher and National Grid, which both yield over 5%. The Fund's holding in BT was also increased following a commitment by the management to increase the company's payout ratio. With these transactions we have deliberately increased the Fund's exposure to FTSE 100 stocks that have performed poorly during the equity market rally.

S&P 500 TOTAL RETURN BREAKDOWN

Decade	Total return	Capital	Dividend Income
1900-1910	9.8%	5.5%	4.3%
1910-1920	4.3%	-1.3%	5.6%
1920-1930	14.7%	9.0%	5.7%
1930-1940	-0.5%	-5.2%	4.7%
1940-1950	8.9%	3.0%	5.9%
1950-1960	19.1%	13.5%	5.6%
1960-1970	7.7%	4.4%	3.3%
1970-1980	5.8%	1.6%	4.2%
1980-1990	17.4%	12.5%	4.9%
1990-2000	18.0%	15.2%	2.8%
1995-2000	28.0%	25.7%	2.3%
20th Century	**10.5%**	**5.6%**	**4.9%**

Figure 3 *Source: Smith Barney Equity Strategy*

Futures

Buy and hold, so long the strategy of the bull market, is out-dated. In the long run, our aim is to buy stocks in businesses that are cash generative, with good growth prospects at attractive valuations. However, in a bear market there is a need for a more pro-active approach. In September we rolled over the Fund's investment in FTSE 100 Futures. This holding gives the Fund £7.2m (25%) of its equity exposure and has, to date, added over £1.3m in value. The use of FTSE Futures serves the Fund in two ways. Firstly, it simplifies the asset allocation process. In one phone call we are able to increase or decrease the Fund's equity exposure significantly. We can, therefore, make a strategic call when markets are moving quickly and it is difficult to buy or sell individual stocks. This is what we did in January and March of this year. Secondly, in these perilous markets, stock-specific risk is high and we are keen to avoid mistakes. Our investment approach tends to steer us towards lower risk and higher yielding stocks. Buying FTSE Futures gives the Fund some exposure to sectors that are higher risk, and/or on high valuations, but minimises stock-specific risk.

The Future

At present, momentum is with the equity market. Although we retain our medium term cautious stance, we have resisted the temptation to decrease the Fund's equity exposure. The Fund's neutral equity weighting of just over 50% reflects our wish to capture part of this liquidity driven rally, but it also recognises our continued concerns about high stockmarket valuations and economic uncertainties. The price of gold has continued to rise during 2003 to over $400, a price not seen since 1996. This gives an indication of the instability and structural imbalances that remain following the equity market bubble. 2003 looks likely to be the first year of positive equity returns since 1999. It has not been dull. Navigating the investment waters in 2004 will be no less exciting and unpredictable.

We would like to thank all unitholders for their support and wish you a very Happy Christmas and a prosperous New Year.

Sebastian Lyon
Troy Asset Management Limited

8th December 2003

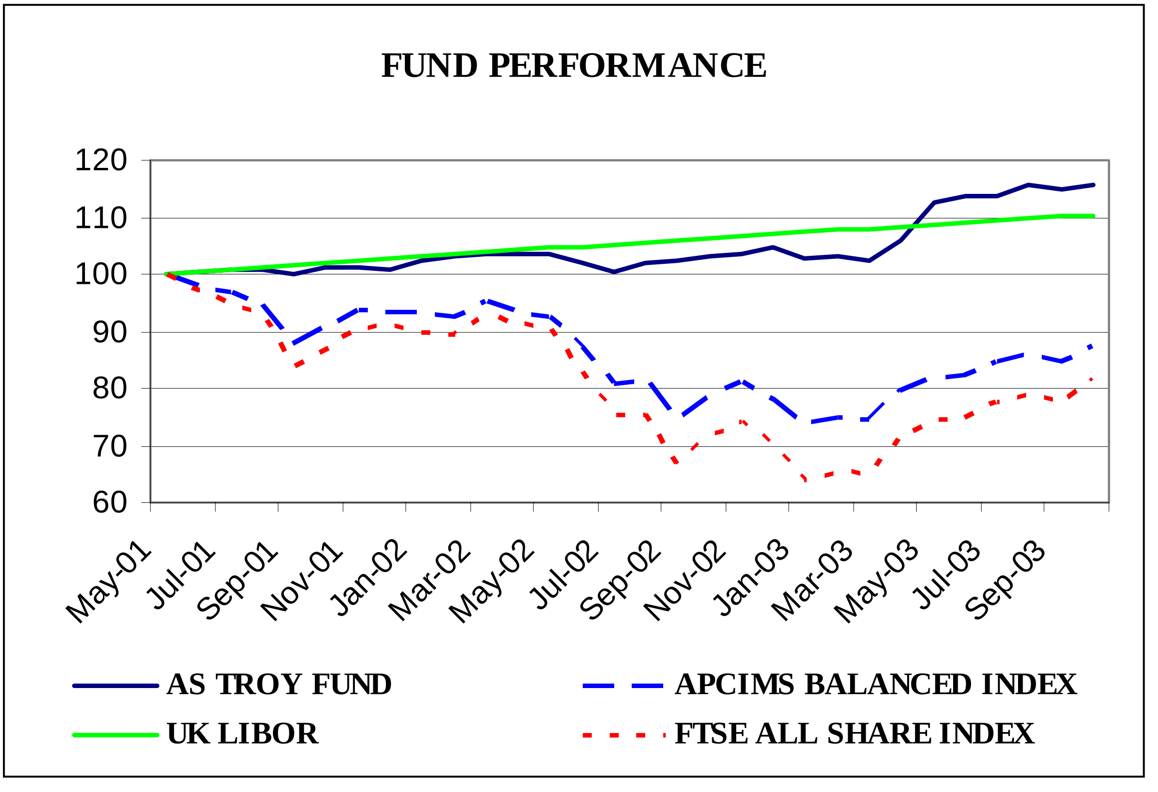
AS Troy Fund

As at 31 October 2003

Unit Price £1.105 **Fund Size** £62.7m

Fund Objectives

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



Performance

	Since Launch 30.05.01	1 year 31.10.02	3 months 30.07.03
Troy Fund[1]	15.9%	12.3%	1.8%
FTSE All Share Index[2]	-20.1%	13.7%	3.9%
APCIMS Balanced[2]	-12.4%	10.9%	3.2%
LIBOR	10.3%	3.8%	0.9%

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

Currency Exposure

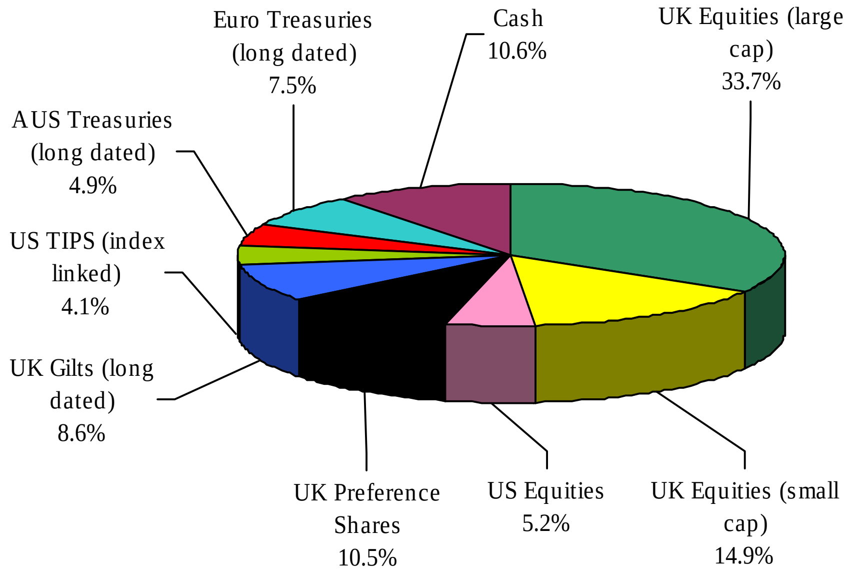
	% Fund
USD	1.2
JPY	0.0
EUR	7.5
AUD	4.9
GBP	86.4
Total	100.0

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

AS Troy Fund

As at 31 October 2003

Asset Allocation



Top 10 Holdings

	% Fund
France Gov't 5.5% 2029	7.5
3.5% War Loan	6.9
Australia Gov't 6.25% 2015	4.9
US TIP IL 3.875% 2029	4.1
Halifax 6.125% Pref	4.0
BT	3.7
NatWest 9% Pref	3.4
HBOS 9.25% Pref	3.0
Glaxo SmithKline	2.7
British American Tobacco	2.6
Plus 22 other holdings	46.6
Cash & Equivalent	10.6
Total	100.0

Manager
Liontrust Investment
Management Ltd
2 Savoy Court
London WC2 0EZ

Enquiries
Vinay Abrol
Liontrust Investment
Funds Ltd
020.7412.1700

Dealing
Fortnightly – 15th of each
month or closest working day
Month end
12 noon

Dividend
Paid annually
ex date 03.02.03
Final 2.86p
payment 31.03.03

Investment Adviser
Troy Asset
Management Ltd
15 St James's Place
London
SW1A 1NW
020.7514.1934

Auditors
PricewaterhouseCoopers

Bloomberg
LTASTRY_LN

Management Fees
Standard fee:
1%

Launch Date
30 May 2001

Denominated Currency
GBP