TROY
ASSET MANAGEMENT

www.taml.co.uk April 2012

Investment Report N°·35

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

I promise to pay the bearer

"No private company could have kept a casino running under these conditions, and the government had taken it over; now every night they made a loss, but it was a loss in gourdes and the government could always print more"
Graham Greene (*The Comedians, 1966*)

The Bank of Japan decided to come out fighting in February with its latest round of quantitative easing, aiming to buy $130bn of government bonds. The Japanese were the last of the large monetary authorities to yield to the temptation to print money. The stubbornly strong yen was too much for their anaemic economy to bear. A glance at central bank balance sheets (*see Figure 1 on final page*) since 2006 explains why the yen has been so resilient.

Following on from the Swiss and the ECB's decisions last year, the UK has also upped its bond purchases by a further £50bn, which would take the total purchased, since 2009, to £325bn. This equates to nearly 30% of all UK Gilts in issue. These beggar thy neighbour policies, reminiscent of the 1930s, have taken another turn for the worse. Brazil's Finance Minister, Guido Mantega, complained that everyone's at it: *"While advanced countries and those of Asia are continuing to manipulate their exchange rates [lower], we will also intervene to keep the Real at a level that will permit the survival of Brazilian industry".* He added, "*Brazil is not taking protectionist measures. It is taking defensive measures.*"

Markets have shown themselves to be vulnerable to aggressive short squeezes based on these policy decisions that have neutralised the short term "fat tail" risks. These episodes include the 2009 banking intervention and QE, the 2010 QE and the 2011 European Long Term Refinancing Operation. The bounces are getting smaller each time. To some degree this is because we are getting further away from 2008 and the perceived risk of total systemic failure. Investors have become more adept at anticipating the implementation of these interventions - thus the run up of stocks ahead of QE2 in the US and again more recently before the LTRO2 at the end of February. Ben Bernanke recently distanced himself from QE3, which led to a brief market wobble. We are not surprised he wants to keep his powder dry. The baton in the relay race to debase is firmly in the grip of the Europeans for now. Meanwhile, these words of Sir Mervyn King, at a press conference following the Bank of England's February 2012 Report on inflation, send shivers down the spine:

'It is now possible to move to a period ahead when inflation will be much closer to the target. It's very hard to know precisely what will happen because all kinds of unexpected events can occur, and we will see a gradual recovery. And that is one which should not lead us to be worried about the size of the balance sheet. ***I have absolutely no doubt that when the time comes for us to reduce the size of the balance sheet that we will find that a whole lot easier than we did when expanding it.***'

Our colleague, Robin Angus, at Personal Assets Trust puts our response best when he remarked: 'It is like saying that after an orgy of Christmas guzzling it will be easier to shed those few extra pounds than it was to gain them'. The Governor exudes confidence reminiscent of Ben Bernanke when asked about inflation on *60 Minutes* in 2010;

CBS: "*You have what degree of confidence in your ability to control [inflation]?*"

Bernanke: "*One hundred per cent.*"

The biggest risk for Troy's asset allocation is that the Fed and other central banks manage to navigate a perfect angle of re-entry and western economies neither bounce back into deflationary space nor burn up in the inflationary atmosphere. Given that this requires negotiating the biggest debt burden in history and somehow managing to neutralise the unprecedented expansion of central bank balance sheets, we remain sceptical.

Out to pasture, again

"So the last shall be first and the first shall be last." Matthew 20:16

Stock markets have been off to the races in 2012, but Troy and in particular the Trojan Fund, has been stuck in the starting stalls. At times, I have felt like the jockey in the 1970s Hamlet advertisement – see link:

(http://www.youtube.com/watch?v=C49g0sU724A)

Trotting whilst our peers are galloping is not something we take pleasure in but after a respectable year in 2011, we are not surprised that our style is temporarily out of fashion. It has happened before and it will, no doubt, happen again. We may look very wrong over short periods as yesterday's losers – banks, life companies, house builders and auto makers have become (for a spell) today's winners. In 2009, 2010 and 2011, we were slow out of the gates. The 'January effect' – a typical seasonal bounce - seems to be one of many factors that the efficient market hypothesis cannot explain. Each of these years started with hope and optimism – the expectation of improved economic growth and ultimately rising interest rates – a return to normality – only for hopes to be dashed.

The investment waters have been muddied by yet further monetisation which has quenched the thirst for speculation. Valuations flatter to deceive as global operating margins are at an all-time high. Profitability will, at some stage, revert to the mean (*see Figure 2*).

It never ceases to amaze us how quickly confidence can return. According to a recent investment bank survey, 47% of fund managers believe the days of money printing are over and that, in other words, we have returned to monetary normality. This just shows how deceitful a zero interest rate environment is for investors. In these uncharted waters, perhaps we should have quoted from Greene's *Journey Without Maps*. It is our belief that we are in the midst of a period of competitive devaluations. Investors are likely to be shocked by the extent of unorthodox policies before the game is up. As with the last three years, stock market rallies are likely to prove temporary as the economic pressures of low growth reassert themselves. As Christopher Wood, the CLSA strategist highlights, the survey has, hitherto, "*proven to be a reliable contrarian indicator*".

Quality at a premium

"*Everybody invests like you now*" a friendly stock broker told us late last year. He was half right. Back then, we found ourselves in the uncomfortable position of many investors extolling the virtues of our particular investment style - buying quality businesses with strong balance sheets and good dividend track records at the right price. Investment can, at times, be reminiscent of a junior school football match. Most players huddle round the ball kicking one another's shins – we have been happier at the other end of the pitch. More recently our end of the pitch had become a little more crowded.

We were convinced that would change – these are fair weather friends whose Damascene conversion would be reversed quickly when our favoured sectors suddenly started to underperform. This may mean a period of lacklustre performance for us. Ultimately when they leave, and leave they will, it will give us a wonderful buying opportunity of the kind we had in mid-2009.

Fund Sector Changes

With effect from the 1st April, the Trojan Fund has moved from the IMA Mixed Investment 40-85% Shares sector (formerly IMA Balanced Managed sector) to the IMA Flexible Investment sector. Some of our investors may find this of little interest. It is the returns we generate that matter and not necessarily peer group comparisons. Nevertheless, the new sector we found ourselves in, following changes made by the Investment Management Association in January, gave us less flexibility. Moving to the Flexible sector gives us a significant degree of discretion over asset allocation with no minimum or maximum equity requirements. At the same time, the Trojan Capital Fund has moved from the IMA Flexible Investment sector to the IMA Global sector, where funds have at least 80% of their assets invested in global equities.

We believe the change in sector for both funds is in the best long term interests of our investors. Moving the Trojan Fund to the IMA Flexible sector gives us greater scope. The prior 40-85% limits restricted flexibility to protect on the downside. Moreover, in the longer term, we may well be fully invested in equities. The 85% limit would have constrained us from being more positively positioned. The move of the Trojan Capital Fund into the Global sector better reflects the more international approach taken by Gabrielle Boyle and capitalises on her experience as a global equity fund manager.

Michael Lester 1940-2012

It is with great sadness that we report the sudden death of our fellow Troy director, Michael Lester. Michael was a founding director of the Company, joining the Board back in 2001 and playing a pivotal role over the years. Formerly Group Legal Director of BAE Systems and prior to that Legal Director and Vice Chairman of the General Electric Company plc, Michael had a wealth of experience that he was happy to share with colleagues. His keen eye was a great asset and when he felt it appropriate, Michael would correct us gently with a twinkle in his eye. He represented the Weinstock family interests on Troy's Board and always understood Lord Weinstock's original aspirations for the company and kept true to them. Michael was an immaculate, understated and gracious man. In his modest way, he was one of our greatest supporters. We will miss him.

Sebastian Lyon April 2012

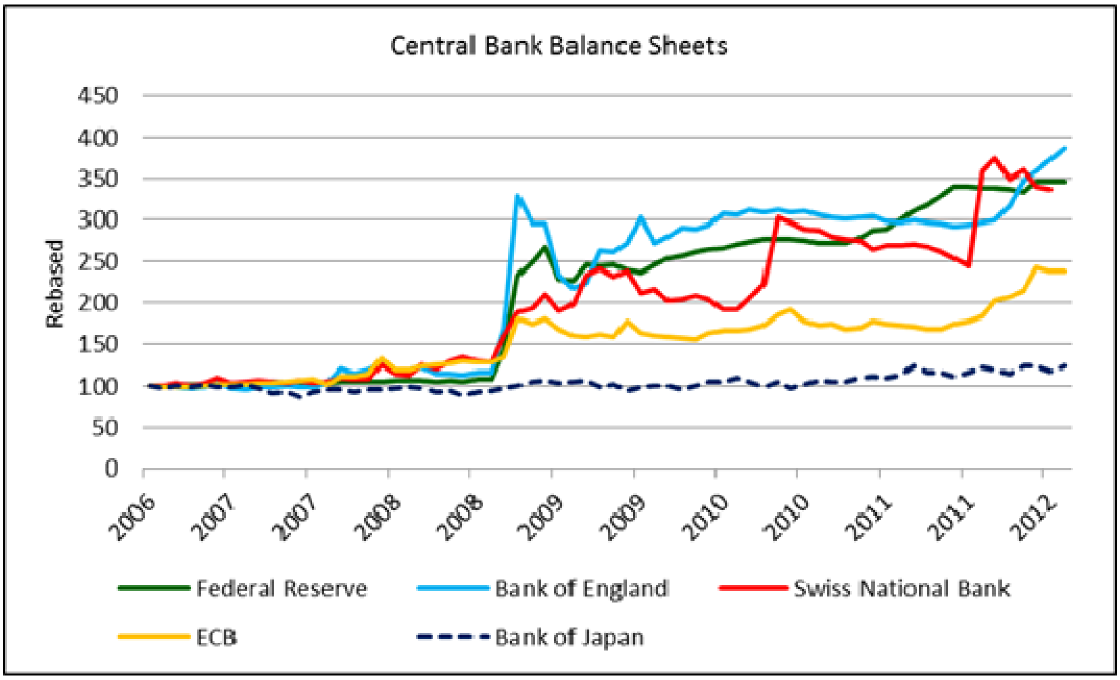

Figure 1 *Source Bloomberg, Bank of Japan, Swiss National Bank*

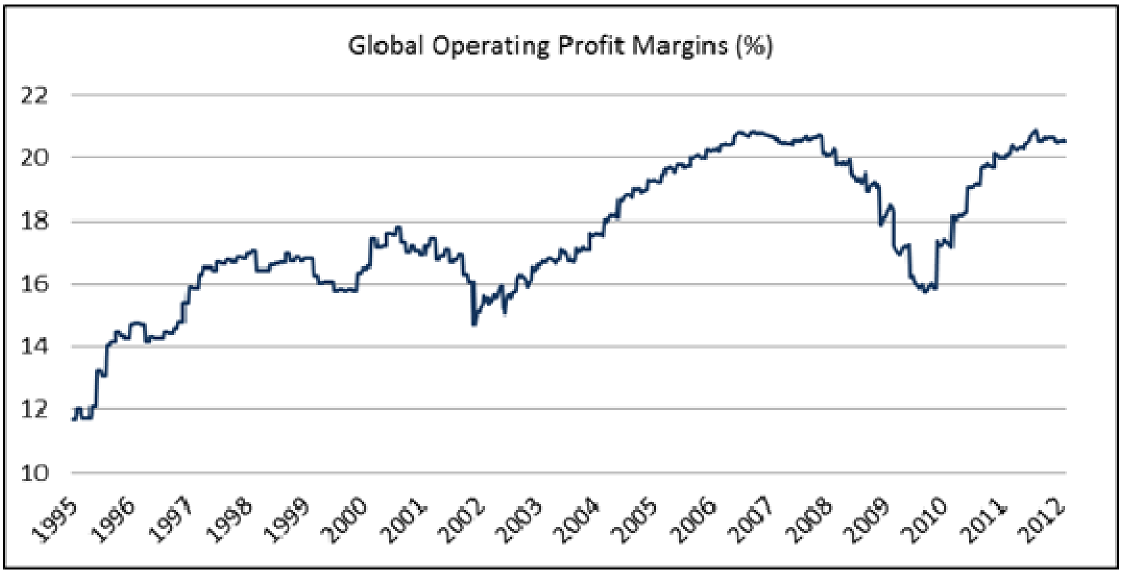

Figure 2 *Source Bloomberg*