

Sebastian Lyon & Charlotte Yonge (Troy) – Evolve to Preserve

Tom Yeowart: Charlotte, Sebastian, welcome back to the podcast. Thank you very much for coming on again.

So, we're coming up to the 25th anniversary of Troy's founding. And over that time, we've navigated a very broad range of market environments from a technology boom and bust to a global financial crisis. And more recently, a global pandemic. And I'd love to hear you talk a bit about, how our founding philosophy and the principles in which we invest have helped you navigate those very different environments and ultimately produce fairly consistent results across them.

Sebastian Lyon: Thanks, Tom. What we've been trying to do with the multi-asset mandate at Troy really since the fund was founded, was to give our investors a more comfortable ride. To protect on the downside and try and give our investors reasonable returns. But in particular, to protect when markets were very volatile. Now we saw that, as you say, back in the dotcom bust. We launched obviously in 2001. The bubble was deflating at that time, but we had a very, very nasty bear market and economic downturn in the early noughties. We were prepared for that. Valuations were very high. We were very mindful of valuation risk as well as some earnings risk. And that led to those very sharp falls in equity markets back in 2001 to 2003.

When it came to the financial crisis, it was actually relatively predictable. Now, clearly Lehman going bust wasn't predictable, but there were signs that the financial sector was really beginning to struggle. And so, we were out of the trouble areas, out of banks, and out of financials more generally, where the damage was done. And we were in more defensive stocks, and our equity allocation was relatively low. And then after the financial crisis, when valuations had fallen precipitously, we were very happy to lean in and take more risk. And actually, that was the highest level of equity exposure that we've had in the life of the fund immediately after the financial crisis.

COVID, clearly that was something which was totally unpredictable, a genuine sort of black swan from that perspective. And it came totally from nowhere. There was no time to prepare. The downdraft in the equity market was a mere nine weeks. So, if you weren't ready for that outcome, you potentially lost a lot of money in a very, very short space of time. We were prepared for that because firstly our allocation to equities was relatively low because valuations were quite high. And so, we didn't think equities offered a great return at that particular point in time. And so, when the pandemic hit and clearly the earnings were going to fall, then we were in a good position to take more risk after the falls had occurred. Clearly, we didn't know the pandemic was going to happen, but we were prepared for an eventuality like the pandemic. Ultimately, we could change the portfolio during those periods of falls and be ready for a recovery.

And I think those three chapters, if you like, have been an indication of seizing those opportunities as and when they've arisen, but also being prepared for them as well. And I think that's the key in terms of preservation of capital, is being prepared for those eventualities.

Tom Yeowart: Why is avoiding complexity so important to you both. And what have been the common pitfalls you've sought to avoid as you've generated this 25-year track record?

Charlotte Yonge: Avoiding mistakes is really the main reason to avoid complexity. I remember when I first came across Troy, over 15 years ago, and finding the, keep it simple stupid phrase, keep it simple, stupid, was a concept used by the US Navy which applies to engineering, but it also applies to investment. The whole premise is that complex systems tend to be more prone to error and harder to fix. And at least you understand with a simple system if it breaks, you know why? And I sort of think it's the same with investing in that because we understand what we own and why we own it, if as things invariably do, something doesn't perform as you expect it to, you can understand.

So very basically with a company if the earnings are not delivering, that is the problem. If you are in more esoteric investments, whether it's going into illiquid spaces, going into frankly more speculative areas like let's say crypto. A lot of those, there's no sort of gravitational underpinning in the same way that you have with a company that has a balance sheet and an income statement. And therefore, when it goes wrong, it's often the narrative that leads, and then that, particularly if there's a liquidity issue can just be self-fulfilling as soon as the market decides it doesn't like it.

So, I think in terms of avoiding mistakes that's the real reason to avoid complexity. And then our clients also, they understand when things aren't working, they understand why, because everything we own, we can explain.

Sebastian Lyon: I think one of the things that we try and do in terms of avoiding complexity by way of an example is we're always thinking, what can go wrong? And a very good example of that was the very material issuance in diversifiers, in renewables, in particular in the investment trust world, in the late part of last decade and in the early part of this decade.

And we saw with interest rates falling, through from sort of 2015 to 2021 there was a huge demand for investments that offered a yield. And the question that we were asking, and the reason why we didn't go into those areas at the time was because the first thing is I thought, what could go wrong here? Well, what could go wrong here was that yields recovered, interest rates started to rise, and all of a sudden, the demand for those assets would deteriorate significantly because there was an alternative. And the second thing is that actually the secondary market for those assets would suddenly dry up. And so, you've got the potential for very material downside there.

That's an example of what we are looking at. We can see at the moment those assets are attractive, but it's actually under what circumstances could the demand for those assets deteriorate? And so actually we've always been very keen on liquidity, and we want to be able to have manoeuvrability and not to be stuck in assets. And if you're stuck in assets where the values deteriorating, you really are stuck. And you can't avoid those draw downs.

Tom Yeowart: And I guess this keep it simple framework is also why we don't own derivatives. Derivatives obviously require you to make a good decision on the way in and on the way out. You just have to make more good decisions. And we like to frame things longer term.

Sebastian Lyon: There are two reasons why we don't own derivatives. I can see the appeal, but firstly as you say Tom, you've got to get the entrance right and the exit, right? The derivative markets are not always priced according to what you would expect. If you remember, going back to the financial crisis, the whole concept of the Big Short was the shorts were not winning until right at the end because the assets weren't being priced as they should have been. So, there is a real issue with derivatives, but also there's a cost. We want to keep our investors' costs as low as possible. And the derivatives it's rather like paying a constant insurance week in, week out, year in, year out, which has a cost. Our returns would not have been what they are today if we have been trading derivatives all the time.

And then finally, in terms of shorting, it's a very, very different discipline to being long only and all of a sudden, you've got a balance sheet as it were. You've got moving parts within the portfolio that you haven't in a long only portfolio. And the risk is that you get a short wrong. And it's rather like a weed growing within your portfolio. Can be extremely distracting and actually very stressful. Long shorts were very popular in the early part of the fund's life. But interestingly now, very few people are doing it. And I think the reason for that is because of how very difficult it is to actually make good returns from shorting.

Tom Yeowart: And Charlotte, you've been at Troy for just over 12 years. How did you find Troy?

Charlotte Yonge: I first found out about Troy when Troy was doing rather well particularly relative. So obviously we think in absolute terms. But, in 2008, anyone who wasn't down was pretty good. And the Trojan Fund, which Sebastian clearly managed at the time on his own, was up 1% that year. And I was looking for internships, but I didn't want to work at a large corporation.

A little bit back to your simplicity question, I could see an advantage in small boutiques in terms of independence of thought. It just seemed set up for better investment outcomes potentially. So, I actually wrote to someone I knew and said, can you send me a list of good London boutiques? And Troy was in the long list. And then I sort of made a short list of the ones that looked to be doing quite well. And Troy was definitely top of the short list. So that was the start. And I met Sebastian and Francis in October of 2008. So shortly after a few things had gone wrong and they seemed very calm, which I thought was a good indicator.

In terms of ending up here 13 years ago, just under, I did move around once, so I was at Ruffer previously and I came to Troy in 2013 really for the reasons I already knew the company and knew why it was great. But also, there was just this focus on companies. I really liked this simplicity, but also clarity that if you focus on great companies and own them at the right price for a long time, that's actually the best way to preserve capital. And that really appealed to me. That's why I came back.

Tom Yeowart: And you've both been working together for quite a long time, but fairly recently, Charlotte, you became co-manager of the Trojan Fund and Personal Assets Trust. Has anything changed in practice on the day-to-day management of the fund and the trust? But also, Sebastian, when was it that you decided, Charlotte was the person you wanted to be your long-term partner in managing the strategy?

Sebastian Lyon: Charlotte, when she came as an intern, she really impressed me and she impressed me in one particular way, which was that she was really, really interested, clearly, really interested in investment. And really interested in the stock market. And really interested in companies and I think that people who do well in this business live and breathe it. They don't clock off at five o'clock and stop thinking about it as soon as they're out of the door, they're living and breathing it every day. That's what I do. That's what I've done for the last 36 years. And there's a real sort of love and passion for it. And I could see that Charlotte was one of those people.

And so, that's why I was very keen for her to come back to Troy and to work for us and why I recruited her back in 2013. And then she did some more general analysis rather than being tied to a particular mandate. And then in 2016-17, she gradually did more and more work on multi-asset. And the other thing is I could see that she was interested more broadly in other asset classes, not just in equities as well. So, from that perspective multi-asset was more appropriate for her than a pure equity mandate.

And to answer the second question, Charlotte has been doing more and more. We've been working more closely together, certainly since 2019, 2020. And really in terms since the co-manager announcement, really nothing has changed in that we've been managing the portfolio together. Effectively what the co-managers announcement confirmed really is what we were already doing as far as I was concerned.

Charlotte Yonge: I would agree, and I think in terms of Sebastian's strengths, it's very much meritocracy of ideas and listening to people and involving the best ideas. You have always allowed and enabled that input from, as you say, from 2016-17. So, I think in terms of us both influencing the decision making, that's been the case for the last three to four years.

Tom Yeowart: How would you say you complement each other in terms of your specific attributes?

Charlotte Yonge: I've been thinking about this, I suppose as we've been managing the fund together. It's hard to disaggregate what's nurture versus nature. We're different ages. We had different backgrounds. Your background was UK equities initially. Mine was a multi-asset background, which I suppose is why it sort of lent itself to this, but probably more global. And so, a lot actually is in nurture.

You do just have that pattern recognition that comes with having been in markets for well over three decades now. And I suppose I have that fresher pair of eyes, even though my career is well into its second decade now. I think those different backgrounds are very complementary in that I think our ability to spot what is shifting in terms of whether it be the types of sectors that we favour, more into digital payments, for example, more into the hyperscalers, and Sebastian's pattern recognition of cycles and markets feeding into that and the valuation discipline, which frankly, and I'll be, the first to say this, if you've started your career after 2009, you haven't really experienced a bear market or seen valuations that are tethered to the ground because of quantitative easing and frankly, the very low pain threshold of financial markets ever since. So, I think those two different backgrounds complement each other.

And then I suppose on the innate characteristics of each of us, we are very different people as well. The things I would probably pick out. Sebastian, you always say you are a very instinctive investor. And really see the wood from the trees. You have a grasp of the real sort of high-level changes that are going on. I think you refer to yourself as a sort of financial market historian and you are a historian and that is noticing why things happen and the fact that history does rhyme has really played into understanding why markets ultimately collapse, why things fail.

I think that's almost to be an expert in capital preservation. You need to be an expert in capital destruction, and I think probably your early observation of Marconi would've been part of that data set that's informed you as to why things can go wrong in the future.

Sebastian Lyon: I think I have a sort of innate cynicism, which can be helpful, but also, I think that what Charlotte brings to the party is she has a sort of energy and enthusiasm for the new to some extent. And the fact of the matter is, is that within equity markets, one needs to see how things are evolving, how industries and companies are evolving. And companies don't last. You mentioned Marconi, but there are an awful lot of companies that were in the FTSE 30 years ago that no one talks about anymore that have disappeared or that are in the 350 or have been taken private and put out of their misery.

So there is this evolution and I think what Charlotte's brought to multi-asset is companies like Visa and Alphabet, which went into the portfolio just before COVID and that we bought into during COVID and the falls of COVID, which we had the confidence to do because we knew the businesses. That's brought freshness, if you like, an evolution to the portfolio, which has been very positive.

In terms of the whole corporate memory and the rhyming of history, if you like. What I've always felt I've liked to do is position the portfolio within sort of longer-term themes. For example, ever lower interest rates. And during that period we had quite a material exposure to very long bonds as we went into the financial crisis, which did us a lot of good to a period where actually we're seeing higher stickier inflation and rising yields and making sure that we've got a portfolio that's, if you like, it's not permanently pointing in that direction, but at least it has that tilt. And having that overall view of history and having a view of sort of where we are in the longer term context, I think is where we have succeeded from the point of view of the mandate because we've had an idea as to where things are headed.

Tom Yeowart: You've obviously talked about the importance of capital preservation and resilience. And I'd like to discuss how that informs our approach to equity selection but also within that framework, how we also adapt and evolve to a dynamically changing world?

Sebastian Lyon: I think in terms of the evolution of the portfolio, one of the things that I've always had an eye on is making sure that we didn't have wasting assets. That's where the dangers lie. By wasting assets, I mean companies that don't have a good future, don't have a strong future, aren't going to be around in five- or 10-years' time, or are going to be materially weaker in five to 10 years' time.

It was quite useful in terms of when we launched the fund in terms of the dotcom bust. What happened after that was the impact the internet started to really be seen and there were a lot of

companies that were being gradually hit by the impact of the internet. Regional newspapers being a really good example. There was a vast part of the media, the old media if you like, that looked very cheap, but was very, very cheap for a reason because those businesses were clearly going to struggle if not go bust over a period. And so, I think that in terms of the evolution of the equity mandate, I've always been looking to avoid things which I don't think are going to survive. We want to be in companies where we've got the confidence that they can ultimately get stronger.

If you look at the evolution of the portfolio, that's really what it's been about. It's about focusing on businesses where you can see the future more clearly, and you can ultimately see, importantly, the sustainability. Because if there isn't the sustainability of profitability, then that's where your asymmetric risk works the other way, and you start losing money. But not just looking at the downside, but also looking at the prospective upside of is this business going to be bigger? Is it going to be stronger? Is it well run? And I think that has been the entire evolution and making sure that we could see how industries were performing, how industries were evolving, how new industries were coming through, that were taking market share. And if one looks at the evolution of the holdings of the portfolio, I think that's really what you can see.

Charlotte Yonge: Coming back to this working out what can cause things to fail, what can cause companies to fail? And there are a number of ways which people know very well, but overpaying is one. Having over levered balance sheet and actually just that combined with cyclicalities. We eschew cyclicalities, but particularly we eschew cyclicalities and leverage. And then there's that risk of business obsolescence, which you mentioned. We are very clear about the fact most businesses are not investible for us, and that's because of the ways to fail. They might do really, really well and there'll be periods where they do lead the market and we are not in them, whether it's house builders, whether it's mining companies. Whether it's profitless tech. We just want to see that consistency and durability of growth. And that won't always work because there's a qualitative assessment behind that. But you've got to avoid those pitfalls.

Sebastian Lyon: I think from the point of view of looking for investment opportunities with asymmetric risk, I think there are times when the market will just be tired or bored of companies. That's the time when you want to be buying them. That's when they're at their most interesting. So, there are companies which the market might think have gone ex-growth, but which haven't. Or there might be companies where five years ago the market was just overly excited in something and derated it over a long period of time. The company's absolutely fine, but for whatever reason, the market has lost that interest. The valuation therefore is materially lower. And prospective returns from those levels are higher if one assumes that the company can deliver, generating the sort of returns that it has done in the past. I think those to some extent are the most interesting opportunities for multi-asset because the risk is lower within those sorts of stocks.

Tom Yeowart: What would be some historic examples?

Sebastian Lyon: So, historic examples would be, I mean, after the financial crisis, there had been a lot of deratings in good businesses due to lack of liquidity really. And we bought into Nestle just after the financial crisis. Everybody wanted to buy recovery stocks. Everybody wanted to buy banks because banks had done so badly. But actually, there were defensive

stocks like the Nestle's of this world, which were on the lowest valuation I'd seen in 30 years. And knowing that they were fundamentally a good business, but everybody was looking the other way because they were thinking about recovery. That was a wonderful opportunity to buy a good business at a very advantageous price.

But another would've been something like Microsoft, which had de-rated over a decade. So had peaked during the dotcom boom. I hadn't looked at it over a long period of time and then looked at it in 2010-2011 to see that it had been derated from 75x earnings during the dotcom boom to 10x earnings or even sub 10x earnings. And people weren't just looking at it and people were writing it off. And those sorts of opportunities are, as long as you feel the earnings are intact, to Charlotte's point, and there isn't high levels of leverage and there aren't high levels of cyclical, then if you can find those things on those low valuations, which have been ignored, then you've got that asymmetric risk. If you're wrong, you've got very low downside risk. But if you're right and the narrative changes for that company and other investors view it in a different light, the potential for a rerating of those earnings can be very material and was in both cases.

Tom Yeowart: Turning to the environment we're in today, where are we finding opportunities?

Charlotte Yonge: So, we've found quite a few recently. We don't ordinarily buy a lot of stocks every year. Our turnover is relatively low. Nestle, we've now owned it for 16 years. However, although the market's expensive, there are a lot of sectors, a lot of companies which are slightly out of favour for various reasons.

One business, for example, that we've bought in the last two months is a company called Hubbell. Often the opportunity comes because the narrative is just a bit boring or it's not understood. And Hubbell's more a case of the latter. It's not a particularly well-known business. It's also not particularly sexy. So, what they do is produce and distribute equipment for the US grid. For example, grid connectors, lightning arresters, which stop lightning from completely damaging your cables and ultimately costing you millions of dollars. And they're the largest manufacturer of those items, which on average cost \$50. And so, you can imagine there's just incredible pricing power if you're the largest and reputationally the most reliable, highest quality. And you have very sticky relationships, with predominantly utilities.

That is just a very consistent business. It looks quite dull but it's really not. And although it's grown sort of 5-6% very consistently over time, we were able to buy it on just under 20x earnings, which I think particularly given the underpinnings going forward, if you think about all the investment that needs to be made in the grid. There will be increasing electrification of the way we consume energy, as we kind of do move away from fossil fuels over time. But even just the sort of data centre requirements today and the fact that the grid is aging. There are just all of these tailwinds. This is a company that have that wind at their back, but it's not particularly well understood by the market.

Sebastian Lyon: Another example that we bought about nine months ago was Verisign, which effectively registers .com and .net names. We looked at this a few years ago and the valuation was very high. We liked the business. A very good example of markets changing their view of a business. We watched a derating post all of the excitement around growth

during COVID and online growth in particular during the period of the pandemic. The company rerated very materially to about 40x. We waited very patiently. The business really hasn't changed; the profitability hasn't changed. They continue to grind out profits. They've got good pricing. Very, very strong balance sheet. Have looked after shareholders for as long as they've been listed, going back to the late nineties.

But this thing derated over a period of two years down to a similar valuation of about 20x earnings. And we felt that was a very good opportunity to make a start last summer. The shares have performed very well subsequent to that. It's a good example of a company that's not necessarily very well known in a little bit of a niche that could be ignored for a period. And that provides us with the opportunity.

Tom Yeowart: So, we've talked a lot about equities, but turning to fixed income, can you talk about how your approach to investing in bonds has evolved over the 25 years?

Sebastian Lyon: From a top-down perspective, there have really been two or three cycles within the life of the fund. If one looks back to the beginning of the life of the fund, back in 2001, 2002, 2003, you had interest rates in mid-single digits. You had fixed income earning us 5-6%, at a time when inflation was 2%, 2.5%. Real yields were very attractive. Nominal yields were good, real yields were good. And so, you had very acceptable returns for fixed income. You also had a tailwind of ever falling inflation and basically ever falling yields. And that actually carried on for a very long time, indeed, longer than I thought it would. That carried on until the summer of 2020 until COVID hit.

And so throughout certainly the first 10 years, we were very comfortable having long dated fixed income, which generated a very good return for us. When interest rates were slashed during the financial crisis bonds looked less attractive to us. Our preference was for index linked which did okay. And ultimately when inflation did come back, they provided actually very good returns compared to conventional bonds. But I think what has happened subsequently since the yields troughed and you saw the 10-year US treasury yield trough at about 50 basis points during the summer of 2020, five years ago. Ever since then, I've been convinced that we've been in a rising yield environment where we've got stickier inflation. So, the environment has totally changed to one of actually yields where the risk is actually on the upside. And so therefore, within that environment, firstly, bonds are less attractive. Bonds do not provide the protection that they did hitherto. So, the old 60:40 model I don't think is necessarily working any longer. And so, we've changed the portfolio according to that, and we want to have inflation protection, but we also want to be very, very careful about duration. Whereas you wanted to take the risk for duration as yields were falling, you do not want to take duration risk in an environment where yields are rising.

Tom Yeowart: We've clearly had fairly contained duration. It's come down further. I guess one of the reasons for that is despite a stickier and higher inflationary environment, we found that some of the longer dated inflation linked bonds haven't really lived up to their inflationary promise. Can you talk a bit more about that and why we think actually inflation protection is better served by shorter duration as well.

Charlotte Yonge: Yeah, it's a great question. So, we had an overall low modest duration. So, it fluctuated between, starting in 2018, we had very low duration, rightly in hindsight for that

sort of fourth quarter of 2018 when you'll remember, the 10-year got to 3% and that was quite a big deal. That was two and a half years duration then. And then we had at tops just over five-year duration in March of COVID, we got an opportunity basically to add to what was a nascent holding in 2042 US TIPS. So, we had this sort of barbell approach where majority was short duration, and we had some longer duration, and we added to that holding on positive real yields, which hadn't been around really. And in the short term, they were very attractively valued, and we made quite a lot of money. And then we sold a chunk of them, but frankly, not enough, in November of '21, when you can remember that real yields were negative across the board for most developed sovereigns.

We went into 2022 with a circa 4.5% holding in these bonds and we had inflation linked protection in the portfolio of around 30%. So, it was a minority of that. But what really disappointed us, but informed us going forward, was that bond yields clearly rose in '22, but inflation expectations didn't. That was really surprising because you had a US CPI of 9%. So, you had highest inflation you'd had in the US for 30 years plus. And the bond market cared. The inflation linked market didn't care. And they just didn't work. That was quite damaging because in a year where that should have been working for us when equities weren't, equities had a really tough year, and at the same time bonds didn't help us either. Currency did. So fortunately, we had something that was kicking in and gold was fine.

But the bonds should have in a year where inflation was kicking off. And so, I think the lesson here was twofold. I definitely underestimated the ability, particularly of the US economy, to withstand higher rates. It's a rate sensitive economy but with a lag and maybe it's actually robust enough to withstand higher rates longer term. That's the first lesson. And the second lesson is when you have duration, narratives will prevail unless you're holding for the whole 20 years. Our time horizon is long, but we still need to think in terms of five to seven years. That's what our investors care about. We are not holding for 20. So, you're really trying to predict where macro forecasts are going to go, i.e. what the bond market thinks growth is going to be, what inflation's going to be in 20 years' time.

In this vein of avoiding complexity that's in the too hard bucket. We can't do that. So, it's been structurally and philosophically helpful because I don't believe that we have an edge investing in that level of duration. So we now own, and this is what we really did learn in 2022, if you own to maturity, so if you buy and hold for that time horizon, whether it's two years, the duration we have currently, you know what you're getting. You will get the real yield plus inflation. So, you will actually track that experienced CPI as opposed to just the speculated future expectation of inflation. And that was very helpful. In 2022, those bonds, which were the majority of our index linked bonds, did really well, because they just accrued with actual inflation when CPI was 9%.

That's the lesson. So, all of our bonds we can foresee holding to maturity. They're not pricing in a load of inflation. Breakevens are still low. The bond market still believes that inflation's a transient and not a permanent risk. So, it's an attractive place in the market to be.

Sebastian Lyon: And they're more liquid as well. So, we've got much more flexibility within the bond part of the portfolio.

Tom Yeowart: You mentioned currency, Charlotte, having played an important role in 2022. But zooming out, the US dollar, specifically, has played a very important role over the 25 years in helping us preserve capital. That wasn't the case in April of this year, and clearly, we've made a few changes to the portfolio this year because potentially the dollar won't be as supportive going forward. But can you talk through the rationale for that and also the introduction of the Japanese yen as a potential offset?

Charlotte Yonge: So just in terms of the dollar, as you say, historically, it has very consistently performed well when equities have been weak and there are quite a few reasons behind that. There's sort of a mechanical factor, which is that it's still and has been very strongly the world's reserve currency. So, people tend to borrow in dollars and when they get more nervous about risk assets, they tend to repatriate those borrowings back into dollar cash. So, in COVID, in the financial crisis, but even in shorter stretches of market selloffs in the past 15 years, the dollar has appreciated in every single one until April.

And the reason we think is there's something structurally changing here. There has been a move away from the dollar for quite a time. So, if you go back to 2015, 65% of Central Bank FX reserves around the world were in dollars. That's now 58%. So, it's on the decline and what's clearly potentially accelerating now is central banks not trusting the dollar. So, what happened on the 2nd of April with liberation day, eroded decades of trust in the US we believe. And to that end, is the dollar going to be the world's reserve currency? Is it going to be the default for a central bank allocating its incremental dollar or euro? I think not going forward. I think we see that shift accelerating. And a big problem for us is that well if the dollar's not going to perform in a time of crisis, then we don't necessarily want to take that currency risk.

Again, coming back to this avoiding things that you can't predict and can't know. If we don't have a view on a currency, we'll hedge it back to Sterling. At the beginning of this year, we had 25% in dollars for the reason that the dollar had a track record and had consistently proven to us that it can be a safe haven in a time of crisis. April, things were changing so I remember on the Friday, the 4th of April, we took that dollar waiting from 25% to 20%, and then in the following fortnight, we took it from 20% to near a 10% and it's now just below 10% today.

So, we acted quite quickly on that. I think this is structural. If US interest rates are higher, that tends to be good for the dollar because obviously it attracts flows into that currency. Given where interest rate differentials are today, the dollar should be stronger. And also, people are buying US equities. So, what's going on? There's obviously something beneath the surface going on with that currency. And we can talk about the flip side to that, which is more positive on other things like gold, also like yen.

Sebastian Lyon: One of the things from the point of view of constructing the portfolio is we need to build a portfolio that's resilient, and that does have offsets, because we know that equity markets do fall and we want to, within those environments, be able to try and protect our investors from some of that equity downdraft. If the dollar's not going to do that job for us, then we need to find something that is going to do the job for us. Actually, there's nothing new on this score in that we have been fully hedged in the past. When I first launched the fund, we had a lot of dollar assets, and we were fully hedged. There was a period where the dollar was weakening ahead of the financial crisis. So, from about 2002 to 2007 the dollar

was very weak. If you remember against cable, it went from something like 145 to 211 back in 2007. And we decided to, at that particular point in time in 2007, totally unhedge. We had no hedges in the portfolio at all because we just thought that the upside in the dollar from 211 was just fantastic. Which it was and really helped us during the financial crisis.

But I think we have held other currencies and perhaps newer investors to the fund over the last decade or so, won't necessarily be familiar, but we have held other currencies. Aussie dollars, we've held Euros, we've held Swiss Francs, we've held Singapore dollars. It has been rather about the dollar since the financial crisis. And I think that Charlotte and I agree that that has actually changed in the past 6-9 months. And so, we need to find other assets.

Tom Yeowart: And we have confidence in the yen because it's exhibited the same traits of consistently protecting when equity markets become very weak.

Charlotte Yonge: In the financial crisis versus sterling, the yen appreciated over 80% from the market's peak to its trough. COVID clearly was a shorter-lived crisis, but it was 15% then. Again, the carry trade is important, particularly for the yen, more so than the dollar. People tend to borrow in that currency. It's cheap to borrow in and you get that mechanical unwinding. It's also now, on almost every single measure, very cheap versus both sterling and the dollar, purchasing power parity. And you have a central bank in Japan who will act if they're worried about inflation, they will raise interest rates. They're poised to, and you saw that in August of last year, and that clearly helped the yen. So, there's a number of reasons why it should do well on a standalone basis over time but it's really that crisis performance that characteristic that we own it for.

Tom Yeowart: Gold has been another important offset for the strategy over time, and it has clearly been a very strong performer over the last couple of years and contributed significantly to our returns. And I'm sure many people recognise the increase in central bank buying of gold. But what gives you confidence that these are structural, long-term trends. That gold's ability to help protect and offset in the portfolio can be sustained over time.

Sebastian Lyon: I think gold needs to be put into some context within the portfolio. I've described it as essential portfolio insurance. So, what gold effectively offers us is it provides scarcity, it provides permanence, it provides resilience. It is, if you like, the ultimate portfolio reserve asset.

And that is actually the case with Central Banks as well. It is their reserve asset, and they have been increasing it. Why have they been increasing it? Well, I think for the reasons that we gave earlier in terms of the dollar. And also, I think debt. What is the opposite of debt? It's gold. And we have got huge amounts of debt. But the interesting thing about the rise in debt, and particularly government debt in the post COVID world, is that whereas in the pre-COVID world, the debt didn't really matter because the interest costs were so minimal, because interest rates were so low. Now the pain is being felt because the interest rates have risen and therefore the interest costs have risen. And you can see that with the fact that the US government now has to spend a trillion dollars a year on interest charges.

The other perspective from a central bank demand point of view is the Russian sanctions that obviously took place back in February of 2022. And that was the catalyst that really triggered

the material central bank buying over the last three years. The good thing about what's happened within the reappraisal of gold over the last two or three years, it hasn't been about retail or institutional investors piling in, speculating. It's been a bull market of relative stealth. Now I think that in the last few months, we recognise that it has got a little bit hotter and therefore we have reduced the holding. So, we have been very methodical and clear about the fact that as prices have risen, we have taken some gains. If we had done nothing within the portfolio, I think gold would be getting on for 20% of the portfolio. It's currently 11%. So, we've been careful not to get more bullish as the price rises, but it still has that core role within the portfolio, which at the moment we see in a very febrile world, geopolitically, it remains important portfolio insurance.

Tom Yeowart: There's always a dizzying amount of noise on the sort of macroeconomic and geopolitical front and it seems to have been amplified this year with everything going on from Liberation Day to the US bombing Iran. There's an awful lot going on. How do you factor, if at all, all that macroeconomic and geopolitical noise into asset allocation as well as the selection of the underlying assets we own?

Charlotte Yonge: It's a great question because as you say, most of its noise, most of it's unpredictable. I've just been writing about what's going on in the labour market this morning, and you don't know that a recession is here until it's here. There are very few good leading indicators. And everyone obsesses over unemployment. That is a very bad leading indicator. So, I think we have to be really humble about what we can forecast and what's worth spending time on as well. And really on this sort of don't lose money. Okay, well, let's maybe just look at valuations and look at what's in the price and look at what the scope is for that to be wrong and for those expectations to be disappointed.

And so, it's really the same in terms of just understanding what's priced in, in terms of economic expectations for the wider economy. So, looking at other asset classes, but within equities, is this level of earnings growth reasonable? Is it pricing in the risk that there could be a recession that no one's talking about. And we'd say probably currently no. And then to your point on noise, focus on what you actually own and what companies are doing. And that's what I think is most compelling. It's why I came here. It's why I really believe in what we do. Where you can have an edge I believe, still is really understanding companies and particularly within that asset allocation, that macro multi-asset context, is leaning in to buy those businesses when everyone else is selling and you know exactly what you're buying. But there is just a pandemic or a tariff situation which makes everything really murky in that moment but actually you can look through that murkiness because you understand that in five, 10 years' time, Visa or Microsoft, or one of our consumer businesses that we've owned for a while, they are going to be there and stronger. It gives you that clarity in the noise to have that bottom-up focus.

Tom Yeowart: Turning to our closing question, I'd love to hear what our ambition is for the next 10 years?

Sebastian Lyon: In terms of our ambition for the fund, and for our investors, we want to generate consistent, if possible, high single digit returns. And one of the things that we've recognised is that coming back to the question about asset allocation and particularly about fixed income, we do not believe we're in a world at the moment where fixed income is necessarily going to be very kind to investors, particularly if you've got long duration.

So, we need to think about how are we going to generate the sort of high single digit returns that we have done in the past with low volatility? And I think we need to ultimately improve and increase the returns that we generate from equities as well as the other parts of the portfolio. But in particular, we need to think about the equity part of the portfolio and that's where I think the returns are going to come from. But that's where we need to be spending, as we always have done, a disproportionate amount of our time.

Charlotte Yonge: I agree. I think it's that preserve and grow. If you stand still, then you actually go backwards. So, if we ignore the latter part of this mandate, the growth, then there's a risk that we don't even preserve. So, it's making sure that we remember both of those things, and why people own us and it's for that ongoing consistency, protection first, but really that consistency of returns over time.

Tom Yeowart: Great. Thank you, Charlotte. Thank you, Sebastian.

Charlotte Yonge: Thank you. Thanks Tom.

Sebastian Lyon: Thanks Tom.