ES River and Mercantile Global High Alpha Fund

Quarterly Report to 30 June 2020

RIVER AND MERCANTILE
ASSET MANAGEMENT

For unitholders only

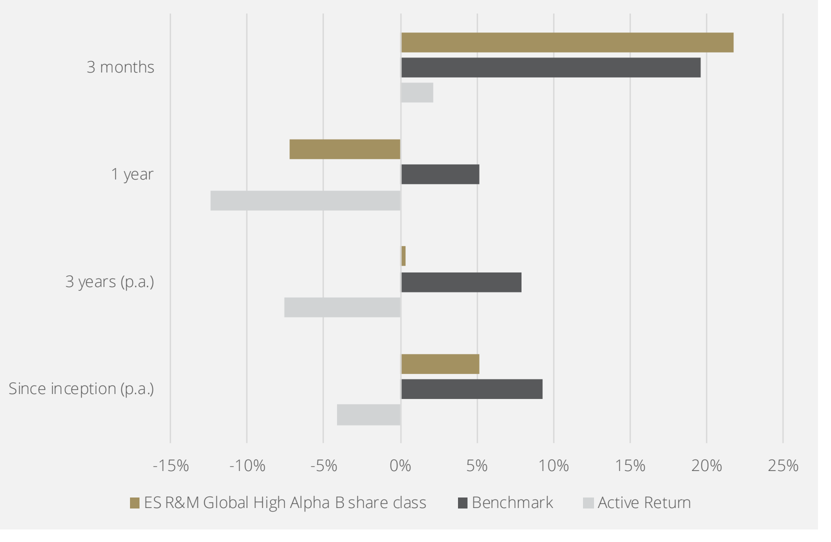
ES R&M Global High Alpha Fund
Quarter 2, 2020

Fund Objective

The investment objective of the fund is to grow the value of your investment (known as "capital growth") in excess of the MSCI All Country World Index (ACWI) Net Total Return (the "Benchmark") over a rolling 5 year period, after the deduction of fees.

Performance (net of fees)

	B share class	Benchmark	Difference
3 months	21.8%	19.6%	2.2%
1 year	-7.3%	5.2%	-12.4%
3 years (p.a.)	0.4%	7.9%	-7.6%
Since inception (p.a.)	5.1%	9.3%	-4.1%



Performance (gross of fees)

	Z share class	Benchmark	Difference
3 months	22.0%	19.6%	2.4%
1 year	-6.6%	5.2%	-11.7%
3 years (p.a.)	1.1%	7.9%	-6.8%
Since inception (p.a.)	5.9%	9.3%	-3.4%

Source: River and Mercantile Asset Management LLP. Benchmark is the MSCI All Country World Index (ACWI), net GBP. Fund performance shown is of B share class (accumulation units) which is net of an annual management charge of 0.75% per annum, and the Z share class (accumulation units) which reflects the fund's gross performance before any fees are deducted. Fund performance is calculated using the midday published price. Please note that the benchmark performance is calculated using close of business mid-market prices. Other share classes may be available. **Past performance is not a reliable indicator of future results.**

Portfolio Summary & Key Risk Characteristics

AUM	£116.4m	Price to Book	1.32
Strategy Capacity	£7bn	Price to Sales	1.04
Inception date	12 August 2016	Portfolio Beta	1.06
Number of stocks	305	Tracking Error	4.10 %
Largest Holding	Alphabet class A 1.69 %	Active Money	77.45 %

Lower risk — Higher risk

1	2	3	4	**5**	6	7

Typically lower rewards — Typically higher rewards

The Synthetic Risk and Reward Indicator (SRRI) is based on how much the returns of the shares have varied over the last five years, or since launch (whichever is the shorter period). The higher the rank the greater the potential reward but also the greater the risk of losing money. For more details please refer to the Key Investor Information Document.

Investment commentary

The information contained in this report does not constitute as investment advice and should not be treated as a recommendation to invest in any security. The information is based on the historical performance of the ES R&M Global High Alpha Fund and may no longer be current. Any references to securities are for illustrative purposes only and these securities may no longer be held. The information should not be used as the basis for any investment decision. Any opinions expressed are opinions of the relevant portfolio manager and are given in good faith as of the date of the report but should not be considered operative at any date thereafter.

'When you walk through a storm, hold your head up high, and don't be afraid of the dark…' – ***'You'll Never Walk Alone' by Gerry and the Pacemakers*** *(Liverpool football club anthem)*

Source: Bloomberg

Our reports and communication to you

The way the world and you, our clients, consume information has clearly changed over the last few years. Whilst our quarterly reports have always been held in high regard because of the richness of their content and their consistent reference to our PVT philosophy and process, they have perhaps become too long for current day requirements. As a result, I intend to provide a deeper Executive Summary going forward, providing a more distilled, punchy articulation of key events, observations and portfolio activity during the quarter. A more in-depth commentary, which will incorporate my usual thought pieces and examinations of subject matter that demand greater explanation, will be made available separately from the quarter-end reporting cycle, which also allows us to get the more time-sensitive information to you more quickly. In addition, we will be continuing with our regular webinars, adding a little bit more depth to our monthly updates and providing links to short video clips if we are particularly excited by a topic.

Executive Summary

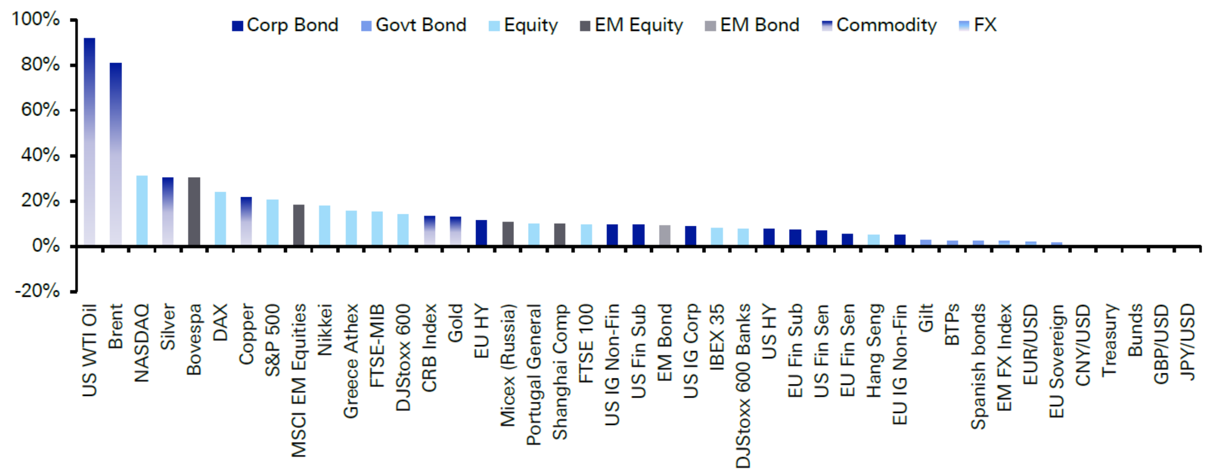
- Covid-19 cases declined in areas where strict social distancing was implemented.
- Perhaps more importantly, rates of hospitalisation and death appeared to fall throughout the period, including in countries where cases were still increasing. Healthcare infrastructure has been able to cope.

- Economies around the world bottomed-out in April, with the recovery starting to come through in May and June, relatively V-shaped so far.
- Equity markets rallied robustly as the threat of Covid-19 peaked, as economies and corporate profits bottomed-out and as very supportive monetary and fiscal policy kicked in.
- Our key investment factor, value, had another difficult quarter. It is highly unusual for value to underperform during economic recovery periods, so this is a very significant anomaly that needs some explaining. Suffice it to say that growth and quality have benefited from falling interest rates, relatively strong corporate fundamentals through the Global Covid Crisis (GCC) and crisis-related flows of liquidity. Value has not benefited from these.
- As a result of this further weak period for value the anecdotal evidence of investors 'giving-up' on this time-honoured approach has become marked; some very high-profile value managers have left the marketplace.
- However, value will be back. As I just mentioned, value nearly always does well in an economic recovery period, especially if that recovery happens at a time when value is relatively attractively priced, which it most definitely is today. What is likely to happen at some point over the next few quarters is this: global economies will continue to recover; the massive monetary and fiscal stimulus will continue to positively impact; deflation will turn to reflation; bond yields will bottom-out; growth and quality stocks' relative fundamentals will peak as more cyclical value stocks start to see profits recover and brought forward digital spending struggles to preserve the momentum embedded in many growth and quality stock share prices; and finally, liquidity and passive based investing may change direction as momentum shifts from deflation to reflation beneficiaries.
- I, like fellow Liverpool FC fans, have continued to believe during the dark times for the club, as well-articulated in this article by Research Affiliates:
- Indeed if you were a visitor to Earth from Mars, and all you had was a deep set of data on factor returns and economic and profit cycles over the last 100 years (since proper equity markets began) and you set yourself the ten key tests on whether now was the time to invest in value, recovery and multi-cap stocks then the answer to all those key tests would be very supportive. Now is, at least according to the data, the best time to invest in value, recovery and multi-cap that I have seen in my career.

Market returns and our performance

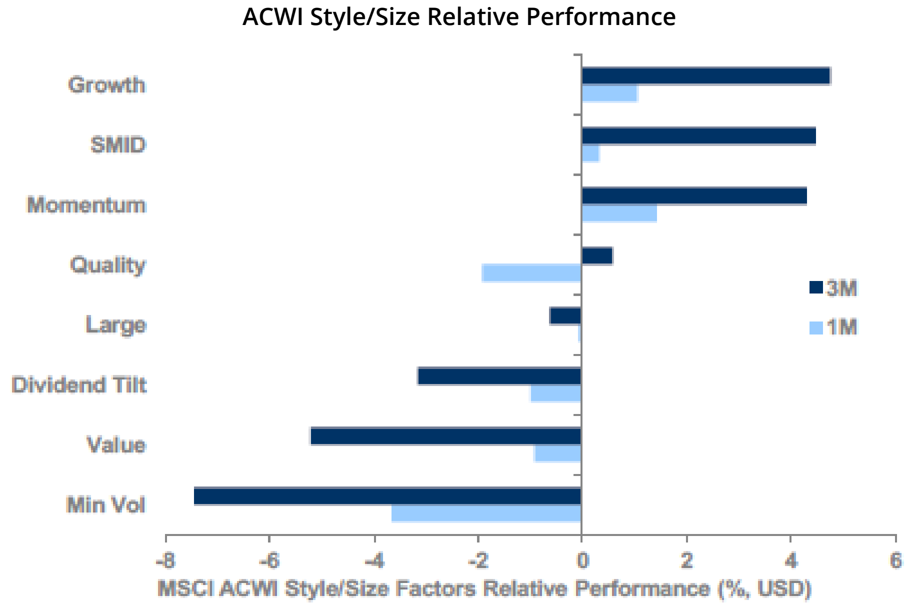
- Equity markets rebounded strongly, led by the safety first and liquid US market and followed by others to varying degrees depending on perceived ongoing risks. The MSCI ACWI returned +19.2%, the MSCI World +19.4% and MSCI EM +18.1%. The MSCI ACWI Enhanced Value index returned 10.9%.

Total Return performance of major global financial assets in Q2 (in local currency)



Source: Deutsche Bank, Bloomberg Finance LP, Mark-It

- Value factors were weak, growth and momentum particularly strong



Source: MSCI, Morgan Stanley Research

- Our other key factors were, on balance, more supportive: smaller companies started to outperform again, with the MSCI World Small Cap Index returning 24.7% though US equity returns continue to be dominated by the tech-mega-caps. Recovery stocks were somewhat mixed, though some rallied pretty hard, while others like interest rate sensitive stocks (banks) were poor. Regional equity performance was more nuanced, led by the US (a continued negative for our global strategies) but also well supported by Europe (Dax) and some emerging markets.
- Despite the value headwind we had a pretty strong quarter, clearly with strong absolute returns (recovering somewhat from a very weak Q1) and good relative returns. As for much of the anti-value period since the Global Financial Crisis (GFC) (until 2018), we managed to offset value headwinds with robust multi-cap investing and exposure to companies that were clearly going to increase shareholder value, either from a low point for recovery stocks or through ongoing structural growth delivered by the good value growth stocks in the portfolio, including digital economy exposure.
- The ES River and Mercantile Global High Alpha Fund returned +22.0% (gross, Z shares) and +21.8% (net, B shares), an outperformance of 2.4%.
- During the relatively short-lived periods when value did well during the quarter, often when bond yields moved up a few basis points and other investors were prepared to look beyond the most reliable stocks, we performed very strongly indeed.
- Our medium-term returns have been negatively impacted by the post-2017 period, during which all our factors have struggled at the same time: namely value, recovery, multi-cap and regional diversification. This has been a difficult period of performance for which I remain very sorry.
- Our long term, and since PVT-inception returns are strong, especially versus value benchmarks and peers. My 25-year track record continues to annualise at almost 4% p.a. ahead of benchmark.

Activity and positioning

- The portfolio continues to have a very clear value bias, with strong absolute valuation support including a 1.3x price to book valuation and double-digit earnings and cashflow yields (which more than discounts the fall in corporate profits in 2020).
- We combine stocks with traditional value characteristics (such as banks and specialist financials), with attractively valued and out of favour at time of purchase Quality and Growth franchises (such as Amadeus, Jardine Strategic, Alibaba, Walt Disney, Prosus, Treasury Wine, Bolsa de Valores de Colombia, Hong Kong Exchanges, Shop Apotheke, CTrip, SATS, Starbucks and Intel), many high scoring *MoneyPenny* recovery stocks (Baidu, Nokia, Capita, Playtech, FNAC Darty, Hunting, Dormakaba and

Owens Corning), classic global cyclicals but with a focus on those with leading franchises (Fanuc, Infineon, Volvo, Valeo, CBRE, Avnet and Anglo American) and domestic stocks that are temporarily disliked (Persimmon, Knight-Swift Transport, Resideo and Southwest Airlines).

- Our activity over the last quarter focused on adding to the above, with significant purchases of CBRE, Alibaba (including a switch of the ADR to the HK listed line), Boeing, Resideo, Southwest Airlines, Hunting, Starbucks, Amadeus, Owens Corning, Jardine Strategic, Infineon, Walt Disney, Axa and Hong Kong Exchange. Sales have included taking profits where our PVT thesis has been delivered, including United Health, Tingyi, and Direcional, top-slicing into relative strength (Facebook, Prada, Shop Apotheke, eBay) or re-focusing capital towards higher conviction ideas (MGM China, Ajinomoto and Lufthansa).

Are we following our PVT philosophy and process and a consistently articulated style and factor bias?

- Yes. The portfolio remains clearly skewed towards high scoring *MoneyPenny* stocks; it has a clear value bias; it has exposure to all four of our categories of potential but with a greater tilt to recovery and asset-backed due to the richer anomaly set in this part of the market; it is a multi-cap portfolio.

Team and investment philosophy updates

- In previous reports, we have mentioned continued investment in the PVT team despite the value headwinds. This is now very much in place, with James Sym (to launch our European Equity strategies and support our global franchise), Alexander Stout (Global Analyst) and Laura Corbetta (Quantitative Analyst) all having started (from home sadly) in June.
- As a team, we have, led by Gary Dowsett, spent a considerable amount of time formalising our own core sustainability beliefs to act as a long-term foundation for this now key part of investing. The key pillars of Sustainable PVT are People, Innovation and Environment which better reflects our beliefs than ESG.

Outlook

- Equity markets have perhaps recovered ahead of many people's expectations and, given the many Covid-19 related uncertainties, will remain volatile.
- However, the global economic and profit cycle has now bottomed-out.
- Medium-term valuation metrics in most equity markets, outside of the momentum-driven US market, remain supportive.
- This portfolio is very modestly valued and has a well-diversified exposure to companies that will be able to grow profits and cash flow robustly from this current low point. This should allow for attractive absolute and relative returns.

Thank you for your continued support and patience.

Hugh Sergeant

Head of Value and Recovery Strategies, PVT Equities

July 2020

Fund Information

Launch date	12 August 2016
Fund manager:	Hugh Sergeant
IA sector:	Global
Benchmark:	MSCI All Country World Index (GBP)
Tracking error range:	N/A
Strategy capacity:	£7bn
XD dates:	1 April & 1 October
Dividend/Accumulation payment date:	31 May and 30 Nov

Share class:	B	Z
Launch price (shares):	250.00p	500.00p
Share classification:	Retail/Institutional	Institutional
Type of shares:	Accumulation	Accumulation
Fund charges:		
Annual	0.75%	Variable*
Initial (up to)	5.25%	5.25%
*Z share class AMC is charged outside the Fund		
Minimum investment		
Initial	£2.5 million	£5 million
Subsequent	£25,000	£50,000
Sedol	BZB1R49	BZB1SM4
ISIN	GB00BZB1R490	GB00BZB1SM46

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