ES River and Mercantile UK Dynamic Equity Fund

Quarterly Report to 30 June 2020

RIVER AND MERCANTILE
ASSET MANAGEMENT

For unitholders only

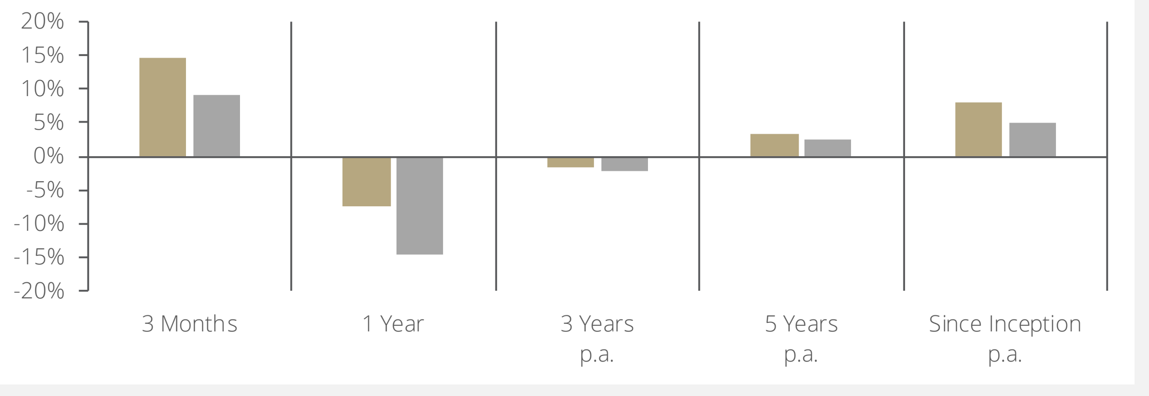
ES R&M UK Dynamic Equity Fund
Quarter 2, 2020

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 United Kingdom Investable Market Index (IMI) Net Total Return (the “Benchmark”) over a rolling 5 year period, after the deduction of fees.

Performance

B share class	Fund	Benchmark	Difference
3 months	14.5%	9.2%	5.4%
1 year	-7.3%	-14.7%	7.3%
3 years (p.a.)	-1.7%	-2.2%	0.5%
5 years (p.a.)	3.3%	2.4%	0.9%
Since Inception (p.a.)	7.9%	5.0%	3.0%



	Fund	Benchmark	Difference
3 years (cumulative)	-5.1%	-6.4%	1.3%
5 years (cumulative)	17.5%	12.7%	4.8%
Since inception (cumulative)	78.4%	44.5%	34.0%

Source: River and Mercantile Asset Management LLP. Benchmark is the MSCI UK Investable Market Index, net GBP. Fund performance shown is of B share class (accumulation units) and is calculated using the midday published price, net of an annual management charge of 0.75% per annum. 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

Fund AUM	£56.3m	Tracking Error	4.85 %
Strategy Capacity	£2bn	Active Money	74.04 %
Number of stocks	56		
Largest Holding	Prudential 4.1 %		

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 UK Dynamic Equity 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.

Quote for the Quarter

"Generally, in cricket teams you want contrasting players that present different challenges: if possible, you want a left-hand, right-hand combination at the top of the order, and you want grafting players mixed in with some expansive stroke makers. Similarly, it's good to have a swing bowler, a tall fast bowler who hits the deck, a left-armer and an off spinner in your bowling attack. You don't always get that, it depends on the personnel, but ideally that's what you want."

Graham Gooch (former England cricketer)

Market Background

During Q2 2020, global stock markets recovered much of the ground lost during the first quarter. Activity measured by mobile phone location data, which had started showing a pick-up in driving and footfall from the middle of April and accelerated through May, continued to improve in June as lockdowns were further relaxed across most developed markets. These real-time measurements have now been followed by official economic data, such as PMIs and retail sales, beginning to beat depressed expectations, demonstrated in improving Citi Economic Surprise indices. Reflecting this increased optimism, the best performing assets have generally been those with a more pro-cyclical bias, such as German and Japanese equities and commodities, while the safe-haven US dollar index fell modestly. From the middle of June, however, increasing focus on rising infection rates in southern states of the US re-injected some volatility into markets with the S&P 500 retracing 7% from intra-month peak to trough.

In the UK, concerns over Brexit negotiations and the re-emergence of a year-end 'cliff edge' put pressure on sterling (GBPUSD -1.5%), while 10Y (year) gilt yields fell to 0.17%. This is not out of line with our expectations at the start of the year for the trajectory of these discussions, and later in the quarter more positive noises have emerged demonstrating a path forward via some potential compromises.

How did we perform and why?

(Fund performance references the B share class and is calculated net of a 0.75% p.a. annual management charge)

The Fund rose by +14.5%[1] in the quarter, versus a total return of +9.2% by its comparator benchmark, the MSCI United Kingdom Investable Market Index (IMI)[2]. Stock picking and sector allocation contributed equally to outperformance. Over the longer term, the Fund has returned +7.9% per annum since inception of the B share class in 2012, versus a benchmark return of +5.0%.

Our gold miners, Barrick Gold and Centamin, were leading contributors again (contributing +2.6% combined to absolute performance) as the spot gold price approached $1,800 by quarter end. Specialty insurance and re-insurance provider Lancashire Holdings (+0.5% absolute contribution) raised ~20% in additional capital to go after growth opportunities being presented by what the management believe are the first 'hard market' conditions in global property & casualty insurance markets since the wake of 9/11. Lancashire's nimble structure and culture makes this the ideal vehicle to take advantage of current dislocations. 888 (+0.7%) positively profit warned, with strong Q1 trading having accelerated through Q2 resulting in material forecast upgrades. Coupled with ongoing consolidation in the gambling software market – Evolution Gaming is paying ~15x 2021e EBITDA (earnings before interest, taxes, depreciation and amortisation) to buy peer Net Entertainment – these strong results demonstrate the excellent value still in 888's proprietary technology stack (which drives sustainably high return on capital), currently trading on 7x EBITDA and a 10% FCF (free

---

[1] B share class (GBP), mid-day to mid-day pricing.
[2] Close-of-business to close-of-business pricing.

cash flow) yield. Larger gambling peer Flutter Entertainment (+0.9%) also performed well, with global investors increasingly enthused by the US market opportunity. Flutter's likelihood of being a market leader has been reinforced by the acquisition of The Stars Group (PokerStars, SkyBet, and Fox Bet brands), which closed last quarter. Stock Spirits (+0.5%) and B&M European Retail (+0.6%) both rose on strong trading updates.

Zero weights in HSBC and Royal Dutch Shell (A class) added 2.0% combined to relative returns.

The most material negative contributor was Smart Metering Systems (-0.2% absolute contribution), which fell 10% on no news, having been among the strongest performers last quarter. Softer near-term pricing trends in the motor insurance market saw analysts reducing profit forecasts for Sabre Insurance (-0.2%).

Zero weights in mega-cap defensives AstraZeneca and Reckitt Benckiser detracted -0.7% combined from relative returns, while zero weights in mega-cap miners Rio Tinto, BHP Billiton and Glencore together cost a further -0.9% relative.

Portfolio Activity

Key purchases

A new holding in vertically integrated paper and packaging provider Mondi provides us with attractive and undervalued *Growth* characteristics, both via a recovery in broader economic activity and its strength in niches which benefit from accelerating structural growth in e-commerce. With the bulk of its operations in Central and Eastern Europe, Mondi's low-cost access to fibre (the key raw material) and labour coupled with significant investment in processing efficiencies underpin its sustainable cost advantage (80% of its operating capacity is in the bottom half of the cost curve) and high market share in Europe. We perceive Mondi's strength in virgin containerboard to be of increasing strategic importance, as the scarcity of assets which can produce virgin fibre of suitable quality is likely to drive raw material price inflation from depressed levels relative to history.

Homebuilder Persimmon is a cyclical *Quality* idea with a strong balance sheet (net cash at its March update equivalent to c8% of its current market cap) and the highest operating margins (~30%) in the sector. It is resilient: gross margins embedded within the landbank imply a lower probability of balance sheet impairments compared to the previous downturn, and we believe it would continue to generate a relatively high return on capital even in a scenario of -20% volumes and -10% prices. Current restrictions on high loan-to-value mortgages will likely push buyers towards Help to Buy (HTB) / new builds (HTB is ~50% of Persimmon units). Balance sheet value implies only modest downside potential, while the low starting multiple of 9x trailing profits and 8% dividend yield underpin an attractive total return in a more positive economic scenario.

I re-initiated a position in Meggitt as a direct replacement for our holding in Rolls-Royce, which was sold. Although exposure to civil aerospace has hurt the share prices of both (-55% and -58% respectively year-to-date), having reflected on the two investment cases again, Meggitt offers a superior margin of safety via reduced downside risk. Its exposure is more balanced between civil and defence (36% of FY19 revenues), and, within civil aftermarket, between widebody (56%) and narrowbody / business jets (44%). Rolls is more skewed to long-haul widebody jets, where there is greater debate about the speed and extent of flying hours recovery. Meggitt had a self-help cost saving programme already in place coming into 2020 to drive higher margins in its Polymers division so this helps protect profitability to an extent in the near term, while recent calls with the two management teams suggested a lower risk of material working capital outflows putting pressure on net debt and leverage ratios.

We used a placing to initiate a position in Supermarket Income REIT, a real estate investment trust dedicated to investing in supermarket property. Long-dated, secure, inflation linked rental streams underpin this *Asset-backed* thesis, but the exciting part is the valuation rerating potential on the portfolio, closing the gap that has opened to the valuation of distribution warehouse REITs. Supermarket real estate has proved to be a critical part of the UK's infrastructure during the COVID-19 crisis, operating as multi-channel distribution hubs for last mile online delivery as well as physical retail stores.

IMI designs, manufactures and services highly engineered products (mainly valves) that control the precise movement of fluids. Its products are used in a wide range of end markets including energy, transport, life sciences and HVAC (heating, ventilation and air conditioning). Deep IP (intellectual property) in harsh environment valve manufacturing and its dense global distribution network confer sustainable advantages that have allowed IMI to generate returns above cost of capital in each of the last 20 years. We were able to buy the shares trading close to trough multiples versus normalised earnings as near-term profits have been under pressure owing to cyclical end market exposure, notably factory automation, construction and trucks. We assess these markets, and consequently group profitability, to be at or close to trough and believe a management team is in place who can drive shareholder value harder independent of the cycle.

Synthomer is another industrial cyclical whose return on capital track record is overlooked, considering its lowly 10x profit multiple. Investors are underestimating the scale and sustainability of demand growth in nitrile latex, and the value that will be created from the OMNOVA acquisition. The key driver of higher demand in nitrile is rubber gloves, where recent industry expert calls and customer announcements suggest that demand growth is likely to be sustained at +15-20% year-on-year due to COVID-19, versus previous consensus expectations nearer 10%. Owing to the lead-time to bring on new capacity, incumbent operators should enjoy 18-24 months of very tight supply/demand conditions before any new capacity hits the market. Meanwhile, our analysis suggests that guidance on cost synergies from the Omnova deal has been set conservatively and should be exceeded.

Key sales and reductions

As well as Rolls-Royce (see above), we sold our remaining position in Legal & General. A re-assessment of the investment case suggested that capitalising on growth in the bulk annuity market involves a fundamental trade-off between growth, solvency and dividends, about which we became less confident. Following a well-timed reduction in our Intertek position earlier in the year, we exited the shares less well ahead of its trading statement. Having seen peer Bureau Veritas report a -18% year-on-year sales decline in its Products division, we believed a negative shock versus consensus forecasts was not priced in at Intertek. I exited the holding in Lloyds Banking Group to avoid skewing the portfolio further towards UK domestic exposure, particularly the UK housing market (given Lloyds's large mortgage book), following the Persimmon purchase. Our higher conviction UK banks holdings are RBS, differentiated by its strong capital position and lower exposure to areas of enhanced credit risk such as credit cards and auto financing, and Barclays, which offers a slight hedge to protect downside via its investment banking franchise which gains from higher trading volumes during volatile market periods.

Portfolio Fundamentals

The fundamentals of the companies in our portfolio are robust. Overall, we own high cash margin, attractive return on capital (CFROI) businesses that are growing faster than the comparator benchmark, while employing lower levels of debt (see table below). The fact that companies with these characteristics are available at attractive cash earnings yields while sovereign debt trades below 1% (and UK gilt yields nearer zero) should provide much comfort to longer-term investors.

	R&M UK Dynamic Equity	UK benchmark weighted average
Average market cap (£bn)	31.9	57.6
Fundamentals		
Cash Flow Return on Investment (5Y average)	13.2%	14.6%
5Y sales CAGR	4.4%	3.2%
Debt leverage (incl. financials)	3.0 x	4.1 x
Valuation		
Price-to-earnings (+12mths)	15.8 x	15.6 x
Equity Free Cash Flow yield (trailing 12mths)	10.1%	8.4%
EV to replacement cost (inflation-adjusted)	2.6 x	3.8 x

Source: Credit Suisse HOLT, Bloomberg. Data to 30 June 2020.

Final word

The UK stock market is today among the most attractive globally from a stock picker's perspective, due to levels of valuation dispersion at historic highs. This set up exists because uncertainty remains elevated – we don't really know how the 'pitch is going to play' from an economic backdrop standpoint, so we want to build a portfolio akin to Graham Gooch's ideal cricket team of "grafting players mixed in with some expansive stroke makers". Portfolio positioning is therefore currently a 'bar-bell' between bigger positions in larger caps with more defensive earnings profiles, and smaller weights in strong companies within cyclical or deeply out-of-favour sectors which will participate in any economic recovery. I anticipate volatility being a feature of the summer months until there is more concrete news around vaccine progress, as well as what follows on from the current rounds of monetary and fiscal support. At this stage, we expect localised or targeted lockdowns to be more likely than the whole economy 'induced coma' previously deployed. A balanced approach to risk makes sense in this context.

Thank you – as ever – for your patience, ongoing support and partnership.

William Lough

William Lough
Portfolio Manager
July 2020

Fund Information

Launch date	22 March 2007[1]
Fund manager:	William Lough (from 3 April 2018)
IA sector:	UK All Companies
Benchmark:	MSCI UK IMI (Total Return, net GBP)
Tracking error range:	N/A
Strategy capacity:	£2bn (pooled & segregated)
XD dates:	1 April & 1 October
Dividend/Accumulation payment date:	31 May and 30 Nov

Share class:	A	B	Z
Launch price (shares):	100.00p	250.00p	500.00p
Share classification:	Retail	Retail/Institutional	Institutional
Type of shares:	Income	Accumulation	Accumulation
Fund charges:			
Annual	1.50%	0.75%	As agreed*
Initial (up to)	5.25%	5.25%	5.25%
Ongoing Charge Figure (OCF) (incl. AMC)	1.68%	0.93%	AMC* + 0.18%
*Z class AMC is charged outside the Fund			
Minimum investment			
Initial	£1,000	£2.5 million	£5 million
Subsequent	£500	£25,000	£50,000
Sedol	B1NG829	B7H1R58	B1NGCT4
ISIN	GB00B1NG8296	GB00B7H1R583	GB00B1NGCT49
Bloomberg	RIVMERALN	RIVMERB LN	RIVMERZ LN

[1] B share class launched 21 November 2012

Important disclosures

The information in this document has been prepared and issued by River and Mercantile Asset Management LLP (trading as “River and Mercantile” and “River and Mercantile Asset Management”) registered in England and Wales under Company No. OC317647, with its registered office at 30 Coleman Street, London EC2R 5AL. River and Mercantile Asset Management LLP is authorised and regulated by the Financial Conduct Authority (Firm Reference Number 453087), is registered with the U.S. Securities and Exchange Commission as an Investment Adviser under the Investment Advisers Act of 1940.

River and Mercantile Asset Management LLP is a subsidiary of River and Mercantile Group Plc which is registered in England and Wales under Company No. 04035248, with its registered office at 30 Coleman Street, London EC2R 5AL.

This document is directed at professional and retail clients. The information in this document should not be relied on or form the basis of any investment decision. Retail clients requiring any information should seek the advice/assistance of a Financial Advisor. The information contained in this document is strictly confidential and must not be reproduced or further distributed.

The value of investments and any income generated may go down as well as up and is not guaranteed. An investor may not get back the amount originally invested. Past performance is not a reliable guide to future results. Changes in exchange rates may have an adverse effect on the value, price or income of investments. Please refer to the ES River and Mercantile ICVC principal prospectus for further details of the financial commitments and risks involved in connection with an investment in this Fund. The information and opinions contained in this document are subject to updating and verification and may be subject to amendment. The information and opinions do not purport to be full or complete. No representation, warranty, or undertaking, express or limited, is given as to the accuracy or completeness of the information or opinions contained in this document by R&M, its partners or employees. No liability is accepted by such persons for the accuracy or completeness of any such information or opinions. As such, no reliance may be placed for any purpose on the information and opinions contained in this document.

Please note that individual securities named in this report may be held by the Portfolio Manager or persons closely associated with them and/or other members of the Investment Team personally for their own accounts. The interests of clients are protected by operation of a conflicts of interest policy and associated systems and controls which prevent personal dealing in situations which would lead to any detriment to a client.

The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property and a service mark of MSCI Inc ("MSCI") and Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P") and is licensed for use by River and Mercantile Asset Management LLP. Neither MSCI, S&P nor any third party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any of such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

Neither MSCI nor any other party involved in or related to compiling, computing or creating the MSCI data makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any such data. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in or related to compiling, computing or creating the data have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages. No further distribution or dissemination of the MSCI data is permitted without MSCI’s express written consent.

Although River and Mercantile’s information providers, including without limitation, MSCI ESG Research LLC and its affiliates (the “ESG Parties”), obtain information from sources they consider reliable, none of the ESG Parties warrants or guarantees the originality, accuracy and/or completeness of any data herein. None of the ESG Parties makes any express or implied warranties of any kind, and the ESG Parties hereby expressly disclaim all warranties of merchantability and fitness for a particular purpose, with respect to any data herein. None of the ESG Parties shall have any liability for any errors or omissions in connection with any data herein. Further, without limiting any of the foregoing, in no event shall any of the ESG Parties have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

River and Mercantile Asset Management LLP
30 Coleman Street
London EC2R 5AL

www.riverandmercantile.com