FUND PROFILE

RSMR

RIVER AND MERCANTILE
UK EQUITY INCOME

April 2021

RSMR RATED FUND

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ES RIVER AND MERCANTILE UK EQUITY INCOME FUND

OUR FUND PROFILES provide an in-depth review of our leading rated funds and are designed to give advisers, paraplanners and analysts an 'under the bonnet' view of the fund. In providing more detailed commentary than a standard fund factsheet we believe our fund profiles set the standard for the next generation of research notes, aiding in fund selection and in meeting the ongoing suitability requirements expected by the FCA, and helping ensure firms deliver good client outcomes.

All of our rated funds are subject to rigorous and ongoing scrutiny on both a qualitative and quantitative basis. Our fund methodology is available for download from the RSMR Hub – www.rsmr.co.uk

The ES River and Mercantile UK Equity Income Fund is a multi-cap UK equity income fund which has a very distinctive investment process. The fund is managed on a total return basis (i.e. seeking income and capital growth) with a keen eye on the downside and these two factors differentiate the fund from most of its peers.

Integral to the River and Mercantile (R&M) PVT equities team investment process is a complex and versatile quantitative screening process (PVT (Potential, Valuation and Timing) Quant Screen) which does a lot of the heavy lifting for the equity team, from which they can leverage and build on their own wide experience and knowledge of companies. The team might not be the largest UK equities team in the UK but the PVT Quant Screen (which in current parlance deals with 'big data'), give them a distinct advantage.

Whilst this is not a responsible fund, ESG has been integrated into the investment process. There is a distinct emphasis on sustainability based upon pillars of People, Innovation and Environment which the River and Mercantile PVT team see as being the factors which most commonly impact a company's long-term value creation potential. These pillars provide a common framework for their fundamental research. This part of the process is constantly evolving, but the analysis is focused on material sustainability issues that have the capability to become financially material to companies.

Dan Hanbury, the lead fund manager, established an excellent track record at Investec, prior to joining River and Mercantile, and he has continued to consistently produce alpha for investors, and we have known him for most of his long investment career. Overall, the individuals in the UK equity team provide it with strength and depth which, coupled with the quantitative resource, make it a strong proposition.

Stephen O'Mara – Investment Research Manager, RSMR

Prior to joining RSMR in 2015, Stephen was Head of Investment Solutions at Ashcourt Rowan (formerly UK Wealth Management and Yorkshire Investment Group). Before that he ran the investment division of Pointon York and he worked as a discretionary portfolio manager at David Booler & Co. In these roles, he gained extensive experience in fund research, building investment propositions (advisory & discretionary) and working with clients, advisors & investment managers. He is a Chartered Fellow of the Chartered Institute for Securities and Investments, has a Diploma in Financial Planning and an Investment Management Certificate.

IA UK EQUITY INCOME

The ES River and Mercantile UK Equity Income Fund is classified in the Investment Association (IA) UK Equity Income sector. The IA UK Equity Income sector comprises funds which invest at least 80% in UK equities and which intend to achieve an historic yield on the distributable income in excess of 100% of the FTSE All Share yield at the fund's year end on a 3-year rolling basis, and 90% on an annual basis.

For many investors and advisers, funds in the IA UK Equity Income sector are an important investment option when looking to generate income, where the volatility associated with equity investment is an acceptable risk. The yield on the UK market is generally dependent on a small number of large companies such as Shell, Lloyds, HSBC, BP and GlaxoSmithKline generating a high proportion of the overall income. Common to these stocks, and to an increasingly large proportion of the UK market, is their global presence and their ability to generate significant revenues from outside the UK. The sector has had a more difficult period in recent years as growth stocks outperformed the value stocks which tend to form the base of equity income portfolios. So far in 2021, however, value stocks, particularly commodities have strongly rebounded on speculation that the global economy will strongly recover post-pandemic.

A high initial income or yield in a climate of low growth can provide an investor with a return ahead of inflation and so investing in equity income funds is a very pragmatic long-term investment strategy. In times of uncertainty, funds that can generate a defensive yield will fare better overall than pure growth-orientated alternatives. Equity yields have been relatively strong over the last few years, outstripping the benchmark 10-year gilt on several occasions, and this has led to investors looking more closely at income generation within a total return strategy.

Income has always been an important part of overall return, but it is in the current difficult climate, which seems likely to continue, that investors have refocused on using equity income funds. Even in the current pandemic, yields are still higher than many alternatives. There are of course different strategies that managers can use, and a popular one is termed ‘barbell’ where the manager seeks to create the income from holdings paying strong dividends at one side of the portfolio, whilst seeking to boost growth and return prospects from the other side, often holding stocks with lower dividends but stronger capital potential. Other developments in the income sector include managers using derivatives to create additional sources of income using the UCITS and NURS rules.

The typical equity income fund can form an integral part of both an income and growth strategy if used carefully in a portfolio – it makes sense, in the case of a longer-term growth strategy, that returns from income are included. In some cases, the tax implications may reduce this impact, but generally the benefits of having an ongoing income stream, even during times of economic difficulty, will enhance long-term returns and help reduce the impact of falls in capital value.

The recent environment for equity income funds has been one of the harshest in modern times. In addition to any drag that will have come as a result of many of them being more value-based, we have been experiencing an economic shock caused by the coronavirus pandemic which has affected dividend payments from companies across the globe. This is particularly important in the UK as companies on the UK exchanges tend to be some of the highest dividend distributors in global terms.

RIVER AND MERCANTILE ASSET MANAGEMENT LLP

River and Mercantile as founded in 2006 and set out to create an environment in which active fund management could thrive and prosper free from the constraints typically associated with larger organisations. This was a belief founded on the experience that an entrepreneurial environment rewards the genuinely active fund manager to the benefit of their clients.

In March 2014, the company merged with P-Solve, another entrepreneurial organisation with a similar approach to providing strong 'through the cycle' investment returns for their clients. This merger created River and Mercantile Group PLC (RMG) – a diversified, broad-based investment solutions business covering equities, multi-asset class strategies, liability-driven investments, structured equity, fiduciary and investment advisory services. As at 31 December 2020, RMG had £45.7 billion of assets under management. RMG is highly profitable and cash generative. The company's core markets are the UK, US and Australia and they have distribution partnerships in the US, Japan and Asia/China.

Since the merger, RMG has become an investment-led asset management business, built around strong product manufacturing and a growing distribution capability.

RIVER AND MERCANTILE UK EQUITY INCOME

Manager	Daniel Hanbury
Structure	UK OEIC
IA Sector	IA UK Equity Income
Launched	3 February 2009
Fund Size	£135.0m as at 31 March 2021

Fund Manager

Daniel Hanbury – Head of Income and Smaller Companies PVT Equities

After graduating from Loughborough University with a first-class degree in Mechanical Engineering, he began his investment career at Schroders on the UK fund management desk before joining the research department as an analyst in the UK research team. He joined Investec Asset Management in 2000 and was responsible for the UK Smaller Companies and the UK Unconstrained portfolios.

Dan was a founding member of River and Mercantile Asset Management LLP. Joining in October 2006, he successfully launched the UK Equity Smaller Companies and UK Dynamic Equity strategies and currently manages the UK Equity Smaller Companies, UK Equity Income and Core strategies

George Ensor – Portfolio Manager

George began his career at Smith & Williamson as a graduate trainee where he worked for five years as a Private Client Investment Manager. He had obtained a degree in Chemistry from Bristol University. He joined R&M in March 2014 as a UK equity analyst and is currently portfolio manager of the UK Micro-Cap Investment Company. He is a CFA charter holder.

Anna Pugh – Equity Analyst

Prior to joining R&M in 2018, Anna worked as a product specialist at Neptune Investment Management. She graduated from Bath University with a degree in Economics. She is a CFA charter holder.

Mayan Uthayakumar – Director of Research

Mayan joined Goldman Sachs in 2010 where he worked as an Associate in the Global Investment Research team. In 2014 he joined Sanford C Bernstein where he researched European utilities. He joined R&M in November 2015 as an Equity Analyst. He graduated from Oxford University with a degree in PPE. He also graduated from St Andrews University with a Master's degree in Finance, Money and Banking.

Laura Corbetta – Quantitative Equity Analyst

Laura began her career in 2016 in Milan, where she worked for Morgan Stanley Investment Management and Algebis Investments. She moved to the UK, joining the London Stock Exchange Group as a graduate associate and then served as a senior portfolio analyst at Natixis Investment Managers, prior to joining R&M in June 2000. She graduated with a degree in Business Administration and Management from the University of Milan Bicocca and an MSc in Finance from Bocconi University.

The broader team also includes:

Charles Benett – Managing Director, PVT equities

Hugh Sergeant – Head of Value and Recovery PVT

James Sym – Head of European PVT Equities

Gary Dowsett – Director of ESG, Global Analyst, PVT

William Lough – Portfolio Manager

Eduard Hernandez – Equity Analyst

Alex Stout – Equity Analyst

Fund Objectives & Targets

The investment objective of the fund is to generate a rising level of income (above the yield of the benchmark over a rolling three-year period) combined with the potential for capital growth (delivering a total return, net of fees in excess of the benchmark, over a rolling five-year period) through investing in a portfolio which will primarily consist of UK equities. The benchmark is the MSCI United Kingdom Investible Market Index Net Total Return.

Investment Philosophy & Process

The R&M PVT equities team has an investment philosophy called PVT, representing Potential, Valuation and Timing, which are the three factors the team analyse when assessing a stock's potential to generate absolute and relative returns.

The Potential of a company represents its ability to create economic value for shareholders. They look at four aspects of a business, which they see as enabling them to deliver above average returns which they relate to where a company is in its lifecycle:

- Growth – the delivery of strong revenue and profits growth
- Quality – a business franchise that delivers a superior return on investment
- Recovery – the process whereby a company produces a recovery in profits to normal levels following decline
- Asset backed – the delivery of asset backed growth to a long-term investor.

The Valuation factor seeks to establish the gap between the market's valuation and what the PVT team believes is a company's true underlying economic value.

Timing is all about determining the right time to buy and sell, with a view to reducing the risk of buying or selling an investment too early or too late.

The team operates a very comprehensive PVT Quant Screen which does a lot of the heavy lifting, in terms of the initial analysis, for portfolio managers. It ranks the whole investment universe (circa 10,000 stocks) within each category of stock potential. In addition, the fund managers draw on their own experience, as both analysts and portfolio managers, to generate investment ideas. The experience driven element is applied where the PVT Quant Screen cannot score an investment completely due to lack of complete historical data, but where the fund manager believes there may be a strong PVT investment case.

After the ideas are generated, they are verified through fundamental research, combining financial analysis, business analysis, sustainability considerations and management interrogation. The verification process entails a detailed analysis of the factors driving each element of the PVT score.

As a small team without sector specialists, the team do access trusted sell-side analysts, although they describe the contact as being 'outbound'; that is verifying the team's ideas rather than ideas being pushed by brokers. Although there has been a decrease in the coverage that sell-side analysts provide, the team still has access to 50 suppliers including all the major banks and brokers. Proprietary financial models are utilised, using a 'common language' between fund managers and analysts to get 'underneath the bonnet' of what is driving the performance of companies.

Corporate meetings are an integral part of the process (circa 120 annually), but the intention is to only have meetings when they need answers, rather than having them because the option is there. Whilst the team try to meet a material number of companies in any one year, they avoid an excessive number of meetings, recognising the value of having enough time to prepare and follow-up. The key verification reasons for having a meeting are to: develop and test the PVT investment case (particularly the drivers of return on capital), evaluate management, improve understanding of strategy and business franchise, test analysis forecast expectation sets and discuss any other relevant issues. The PVT Quant Screen helps to reduce the need for unnecessary company meetings, eliminating some of the emotional and behavioural biases which can arise. The team also believes that the further up the market cap scale you go, the proportion of value the meetings add decreases. Meetings are consequently skewed towards small and mid-cap businesses.

The selling process is driven by the inverse of the PVT philosophy. Shares where the Potential is deteriorating, such as falling returns for a quality stock, where Valuation anomalies have unwound due to outperformance, and where Timing has turned, possibly due to earnings downgrades, will be assessed for sale.

The team systematically monitors the PVT scores of holdings. Where scores fall significantly or are in the bottom four deciles of the key category, the original sponsor of the holding is required to re-verify the PVT investment case and then the holding is debated by the team at the weekly meeting. This function facilitates a rapid overview of the PVT scores across individual portfolios, highlighting any significant changes that may warrant further investigation.

ESG Integration in the Philosophy and Process

The R&M PVT equities team's Statement of Intent is to deliver consistent alpha for clients by investing in a portfolio of PVT selected companies. The team believes that analysis of a company's sustainability attributes is a critical component of any approach that seeks to deliver attractive risk-adjusted returns.

The sustainability analysis is focused on material sustainability issues that have the capability to become financially material to companies. They believe financial materiality represents the crossover between what is important to society and – via a positive or negative feedback loop to business performance – shareholders. Consideration of these issues is therefore considered to be a key part of good fundamental analysis, allowing the managers to deliver the aims and objectives of the mandate with a wider positive impact.

The managers aim to invest in companies with a net positive impact on society by analysing the key company specific and sector specific 'People, Innovation and Environment' issues that most commonly impact a company's long-term value creation potential.

The team has developed what they term a 'Sustainable PVT' (S-PVT) framework, centred around the pillars of People, Innovation and the Environment. This is utilised as part of the research process alongside the assessment of a company's potential, valuation and timing. In this sense, R&M see ESG as being integrated to their investment process. They do not exclude investments at the screening stage but look to consider ESG as being part of the verification process. They use the SASB (Standard Accounting Standards Board) materiality map to guide the approach and investigate where third party ESG research has flagged any significant sustainability issues.

The issues which the S-PVT pillars cover can be summarised as follows:

People

- Governance
- Employees
- Diversity and Inclusion
- Community
- Customers
- Supply Chain

Innovation

- Strategy
- Process
- Products
- Change

Environment

- Climate
- Clean Energy
- Biodiversity
- Clean Water
- Recycling

S-PVT pillars have long time horizons for results to be realised. Whilst a company can make improvements year on year, there will likely be a lag before stakeholders may see a tangible benefit from management actions. Over the next 2 to 3 years, the team expect more information to be published by companies and for it to become more common that executive remuneration is linked to people/social, innovation and environmental factors.

A four-tier scoring system has been developed which is designed to help identify an investment case which may be compromised by weak sustainability characteristics. The tiers are as follows:

- S1: A sustainable leader in its field and/or clear beneficiary of sustainability trends
- S2: Solid S-PVT considerations and no clear impediments to value creation or share price performance
- S3: ESG improvement needed by evidence of improvement and/or engagement potential
- S4: ESG a barrier to value creation, no evidence of improvement and/or low likelihood of engagement access

The tiers are assessed based on both analysis of quantitative metrics (with reference to SASB) and qualitative judgements. MSCI ESG scores are also included in the verification reports although they do not believe that the quality of data available today merits a purely quantitative approach to ESG investment.

S4 names are candidates for divestment (or to avoid purchasing at all), even if the financial aspects look attractive. S3 names need to be monitored to see that they are continuing to improve.

This framework means that the team have a clearly thought-out view of sustainability when considering a stock for inclusion in the portfolio. RMG has an A+ rating for Strategy & Governance from UN PRI and an A rating from MSCI ESG Research.

PAST & CURRENT POSITIONING/STRATEGY

The portfolio currently holds 74 names. It has a beta of 0.86, with an active money position versus the benchmark of 68.9%. Volatility and drawdown continue to be below benchmark.

The manager believes UK equity income funds have suffered from several headwinds over the past few years:

- UK equities are trading at an excessive discount to other global markets, and they have done so since the Referendum on Britain's membership of the EU with no significant recovery having emerged since
- Income stocks have sold off and struggled relative to their more growth-orientated peers
- There have been some examples of high-profile UK equity income funds imploding, which has led investors to shun and leave the sector
- The big cuts in dividends in 2020, with the likelihood of it taking a couple of years to get back to the record levels seen in 2019, has also detracted from the attractiveness of the sector.

In 2021 the manager expects the outlook to change:

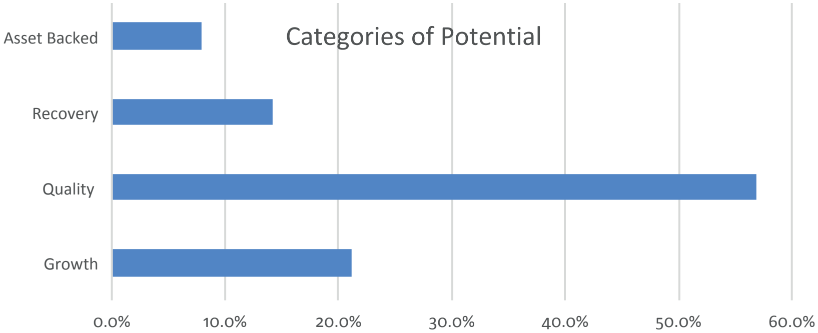
- There will be good stock picking opportunities, particularly in the small cap arena, which a relatively small and nimble fund can take advantage of
- The success of the vaccine programme will add to economic momentum
- Dividends are already beginning to recover, coming back quite strongly over the next 18 months. The manager expects above inflation dividend growth over the next couple of years.
- With bond markets coming under pressure, equity income funds will become more attractive to investors.

The manager is positive on the outlook for the UK market. It remains cheap (and hence attractive) on a relative basis compared to other markets, such as US large cap, where valuations look stretched. The UK market also provides a good mix of domestic stocks, which will benefit from the momentum building in the UK economy and global exposure.

In a sense, the manager has adopted a barbell approach, investing typically over 50% in high quality names which are strong, sustainable businesses that can also deliver relatively high, sustainable yields. In addition, the fund is invested in some deeply discounted recovery plays, for example in travel and leisure, including Whitbread, Halfords, DFS and EasyJet, which should benefit from the economic recovery. There is also exposure to dividend paying financials.

The chart below sets out the current positioning in terms of the four categories of potential, related to the stages of a company's life cycle:

Categories of Potential



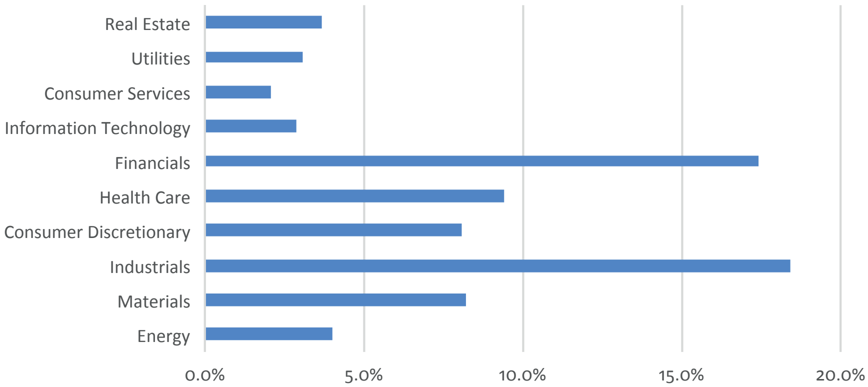
Source: River and Mercantile Asset Management LLP, as at 31 March 2021

Market Capitalisation

Market Cap		Fund	Benchmark	Active
Mega Cap	£20bn+	29.2%	55.7%	-26.6%
Large Cap	£4bn-£20bn	25.5%	29.6%	-4.1%
Mid Cap	£2bn-£4bn	6.4%	7.2%	-0.9%
Small Cap	£100m-£2bn	35.5%	7.4%	28.0%
Micro Cap	£0m-£100m	0.0%	0.0%	0.0%

Source: River and Mercantile Asset Management LLP, as at 31 March 2021

Sector Weights



Top Ten Holdings

	Weight (%)
Unilever	3.9
Diageo	3.5
Smart Metering Systems	3.1
Direct Line Insurance	2.7
Bunzl	2.6
National Grid	2.6
Whitbread	2.5
RELX Group	2.5
Tate & Lyle	2.5
Aviva	2.5

Source: River and Mercantile Asset Management LLP, as at 31 March 2021

PERFORMANCE

The fund had a good year in 2020, being top decile since the beginning of the pandemic. It was positioned quite well going into the pandemic, having a blend of high quality, growth, recovery, and asset-backed stocks. The investment style tends to be low beta which enables the portfolio to stand up well in difficult times versus both the index and peers. The defensive positioning was an advantage in March 2020 when the big sell off in cyclical names enabled the manager to buy some great names including industrial cyclicals with global exposure, and domestic cyclicals including general retailers and travel stocks.

Moving into 2021, the blended approach has been maintained with no significant macro bets, the portfolio is still well balanced. With dividends having been cut significantly in 2020 (on average by 40%) and smaller cap businesses cutting their dividends more than larger cap businesses, the fund manager is optimistic about the opportunities available going forwards.

Discrete Performance

(% growth per annum)

	12 months to 31/03/2017	12 months to 31/03/2018	12 months to 31/03/2019	12 months to 31/03/2020	12 months to 31/032021
R&M UK Equity Income	19.3%	-0.1%	4.0%	-14.8%	28.6%
Benchmark	22.3%	1.1%	6.5%	-19.4%	24.3%

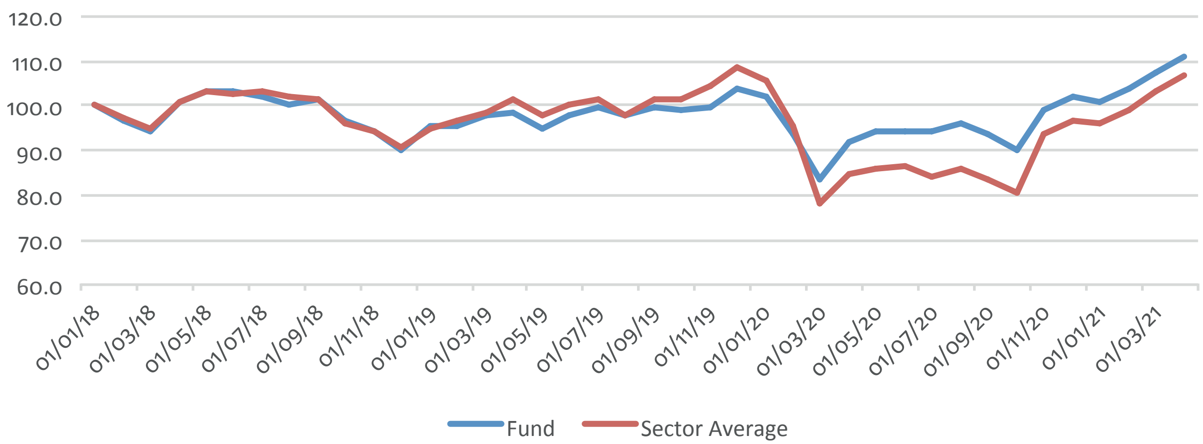
Performance is calculated using midday published prices. B share class (Inc) net of 0.75% AMC.
Source: River and Mercantile Asset Management LLP
Benchmark: MSCI United Kingdom IMI

The portfolio, since launch, has tended to underperform in momentum driven, rapidly rising markets but its resilience in declining or relatively flat markets, has meant that longer term, cumulative returns remain strong. The lack of a strong skew to the large cap income producing sectors is a big differentiator from most funds in the IA UK Equity Income fund sector.

	1mth	3mths	1Year	3Years	5Years	10Years	Since Launch
R&M UK Equity Income	3.3%	5.1%	28.6%	13.9%	35.8%	101.2%	234.4%
Benchmark	4.0%	5.4%	24.3%	6.7%	32.0%	71.6%	178.7%

Source: River and Mercantile Asset Management LLP, as at 31 March 2021
Performance is calculated using midday published prices. B share class (Inc) net of 0.75% AMC.

Three Year performance (total return) vs. IA UK Equity Income sector average



Source: River and Mercantile Asset Management LLP, Performance is calculated using midday published prices. B share class (Inc) net of 0.75% AMC.

SUMMARY & EVALUATION

The ES River and Mercantile UK Equity Income Fund is a multi-cap fund, meaning the income component of returns is not as highly reliant on sectors such as financials, oil & gas and mining which were the sectors hardest hit by dividend cuts and suspensions in 2020. The fund is also managed on a total return basis (i.e. seeking income plus capital growth) with a keen eye on the downside, and these two factors are key aspects which differentiate the fund from most of its peers.

Integral to the team's investment process is a complex and versatile quantitative screening process (PVT Quant Screen) which does a lot of the heavy lifting for the equity team, from which they can leverage and build on their own wide experience and knowledge of companies. The team might not be the largest UK equities team in the UK but the PVT Quant Screen (which in current parlance deals with 'big data'), give them a distinct advantage.

The three-factor process used by the team is designed to produce superior risk adjusted returns and consistent performance. The factors are Potential, Valuation and Timing which complement each other. The Potential is an increase in shareholder returns and could come from growth names, quality names, recovery stories or asset-backed stocks. The team try to buy these cheaply, so Valuation is an important part of the analysis. Timing looks for improving earnings and share price momentum, together with some other technical factors.

ESG has been integrated into the process with a distinct emphasis on sustainability, based upon the pillars of People, Innovation and Environment which the PVT team see as being factors which most commonly impact a company's long term value creation potential. These pillars provide a common framework for the team's fundamental research. This part of the process is constantly evolving, but the sustainability analysis is focused on material sustainability issues that have the capability to become financially material to companies. The PVT equities team believes financial materiality represents the crossover between what is important to society and – via a positive or negative feedback loop to business performance – shareholders. Consideration of these issues is, therefore, considered to be a key part of good fundamental analysis, allowing the managers to deliver the aims and objectives of the mandate with a wider positive impact.

The team itself is very experienced. Dan Hanbury, the fund manager, established an excellent track record at Investec, prior to joining River and Mercantile, and he has continued to consistently produce alpha for investors. Overall, the individuals in the UK equity team, provide it with strength and depth which coupled with the quantitative resource, make it a strong proposition.

RSMR

Established in 2004 RSMR provides research and analysis to firms working across the UK's personal financial services marketplace.

Our work is completed with total impartiality, without any conflict of interest and delivered to a high professional standard by a team of experienced and highly qualified people.

Working with advisers

We provide specialist research, analysis and support to a diverse range of financial advisers and planners helping them to deliver sound advice to their clients, backed by rigorous and structured research and due diligence.

The main regulatory body in the UK, the FCA, states that personal recommendations made by advisers should be 'based on a comprehensive and fair analysis of the relevant market' and this has led to closer scrutiny of the whole advice process. Our solutions are designed to help advisers meet these challenges whilst recognising that advisory firms require a range of flexible options that best meet their own business needs and those of their clients.

Working with providers

We work with all the leading fund groups, life and pension companies and platform operators across the financial services sector offering straight forward and pragmatic advice to help add value and improve their business performance and efficiency whilst treating customers fairly in line with FCA requirements.

Ratings

Our innovative ratings are now recognised as market leading and cover a broad area of investment solutions including single strategy funds, SRI funds, Multimanager and multi-asset funds, DFMs and investment trusts. Our familiar 'R' logo is now recognised as a trusted badge of quality by advisers and providers alike and a 'must-have' when selecting funds. Our ratings are founded on a strict methodology that considers performance and risk measures but places a greater emphasis on the ability of fund managers to continue to deliver performance in the years ahead. based on our in-depth face-to-face meetings with fund managers across the globe.

We understand financial services and we will work alongside you to deliver tailored solutions that are right for your clients and your business.

Our research. Your success.

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