RIVER AND MERCANTILE

ES RIVER AND MERCANTILE DYNAMIC ASSET ALLOCATION FUND

Quarterly report to 31 March 2021

For unitholders only

ES River and Mercantile
DYNAMIC ASSET ALLOCATION FUND

RIVER AND MERCANTILE

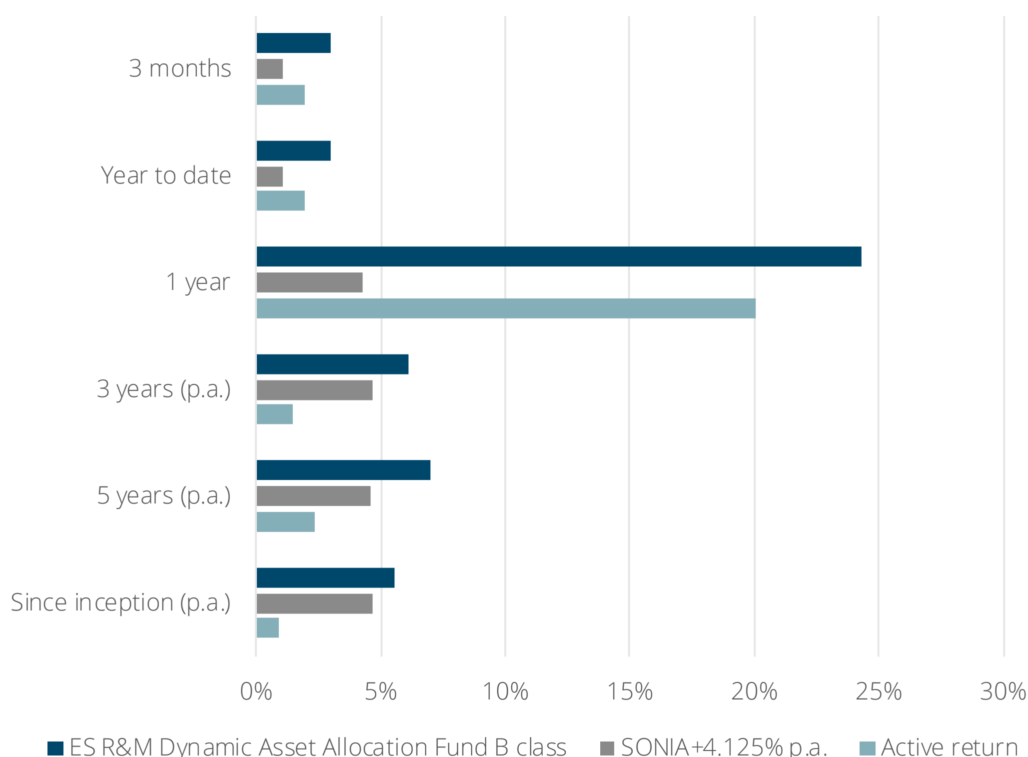
Quarter 1, 2021

INVESTMENT OBJECTIVE

The objective of the strategy is to achieve an average return (income and growth in the value of your investment (known as "capital growth")) of 4.25% per year above cash (based on the SONIA interest rate) (the "Benchmark") over a rolling 3-year period, after the deduction of all fees.

PERFORMANCE

	Fund	Benchmark	Difference
3 months	3.0%	1.0%	2.0%
Year to date	3.0%	1.0%	2.0%
1 year	24.3%	4.3%	20.1%
3 years (p.a.)	6.1%	4.7%	1.5%
5 years (p.a.)	7.0%	4.6%	2.4%
Since inception (p.a.)	5.5%	4.6%	0.9%



	Fund	Benchmark	Difference
3 years (cumulative)	19.6%	14.7%	4.8%
5 years (cumulative)	40.2%	25.4%	14.8%
Since inception (cumulative)	42.6%	34.8%	7.8%

Source: River and Mercantile Group PLC. 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 0.55% per annum. Other share classes may be available. ***Past performance is not a reliable indicator of future results.***

PORTFOLIO SUMMARY

AUM	£249.1m
Benchmark	3 month SONIA + 4.25% p.a.
Inception date	2 September 2014
IA Sector	Mixed Investment 20%-60%

SYNTHETIC RISK AND REWARD INDICATOR

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.

Snapshot of views

At the turn of the year, we discussed how record stimulus and low borrowing costs presented a great environment for equities. We're pleased to see our view playing out, with equities having another good quarter. But the dominant story over the last few months has undoubtedly been the pace of the rebound in government bond yields. Whilst we expected upwards pressure on bond yields, a return to pre-pandemic levels by the end of March 2021 was certainly faster than we and most other investors expected.

With equities continuing to rise and government bond yields sharply higher, it begs the question, how much longer can this equity rally continue? But we expect equity markets to remain supported for some time yet, as rates are rising for the right reasons (i.e. improving economics). To be sure, rising yields have weighed on parts of the market, in particular technology companies, but improving economic expectations should support broad equity markets in the near term.

Longer-term, we need to be mindful of the risk that higher rates pose to equity markets, as well as the impact of the "stimulus effect" fading. Whilst stimulus has provided a backstop to equity markets over the past year, we expect markets to reconnect with fundamentals as it gets withdrawn. We expect a reversion back to high-quality companies, with ESG continuing to be important. Looking further out, as higher rates start weighing on economic activity, dynamism will be crucial in managing the rotation away from equities when the time comes.

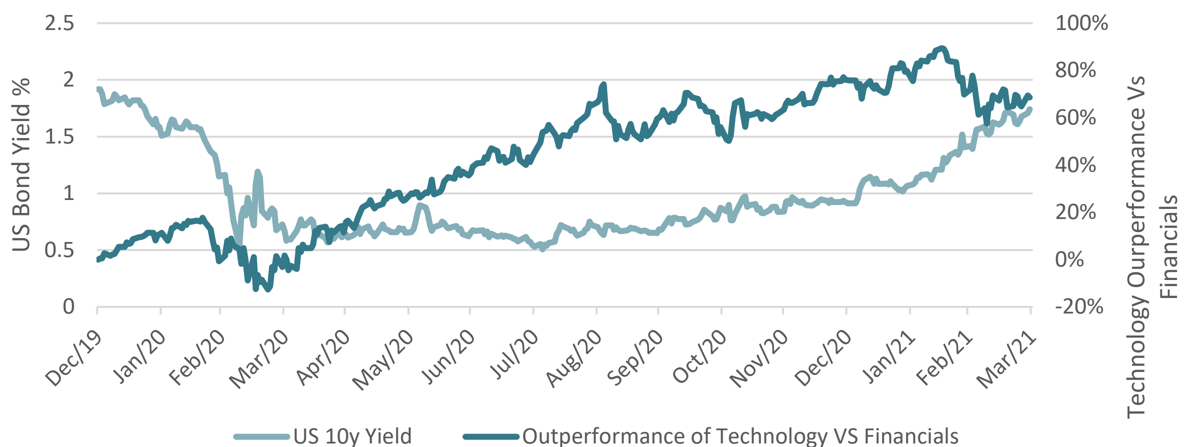
Equities set to keep climbing in the near term, with reflationary stocks catching up

As we take stock after a busy quarter, we find ourselves assessing another period of rising equities. Four consecutive quarters of positive equity performance is not unusual, in the past decade 75% of quarterly periods in have been positive for US equities. But the scale of the rally since markets bottomed a year ago has been extraordinary. Stock markets in the US, Germany and Japan have each risen over 50%[1] since this time last year.

Looking under the bonnet of headline equity indices also paints an interesting picture – we can see the effect rising yields have had. Unsurprisingly high growth technology companies have lagged, with the MSCI World Technology Index broadly flat year to date. Meanwhile, energy companies and financials, two of the worst worst-performing sectors in 2020, appreciated c.24% and c.14% over the same period. This rotation into cyclical sectors is a healthy sign of the equity rally broadening, and one we think will continue in the near term.

Admittedly valuations are not supporting this theme to the extent they were earlier this year. Bond yields have risen rapidly, whilst economic expectations have also picked up. Given cyclical assets have been the major beneficiaries, the opportunity is not quite as appealing as it was, albeit still preferable to defensive sectors in the short term.

[1]Bloomberg, 20 March 2021



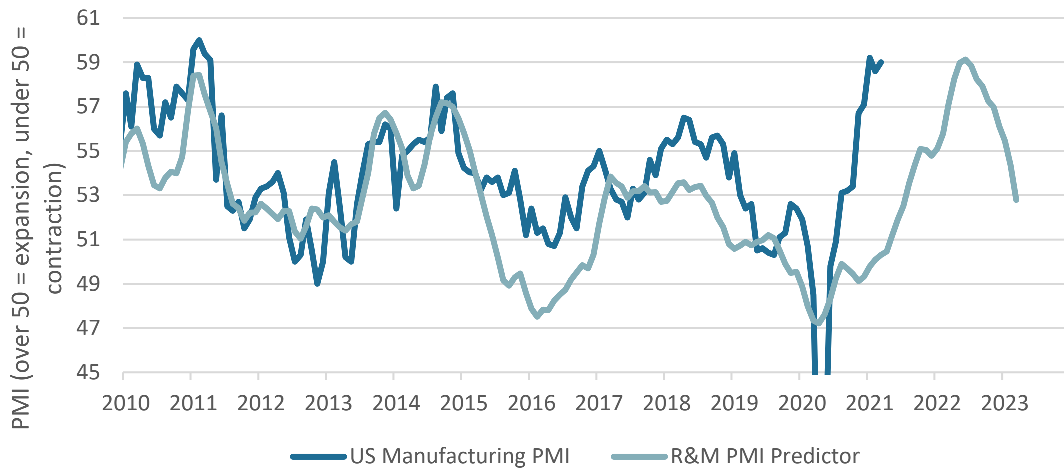
Source: Bloomberg, 30 March 2021

Bond yields have been the dominant story, and will continue to be important

What probably surprised investors most over Q1 2021 was the pace of the rebound in government bond yields. Whilst we expected upwards pressure on bond yields this year the return close to pre-pandemic levels by the end of March 2021 was fairly remarkable. Government bonds suffered losses (yields move inversely to prices), whilst corporate bonds also struggled as a result. Whilst corporate credit spreads were generally steady, higher government bond yields weighed on interest rate-sensitive assets, such an investment grade bonds.

With government bond yields having risen sharply, the obvious question now is whether this affects our high conviction view favouring equities over other asset classes. In the near term, we don't think so. Bond yields at these levels are not an immediate headwind for equities, as yields are rising for the 'right' reasons (i.e. improving growth expectations, as we detailed last month). Equity markets generally absorb rate rises well in these circumstances; the risk comes as higher rates start weighing on future economic activity. Historically PMIs (a key economic indicator which is highly correlated to equity market moves) trail government bond yields by around 18 months, so we expect equities to remain supported in the near term. The chart below illustrates this, with PMIs forecast to stay healthy (above 50) until at least the second quarter of 2022.

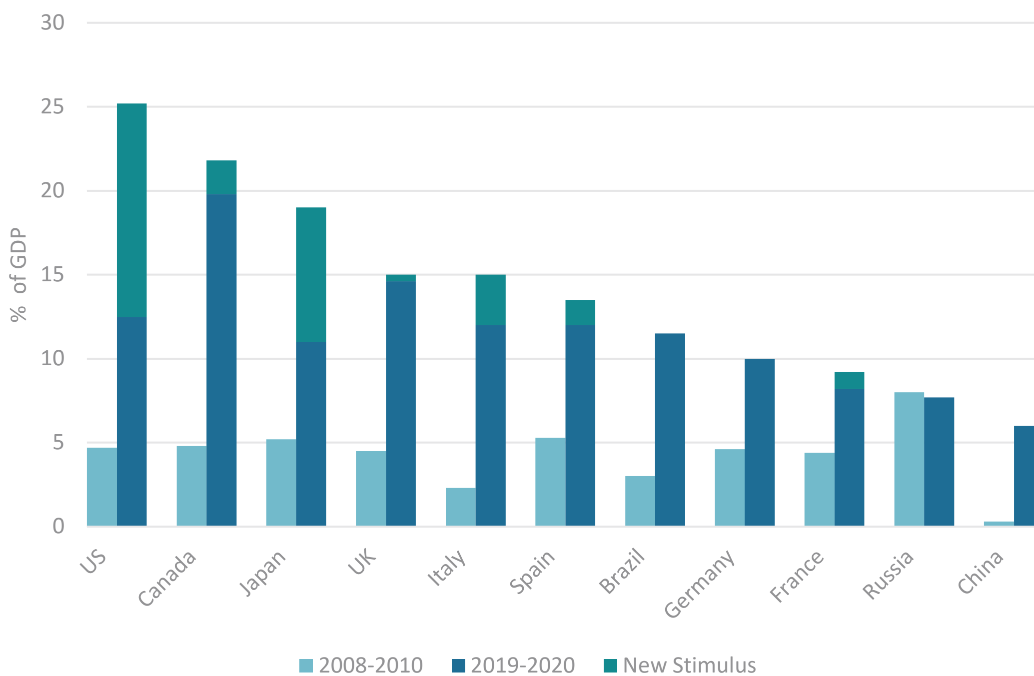
Looking further ahead, we recognise that higher rates may weigh on growth expectations, and consequently equity markets; hence a dynamic approach will be important in managing potential weakness next year.



Source: Bloomberg, 30 March 2021

Where do we go from here? From reflation back to innovation.

Stimulus has dominated the last year. Governments are running deficits not seen since wartime and central banks have increased balance sheets by orders of magnitude higher than in previous crises.



Source: BCA Research, 30 March 2021

But with economies now reopening, the rate of change of new stimulus is going to slow. It's likely that as this happens, we will see markets reconnecting with fundamentals (rather than being driven by the "stimulus effect").

The question then becomes which parts of the market will be winners in a more conventional economic environment. While 'value'-style companies have had their best period of performance in years recently, we find it hard to see that trend continuing over the medium term. Bond yields are still very low by historic standards and we struggle to see structurally higher inflation driving up interest rates over the medium to long term– both headwinds for value stocks Furthermore, green transition requirements will weigh on key value sectors such as energy and automobiles. With this in mind, we expect a rotation back to companies able to grow and innovate; factors such as ESG, quality and growth will probably take over again, and dynamism within equities will be needed to capture this rotation.

While on the face of it this looks much like our pre-pandemic outlook, we expect nuanced differences from previous economic cycles. The US dominated other regions post the financial crisis, whereas we now expect economic growth to be broad-based; we are seeing a global economic recovery, with stimulus reigniting previously stagnant economies such as Japan. As such, we believe there is merit in broad regional exposure.

Portfolio changes

We were dynamic throughout the quarter as markets were bumpy amidst further covid lockdowns and the vaccine rollout. Equities continued to comprise the majority of the portfolio, with our preference for those cyclical sectors set to benefit from improving economic conditions remaining. Our core allocation focussed on high quality cyclical companies with strong ESG characteristics. In addition, we took tactical equity positions specific to cyclical sectors and emerging markets. We also continued to trade precious and industrial metals proactively. Credit was decreased early in the quarter with proceeds going towards increasing equity exposure. US Treasuries were also reduced as rates rose at pace.

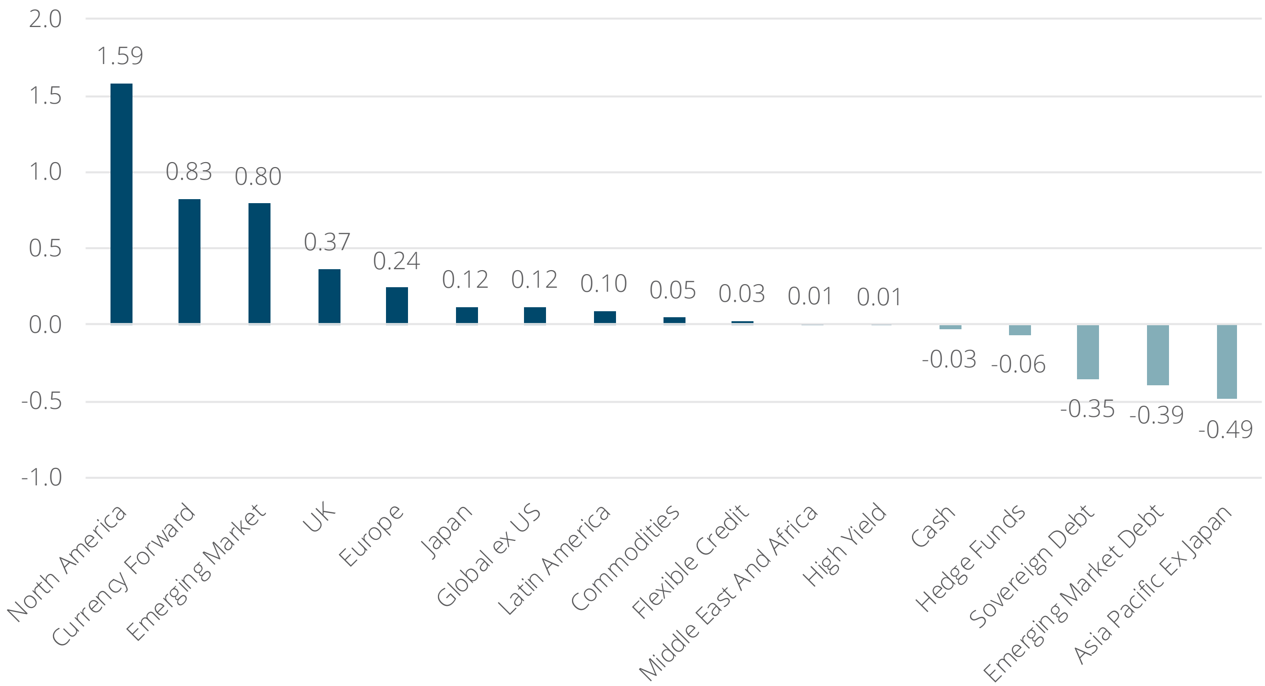
Mike Faulkner & Joe Andrews
Portfolio Managers

April 2021

Asset Class	Rating	Comments
Portfolio Risk View	4	Low borrowing costs and continued economic stimulus are supportive of risk assets. We maintain a preference for equities over credit.
Equity	5	We increasingly favour equities over other on-risk asset classes. Low rates and stimulus are leading to compressed credit spreads and cheaper borrowing costs, meaning more corporate projects are viable, a benefit that accrues to shareholders.
North America	3	North American equities will benefit from low borrowing costs but have less exposure to economically sensitive assets, highlighted by its outperformance in 2020.
Rest of World (ex-North America)	4	We favour regions with greater exposure to cyclical companies that will benefit from improving economic conditions, in line with our Style preference below.
Structured Equity	4	Equity structures with downside protection are an attractive way to express an overweight equity view in a risk-managed way.
Style	5	Current economic conditions favour companies with strong balance sheets and growth characteristics. Cyclical sectors with these characteristics will benefit from an improving economic environment. We favour Industrials, Materials, Consumer Discretionary, Tech and Financials.
Credit	1	Credit spreads continue to compress, resulting in minimal compensation for potential defaults and downgrades.
Investment Grade	1	High valuations relative to government bonds means returns will be muted and are not providing a suitable payoff for return-seeking portfolios.
High Yield	3	We favour selective credit in the higher quality part of the High Yield market, where there is also explicit policy support.
Emerging Market Debt	3	A weaker US Dollar benefits Emerging Markets relative to other Developed Market credit.
Opportunistic	4	We favour strategies with the flexibility to take advantage of specific opportunities across a wide range of credit assets.
Regulatory Capital	4	We view it as a timely investment opportunity brought about by regulatory changes. Pricing and credit quality have been boosted further versus pre-COVID levels.
Direct Lending	3	Credit quality, fundamentals and yield pickup had been deteriorating alongside increased competition for deals. We expect greater stress in mezzanine.
Infrastructure Debt	1	Given considerable demand, spreads have compressed to levels where we do not believe there is benefit relative to more liquid credit.
Property	2 upgrade	Exposure should be opportunistic and favour exposure to logistics and last-mile assets that are supported by the e-commerce theme. We don't expect the stresses in retail to abate soon; where you take office exposure, it will need to be selective.
Alternatives	3	Alternatives are a good diversifier in the current environment with likely ongoing volatility supportive for many Alternative strategies.
Insurance-linked	2	Premiums are elevated, but the asset class continues to face headwinds because of exposure to COVID claims and ongoing uncertainty around the treatment of business interruption claims.
Hedge Funds	3	We favour liquid hedge funds with low net exposure. Sacrificing some return in favour of liquid strategies which can be redeployed into equity and credit is valuable in an environment where volatility is likely to lead to short-term selloffs.
Structured Equity	3	Whilst there are fewer opportunities for structures with alternative-like payoff profiles, opportunities remain in structures with downside protection.
Infrastructure Equity	5	We expect to see long-term opportunities in infrastructure driven by fiscal spending and the drive towards renewable energy.
Private Equity	2	Valuations are not attractive enough versus public markets to demand new allocations. Though we would consider opportunities with more attractive valuations than listed equivalents.
Defensives	2	In line with our more positive risk view, defensive assets with lower expected returns are less favourable.
Cash	3	
Off-Risk Bonds	2	Sovereign yields have the potential to move higher given short-term inflation pressures
Precious Metals	3 downgrade	With real interest rates facing upward pressure, yield-less assets such as precious metals are less valuable.
Anti-Beta Strategies	5	Lower yields mean that the diversification benefits of government bonds are more limited. Strategies that deliver positive returns in weaker periods for equity and credit while preserving capital in strong periods are valuable.
Interest Rate Hedging	3	We do not advocate changes to liability hedging given a preference to play the rising rates theme through equities. A short-term rise in rates could present opportunities to increase hedging this year.
Inflation Hedging	4	Reflationary policies that could help equities and push up rates could lead to higher inflation.

RELATIVE CONTRIBUTION TO RETURN OVER THE QUARTER

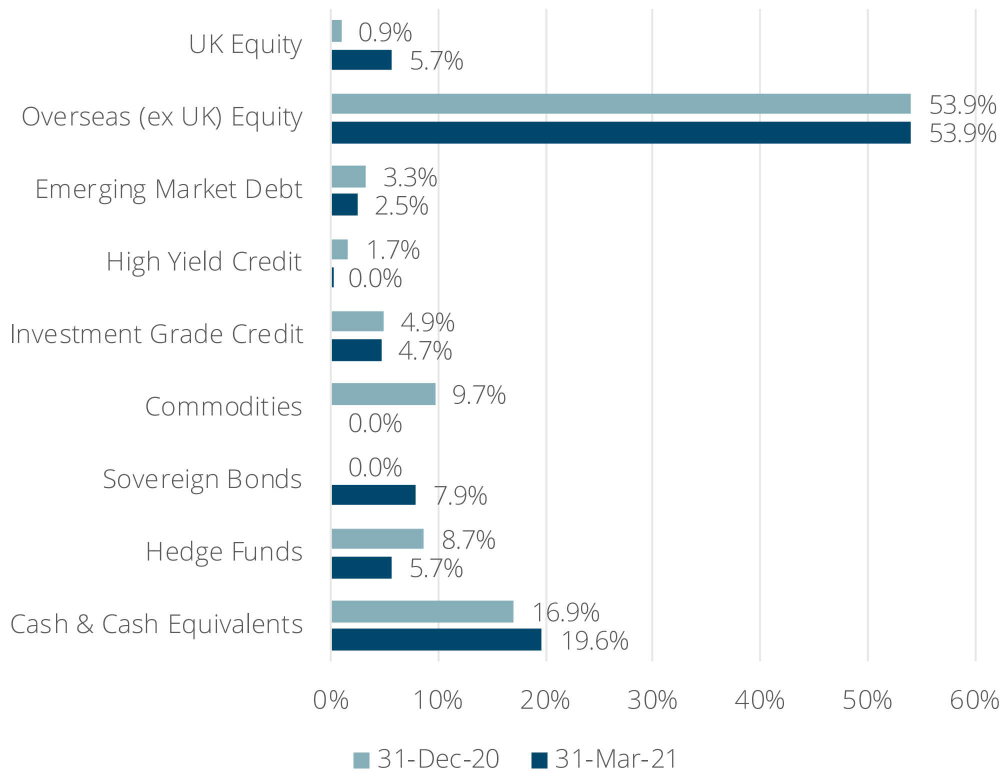
This chart shows the relative contribution to the portfolio's return by region and asset class.



Source: FactSet, based on close of business valuation, gross of fees

ASSET ALLOCATION

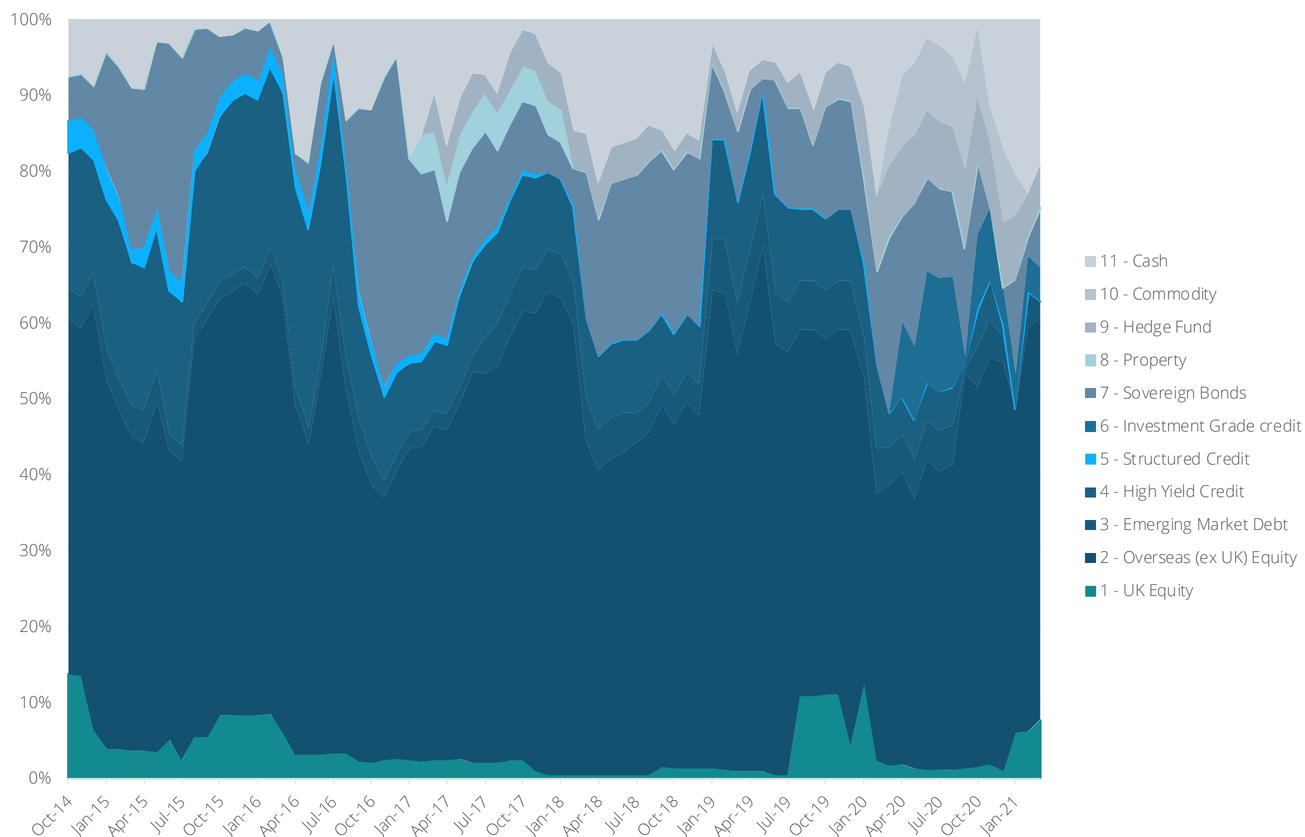
This chart shows the fund's allocation to different asset classes by portfolio weight, at the most recent quarter-end versus the previous quarter-end position.



Source: River and Mercantile Group

ASSET ALLOCATION EVOLUTION SINCE INCEPTION

This chart shows the evolution of the portfolio's weighting to different asset classes over time, since its inception in September 2014.



Source: River and Mercantile Group

TOP 10 HOLDINGS

This table shows the fund's ten largest holdings by weight.

	Weight (%)
River and Mercantile Global Macro Z GBP Acc	5.7
UK Treasury 3.75% Sep 2021	5.5
Vanguard FTSE250 ETF	5.2
iShares MSCI EAFE Small Cap ETF	5.0
Vanguard S&P 500 UCITS ETF	5.0
UBS MSCI EMU ETF	5.0
Neuberger Berman Global Flexible Credit Fund	4.7
Insight GBP Liquidity Fd	3.1
iShares MSCI Brazil UCITS ETF (DE)	2.5
UK Gilt 0.625% 22 Oct 2050	2.5

Source: River and Mercantile Group

BROKER COMMISSIONS ANALYSIS

Counterparty	Total (£)	Commission Paid (£)
		Execution Only
ABG SUNDAL COLLIER	0.00	0.00
ATLANTIC SECURITIES	0.00	0.00
BARCAP	0.00	0.00
BERENBERG	0.00	0.00
BMO	0.00	0.00
BNP PARIBAS SEC (ASIA) LTD	1,233,602,947.40	0.00
BofA MERRILL LYNCH	1,209,463,920.00	0.00
BTG PACTUAL	0.00	0.00
CANACCORD ALGO	0.00	0.00
CANACCORD GENUITY	0.00	0.00
CENKOS	0.00	0.00
CITI PROG	0.00	0.00
CITIGROUP	0.00	0.00
CLSA	0.00	0.00
CREDIT SUISSE	0.00	0.00
DEUTSCHE BANK	1,511,026,675.01	0.00
EXANE	0.00	0.00
FINNCAP	0.00	0.00
GBM	0.00	0.00
GOLDMAN SACHS	2,587,907,909.89	0.00
GOODBODY	0.00	0.00
HSBC	0.00	0.00
ING	0.00	0.00
INSTINET	0.00	0.00
INVESTEC	0.00	0.00
ITG	0.00	0.00
ITG ALGO	0.00	0.00
ITG EURO	0.00	0.00
J&E DAVY	0.00	0.00
JANE STREET	114,368,358.87	0.00
JEFFERIES	0.00	0.00
JEFFERIES ALGO	0.00	0.00
JPMORGAN CHASE	545,875,507.83	0.00
KEPLER CHEUVREUX	0.00	0.00
LIBERUM	0.00	0.00
LIQUIDNET	0.00	0.00
MEDIOBANCA	0.00	0.00
MIZUHO	0.00	0.00
MORGAN STANLEY	1,842,659,041.44	0.00
NORTHERN TRUST CORP	0.00	0.00
NPLUS1 SINGER	0.00	0.00
NUMIS	0.00	0.00
PANMURE GORDON	0.00	0.00
PEEL HUNT	0.00	0.00
RAYMOND JAMES	0.00	0.00
RBC	0.00	0.00
RBC ALGO	0.00	0.00
REDBURN	0.00	0.00
SANFORD BERNSTEIN	0.00	0.00
SANTANDER	0.00	0.00
SHORE CAPITAL	0.00	0.00
SOCIETE GENERALE	7,979,813.59	0.00
STIFEL EUROPE	0.00	0.00
STIFEL NICOLAUS	0.00	0.00
SUSQUEHANNA INTERNATIONAL GROUP	14,456,575.76	0.00
UBS	0.00	0.00
UBS PROG	0.00	0.00
WINTERFLOOD	0.00	0.00
FLOWTRADERS	207,055,552.19	0.00
CONFIRMED FUND PRICE	62,339,400.10	0.00
OPTIVER	106,662,143.86	0.00
BANK OF MONTREAL	0.00	0.00
BTIG	0.00	0.00
CITADEL INVESTMENT GROUP L.L.C.	12,159,163.66	0.00
BANQUE NATIONALE DE PARIS	810,962,363.05	0.00
BRBNPMBS	0.00	0.00
STIFEL FINANCIAL CORP	0.00	0.00
CITI UK	6,399,214.69	0.00
DAVY	0.00	0.00
	£ 10,272,918,587.34	**£ -**

Firm Wide Comparators

All Equity Trading	**£ 11,902,256,359.32**	**£889,533.99**
Trades:	**£ 10,272,918,587.34**	**£0.00**
Average Firm-Wide Commission Rate (%)		0.01%
: Average Commission Rate (%)		0.00%

Source: River and Mercantile Asset Management LLP

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