RIVER AND MERCANTILE

ES RIVER AND MERCANTILE UK RECOVERY FUND

Quarterly report to 30 September 2021

For unitholders only

ES River and Mercantile
UK RECOVERY FUND

Quarter 3, 2021

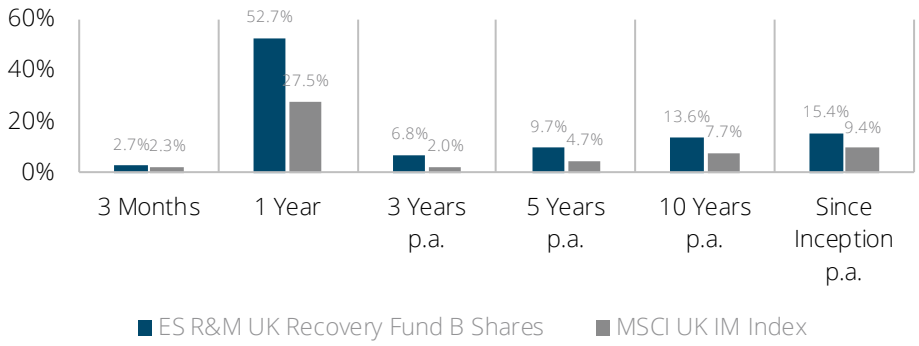
RIVER AND MERCANTILE

INVESTMENT OBJECTIVE

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 (NET OF FEES)

	B share class	Benchmark	Difference
3 Months	2.7%	2.3%	0.5%
1 Year	52.7%	27.5%	25.1%
3 Years p.a.	6.8%	2.0%	4.7%
5 Years p.a.	9.7%	4.7%	5.0%
10 Years p.a.	13.6%	7.7%	5.9%
Since Inception p.a.	15.4%	9.4%	6.0%



PERFORMANCE (BEFORE FEES)

	Z share class	Benchmark	Difference
3 Months	3.0%	2.3%	0.7%
1 Year	54.2%	27.5%	26.7%
3 Years p.a.	7.8%	2.0%	5.8%
5 Years p.a.	10.8%	4.7%	6.1%
10 Years p.a.	14.8%	7.7%	7.1%
Since Inception p.a.	12.6%	6.9%	5.7%

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 (income units) which is net of an annual management charge of 1.00% per annum, and the Z share class (accumulation units) which reflects the fund's gross performance before any fees are deducted. Inception date of the B share class is 1 April 2009 and inception date of the Z share class is 17 July 2008. 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 AND KEY RISK CHARACTERISTICS.

Fund AUM	£216.2m	Tracking error	5.1 %
Strategy capacity	£500m	Active money	63.4 %
Inception date	17/07/2008	Portfolio beta	1.12
Holdings (UK/Non-UK)	256/49		

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.

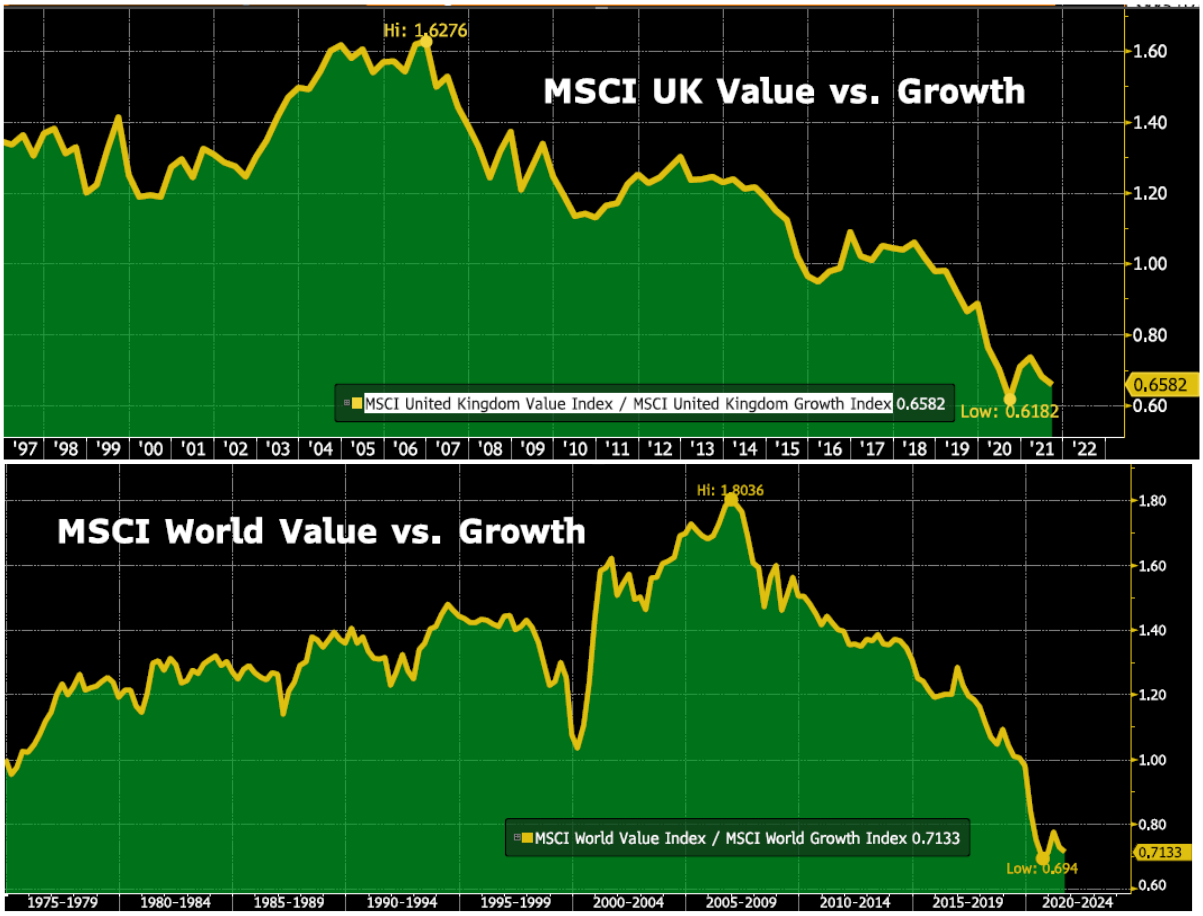
Our High Alpha and Recovery approaches

We invest in companies with Potential, Valuation and Timing with a strong portfolio construction commitment to attractively valued companies, to good businesses with recovery potential, to being interested in structural growth when it is temporarily unpopular and to getting most interested in an investment when it is out-of-favour but where the fundamentals are on the turn. We repeat this investment approach day-in and day-out, aided by systematic screening. We try to stick to our approach during the difficult times (such as the anti-value market of the last few years) so that we nearly always participate when there is a following wind for our factors. Our High Alpha strategies include being benchmark aware when constructing the portfolio; our Recovery strategies are unconstrained and focus on medium to long term wealth creation.

Executive summary

Back at the bottom of the Value cycle

Over the last two quarters value has given back nearly all its post vaccine news rally. A combination of worries about economic growth, the Delta wave of Covid, bond yields again falling (for a short period) and a continued love of all things growthy led to Value falling back towards its relative nadir. The same picture can be seen in the UK and globally - Value back towards its cycle low:



Source: Bloomberg

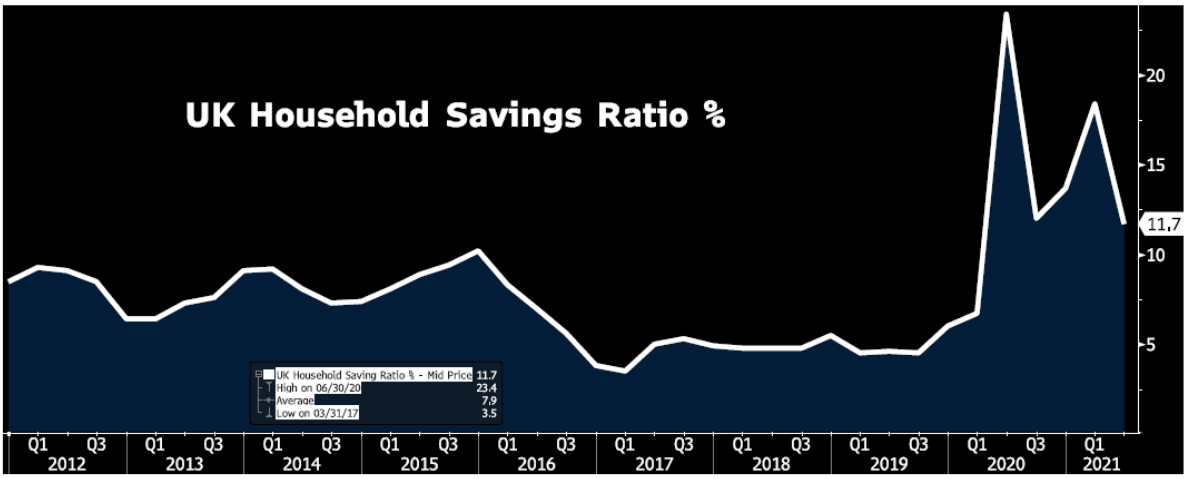
However, the last few weeks have hinted at another return to value. The attempt by the stockmarket to return to the post global financial crisis (GFC) deflationary playbook seems to be failing as nominal GDP growth is very robust, including the inflation component. This switch to a reflationary narrative has, in the short term, benefitted the deep value stocks, notably higher interest rate beneficiaries such as

banks and stocks that are geared to higher energy prices. Other parts of the value complex - consumer discretionary recovery stocks in particular - have lagged due to the threat of stagflation on their business models. We will argue later in this report that it is too early in the return to reflation cycle for stagflation to be a sustained threat – supply chains disrupted by Covid will be fixed and pricing pressures will abate – and as a result we see a significant opportunity in the price corrections we are witnessing in the consumer cyclicals which have yet to benefit fully from re-opening or the unwind of the large consumer savings seen during the pandemic.

Why the anti-consumer stock narrative because of 'stagflation' is wrong - the opportunity in consumer cyclical stocks

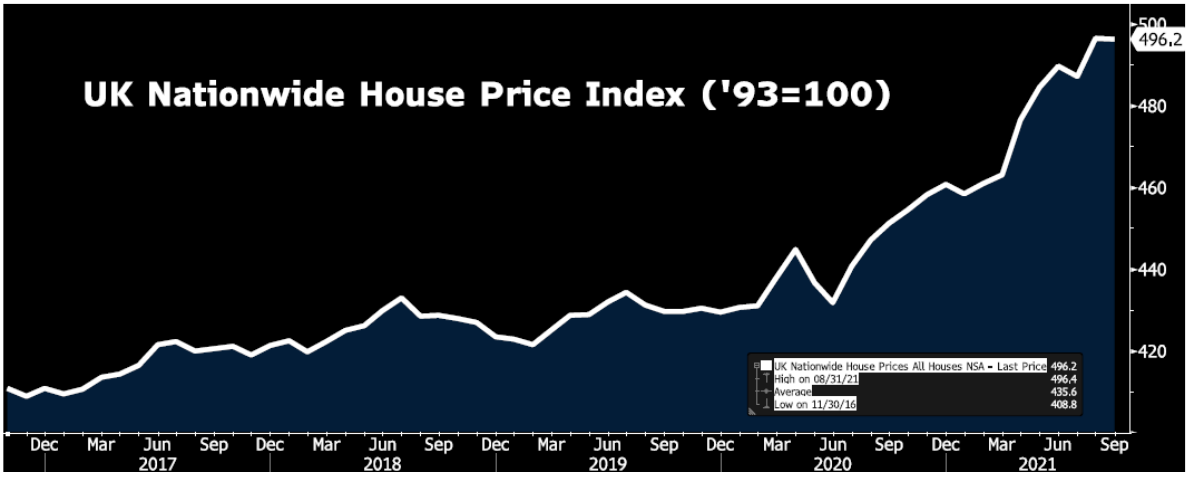
Whilst the UK and global consumer may well be a bit cautious in the very short term as energy prices and negative media commentary combine to create uncertainty, the fundamentals lying behind consumer spending are strong with the observations below (UK focused) applying in most countries around the world.

Firstly, because the savings ratio has remained high throughout the pandemic period there is a lot of cash to be spent. The graph below shows that the UK savings ratio has remained elevated throughout the last two years:



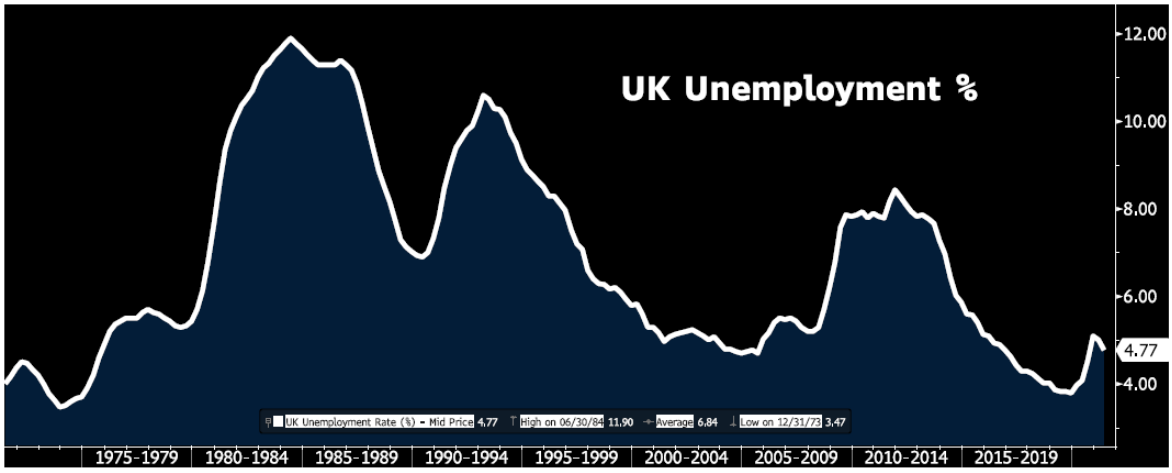
Source: Bloomberg, ONS

Secondly, consumers, whilst under short term pressure from higher energy prices, actually are likely to be feeling a lot wealthier because house prices have been so strong. Again this has been a global phenomenon:



Source: Bloomberg, Nationwide

And then thirdly, unemployment is falling, as shown below, from a not very elevated level (thanks to furlough schemes), wages are increasing (maybe not as much as inflation but they are at least going up vs. the post GFC stagnation), interest costs on credit have remained very low and yes, quite a big part of the UK population believe in the PM's levelling up narrative. Actually, looking at all the data makes me even more bullish on consumer stocks, not just in the UK but around the world; consumers are in a good place and consumer cyclical stocks are discounting the next recession when 2022 should be a strong year.



Source: Bloomberg

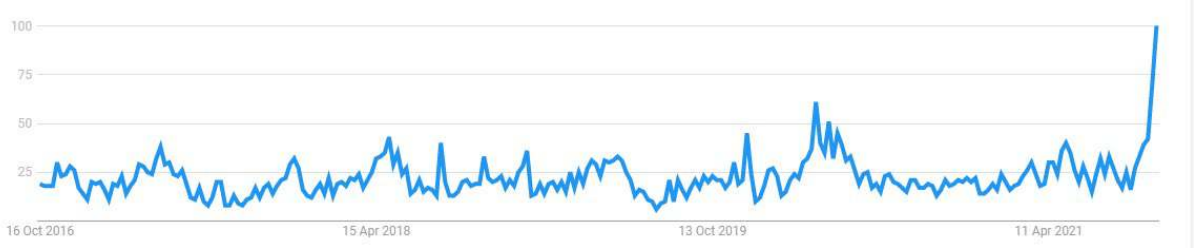
Key points

- The Value Cycle: rather surprisingly, and despite the beginnings of a rally late in the quarter, Value has corrected further over the last three months and is now back towards its post GFC nadir; from my perspective this provides another significant opportunity.
- Recovery: whilst the traditional value parts of the market have done well very recently, supported by higher interest rate expectations and energy prices, many classic consumer and industrial recovery stocks have pulled back aggressively over the last few months due to a combination of stagflation fears and input price pressures. We think this provides a very attractive opportunity in these parts of the market.
- Growth stocks moved back to all time high valuations during the quarter. It does surprise me that investors have been so quick to re-embrace expensive growth, as shown by the US IT Index price to sales multiple moving beyond the TMT bubble peak.

Source: Bloomberg

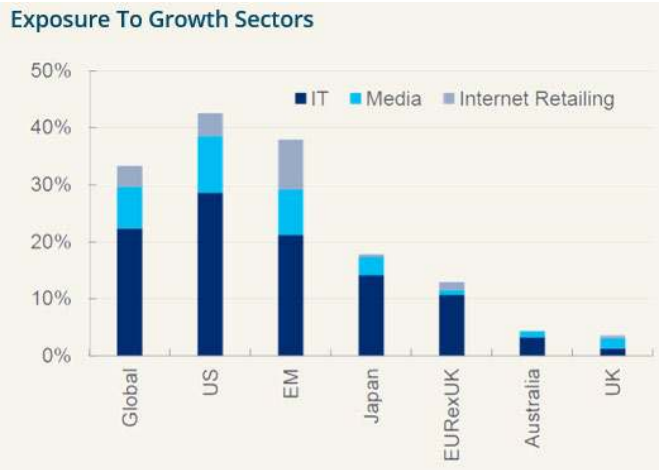
- Stagflation: as the world has become more normal again and global GDP moved back towards pre-Covid levels, parts of the global economic infrastructure have creaked under the pressure, especially as there remain quite a few Covid related inefficiencies in the system that will take a combination of i) policy change (full re-openings), ii) price incentivisation (for example, it would be surprising if quite a few truck drivers around the world did not come out of the Covid related early-retirement given the higher wages that are now on offer), and iii) demand going elsewhere (for example, ecommerce spending will peak as consumer cash finds other homes, reducing some of the pressure on the global logistics network). So, I would suggest that we are getting close to peak worry about the global supply chain and short-term stagflation fears as the world's pretty sophisticated infrastructure will adapt.

Stagflation commentary – peak on Google Trends



Source: Google Trends. 100 is peak

- Reflation: That said we remain high conviction that the world of the next ten years will be different from the post GFC era, that inflationary pressures are greater for a number of reasons (political support for levelling up, less deflation exported from emerging markets, bank balance sheet expansion rather than contraction, under-investment in commodity production, Greentech investment) and that we are now in a period of higher nominal GDP growth (real GDP plus inflation) that will encourage an upward movement in bond yields and be more supportive of shorter duration assets than the post GFC era.
- The profits growth for this portfolio should be robust over the next 24 months as exposure to both classic recovery stocks and structural growers that were purchased cheaply in the 2020 sell-off and act in tandem to drive increasing profits and cash flow for the portfolio.
- Good value PVT stocks in an often-expensive world – with many of our favoured stocks, themes and regions having suffered a mini correction over the last six months, they are now again very good value and have become oversold; at the same time Growth and Quality stocks are expensive in absolute terms and relative to their own history. So, in relative terms our portfolio is good value, oversold and showing strong profits and cash flow growth fundamentals. This should be an attractive mix.
- The UK vs global benchmark – one reason why UK equities have lagged the rest of the world since the GFC is that the UK benchmark is essentially a Value one, dominated as it still is by more traditional sectors such as banking, energy and pharma; meanwhile the global benchmark is essentially a growth one, increasingly dominated by mega cap tech. But if value starts outperforming, expect a much more respectable performance from UK equities in general.



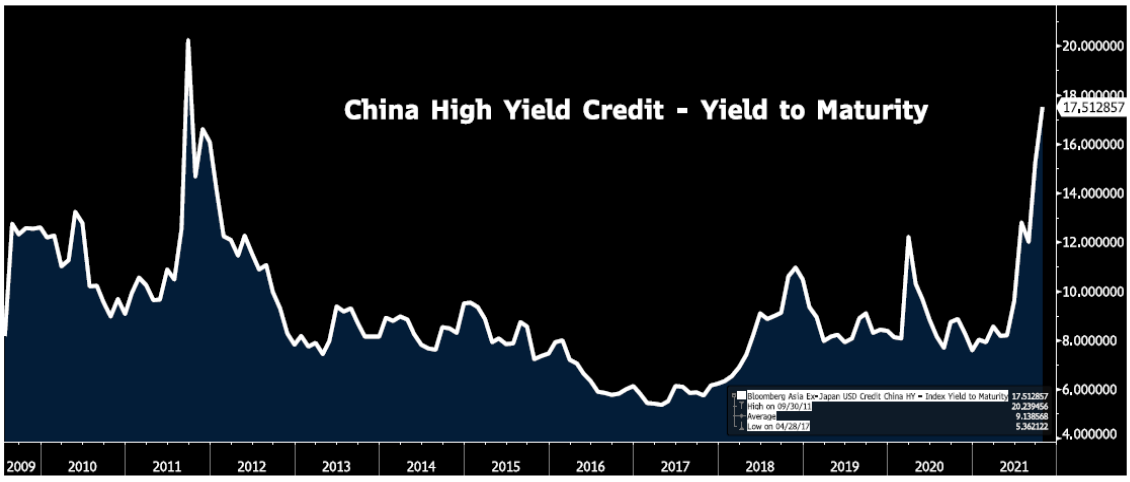
Source: Citigroup

- The role of small and mid-cap – following on from the above, one way of increasing exposure to Growth stocks in the UK has been via exposure to small and mid-cap companies. Indeed, the vast majority of UK fund managers who have 'survived' and prospered during the post GFC era have a structural overweight to these stocks. My funds have been no different, though my hunting ground has not been Growth small cap but Recovery, so that whilst I have benefitted from a multi-cap approach this following wind has been far less than the Growth and 'compounding' managers. And I have always had one eye out for large cap value, consistently keeping an overweight position in banks in particular. But just as I am worried about how much crowding and capital there is invested in the global titans (tech in particular), I would have the same worry in the UK regarding the big winners of the last ten years, the small and mid-cap compounders (Growth and Quality) that really are on full valuations. But then contrast with this globally – now because the global benchmark is a Growth one and because the mega cap tech stocks have been some of the best compounders - small and mid-cap stocks have actually lagged over the last few years as they have often been more value focused and less consistently able to grow. But eventually the law of large numbers (plus high valuations) will catch-up with the global nifty fifties and multi-cap investing will then be the optimal way to construct global portfolios.

Source: Bloomberg

- China Growth has been weak and the news flow out of China has been very negative for a while now. The most recent combination of a significant shift in some of their regulatory goalposts and the acute pressures on their real estate industry is making some investors question whether China is investable and has certainly made most observers worry about the negative economic impact of all this on the global economy. I write a bit later regarding our view on the

regulatory side. At this point I will just observe that sentiment towards China is at such a low ebb at the moment, and pretty bearish assumptions are already reflected in asset prices, for example High Yield Credit close to record yields (and internet stocks at record high free cash flow yields):



Source: Bloomberg

The lead economic indicator that we think has the most credible record, the China Credit Impulse is now close to a cycle low. Indeed, policy in China, monetary and regulatory, has clearly been very tight over the last six months; the direction of travel from here will most likely be more accommodative as much of the desired effect of tightening policy has been felt and is in danger of slowing growth too dramatically.

Source: Bloomberg

The global economy

Whilst global economies continue to recover robustly, the market narrative has become a lot more bearish over the last couple of months as economies have struggled to re-open fully without some stresses on the ability of the world's economic infrastructure to service the recovered demand. There are quite a few mismatches between demand recovery as part of a global re-opening and the ability of some industries that might not have fully re-opened or which are not able to get back up to pre-Covid levels of productivity to supply this demand. And then there some areas of demand which are far higher due to Covid (such as semi-conductors) than previously forecast so there is an inevitable need for capacity catch-up. Additionally, some parts of the labour market, such as those that naturally have a high level of annual attrition (truck drivers, for example), have seen labour withdrawal accelerate during Covid, supported by generous furlough schemes. All of the above should be relatively short term in nature, but

with demand running quite hot then the market is probably right to see these issues spilling into the new year. In addition, there are parts of the global economy which have seen consistent under investment since the GFC. The energy complex, in particular, which has also been impacted by a significant increase in equity risk premium associated with all stakeholders desire to move towards a more sustainable world. So, carbon price pressure is unlikely to go away, though some of the exceptional short-term spikes (European gas market) will go the same way as the earlier spike in lumber prices this year.

Putting all the above together. we are clearly going through a period where economic expectations are being reined back, as shown below by the Citigroup Economic Surprise index having rolled over. But perhaps this is a good thing, as when things are going too well they can't get better; expectations are now more modest for economic growth and also for many companies, so it will become a lot easier to beat these more depressed forecasts.

Source: Bloomberg

And coming back to the higher inflation (good for value) becoming stagflation (bad for consumer cyclicals) debate, just look at the Inflation Surprises Index below - it's very high, isn't it (bad)? But is it likely to get worse (no, good)? When the whole world's commentators become experts on the global supply chain then perhaps it's time to think we are close to peak stagflation worries and it's time to buy the stocks that are beaten up by these fears.

Citigroup Global Inflation Surprise Index

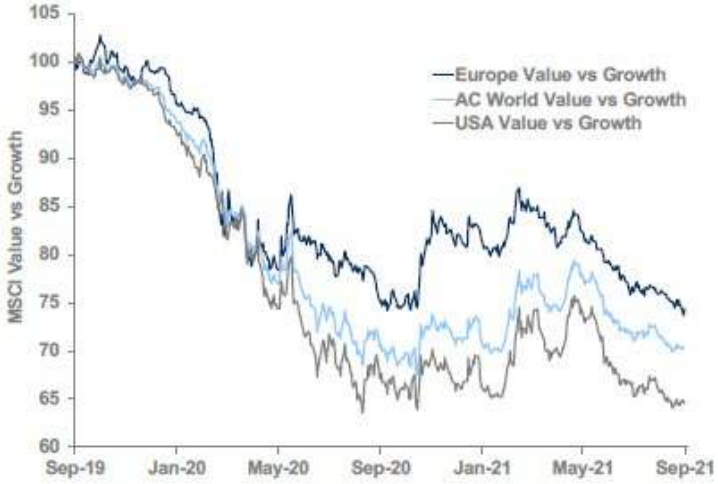
Source: Bloomberg

However, let me repeat my long held view that I do expect price increases (and wage inflation) to be more of a sustained feature of the next ten years than the last ten as there is a strong desire from economic stakeholders to have higher levels of nominal GDP growth (real growth plus higher inflation) than those witnessed during the post GFC era, but I don't see us moving from a deflationary world to one where inflation gets out of hand.

How have our key investment factors responded?

Rather surprisingly, Value has continued to be weak over the last three months and is now very close to its post GFC nadir; from my perspective this provides another significant opportunity.

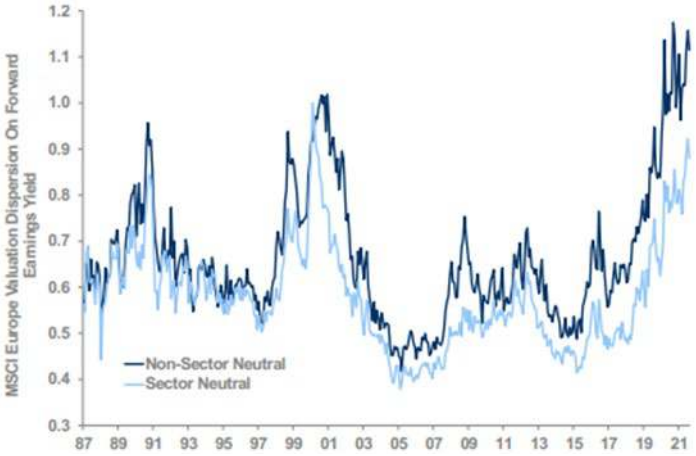
Value vs. Growth around the world over the last 2 years



Source: Morgan Stanley Research

And Value dispersion has remained at extremes:

Value Dispersion in Europe – Earnings Yield



Source: Morgan Stanley Research

Market returns and our performance

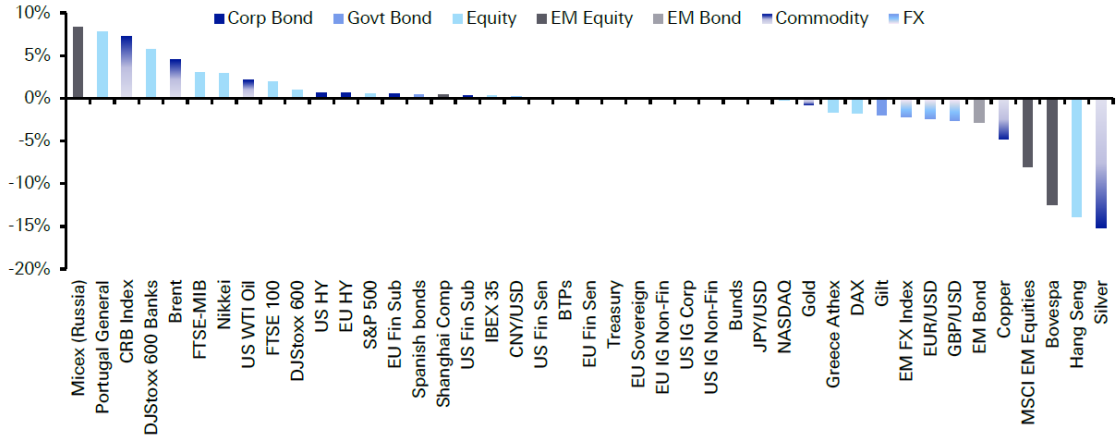
Global equity returns were mixed during the third quarter of 2021. The primary themes were continued robust economic and profits recovery, but at the same time nervousness regarding the Federal Reserve (Fed)'s monetary policy and the developing worries regarding price pressure as inflation quickly moved on to a discussion of stagflation.

The run of seven positive return months from global equity markets was emphatically broken in September (MSCI ACWI -4.1% total return in USD), bringing the total return for Q3 2021 to -1.1%. Having

bottomed below 1.2% in early August, US 10-year bond yields moved sharply higher in late September to 1.5%. The US dollar also rose (DXY +1.9%), reflecting an increasingly hawkish tone from the US Federal Reserve. Energy-related commodities rose sharply – most notably natural gas and thermal coal – while the Commodity Research Bureau (CRB)'s industrial raw material inputs index remained at multi-year highs. Strong performance from Financials (which benefit from higher interest rates) and Energy companies supported outperformance by 'value' equity benchmarks in the latter half of September. This closed the performance gap to 'growth' benchmarks, which had peaked at ~5% (for the quarter-to-date) in early September. Risks to global growth – Chinese growth in particular – meant the performance of cheaper cyclical companies' shares was not uniform. Significant disruption within global supply chains (which has played a central role in the energy cost rises) is increasingly reflected in weaker manufacturing surveys. Industrial commodities fell – iron ore to below $100/tonne having been $200/t as recently as mid-July – as the solvency issues relating to Chinese property developer Evergrande hit mainstream headlines. Emerging markets were very weak during the quarter, led down by a very under pressure Hang Seng index as China off-shore listed equities fell sharply. Sterling was modestly weak vs. the USD but held up well against the EUR.

The MSCI UK Investable Markets Index (IMI) (GBP) returned 2.2%, the MSCI All Country World Index (ACWI)(GBP) +1.4% and MSCI Emerging Markets (EM) (GBP) -5.7%. The MSCI UK Enhanced Value Index returned +3.2% and the MSCI ACWI Enhanced Value Index (USD) -2.4% compared to the MSCI ACWI (USD) return of -1.1%.

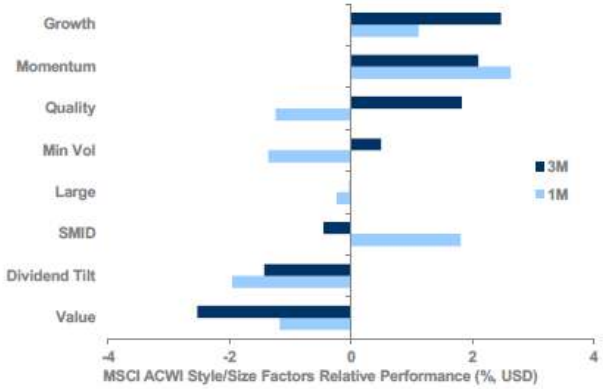
Total return of financial assets in Q3 2021 (in local currency)



Source: Deutsche Bank

- Our key factors were again weak during the quarter, despite a strong Value rally in late September.

MSCI ACWI Style factors relative performance (%, USD)



Source: Copyright 2021 Morgan Stanley

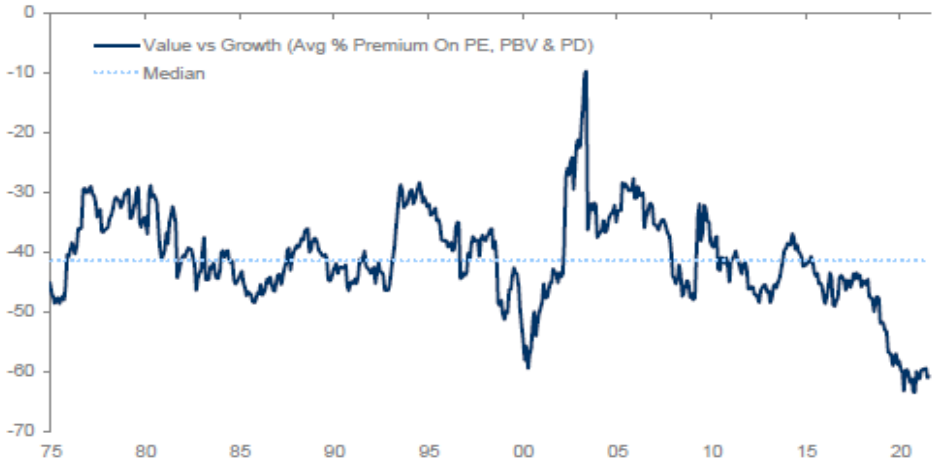
- We benefitted from the value factor rallying towards the end of the quarter as bond yields around the world started to move upwards and as energy stocks finally started to appreciate. We are modestly overweight the energy sector, which is a significantly larger position than most of our UK peer investors, balancing attractive recovery characteristics with S(ustainable)-PVT concerns. We have significant positions in BP and RDS, though underweight versus their rather large benchmark weightings. This underweight is largely offset by exposure to very good value E&P stocks. Whilst large cap value did better during September, this was not the case across the value & recovery piece, with UK domestic recovery stocks weak - consumer discretionary companies in particular - as the market worried about 'Stagflation' and the potential negative impact on consumer spending of price rises in energy; share price falls of between 10% to 30% were seen in this segment of the market, led by UK retailers, leisure stocks and housebuilders. We see this as a buying opportunity in many of these stocks as the consumer has a lot of pent-up-demand in many of these areas.
- The ES R&M UK Recovery Fund returned 3.0% (gross of fees, Z share class) and 2.7% (net of fees, B share class) during the quarter, an outperformance versus the MSCI United Kingdom IMI of just below 1%.
- Our medium- and long-term returns remain robust, especially in the context of a value headwind over much of this period. Over one year the Fund has returned +54.2% (Z shares) and +52.7% (B shares) versus +27.5% for the benchmark; over three years the Fund has returned +7.8% p.a. (Z shares) and +6.8% p.a. (B shares) versus +2.0% p.a. for the benchmark; over five years the Fund has returned +10.8% p.a. (Z shares) and +9.7% p.a. (B shares) versus +4.7% p.a. for the benchmark; over ten years the Fund has returned +14.8% p.a. (Z shares) and +13.6% (B shares) versus +7.7% p.a. for the index: and since inception the B shares have returned +15.4% p.a., 6.0% p.a. ahead of the benchmark after fees.
- 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 over 4% p.a. ahead of the index.

Key performance contributors

- Positive contributors during the quarter: Energy and Financials performed strongly towards the end of the quarter (Serica and JKX, more than offset the inevitable Royal Dutch Shell underweight); PVT stock picks positive (Indivior, Northbridge); Unilever and Reckitt Benckiser weak on worries regarding input price pressures.
- Negative contributors: Consumer discretionary stocks under a lot of pressure (Superdry, Restaurant Group); Value factor unsupportive; Smaller Companies fell in September; large cap Growth and Quality strength (Relx, Diageo); individual stock disappointments (ASOS).

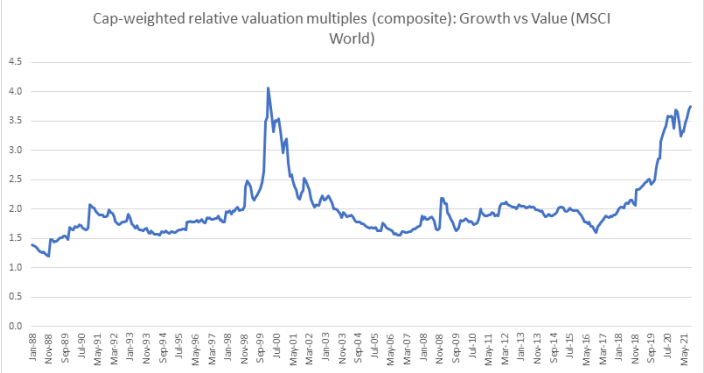
Some additional points regarding the opportunity set and positioning rationale

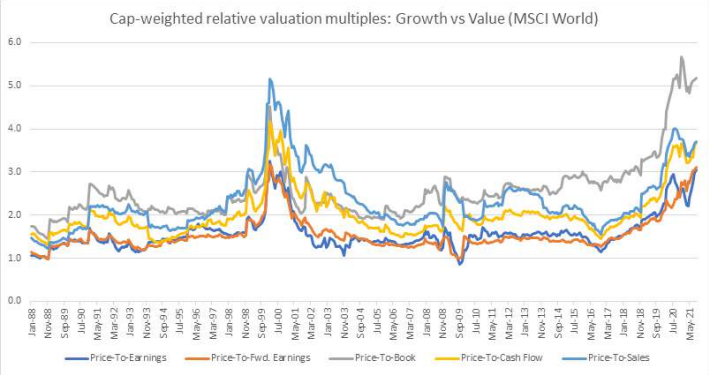
- All around the world, Value is still cheap relative to growth on all metrics including PE and price to book:



Source: Morgan Stanley Research

MSCI World Growth vs MSCI World Value valuation dispersion (market cap-weighted)





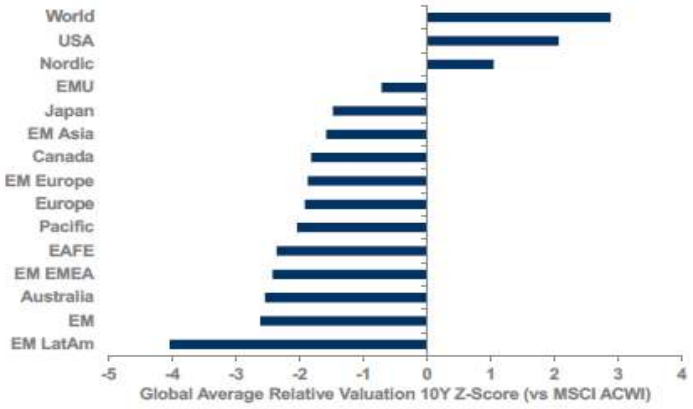
Source: Bernstein, River and Mercantile

- Some equity markets look quite expensive in absolute terms and relative to history, but others still look reasonable value. In simple terms it's US equities (high valuation, but attractive historic growth) versus the rest of the world (often low valuations, but need global economic recovery to generate growth):

Shiller PEs around the world:

Source: Copyright 2021 Morgan Stanley

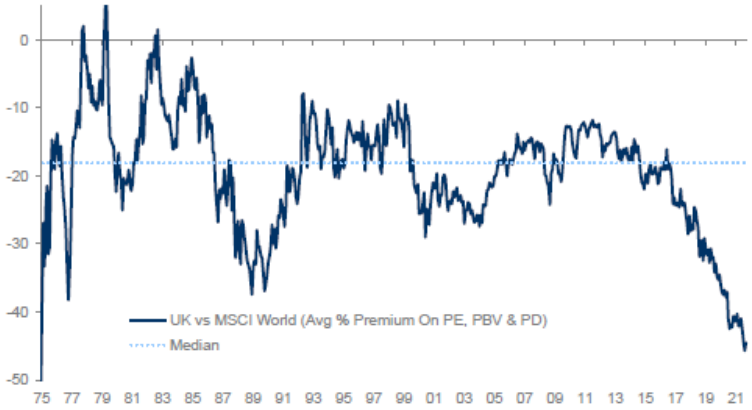
Relative valuations around the world, based on a number of metrics paint the same picture, the US expensive, the Rest of the World looking attractive:



Source: Copyright 2021 Morgan Stanley

- The UK continues to have stand out valuations, good value from an absolute value perspective (prospective PE of only 13x, a discount to its 10-year history) and never been cheaper on a relative basis (or only in 1975 when the UK seemed to be 'bust'):

UK vs MSCI World Average Valuation Premium



Source: Morgan Stanley Research

- China - is a major investment conundrum at the moment. Attractive, long-term growth opportunities, huge innovation, a large and increasingly well-educated workforce which is hard working and entrepreneurial, and a growing equity market that remains very under-represented in global indices. But in the short term much of this is offset by the significant uncertainties thrown up by a period of intense regulatory change. As value investors we do think that the significant corrections in share prices catalysed by the aggressive discounting of these uncertainties has created many very attractive investment opportunities but do accept that these will only prove to be high return investments if you believe that the Chinese Communist Party (CCP) remains supportive of the role of private (and foreign) capital in providing the bedrock for the economic growth and 'common prosperity' that they seek to deliver to their people. We believe that they will struggle to deliver their prosperity mandate without State Capitalism and, as a result, are comfortable to add to the positions we have built in stocks with China exposure.

  The digital economy already accounts for over 30% of China GDP, is a key pillar of growth and, for multiple reasons, there is a desire to compete with the US in this area. There should be little desire to impair the long-term growth of this part of the China economy. However regulatory change has been very significant in the short term for a number of reasons that seem to have

come to a head at the same time - 1) a desire to promote competition, similar to the Western world, where the big internet platforms have exhibited some monopolistic tendencies; 2) a desire to protect consumer interests, and the interest of minors; 3) a fear of excessive financial de-regulation associated with Fintech platforms; 4) a desire to communicate to internet billionaires that they should not stray into politics; 5) a recognition that the explosion of digital data (and its ownership) creates risks as well as benefits and 6) a focus on delivering the key CCP policy of Common Prosperity, so that the whole population can benefit from the growth of the economy.

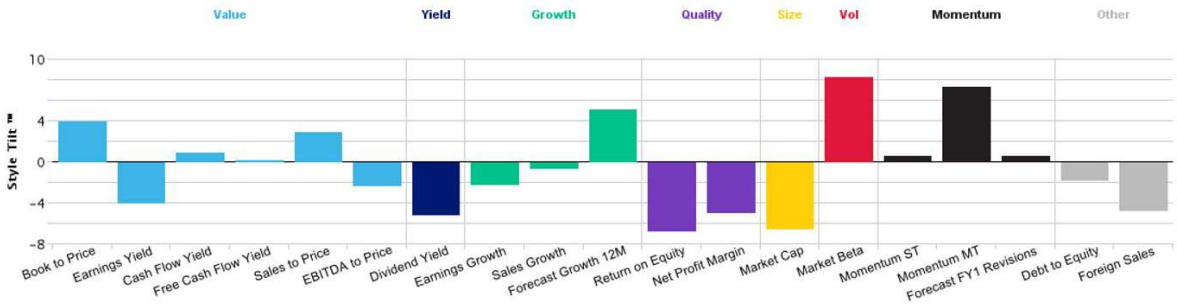
All these concerns have created a period of heightened reform, partly delivered in a way that is unusual to Western markets. However, many of the issues being addressed are familiar to policy makers outside of China but, whilst the changes may be understood, it has created heightened uncertainty and share prices that have fallen greatly, with digital economy related indices down 50%. Many shares have become exceptionally good value as a result; one we have been adding to, Baidu, has only modest direct exposure to the areas of increased regulation, its core market of internet advertising being competitive and its areas of growth, such as Artificial Intelligence and Autonomous vehicles being areas that are strongly supported by the CCP. Stripping out the material value attached to their growth investments, the core search business is on a single digit earnings multiple and a double-digit free cash flow yield and is still growing robustly.

Activity and Positioning

We continue to position the portfolio for Value, Recovery, Multi-Cap investing and for domestic economic recovery, re-opening and global reflation.

The portfolio continues to have a clear value bias, with reasonable absolute valuation support including a 1.6x price to book valuation, good value versus the benchmark on price to sales and high single digit normalised earnings and cashflow yields. Recently, the style bias of the portfolio has shifted a bit in favour of earnings growth being superior to benchmark, delivered by the recovery stocks in the portfolio starting to recover. There is a robust multi-cap bias, including an overweight position in undiscovered smaller growth stocks.

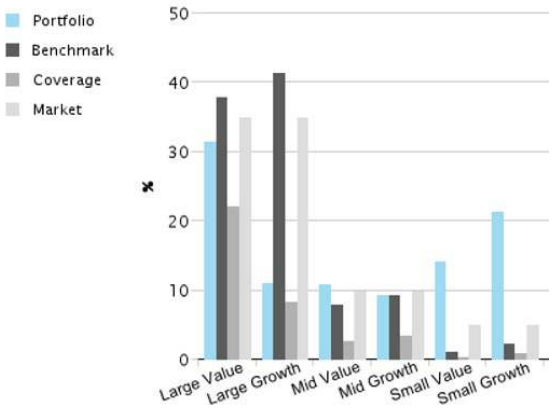
Style Skyline (StyleAnalytics) – clear commitment to Value, Recovery and multi-cap investing



Source: StyleAnalytics

Portfolio allocation to Value and Growth stocks by size and versus benchmark (Style Analytics), big exposure to large, mid and small Value, big underweight large growth, focus of growth is undiscovered small cap:

Allocations to Growth and Value by capitalisation and versus the benchmark



Source: StyleAnalytics

We remain high conviction regarding our key themes of i) the return to value having only just begun, especially given the recent retracement and ii) Value and Recovery stocks are ideally positioned for the economic and profits recovery that is still immature. Our portfolio positioning remains very committed to these themes, with a continued strong style bias towards Value, Recovery and Multi-Cap stocks. In addition, we are well placed for a more inflationary world, where bond yields trend upwards.

Our activity continued in the same vein as last quarter, though with increased purchases of consumer discretionary stocks (as described above, including topping up Restaurant Group, Joules, Berkeley Group, Taylor Wimpey, Coats and Capital & Counties). Where reflation plays have not participated in the value rally we have been adding, notably Anglo American and precious metal stocks and actually our E&P stocks as some have been left behind (Harbour Energy) and energy services (see below, Hunting). Re-opening stocks were laggards for much of the last two quarters. We think this is a great opportunity as 2022 should see most economies and borders being opened – we added to IAG, OnTheBeach, Hyve and Everyman. A number of cyclical industrials have also started to pull back aggressively – this is another opportunity to buy the dip in recovery stocks (RHI Magnesita, Tadano)

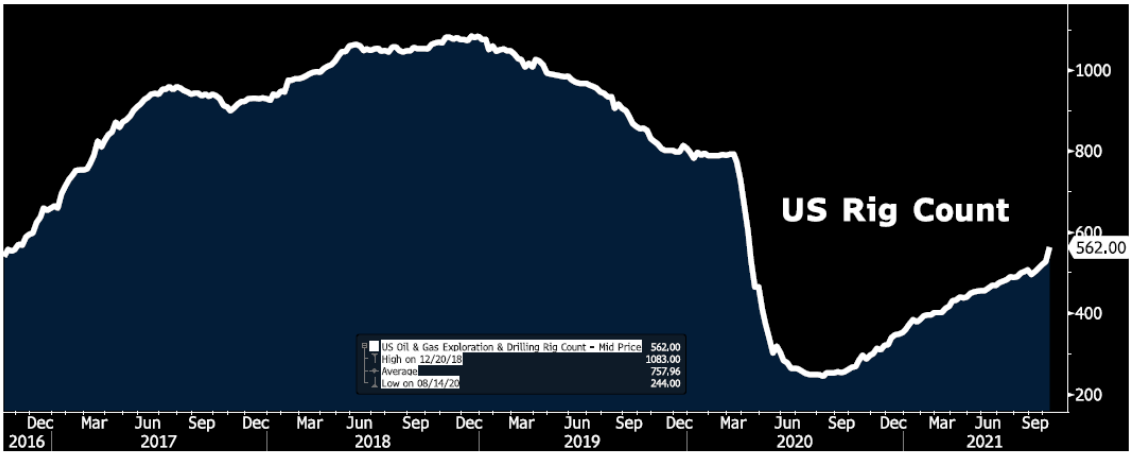
Looking at the component parts of the portfolio: stocks with traditional value characteristics pulled back through much of the period and we saw that as a significant opportunity, adding to banks (Lloyds), insurance (Old Mutual and Prudential) and energy (Royal Dutch); attractively valued and currently out of favour Quality and Growth franchises, such as AstraZeneca (also for risk management reasons), Unilever, Smith & Nephew, SSP, Trainline, AG Barr, Ping An and FD Technologies, formerly known as First Derivatives that has spent the last five years re-investing in order to broaden the market for its data manipulation focused technology suite, depressing returns and its valuation in the process but providing the opportunity to purchase what should be attractive rates of medium term growth on a relatively modest price to sales multiple); high scoring *MoneyPenny* recovery stocks such as Capita and Serco, Severfield, XL Media, Hiscox, Centrica and Indivior; classic global cyclicals, in particular reflation plays that have corrected over the last few months (Anglo American, Antofagasta, Hochschild, Polymetal); UK domestic stocks have also pulled back aggressively and look really attractive again (including housebuilders that have de-rated, despite house price inflation, Berkeley Group in particular where we think the London market will play catch-up); we remain overweight and have been adding, on recent weakness, to stocks that would benefit from a post-COVID world - i.e. those that have been negatively impacted by social distancing requirements (Restaurant Group, Whitbread, Elis, Rolls Royce, IAG, OnTheBeach, Jet2 and Disney). We think that the survivors here will be able to strengthen their market positions and medium term economics despite short term cost pressures; and as we continue to roll-out S-PVT we are allocating increased capital to this area, including adding to SIG (leading insulation product distributor, also a classic recovery stock), adding to our position in Gresham House, a

fund management business that has successfully grown a portfolio of funds oriented towards sustainability, and continuing to build a position in eEnergy, which has an energy procurement and consultancy business which works with UK SMEs to reduce energy use and procure renewable energy to aid the client's transition to net zero; and lastly we continue to think about strategic value, especially at this time of increasing M&A activity, adding to Playtech and Burberry.

We continue to think that the sell-off in Chinese Internet stocks has been over-done. The Chinese are increasing regulation and competition but still believe in State Capitalism and are very supportive of the rapid growth of the digital economy (but in a more regulated manner) – we continue to buy back into Fidelity China Special Situations as a well-managed proxy for this part of the China market and added to Prosus and Baidu. It was not just Chinese internet stocks that were weak during the period, a number of UK listed ones fell sharply providing an opportunity, including in Moonpig.

Sales have included taking full profits where our PVT thesis has been delivered, most notably the continued recipients of M&A activity (Avast, Meggitt, Ultra, Daily Mail, Stock Spirits, Nippo), and also stocks that were starting to discount a full PVT Thesis such as GEA and Helios Towers; reducing into relative strength (Tremor, Accesso, Resideo, Boku, Diageo, Pearl Abyss); and exiting some of the Growth stocks that had been de-rated last year but have had a very robust share price recovery and now look fully valued (Hutchmed China), and re-focusing capital towards higher conviction ideas (Balfour Beatty, ABRDN, South32 and Cegedim from an S-PVT perspective).

Oil Services is an interesting recovery sector with a number of high scoring stocks whose share prices have very materially lagged the recovery in energy prices. The reason for this is a combination of a very muted investment in production response from the quoted energy companies as they have a much higher cost of capital now as we move towards a carbon neutral world, and investor reluctance to apply capital to this area. However, I think both of the above could change; investment in oil and gas production will be catalysed by the economics of higher energy prices, evidenced below by the US rig count picking up, and investors will, over time, move from completely avoiding carbon producers to wanting to engage with the best in the industry to understand how they will make their business models more sustainable. We have positions in Hunting, Wood Group and Weir, attractive recovery stocks that have clearly communicated S-PVT strategies.



Source: Bloomberg

Are we following our PVT and S-PVT Philosophy & Process, a consistently articulated style and factor bias and engaging with the companies we invest in?

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 stocks due to the richer anomaly set in this part of the market; it is a multi-cap portfolio.

Engagement

In this section, we share some highlights from the engagement we had with portfolio companies during the quarter around sustainability issues, including key outcomes. Note that this is not an exhaustive list of engagement activity during the quarter.

An encouraging recent meeting with the new CFO at Capita continued the dialogue previously established with management on strategy and brought forward a new perspective in the recovery of the business from the pandemic. People (employees & customer satisfaction) - Capita have received positive feedback from clients, as the Southern Water example below shows:

Capita Experience
Southern Water - putting the customer first through quality service

Southern Water

- **68%** reduction in complaints since 2015
- **76%** reduction in billing queries
- **9.8/10** personalised customer experience score
- **80-90%** online transaction completions up from <50%
- **247%** increase in collections as a result of the digital campaign

"Without the support of Capita, **we wouldn't have progressed this quickly.** They've accommodated every request for support and put the customer at the heart of everything they do. **The way that we work together is the epitome of a partnership."**

Donna Howden
Head of Customer Service at Southern Water

Source: Capita 1H2021 results presentation

New business opportunities were highlighted in the public sector since performance of contracts with the Royal Navy and Fire services and emphasised the confidence that working-from-home had not impeded productivity or delivery. In fact, benefits of hybrid working included reducing the property footprint, with a default virtual meeting approach. This meeting highlighted continued progress at Capita in its recovery and the ongoing importance of corporate 'purpose' to Capita under new management. It was promising to see the benefits of hybrid working reducing property footprint without impacting delivery and customer satisfaction.

Our Purpose
Our licence to operate

A responsible and responsive employer
- Over 40,000 colleagues working from home
- Published our Ethnicity Pay Gap for the first time to help identify and address differences in remuneration

A good corporate citizen
- Helped train 22,000 young people with essential skills needed for the world of work
- Partnered with The Youth Group to form Capita's Youth Council, helping to shape the future of Capita

WE CREATE BETTER OUTCOMES

Honest and fair with clients and suppliers
- Faster payment terms for suppliers who are sole traders or small businesses
- Continued to support our clients and their customers through the pandemic

A guardian for future generations
- Climate change targets accredited by the Science-Based Target Initiative
- Scope 1,2,3 carbon emissions reduction targets for 2030
- Committed to Net Zero by 2035

Source: Capita 1H2021 results presentation

We encourage diversity (including gender, ethnicity, cognitive and social) at both board and senior management level, in particular our current focus is regarding gender diversity. We expect smaller companies to have at least one female Board member and for large cap companies, a minimum of percentage level is set. In August, we considered voting against the re-election of Renold's Board Chair

since the board currently had no female representation. We reached out to the company to understand whether the Board considers and values gender diversity. Through this engagement, it was clear the board was very aware of the need for diversity but also the difficulties in attracting suitably qualified female candidates in the heavy engineering/manufacturing sector. Having failed to appoint a female candidate at board level, Renold had engaged with a recruitment company to actively search for a female non-executive board director and, as the graduate program restarts after the pandemic, will value the recruitment of female graduates as crucial to the long-term viability of the group. Reassured that Renold values gender diversity and is taking steps to ensure this through-out their business, we decided to vote for the re-election of the Board Chair but will review next year if progress is not made.

Outlook

Economies and company profits around the world continue to recover robustly, especially in nominal terms, and whilst monetary and fiscal policy is tightening it remains very supportive. However, in the short-term, investors are worried about a combination of issues: the latest wave of Covid, supply chain dislocations that are causing shortages and inflation, and more hawkish Central Banks. From my perspective this uncertainty has created another low point of the Value and Recovery cycle. This does not make sense to me - perhaps economic growth rates are peaking but absolute growth will still be strong; yes, Delta Covid caused another wave of cases but fortunately the health consequences have been more modest than previous waves and we are all now learning to live with Covid; and meanwhile the world is clearly more inflationary than it has been for some time which in no way justifies a return to the low bond yield and deflationary consensus but nor does it support worries about permanently high inflation. We think we are close to peak fear regarding stagflation and its impact on consumer spending.

Importantly, recovery stocks are no more than one year into what would normally be at least a three-year positive cycle of profits recovering to pre-recession levels and beyond. But despite the early in the cycle nature of most value and recovery stocks, the market has decided that they already deserve to be de-rated; many are back towards nadir relative valuations (most recently UK consumer stocks); this is a great opportunity!

As we speak, we have a portfolio of recently de-rated companies (profits growing but share prices consolidating or falling), on modest absolute and very low relative valuations, where profits growth will be strong over the next few years as both profits recovery and top-line growth is delivered. Hopefully this should be an attractive combination, especially when there remain some very expensive assets out there.

Thank you for your continued support.

Hugh Sergeant
Head of Value and Recovery strategies

October 2021

FUND HOLDINGS AND PORTFOLIO WEIGHT

Holding	Weight (%)
Royal Dutch Shell 'B'	3.23
BP	2.72
Lloyds Bank	2.10
Barclays	1.96
Prudential	1.93
HSBC Holdings	1.88
Anglo American	1.85
Rio Tinto	1.39
Natwest Group	1.28
Unilever	1.27
BHP	1.13
Standard Chartered	1.09
Somero Enterprises	1.04
Glencore	1.01
GlaxoSmithKline	0.98
The Restaurant Group	0.65
Rolls-Royce	0.64
Ebiquity	0.59
Antofagasta	0.58
Whitbread	0.58
Legal & General	0.58
Playtech	0.53
Indivior	0.51
Reach	0.51
Sage	0.50
Int'l Cons. Airlines	0.50
Gresham House	0.49
Compass Group	0.49
BT	0.48
Renold	0.47
Renewi	0.47
Easyjet	0.45
Old Mutual	0.45
Northbridge	0.44
Xaar	0.43
Serica Energy	0.43
British American Tobacco	0.43
Burberry Group	0.43
Devro	0.43
Capita	0.43
MPAC Group	0.42
Mercia Asset Management	0.42
Capital & Counties	0.42
DP Eurasia	0.42
Coats	0.41
Citigroup	0.41
Kin and Carta	0.40
Premier Miton Group	0.40
Fidelity China Special	0.40
Toyota Industries	0.39
Elis	0.39
Taylor Wimpey	0.39
Tremor International	0.39
Boku	0.39
Strix	0.39
Tadano	0.39
Baidu	0.39
Volex	0.39
Bank of Ireland	0.39
Sony Corp	0.38
Hunting	0.38
Melrose Industries	0.38
Virgin Money	0.38
John Wood Group	0.38
The Weir Group	0.37
Wickes	0.37
Carnival	0.37
Gresham House Strategic	0.37
Aviva	0.36
Banca Farmafactoring	0.36

Holding	Weight (%)
Ted Baker	0.36
Subsea 7	0.36
XLMedia	0.36
Vicat	0.35
Imperial Brands	0.35
Walt Disney Company	0.35
SSP Group	0.35
Secure Trust Bank	0.34
Raytheon Technologies	0.34
AstraZeneca	0.34
Ocean Wilson Holdings	0.34
Seplat Petroleum Developme	0.33
Centaur Media	0.33
ULS Technology	0.33
Tribal	0.33
Science In Sport	0.33
888 Holdings	0.33
Vistry Group	0.33
ING Group	0.32
Dormakaba Holding	0.32
Int'l Personal Finance	0.32
Polymetal International	0.32
Capital Limited	0.32
Hochschild Mining	0.32
Harbour Energy	0.31
Travis Perkins	0.31
Centrica	0.31
ITV	0.31
Eckoh	0.31
Fresnillo	0.31
Elementis	0.31
DFS Furniture	0.31
On the Beach Group	0.31
Associated British Foods	0.31
Enquest	0.30
Ping an Insurance	0.30
Swire	0.30
Essentra	0.30
Marks & Spencer	0.30
WPP	0.30
Smith & Nephew	0.30
Berkeley Gp Hldgs	0.30
De La Rue	0.30
Serco	0.30
Johnson Matthey	0.30
WH Smith	0.30
RHI Magnesita	0.30
Alfa Financial Software	0.30
ASOS Holdings	0.30
Pearson	0.30
Moonpig	0.29
Dixons Carphone	0.29
SIG	0.29
boohoo.com	0.29
Dart Group	0.29
Booking Holdings	0.28
Hyve Group	0.28
Porsche Automobil	0.28
Kier	0.28
Jumbo	0.28
Provident Financial	0.28
Schroder UK Public Private	0.27
TP ICAP	0.27
Koninklijke Philips	0.27
GVC Holdings	0.27
Galliford Try	0.27
Crest Nicholson Holdings	0.27
Tesco	0.27
IMI	0.27
Owens Corning	0.27

Holding	Weight (%)
Flutter Entertainment	0.27
Ricardo	0.27
Brewin Dolphin	0.27
Development Securities	0.27
Shaftesbury	0.26
Revolution Bars Group	0.26
Superdry	0.26
Chemring	0.26
Saga	0.26
Sansei Technologies	0.26
CRH	0.25
Fugro	0.25
RWS Holdings	0.25
Pendragon	0.25
RPS Group	0.25
Prosus	0.25
Flowtech Fluidpower	0.24
Blue Prism	0.24
Filtronic	0.24
JKX Oil & Gas	0.24
Informa	0.24
Greencore Group	0.24
Trinity Exploration	0.24
Accesso Technology Group	0.24
Aston Martin Lagonda	0.23
Safestyle UK	0.23
Incitec Pivot	0.23
Johnson Controls	0.23
Pearl Abyss	0.23
Smart Metering Systems	0.23
Stagecoach Group	0.23
Vodafone	0.23
Central Asia Metals	0.23
EFG Eurobank Ergasias	0.23
Trainline	0.23
Bodycote	0.23
McKesson	0.23
Fukuda Denshi	0.22
Instem	0.22
A.G.Barr	0.22
Hyundai Mobis	0.22
NCC Group	0.22
TT Electronics	0.22
Siemens	0.22
Morgan Advanced Materials	0.22
Drax	0.22
Menzies (John)	0.21
Exor	0.21
Tullow Oil	0.21
Foxtons Group	0.21
Van Lanschot	0.21
PageGroup	0.21
Fourlis Holdings	0.21
Eenergy Group	0.21
Cairn Energy	0.21
Savannah Energy	0.21
Rathbone Brothers	0.20
Biffa	0.20
IG Holdings	0.20
Close Brothers	0.20
Shangri-La Asia	0.20
Inspired Energy	0.20
Diversified Energy	0.20
Ocado Group	0.20
Anima	0.20
Speedy Hire	0.20
Everyman Media Group	0.20
Temple Bar Investment Trust	0.19
IQE	0.19
Centamin	0.19

Source: River and Mercantile Asset Management LLP

FUND HOLDINGS AND PORTFOLIO WEIGHT (CONTINUED)

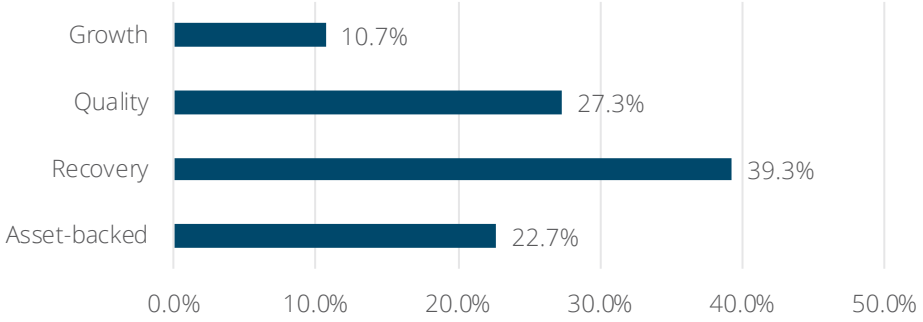
Holding	Weight (%)
AO World	0.19
MySale Group	0.19
TKH Group	0.19
SBI Group	0.19
Nichols	0.19
3i Group	0.19
Ibstock	0.19
Next	0.19
Tekmar Group	0.19
LSL Property Services	0.19
Costain Group	0.19
James Fisher & Sons	0.18
Auto Trader	0.18
Time Out Group	0.18
Tyman	0.18
British Land	0.18
Hostelworld Group	0.18
JD Wetherspoon	0.18
Breedon Group	0.18
Victrex	0.18
Hargreaves Lansdown	0.18
Grainger	0.17
Ascential	0.17
Card Factory	0.17
Mind Gym	0.17
AVI Japan Opps Tst	0.17
Cenkos Securities	0.17
Mondi	0.16
Tachi-S Co	0.16
Staffline Group	0.16
Nippo Corp	0.16
PZ Cussons	0.16
Norcros	0.16
Henry Boot	0.16
Purplebricks	0.16
Rotork	0.15
Angling Direct	0.15
Keller	0.15
Micro Focus	0.15
Topps Tiles	0.15
First Derivatives	0.15
The Gym Group	0.15
Photo-Me International	0.15
Zotefoams	0.15
Bango	0.15
Adept Telecom	0.15
Severfield-Rowen	0.15
Rightmove	0.15
Mitie	0.15
Aberforth Smaller Co's Trust	0.15
OPG Power Ventures	0.14
Thruvision Group	0.14
IP Group	0.14
Learning Technologies	0.14
Kingfisher	0.13
Moneysupermarket.com	0.13
Mediclinic International	0.13
Trifast	0.13
Carclo	0.13
Iomart Group	0.13
Resideo Technologies	0.13
Hill & Smith	0.13
Nintendo	0.13
Oxford Instruments	0.13
Reneuron Group	0.12
Network International	0.12
Blancco	0.12
Mortgage Advice Bureau	0.12
Serabi Gold	0.12
M&C Saatchi	0.12

Holding	Weight (%)
Joules	0.12
Just Eat Takeaway	0.11
JPMorgan Indian Investment T	0.11
Greggs	0.11
Senior	0.11
ADVFN	0.11
Dialight	0.10
Tate & Lyle	0.09
Johnson Service	0.09
Hiscox	0.09
Driver Group	0.09
Majestic Wine	0.08
ConvaTec Group	0.08
Man Group	0.06
Hays	0.05
Smiths News	0.05
National Express Group	0.05
Beazley	0.05
Marston's	0.05
Aukett Swanke	0.05
Altitude Group	0.04
Lancashire Holdings	0.04
Halfords	0.04
Rangers International FC	0.02
Benchmark Holdings	0.00
Cash	0.71
TOTAL	**100.00**

Source: River and Mercantile Asset Management LLP

PVT CATEGORIES OF POTENTIAL

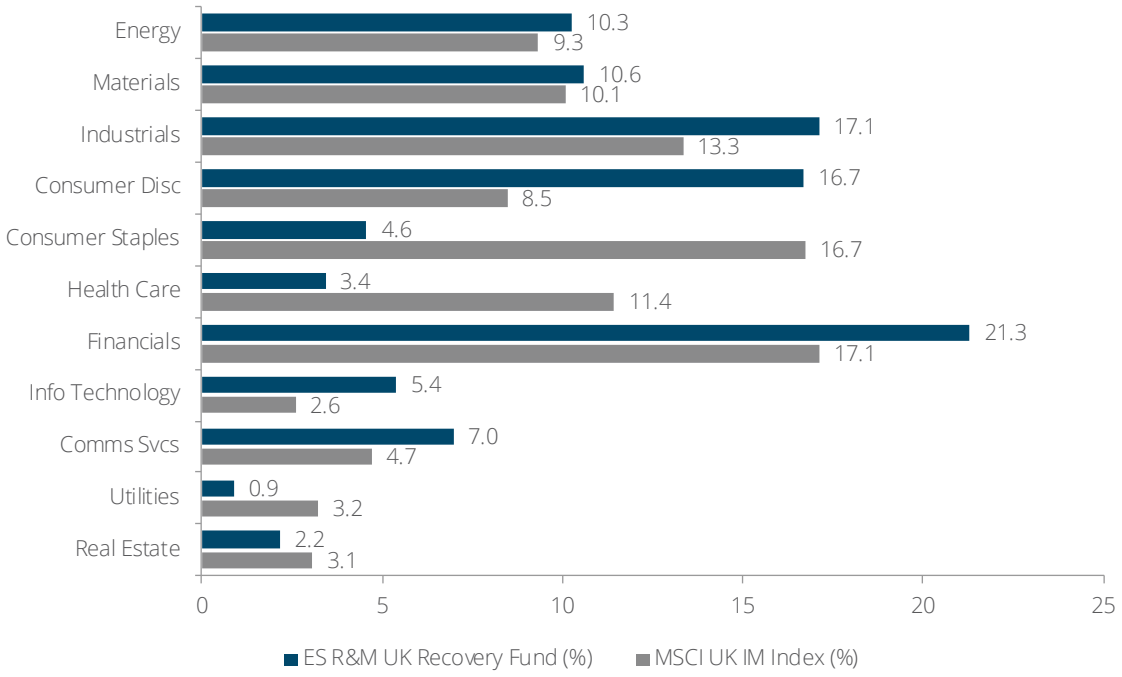
This chart shows the weighting of the fund's holdings across the four categories of Potential, related to the stages of a company's life cycle, as defined within the R&M investment philosophy known as 'PVT' – Potential, Valuation, Timing.



Source: River and Mercantile Asset Management LLP

INDUSTRIAL SECTOR WEIGHTS

This graph shows a comparison of fund and benchmark weightings across the industrial sectors classified by the MSCI Global Industry Classification Standard (GICS).



Source: FactSet

MARKET CAP DISTRIBUTION

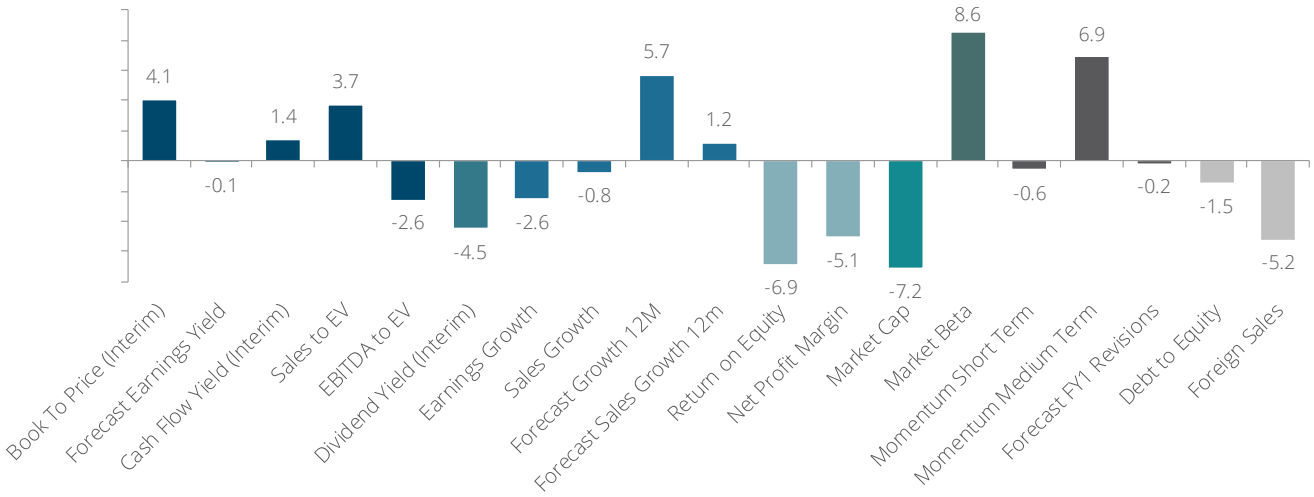
This table shows a comparison of fund and benchmark weightings across a range of company values

		Fund	Benchmark	Active
Mega Cap	£20bn +	28.8%	58.6%	-29.8%
Large Cap	£4bn - £20bn	15.2%	27.1%	-11.9%
Mid Cap	£2bn - £4bn	8.9%	7.2%	1.7%
Small Cap	£100m - £2bn	40.1%	7.0%	33.1%
Micro Cap	£0m - £100m	6.2%	0.0%	6.2%

Source: River and Mercantile Asset Management LLP. Excludes cash and any applicable ETF positions.

PORTFOLIO STYLE SKYLINE

This graph shows the Style Tilts™ of the fund against the benchmark as calculated by StyleAnalytics, highlighting stylistic differences between the fund and its benchmark.



Source: StyleAnalytics

STOCK LEVEL PERFORMANCE ATTRIBUTION

This table shows the best and worst contributors to the fund's performance relative to the benchmark. The average active weight highlights whether the fund held a larger or smaller position in a stock than the benchmark did, on average over the period. As performance is relative to the benchmark, outperformance of the benchmark can come from the fund holding a larger position than the benchmark in a stock that performs well, or a lower position than the benchmark (or even a zero holding) in a stock that performs poorly. The contribution to active return is the return that the position has contributed relative to the benchmark.

Greatest Positive Contribution	Average Active Weight	Contribution to Active Return
Unilever	-3.81%	0.28%
Reckitt Benckiser	-1.91%	0.22%
Rio Tinto	-1.38%	0.19%
Serica Energy	0.32%	0.18%
JKX Oil & Gas	0.19%	0.15%
HSBC Holdings	-1.72%	0.14%
Northbridge	0.32%	0.13%
Somero Enterprises	0.95%	0.12%
Reach	0.51%	0.12%
Indivior	0.35%	0.12%

Greatest Negative Contribution	Average Active Weight	Contribution to Active Return
Royal Dutch Shell 'A'	-2.26%	-0.29%
Superdry	0.37%	-0.19%
RELX Group	-1.86%	-0.18%
The Restaurant Group	0.75%	-0.17%
ASOS Holdings	0.22%	-0.12%
Diageo	-3.60%	-0.11%
Experian	-1.31%	-0.11%
AstraZeneca	-5.43%	-0.10%
Fidelity China Special	0.37%	-0.10%
Ping an Insurance	0.29%	-0.10%

Source: FactSet

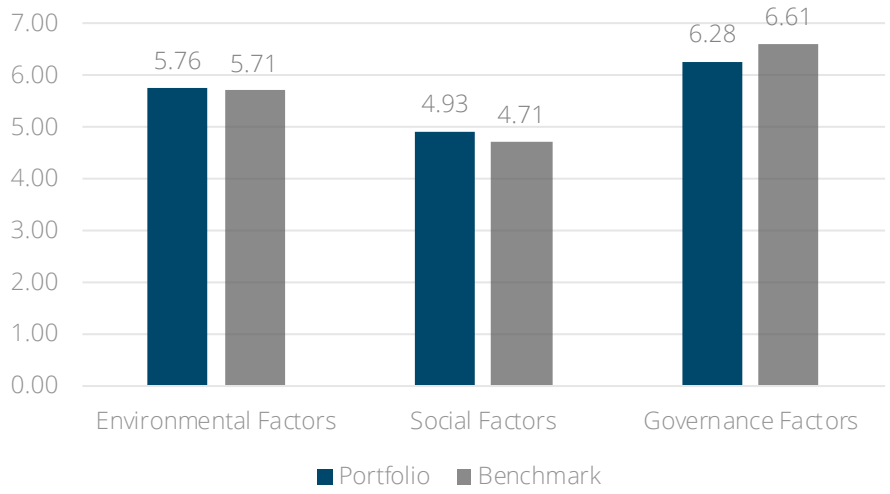
ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) FACTOR ANALYSIS

This report is designed to give a broad overview of the portfolio from the perspective of Environmental, Social and Governance factors. Whilst the portfolio is not run to be optimised with these factors in mind, we may expect to take major risks into consideration when analysing stocks.

This table compares the portfolio and benchmark asset weightings by value with data from MSCI ESG Research.

	Portfolio	Benchmark
Assets covered by MSCI ESG Research	79.9%	99.5%
Assets scoring in the bottom decile	0.4%	0.1%

The chart below illustrates how the portfolio and its benchmark compare on average Environmental, Social and Governance scores. Scores are based on a 1 to 10 scale, where 1 is the lowest/worst and 10 is the highest/best.



10 highest rated ESG companies held by fund	Portfolio Weight	Benchmark Weight	Company Rating	Industry Adjusted Score
Burberry Group	0.4%	0.3%	AAA	10.0
Sony Corp	0.4%	0.0%	AAA	10.0
ITV	0.3%	0.2%	AAA	10.0
Marks & Spencer	0.3%	0.2%	AAA	10.0
Berkeley Gp Hldgs	0.3%	0.2%	AAA	10.0
Johnson Matthey	0.3%	0.2%	AAA	10.0
SIG	0.3%	0.0%	AAA	10.0
CRH	0.3%	0.0%	AAA	10.0
Johnson Controls	0.2%	0.0%	AAA	10.0
Close Brothers	0.2%	0.1%	AAA	10.0

10 lowest rated ESG companies held by fund	Portfolio Weight	Benchmark Weight	Company Rating	Industry Adjusted Score
Carnival	0.4%	0.1%	CCC	0.7
Porsche Automobil	0.3%	0.0%	B	1.4
Hyundai Mobis	0.2%	0.0%	B	2.0
Pearl Abyss	0.2%	0.0%	B	2.3
Tachi-S Co	0.2%	0.0%	B	2.3
Premier Miton Group	0.4%	0.0%	B	2.4
Int'l Cons. Airlines	0.5%	0.0%	B	2.8
Tadano	0.4%	0.0%	B	2.8
Bank of Ireland	0.4%	0.0%	BB	2.9
Tremor International	0.4%	0.0%	BB	3.0

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BROKER COMMISSIONS ANALYSIS

Counterparty	Total (£)	Commission Paid (£)
		Execution Only
ABG SUNDAL COLLIER	0.00	0.00
ATLANTIC SECURITIES	103,860.47	62.32
BANCO ITAU	0.00	0.00
BARCAP	346,225.95	255.72
BERENBERG	772,050.56	617.62
BNP PARIBAS SEC (ASIA) LTD	0.00	0.00
BTG PACTUAL	0.00	0.00
CANACCORD ALGO	3,097,744.41	1,239.09
CANACCORD GENUITY	138,639.80	110.91
CENKOS	351,655.00	281.32
CITI PROG	0.00	0.00
CITIGROUP	861,394.05	675.17
CLSA	154,040.25	107.83
CREDIT SUISSE	1,791,472.03	1,241.95
DEUTSCHE BANK	0.00	0.00
EXANE	322,142.39	193.27
FINNCAP	400,110.72	320.15
GBM	0.00	0.00
GOODBODY	404,347.91	323.47
HSBC	859,934.40	557.46
ING	0.00	0.00
INSTINET	0.00	0.00
INVESTEC	2,669,596.70	2,135.71
ITG	460,468.86	276.29
ITG ALGO	477,157.88	190.87
ITG EURO	0.00	0.00
J&E DAVY	183,653.42	123.70
JANE STREET	0.00	0.00
JEFFERIES	2,558,652.19	1,852.14
JEFFERIES ALGO	2,157,639.80	863.04
JPMORGAN CHASE	1,094,760.22	848.92
KEPLER CHEUVREUX	538,080.40	344.51
LIBERUM	493,582.93	366.73
LIQUIDNET	4,366,566.12	2,618.04
MEDIOBANCA	0.00	0.00
MIZUHO	975,546.43	596.83
MORGAN STANLEY	465,905.00	329.82
NPLUS1 SINGER	2,365,933.82	1,748.76
NUMIS	2,117,438.30	1,677.38
PANMURE GORDON	418,035.11	278.90
PEEL HUNT	4,127,663.40	3,302.14
RAYMOND JAMES	1,250,141.52	750.08
RBC	300,076.25	180.05
RBC ALGO	2,297,371.73	918.93
REDBURN	74,160.00	59.33
SANTANDER	0.00	0.00
SHORE CAPITAL	627,444.32	482.16
STIFEL EUROPE	0.00	0.00
STIFEL NICOLAUS	0.00	0.00
UBS	726,787.82	490.78
UBS PROG	2,568,549.44	869.87
WINTERFLOOD	2,505,624.90	1,949.01
FLOWTRADERS	0.00	0.00
CONFIRMED FUND PRICE	0.00	0.00
OPTIVER	0.00	0.00
BANK OF MONTREAL	0.00	0.00
BTIG	232,407.50	185.92
CITADEL INVESTMENT GROUP L.L.C.	0.00	0.00
STIFEL FINANCIAL CORP	7,639.26	6.11
CITI UK	0.00	0.00
LIQUIDNET ALGO	140,400.41	42.13
SUSQUEHANNA INTERDAA EquityONAL	0.00	0.00
	£ 45,804,901.67	**£ 29,474.43**

Firm Wide Comparators

All Equity Trading	**£**	**942,644,220.83**	**£543,145.84**
Trades:	**£**	**45,804,901.67**	**£29,474.43**
Average Firm-Wide Commission Rate (%)			0.06%
Average Commission Rate (%)			0.06%

Source: River and Mercantile Asset Management LLP

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