RIVER AND MERCANTILE

ES RIVER AND MERCANTILE UK EQUITY HIGH ALPHA FUND

Quarterly report to 30 June 2022

For unitholders only

ES River and Mercantile
UK EQUITY HIGH ALPHA FUND

Quarter 2, 2022

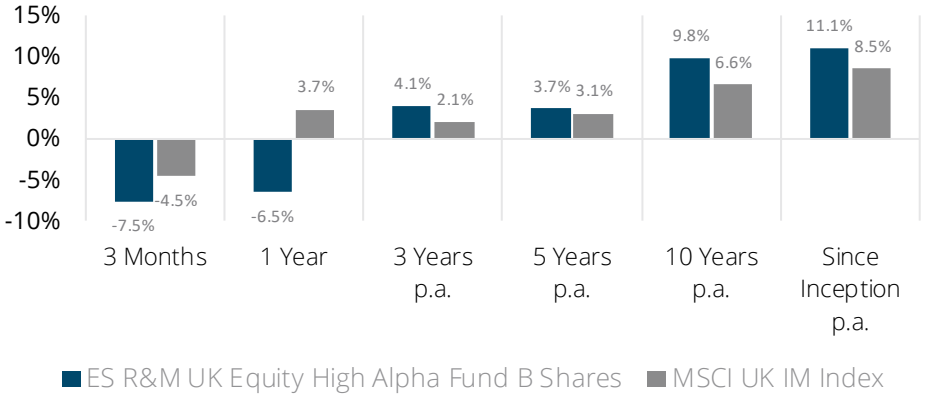
RIVER AND MERCANTILE

INVESTMENT OBJECTIVE

To grow the value of your investment (known as "capital growth") in excess of the MSCI UK 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	-7.5%	-4.5%	-3.1%
1 year	-6.5%	3.7%	-10.1%
3 years (p.a.)	4.1%	2.1%	2.0%
5 years (p.a.)	3.7%	3.1%	0.5%
10 years (p.a.)	9.8%	6.6%	3.2%
Since inception (p.a.)	11.1%	8.5%	2.6%



PERFORMANCE (BEFORE FEES)

	Z share class	Benchmark	Difference
3 months	-7.4%	-4.5%	-2.9%
1 year	-5.8%	3.7%	-9.4%
3 years (p.a.)	4.8%	2.1%	2.8%
5 years (p.a.)	4.4%	3.1%	1.3%
10 years (p.a.)	10.6%	6.6%	4.0%
Since inception (p.a.)	7.4%	5.1%	2.3%

Source: River and Mercantile Asset Management LLP. Benchmark is the MSCI UK Investable Market Index, net GBP. Fund performance shows the B share class (accumulation units) which is net of an annual management charge of 0.75% per annum, and the Z share class (accumulation units) which reflects the fund's gross performance before any fees are deducted. Inception date of the B share class is 20 October 2008 and inception date of Z share class is 28 November 2006. Fund performance is calculated using the midday published price. Note that the benchmark performance is calculated using close of business mid-market prices. Other share classes may be available. Past performance is not indicative of future results.

PORTFOLIO SUMMARY AND KEY RISK CHARACTERISTICS.

Fund AUM	£75.9m	Tracking error	4.2 %
Strategy capacity	£800m	Active money	48.6 %
Inception date	28/11/2006	Portfolio beta	1.15
Number of stocks	242		

SYNTHETIC RISK AND REWARD INDICATOR

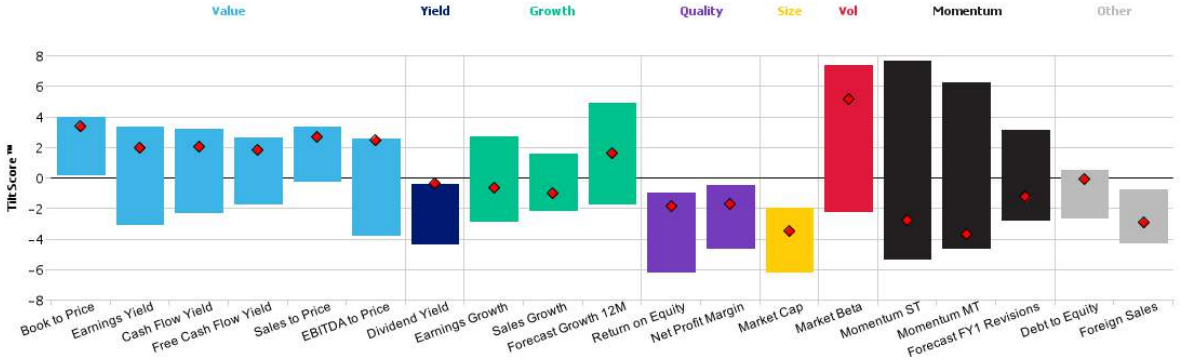
The Synthetic Risk and Reward Indicator (SRRI) is based on how much the returns of the shares have varied over the last five years, or since launch (whichever is the shorter period). The higher the rank the greater the potential reward but also the greater the risk of losing money.

My key message this quarter is that there are some amazing bargains out there. The UK and global stocks that make up our hunting ground are really very cheap now. Small and Mid-Cap equities are on bargain basement valuations. Any equity that has uncertainty associated with it is very depressed. Our types of shares, namely PVT, Value, Recovery, Multi-Cap and out-of-favour Growth are often stunning value with free cash (or capital) yields that are higher than earnings multiples. I will expand on this below, but this is my main message – really, very, very cheap.

Our portfolios – better value than ever

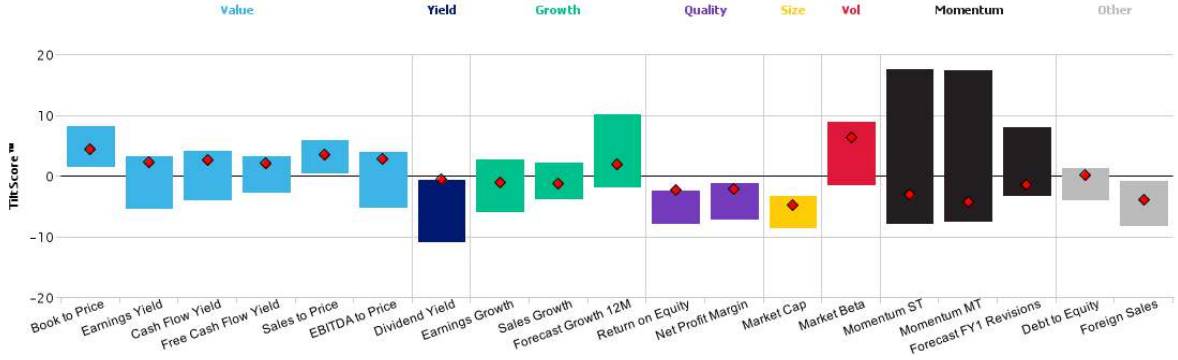
Our portfolios represent a huge store of value (at only around 1.2x price to book and double-digit cash flow yields) and as shown below (represented by the red diamonds) have rarely been cheaper versus the benchmark, with even the dividend yield the same or higher than the market. Also note we have no more leverage than the market and whilst we are bullish on SMIDs we are only in the middle of the range as we have looked to manage this 'risk'. And hopefully it's re-assuring that my three funds are aligned.

UK High Alpha



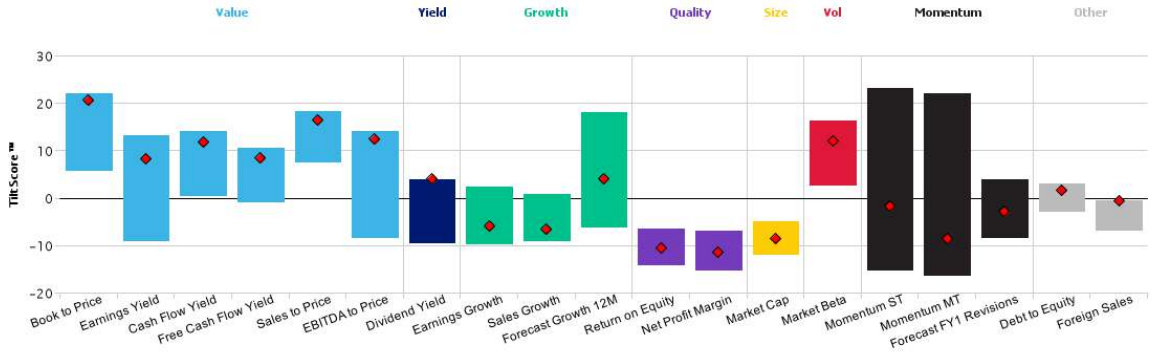
Source: StyleAnalytics

UK Recovery



Source: StyleAnalytics

Global Recovery



Source: StyleAnalytics

How did we get here?

... At the beginning of 2020 the economic background looked supportive, interest rates were trending up and value and economically sensitive UK domestic stocks were doing well; then along came Covid and economies and value tanked, but you had to make sure you bought into the big falls as Government support kicked in, and then Growth stocks led the way as they had the things that everyone wanted during lockdown....and then later in the year vaccines were discovered and investors moved back into value and hurrah, our recovery stocks did well and so did smaller companies...but this only lasted 6 months as other waves of Covid came along and the market started to fear something (not quite sure what it was) that was going to be bad for smaller companies, or maybe it was just that larger companies were the place for ETF cash. Anyway, consumer and industrial cyclicals and smaller companies and UK domestic stocks started a period of underperformance that has carried on until today...and then towards the back end of last year and into this we saw interest rates and bond yields move up, which was initially good for quite a lot of value, but then when Putin invaded Ukraine it was only good for value stocks that were inflation beneficiaries, and then good for large cap perceived defensives, and fast forward to July and an economic and profits downturn has become the new consensus so that the only place to be is certainty (defensive) stocks. But are these now getting expensive? And what if inflation starts to fall and supply chains improve and perhaps some compromise in the Ukraine is reached? The market could change tack again... easy this job is not and really too short term.

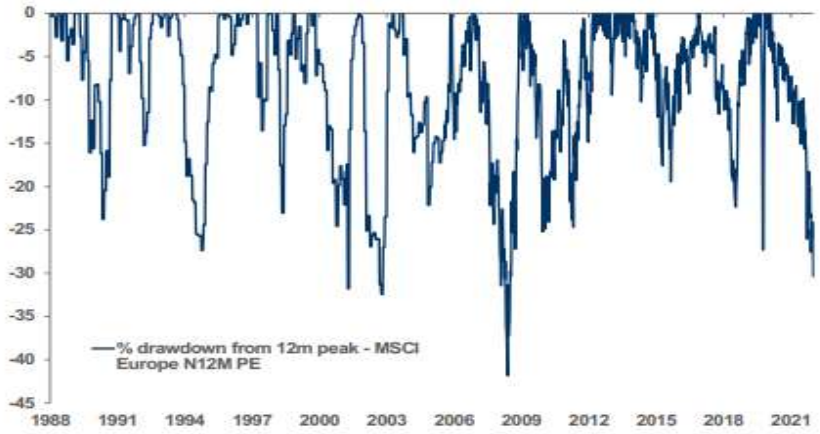
I suppose a point that could come out of the above is that investment cycles have been very short over the last few years, some no longer than 6 months. The current recession phase started with Putin's invasion, so five months ago. We of course shall see...

Timing the nadir

When will the types of shares I favour become less cheap? I don't really know. How bad will the economic and profits downturn be? And in this fast market, with lots of passive and hot capital how much of a bad cycle is already reflected in share prices? Given where valuations have fallen to then it would seem that a lot of bad news is already factored in. My guess is that the inflationary worries will start to subside well before the profit cycle bottoms out. Will markets start to discount recovery at that point or wait for profits to bottom out? To be honest I'm not sure, so as ever it pays to be gradualist as we build up positions in new anomalies that have been created by these uncertainties. We haven't had a bad down cycle (we are not normally great in these anti-risk type markets), protected by our Value bias but it's been bad enough for me and you to lose sleep over. I am sorry but I have not been prepared for such a rapid change in narrative.

How low can it go?

I don't know. But I do believe that in a few years' time if one didn't buy shares in the types of companies we favour at these bargain basement prices then there will be a huge amount of regret. Last quarter I provided a long list of very cheap stocks, it would be a bit dull to repeat that very same list. Suffice to say my funds own stocks that are on as low as 3x earnings and out-of-favour digital platforms that are on less than 1x sales. Of course, cheap stocks can get cheaper, and in the global financial crisis (GFC) bear market (for example) they obviously did (about 20% cheaper, to 1x PB). But this is definitely not our central case, and if it comes to pass then permanent capital will not be lost (just temporary share price corrections) and we will stick to our knitting and apply our gradualist, diversified by stock count (but punchy in every other way) approach. The chart below shows the current de-rating in Europe compared to previous bear markets, so quite extreme though this is yet to include the earnings downturn:



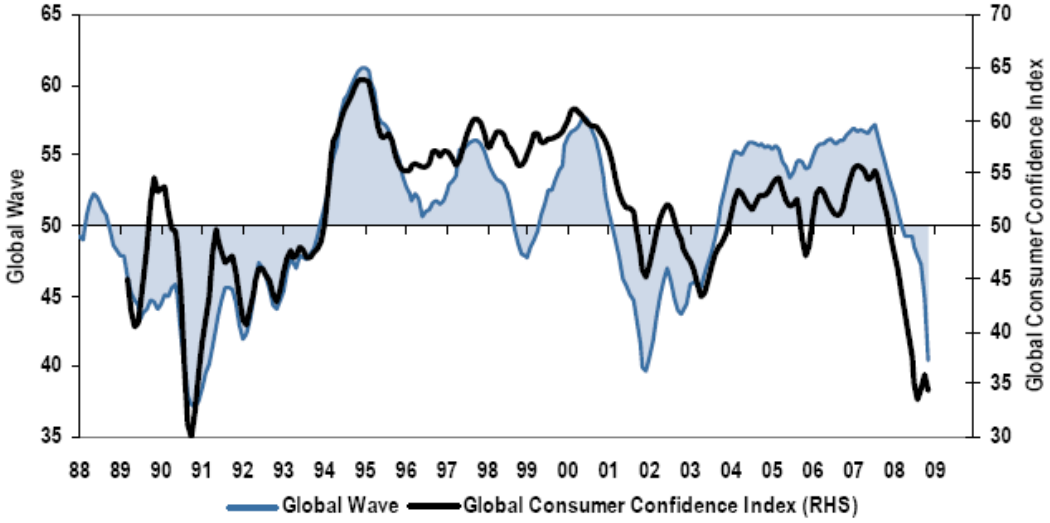
Source: Morgan Stanley

How bad is sentiment?

One of the best contra-indicators is consumer sentiment... this from my Q4 2008 Quarterly Report:

"As Tweedy, Browne identify in our introductory quotation the equity market looks forward not back. So, a key to understand where we are going from here is not how difficult things seem today, but what the consensus is expecting. If the consensus is already very depressed, then a lot of bad news is in the price:

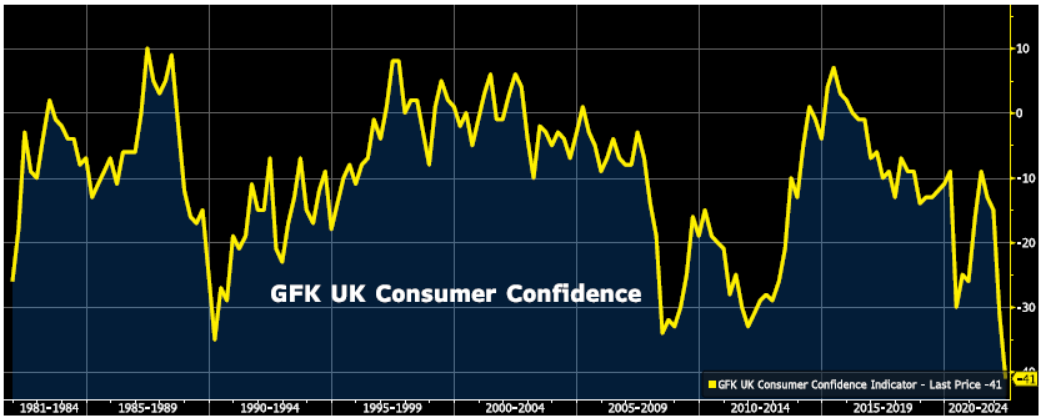
Global Consumer Confidence Index



Source: Merrill Lynch Global Quantitative Strategy, MSCI, IBES, Bloomberg, OECD, IMF

Looking at one key indicator of confidence, that of the global consumer, this is at its lowest point since the recession of the early nineties."

Let's look at consumer confidence today, this should speak for itself, again at a low point which historically has coincided with market lows (give or take a couple of quarters!):



Source: Bloomberg

Things to be positive about

Oh yes there are! We have recovered from Covid. Unemployment is low. Households have really strong balance sheets as their asset values have gone up and they have not binged on credit since the GFC. Wages are going up, not as much as short term inflation but they are still going up. Governments are committed to supporting economies. Banks are in decent shape. Interest rates are going up, but only to more sensible levels. Companies are decently profitable, have strong finances and low valuations so they are creating a lot of value by buying in shares. And aren't we great at a few things? For example, weren't the Jubilee celebrations amazing?! And the Rolling Stones, one of our great British exports still going strong after 60 years! Yes, the cost of living has gone up a lot, yes it will crimp consumer spending but the cure for high prices is high prices and most high prices have started falling because there is some demand destruction and because part of the rise was speculative.

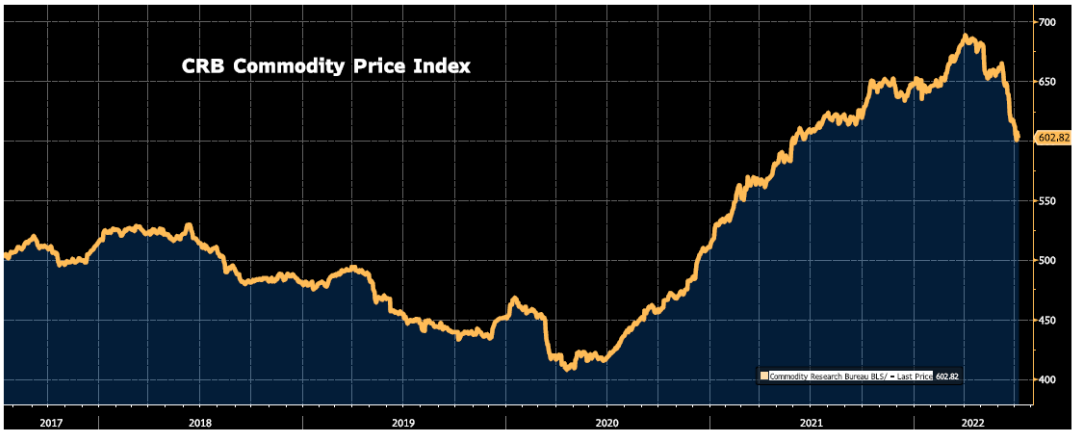
Inflation – long-term higher (James Sym) and short-term rolling over? (chart below)

James Sym and I have been touring the country with what was hopefully a clear message about the new regime of higher inflation and interest rates and how to try and manage client assets against this background. Our big picture assessment of the investment regime for this business cycle is reasonably straightforward. The policy responses to Covid, and a decade of underinvestment from corporates after the GFC, will lead to much tighter labour and, particularly, capital markets than the previous cycle and one where inflationary pressures are highly unlikely to be so supressed, as we became used to over the last 15 years (and for which portfolios around the globe largely remain designed in our opinion). We held this rather anti-consensual view from around 2017 when nascent signs – in the form of labour tightness and increasingly solid capacity-utilisation for example – became apparent. As somewhat of an aside, we are also of the view that the desirable societal pressure to decarbonise our economy will lead to a huge capital investment wave which itself is inflationary, and that finding companies that the market hasn't recognised are exposed to this dynamic is likely to be a very fruitful endeavour.

However, within this medium-term context we have more recently written about the likelihood of a welcome shorter-term abatement of the current very sharp inflationary pressure. This easing of inflationary pressure will be caused by the rise in rates and rate expectations, natural slowdown of demand from inflation itself and unpicking some of the remaining Covid-driven bottlenecks mostly in transportation and China. To be clear, this is a pull back from a high level to something less destructive

– not an expectation of a precipitous drop into the previous cycle's deflationary environment. Ironically, given I have become used to being a relatively lonely voice discussing the likelihood of an inflationary investment regime, this comes at precisely the time most investors are starting to seriously worry about the implications of inflation and the "cost of living crisis" which is plastered all over every major news outlet. Ever the contrarians I suppose!

As we know. volatility in inflation (i.e., unexpected inflation) is the key factor driving markets at the moment. Interestingly, the CRB Commodity Price Index (below) seems to have peaked and indeed did so just as Russia invaded Ukraine. Five-year inflation expectations in the US, Germany and UK have actually come back from >3% to 2-3% (below). Our view is that we are going into an investment cycle that is premised on higher inflation than the last cycle (2-5% not 0-2%) but not the 8-10%+ that we currently have, so a reflationary but not a high inflationary (or indeed deflationary) period.

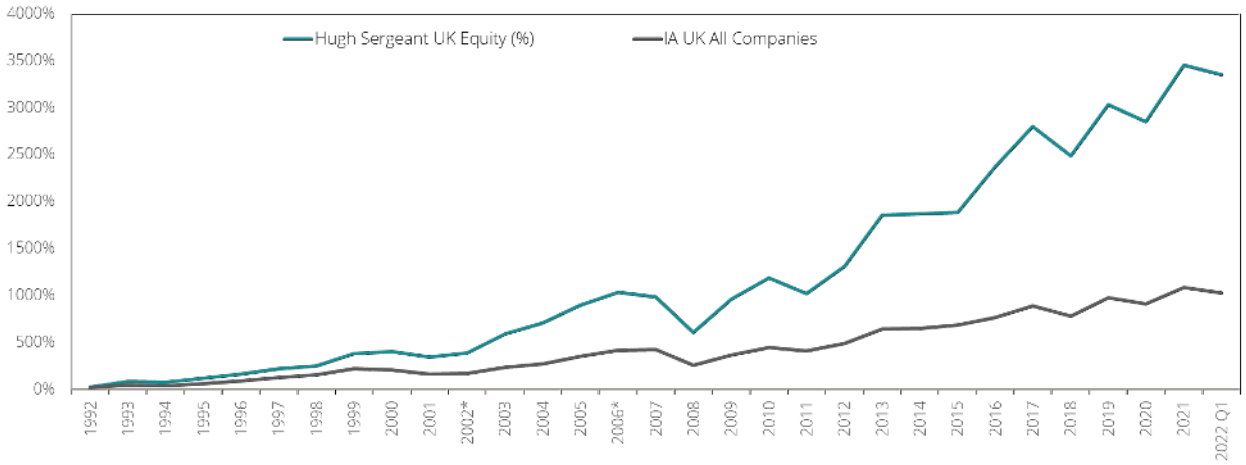


Source: Bloomberg

Source: Bloomberg

Our (High) Alpha and Recovery approaches

We invest in companies with Potential, Valuation and Timing and have a strong portfolio construction commitment to attractively valued companies, to good businesses with recovery potential, to multi-cap investment opportunities, 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 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. Below is my 30 year quite high returns for my UK High Alpha product:



*Notes: The ES R&M UK Equity High Alpha Fund was launched on 28.11.2006. Performance since that date is sourced from River and Mercantile Asset Management LLP. Performance for the IA UK All Companies sector average is sourced from FE fundinfo. Source for other data: The WM Company, Lipper Hindsight. 1992 to 2001 = segregated account with FTSE All-Share Index +2% target, managed by Hugh during his time at PDFM/UBS. 2003 to 2005 = The SocGen UK Growth Fund, managed by Hugh at his time at SG Asset Management. Performance is not shown for Q1 to Q3 for 2002 and most of 2006 as Hugh was on gardening leave due to moves to SGAM and R&M, respectively. *N.B The 2002 return is Q4 2002 (30.09.2002 to 31.12.2002) and the 2006 return is from 31.12.2005 to 31.03.2006 and 28.11.2006 to 31.12.2006. Returns are calculated gross of fees using close of business prices for Hugh Sergeant's UK Equity track record. The IA UK All Companies sector is an average taken of the entire sector which is therefore a mixture of fund share classes that are both net and gross of fees and have been calculated using noon prices. Data to 31 March 2022, cumulative. **The value of investments and any income generated may go down as well as up and is not guaranteed. An investor may not get back the amount originally invested. Past performance is not a guide to future performance.***

Value outperformance or a flight to safety

Of the key factors that we have looked to exploit over the last 30 years, only one has really worked this year. We buy Value, Recovery, Multi-Cap, out-of-favour structural growers and like regions around the world that are good value versus their history and are earlier in their stockmarket cycle. Over the last six months, the first worked, all the rest did not. In fact, what actually worked was protection against higher inflation (until the end of May) and higher economic uncertainty, so large cap energy and defensive stocks. Anything with uncertainty, got clobbered, though of course the worst uncertainty was under-delivery of a growth narrative.

UK Cyclicals vs Defensives 1m Forward Price to Earnings

Source: Morgan Stanley

A new British PM

Whatever your view on Brexit it was voted for and Boris delivered it. He also had a reasonable Covid (apart from not being able to stick to his own rules). However, he was not a competent manager and his Cabinet were weak because of the need to be surrounded by Brexiteers or BoJo supporters. I think this is a good time for change. I would be comfortable with either of the current front runners, Rishi Sunak or Penny Mordaunt. The former is articulate and competent, the latter less proven but if you read her book Greater: Britain After the Storm, she seems to understand this country, its strengths and weaknesses and she might have the most insightful reform agenda. It is likely that the Cabinet after Boris will be considerably stronger as it should be able to appoint the best, rather than the cheerleaders. And it should finally be able to move on from the politics of Brexit and actually focus on extracting the benefits and making our country properly competitive again.

River Strategy and the PVT Platform

With the completion of R&M's acquisition by AssetCo, there is now certainty regarding the ownership of our business and also our investment management team. We have spent fifteen years building a robust PVT equities platform that has created significant wealth for our end clients. We strongly believe in our platform, our team and everyone at River and Mercantile that makes this possible. We now have the opportunity to drive the business forward with a clear strategic vision and an eye on the medium to long-term investment and commercial opportunities. Over the last few years, we have invested in and broadened out the team and product set so that a younger generation of investors are as important as us oldies. We now have strong products in UK Multi-Cap, UK Smaller Companies, Income (now led by Matt Hudson), Value and Recovery, Global, Europe, S-PVT (now launched) and working more closely with the other investment experts under the AssetCo umbrella. Over time we should be a lot bigger than we are today.

My Products and team leadership

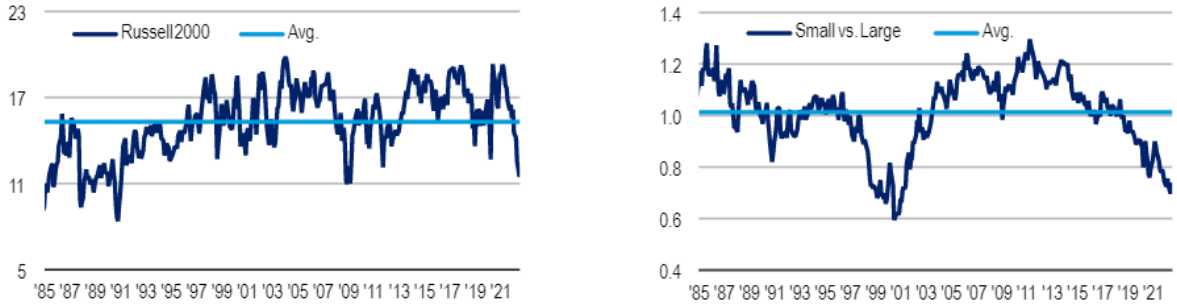
It is really exciting to see James Sym taking on the Equities leadership role; a young and talented investor and manager ready to drive the PVT platform forward. It was also exciting for Will Lough and George Ensor to be made Partners of River and Mercantile LLP and to see the successful launch of our European Change for Better and Global Sustainable Opportunities funds (SFDR 9 and 8 respectively). With Will Lough taking a leadership role in the non-recovery global portfolios, I am now very focused on my UK High Alpha/Recovery and Global Recovery funds. These I have managed for between 10 and 30 years, from inception. As I have suggested above this job has not become easier but during the difficult times, I always have the passion and excitement of finding anomalously valued PVT stock picks to fall back on.

Smaller Companies

Smaller companies peaked at the end of Q1 last year and have fallen over 30% in real terms since this peak. This has created some really great opportunities in smaller companies around the world.

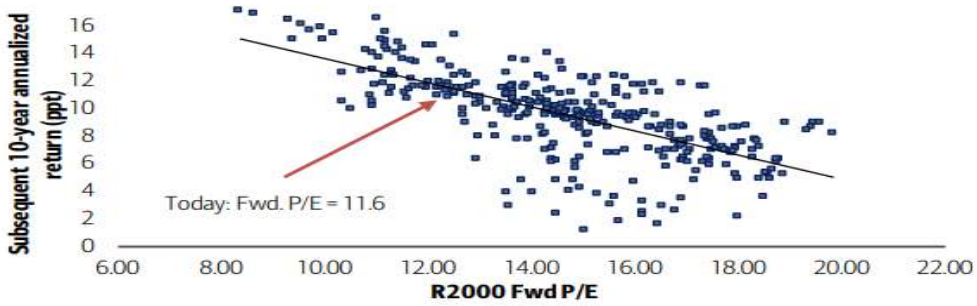
First in the US, where the Russell 2000 has fallen to 2008/9 lows in absolute valuation terms and a very big discount to larger companies; the third graph below plots the ten year returns to US small cap depending on starting valuations, a reassuring message both for US small cap and our portfolio in general with 10x earnings having driven double digit compounding in the past.

Russell 2000 forward PE, absolute and relative to larger companies:



Source: Morgan Stanley

Russell 2000 forward PE vs subsequent ten-year annualised returns:



Source: Bank of America

Now UK Smaller Companies (thanks to George Ensor)

We always like to talk about the 'Small Cap Premium' which is the historic 3-4% return premium (Charts 1 and 2) that has been realised from investing in smaller companies given (i) their higher growth rates (on average they are less mature companies) and (ii) that they are more frequent beneficiaries of M&A.

UK smaller companies have underperformed by 21% over the last 12 months – charts 3&4 put this move into context vs. the last five and twenty-five years. We need to go back to 2007/08 for a more significant drawdown (c.24%). There are a few things at play – exposure to energy, materials and banks (short duration, getting upgrades) probably being the most significant (much higher exposure in large cap); the Small Cap domestic bias is higher (everyone hates the UK), and liquidity / risk aversion is also a feature.

Chart 1: Annualised premium, 2000-22 (%)

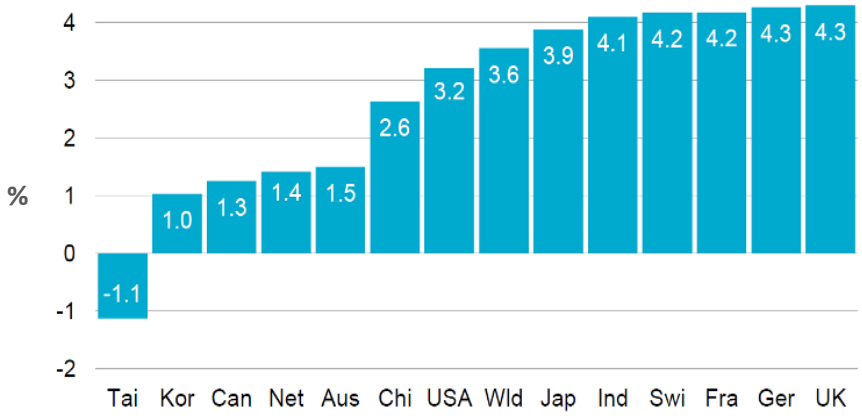


Chart 2: Cumulative return, 1955-2021 (all the equity indices are XIC)

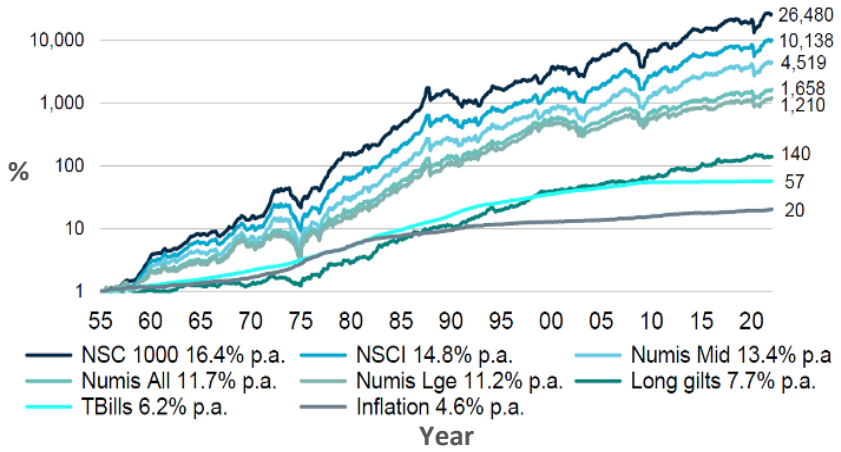


Chart 3: UK Large vs Small & Mid Caps Price Performance

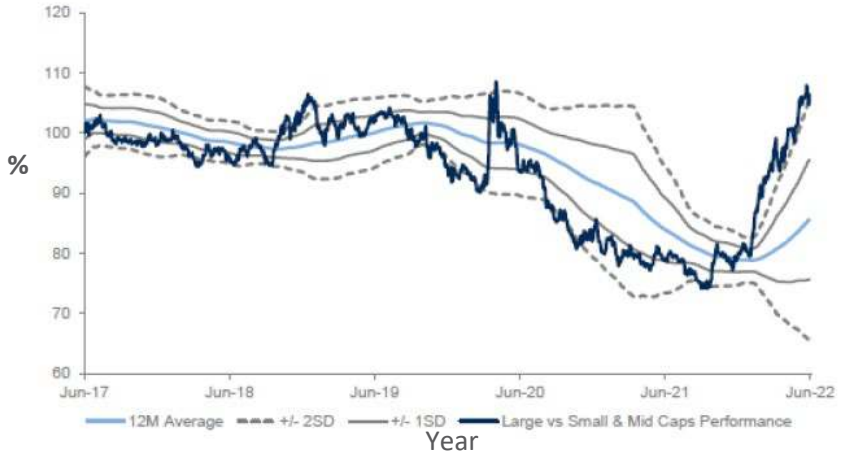
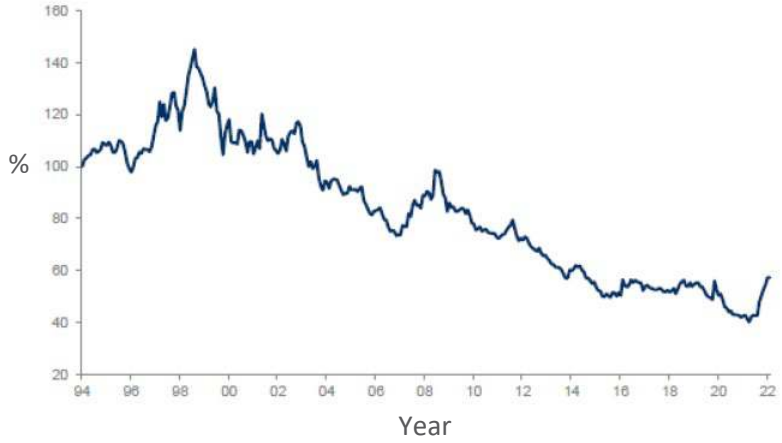


Chart 4: UK Large vs Small & Mid Caps Price Performance



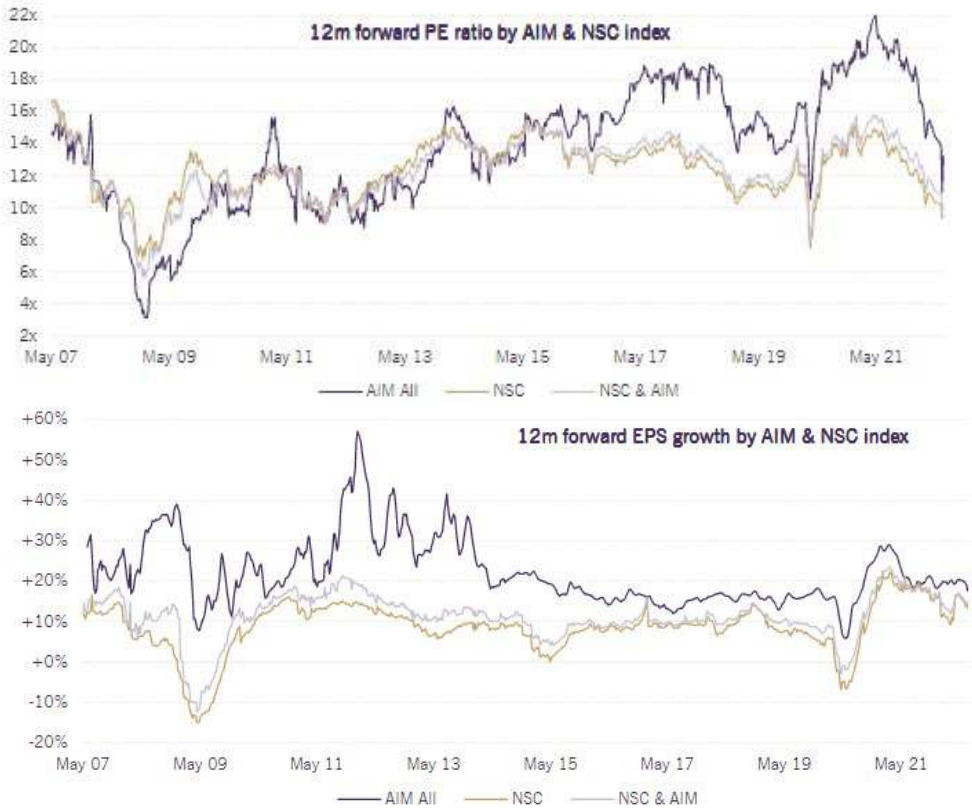
Source: Charts 1 & 2 Numis Indices 2022: Annual Review.

Charts 3 & 4 MSCI, IBES, Morgan Stanley Research. Data to 6 June 2022.

Valuations UK Smaller Companies:

The first chart below from Peel Hunt shows the 1 year forward PE multiple of the small cap benchmark (Numis Smaller Companies plus AIM which is the bottom 10% of UK listed companies) – at 10.2x. The

benchmark has rarely traded more cheaply in the last 15 years and has only done so in periods of extreme stress (GFC, European Debt Crisis and Covid19). It is important to think about earnings expectations which are shown on the second chart below – 12M forward earnings expectations sit at 13.2 % for our benchmark (Numis Smaller Companies plus AIM (excluding investment companies)) which has come down from c.20% at the start of the year and likely have further to fall. We will see to what extent as companies start to provide trading updates for the first half of 2022. The market will likely be ahead of the stabilisation in earnings (as it has been the downgrades).

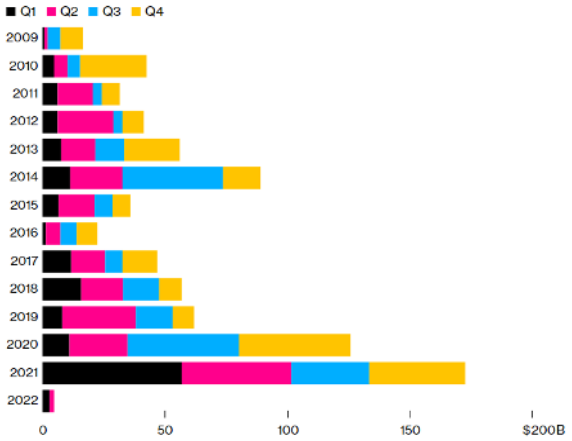


Source: Peel Hunt E&S: UK Market Valuations 27 June 2022

Animal Spirits – from feast to famine

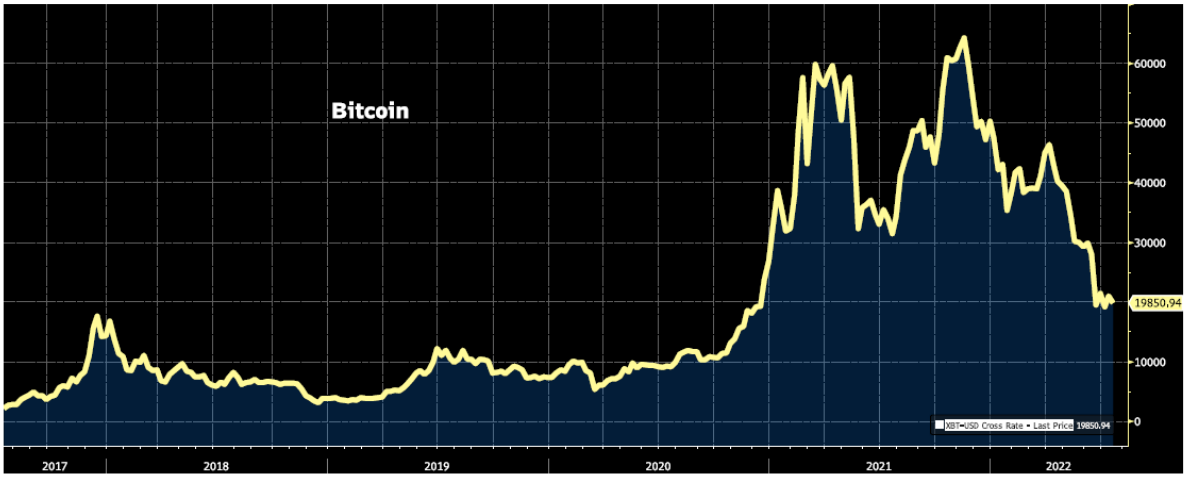
One of our gauges of where we are in the stockmarket cycle are animal spirits, well represented by a few charts:

US IPO Volumes have collapsed:



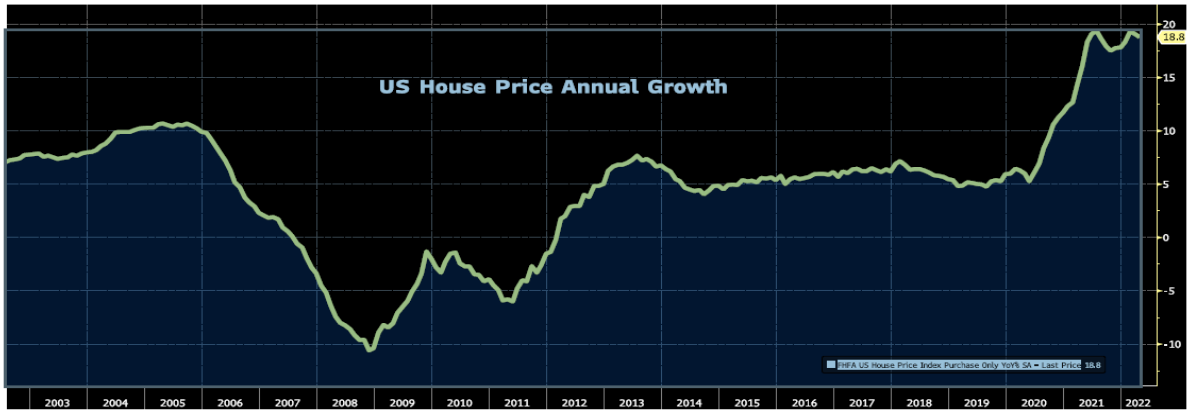
Source: Bloomberg

Bitcoin price has collapsed:



Source: Bloomberg

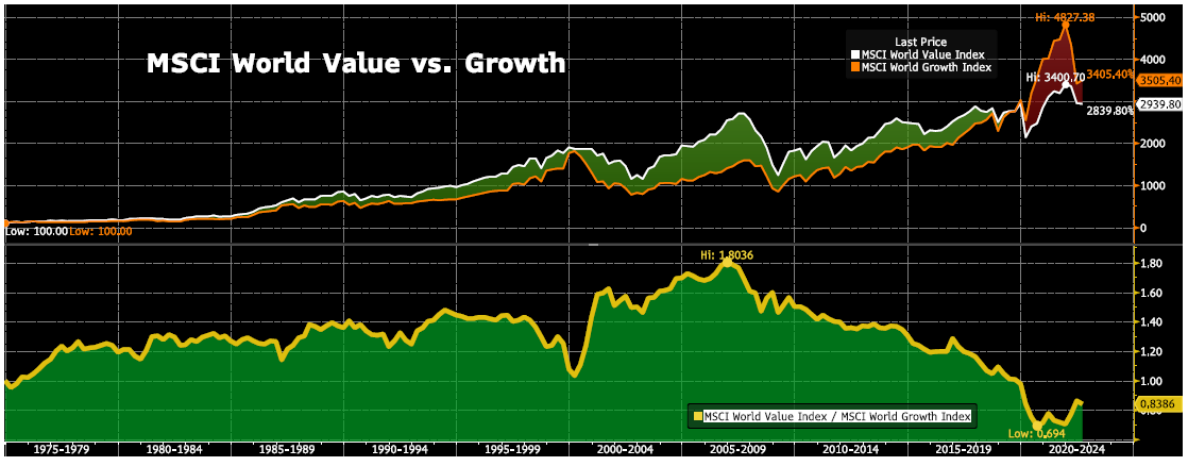
US House Price Growth are peaking, a lagging indicator which as in the UK will head to zero:



Source: Bloomberg

Value & Recovery – still towards the bottom of the cycle, especially if running a genuine global portfolio

MSCI World Value vs. Growth – rallied off the bottom of the cycle:



Source: Bloomberg

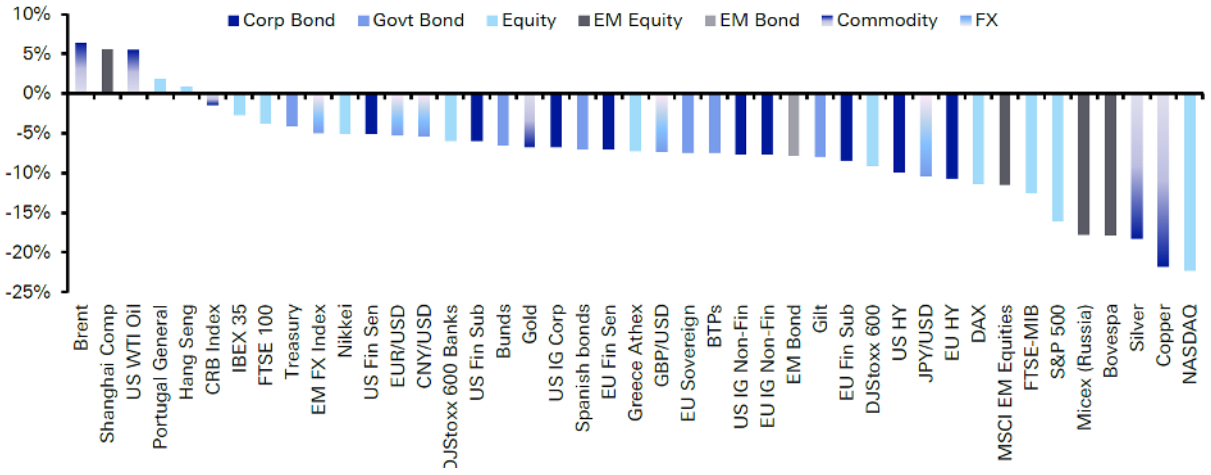
MSCI World value vs US Equities (S&P) – still at the bottom of the cycle, one reason why we have lagged the value rally as the Rest of the World has struggled:

Source: Bloomberg

Market returns and our performance

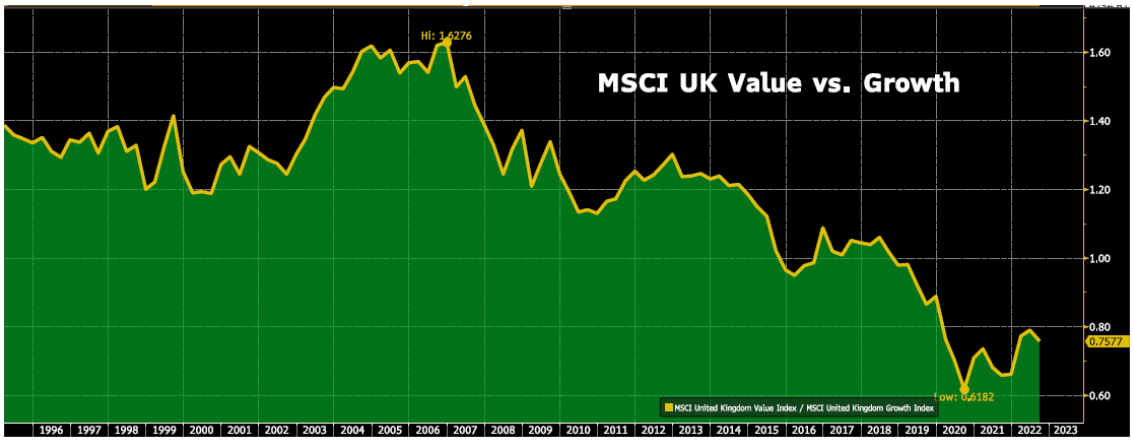
Global equity markets fell sharply in the second quarter (MSCI ACWI -15.7% total return in USD), completing the worst calendar first-half since the 1970s. The same was true for US Treasuries – there have been few places for investors to hide these past six months. Market focus maintained its shift from high inflation towards softer growth. Citi's global economic surprise indicator continues to signal that data is disappointing expectations. Expectations of demands destruction have led to flattening yield curves and inflation expectations continuing May's fall from the peak, the latter helped by a sharp fall in commodity prices. Following more downbeat corporate guidance, the breadth of analyst earnings downgrades has begun to increase. Low volatility as an equity factor has just delivered its best 6-month relative return since 2009. With yield spreads rising to 5-year highs and the dollar rising again the predominant investor stance is evidently risk aversion. In this context, we note with some interest that share prices in several sectors considered economic lead indicators by the great macro investor Stanley Druckenmiller – Trucking, Homebuilding and Retail – have begun to bottom out and outperform the broader benchmark. Whilst UK Equities were under pressure they were again relative outperformers, the MSCI United Kingdom IMI Index returning -4.5%. The median UK share fell a lot more than this, the MSCI UK Small Cap Index falling -12.1% and now down -22.5% for the year to date.

Total Return of Financial Assets in Q2 2022 (local currency)



Source: Deutsche Bank

Value continued to be robust early in the quarter but then rolled over as markets worried about the extent of the economic downturn, this hitting inflation hedge value; as in the first quarter value was a mixed bunch, consumer and industrial exposed value continued to be very weak, whilst only defensive value remained robust throughout the quarter; value within smaller companies lagged large cap value by a wide margin; large cap value in the US remained stronger than elsewhere.



Source: Bloomberg

Our other key factors, namely recovery, multi-cap, out-of-favour growth and regional diversification were all quite weak and for global portfolios we are underweight the strong USD, despite having some hedging in place. Smaller companies in particular have been weak recently, pretty well all around the world, including the UK which has seen over a year of selling pressure.

The Fund's performance during the quarter was weak in absolute terms and modest in relative terms, but remains robust compared to our peer multi-cap fund managers.

The ES R&M UK Equity High Alpha Fund returned -7.4% (gross of fees, Z share class) and -7.5% (net of fees, B share class), an underperformance versus the MSCI UK IMI of 2.9%.

Despite having put quite a lot of capital into more defensive shares over the last year, we are rarely that well placed when equity markets move to discount recession, essentially where we have been transitioning to over the last few months. Inflation hedges such as commodity producers moved to price in an economic downturn rather than continued inflation; value stocks had a correction, cyclical recovery stocks were very weak with the majority of consumer stocks now retracing the lows they fell to during the first wave of Covid, small and mid-cap companies underperformed. All of the above moves are acting as a drag on our performance at the moment, of course setting up a very strong recovery wave when economic fears bottom-out.

Our performance versus value? We have covered quite a lot of this already, but just to confirm. When there is a return to Value we normally fully participate. This time around we have lagged for three reasons: firstly we run multi-cap funds and the small and mid-cap stocks have significantly underperformed, including value SMIDs (note for example the MSCI UK Smaller Companies Index is down -22.5% this year); secondly we have been pro-cyclical as we looked to exploit the recovery post Covid re-opening, including an overweight Consumer stocks – this positioning has not worked as the market has moved to discount a recession associated with monetary tightening; thirdly only part of the Value universe has worked, inflation hedge value (which we are overweight) and defensive value (where we added last year but are not overweight), meanwhile economically sensitive value has really struggled.

Our medium- and long-term returns remain robust, especially in the context of a value headwind over much of this period. Over three years the Fund has returned +4.8% p.a. (Z shares) and +4.1% p.a. (B shares) versus +2.1% for the benchmark; over five years the Fund has returned +4.5% p.a. (Z shares)

and +3.7% p.a. (B shares) versus +3.1% p.a. for the benchmark; over ten years the Fund has returned +10.6% p.a. (Z shares) and +9.8% (B shares) versus +6.6% p.a. for the index, and since inception the B shares have returned +11.1% p.a., 2.6% 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 30-year track record continues to annualise at over 4% p.a. ahead of the index.

Key performance contributors

Positive contributors during the quarter: US interest rate sensitives performed well (Standard Chartered), underweight US exposed growth stocks (Ashtead); individual stock successes (Renold, Savannah Energy).

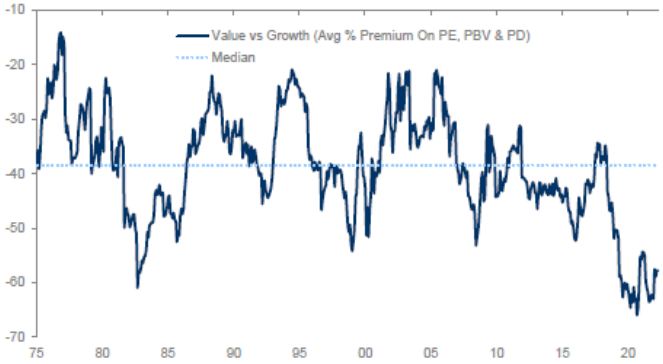
Negative contributors: Overweight smaller companies, underweight mega cap; large cap defensive growth strong (AstraZeneca); consumer cyclicals, industrials and financials weak; individual stock disappointments (ASOS).

Some key charts that support our outlook

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

Source: Morgan Stanley Research

UK Value vs. Growth Average Valuation Premium



Source: Morgan Stanley Research

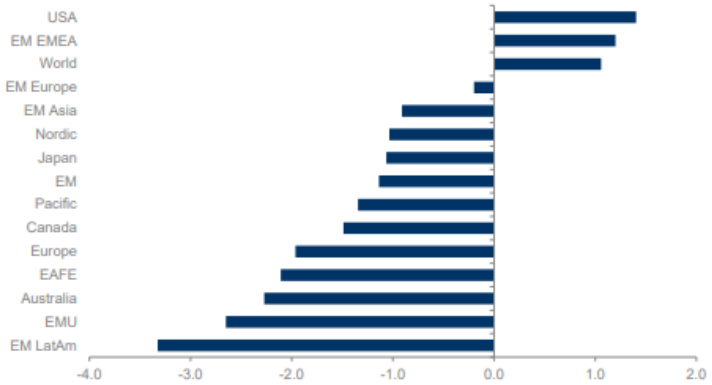
Some equity markets look quite expensive in absolute terms and relative to history, but many now look reasonable value. In simple terms it remains US equities (higher valuation, but attractive historic growth) versus the rest of the world (RoW) (often low valuations, but need global economic recovery to generate growth); the UK market continues to look attractive on this measure:

Shiller PEs around the world

Source: Morgan Stanley Research

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

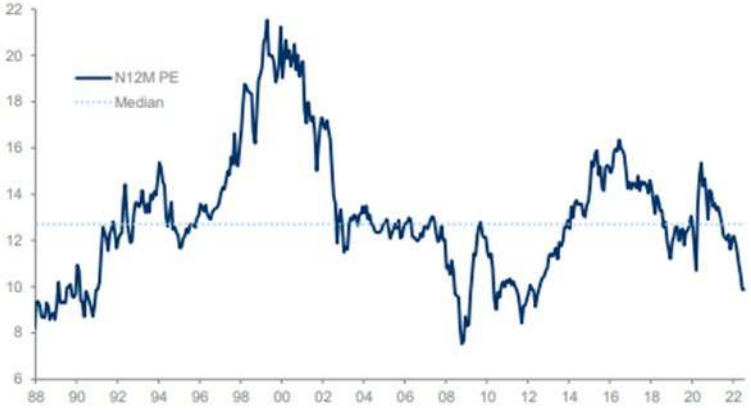
Regional Average Relative Valuations 10-year Z-Score



Source: Morgan Stanley Research

The UK continues to have stand out valuations, good value from an absolute value perspective (prospective PE of less than 10x, a discount to its 10-year history), and rarely been cheaper on a relative basis.

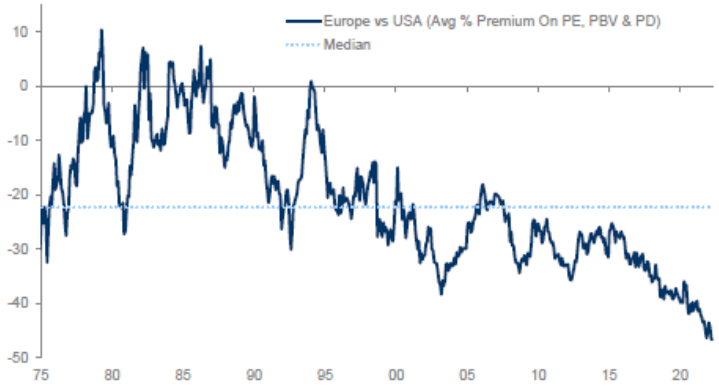
MSCI UK – 12m forward price to earnings



Source: Morgan Stanley Research

And the EU large discount to the US has opened up again following the Putin related set-back and greater exposure to economic risks:

Europe vs USA Average Valuation Premium



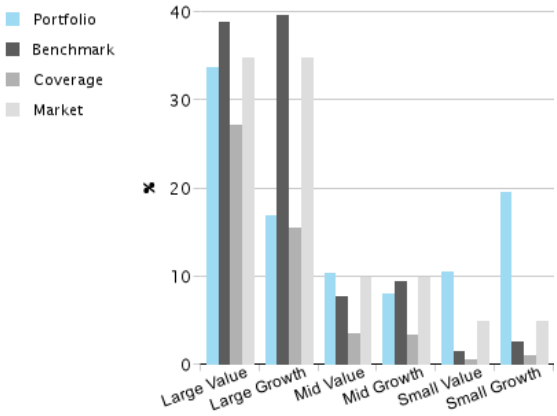
Source: Morgan Stanley Research

Activity and Positioning

We continue to position the portfolio for Value, Recovery, Multi-Cap investing, for deeply out-of-favour structural growers and quality stocks. The latter have made up a greater proportion of activity last quarter with quite a few SMID quality compounders having been de-rated due to fears about an economic downturn and lots of panic selling.

The portfolio's value characteristics have become even more committed over the quarter; as explained above most of our shares are really, really cheap, the portfolio trades on around 10x earnings for 2022, a 1.2x price to book valuation, 0.9x price to sales and high single digit normalised cashflow yields. There is a robust multi-cap bias.

Portfolio allocation to Value and Growth stocks by size and versus benchmark (StyleAnalytics), big exposure to large, mid and small Value, big underweight large growth, focus of growth is undiscovered and out-of-favour small cap though some of the overweight small cap growth is in value stocks, such as ***Harbour Energy*** *that have strong profits momentum:*



Source: StyleAnalytics

Looking at activity in the component parts of the portfolio, we were neutral regarding our activity in large cap deeper value stocks, only really adding to Tesco. This following a significant allocation of capital to this area over the previous two quarters. Our focus (not deliberate, just catalysed by share price corrections) during the quarter was adding to our exposure to medium term quality or growth compounders that have become recovery stocks because they are seen as exposed to the economic downturn and because forced sellers (as capital flowed out of SMID cap funds) created recovery type valuation anomalies. These included significantly adding to our IMI and Moonpig positions (more detail below) and buying initial positions in Ashtead, Intertek, Liontrust, Gamma Communications, JD Sports, Maxcyte, Dr Martens and Sigmaroc. We added to high scoring *MoneyPenny* recovery stocks such as RHI

Magnesita, AB Foods, Vistry and Marks and Spencer. UK domestic stocks, such as Berkeley Group, Royal Mail and MJ Gleeson, have continued to be very weak - we have slowly added to them. To our detriment we remain overweight (and have been adding on continued weakness) stocks that have benefitted (apart from their share prices) from a post-Covid world, including Restaurant Group, Hostelworld and Whitbread, all of which trade at or close to absolute lows achieved when they had no business during the first waves of Covid-19. We continued to add to our S-PVT focused holdings many of which have joined in the worried about the recession sell-off, including adding to SIG (leading insulation product distributor, also a classic recovery stock) and buying Impax. I have become increasingly interested in Real Estate stocks, starting with the UK but looking for opportunities elsewhere. They have sold off quite aggressively during the latest bout of big picture worries. This has left stocks such as British Land and Capital & Counties trading at material discounts to NAV despite their strong inflation hedge credentials and their robust recent fundamentals. London seems to be back to its vibrant and busy self, with strong foot fall and activity, positive for both these property companies which nevertheless have seen their share prices fall significantly. We have continued to add to the sector, taking a new position in Great Portland Estates. Lastly, we continue to think about strategic value, especially at this time of huge anomalies for M&A activity to exploit, adding to Burberry, ITV and Tate & Lyle, the former being far more valuable to its much larger global peers than the current share price discounts.

Sales have included taking full profits where our PVT thesis has been delivered, most notably the continued recipients of M&A activity (Biffa, Schroders (conversion of non-voters), Mediclinic, Euromoney), taking some profits in energy stocks following a strong run (Serica, Harbour, Hunting); reducing into relative strength (Smart Metering, Pendragon), and re-focusing capital towards higher conviction ideas (Avon Protection). We also quite aggressively reduced Standard Chartered, not because we don't like the story but if short term US interest rate expectations peak then the narrative will weaken. Yes (to answer your question), we are being a bit more tactical in this short sentiment cycle market.

More detail on a couple of high conviction stocks:

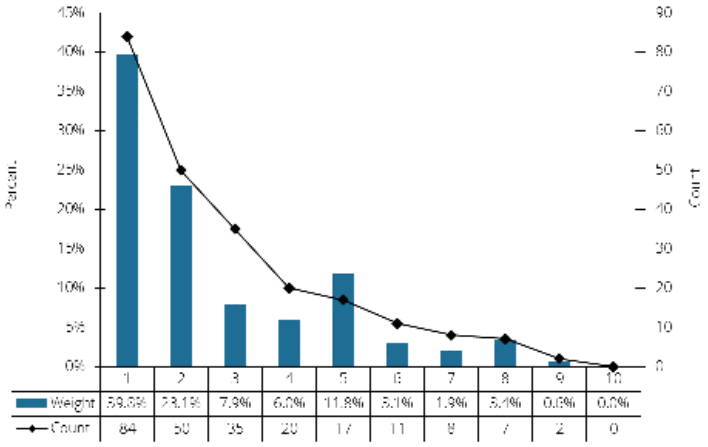
IMI's (2nd decile *Quality*, S-PVT 2) products and services control motion and fluids in mission critical applications in niche markets. Following a period of underinvestment and overearning that prioritised returns at the expense of growth, new management launched a strategy refresh in 2019 focused on the putting the customer first, reducing business complexity and driving market-led innovation. Initial evidence points to this strategy augmenting groups through cycle growth and returns potential, however the market appears to discount the recent improvement in financial performance as cyclical rather than structural and is now concerned about the impact of the current economic slowdown. This provides the opportunity to build up a meaningful position in a newly discovered quality compounder on a very modest valuation, only 11x PE and a 6% free cash flow yield.

Moonpig (1st decile *Quality*, S-PVT 1) is the dominant online greeting card retailer in the UK and Netherlands. Since IPO a couple of years ago, it has delivered robust growth but has recently been hugely derated as the benefits of Covid (to its online business model) rolled over and it got caught up in the flood of capital out of UK SMIDs (shares halved this year). This has left the valuation on a modest 15x earnings with our analyst valuing it at over 100% premium to the current share price. They have a relatively modest c10% of the UK card market, this will continue to grow as will the take-up of gifts that are bought alongside cards. Revenue, profits and cash flow will grow robustly as a result. In a normal (non-Covid rollover) year it would not be cyclical.

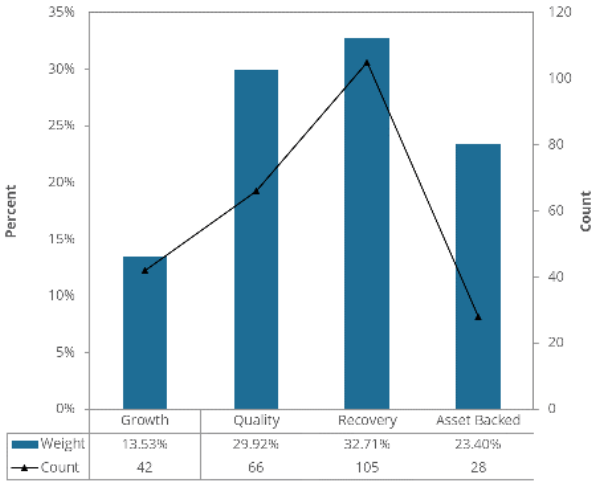
Are we following our PVT and S-PVT Philosophy & Process and a consistently articulated style and factor bias?

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

Decile skew to 30 June 2022:



Category skew to 30 June 2022:



Source: River and Mercantile Asset Management LLP

Outlook

As I have articulated above, the big picture is confusing for most investors at the moment so for me, the current focus is the huge bottom-up stock picking opportunities where this portfolio, and indeed all three portfolios that I run, are extremely lowly priced and have strong medium term shareholder value growth potential. It is a portfolio that should create significant wealth over the medium term and should not lose permanent capital for patient investors.

In the short term it is difficult to say; perhaps the current fearful consensus is right and stagflation impacts and economic uncertainty will prevent good value shares from rising in price; or perhaps the worries are consensual enough, having created such deeply discounted share prices for consumer and industrial cyclicals (for example) that any abating of inflationary fears will lead to a quick shift in the narrative that will allow our lowly valued stocks to rebound vigorously.

Meanwhile our key factors - Value, Recovery, Multi-Cap, out-of-favour Growth and value based regional allocation - are all at, or close to the low point of their cycles. There is a lot of potential performance in this portfolio.

Thank you, as ever for your support and patience.

Hugh Sergeant
Head of Value and Recovery strategies

July 2022

FUND HOLDINGS AND PORTFOLIO WEIGHT

Holding	Weight (%)
Shell	4.52
BP	4.51
AstraZeneca	4.00
HSBC Holdings	3.84
Unilever	3.22
Rio Tinto	2.74
British American Tobacco	2.53
Lloyds Bank	2.15
Vodafone	2.01
Barclays	1.98
Prudential	1.95
Anglo American	1.88
Natwest Group	1.47
Glencore	1.37
Standard Chartered	1.32
Imperial Brands	1.24
BT	1.11
GlaxoSmithKline	0.97
Somero Enterprises	0.86
Centrica	0.68
Harbour Energy	0.65
Smith & Nephew	0.65
Reckitt Benckiser	0.62
Legal & General	0.60
Capital & Counties	0.56
Diageo	0.56
Compass Group	0.55
Associated British Foods	0.53
Taylor Wimpey	0.52
Berkeley Gp Hldgs	0.49
Whitbread	0.49
The Restaurant Group	0.48
Vistry Group	0.48
Antofagasta	0.47
Johnson Matthey	0.47
Coats	0.46
Old Mutual	0.45
Mercia Asset Management	0.45
SSP Group	0.44
Savannah Energy	0.44
RHI Magnesita	0.44
Gresham House	0.43
Sage	0.43
Marks & Spencer	0.42
Enquest	0.42
Ebiquity	0.42
Renold	0.41
Aviva	0.41
Fidelity China Special	0.41
Int'l Cons. Airlines	0.41
Moonpig	0.41
IMI	0.40
Burberry Group	0.40
Secure Trust Bank	0.40
British Land	0.39
Central Asia Metals	0.39
Ocean Wilson Holdings	0.39
Essentra	0.39
Serco	0.39
Easyjet	0.39
Rolls-Royce	0.37
Volex	0.36
Melrose Industries	0.36
Bank of Ireland	0.36
Tullow Oil	0.36
John Wood Group	0.36
Hiscox	0.35
Wickes	0.35
Centaur Media	0.35
Premier Miton Group	0.35

Holding	Weight (%)
Reach	0.35
Renewi	0.35
Serica Energy	0.34
WPP	0.34
Next	0.34
Mediclinic International	0.34
Tate & Lyle	0.34
Elementis	0.34
Hargreaves Lansdown	0.34
Gresham House Strategic	0.33
CRH	0.33
Capita	0.33
Close Brothers	0.32
Vesuvius	0.32
Virgin Money	0.32
Devro	0.32
The Weir Group	0.31
Provident Financial	0.31
MPAC Group	0.31
GVC Holdings	0.31
Dart Group	0.31
TP ICAP	0.31
Pearson	0.31
ITV	0.31
Centamin	0.31
WH Smith	0.30
Indivior	0.30
Crest Nicholson Holdings	0.30
Flutter Entertainment	0.30
SIG	0.30
First Derivatives	0.29
Strix	0.28
Liontrust Asset Mgmt.	0.28
Tremor International	0.28
XLMedia	0.28
DFS Furniture	0.28
ULS Technology	0.28
Workspace	0.28
Hunting	0.28
A.G.Barr	0.27
Eckoh	0.27
Beazley	0.27
Shaftesbury	0.27
NCC Group	0.27
Boku	0.27
ASOS Holdings	0.26
Xaar	0.26
Victrex	0.26
Iomart Group	0.26
Foxtons Group	0.26
Int'l Personal Finance	0.25
Ricardo	0.25
Hostelworld Group	0.25
Capital Limited	0.25
Fresnillo	0.25
Informa	0.24
Trainline	0.24
Card Factory	0.24
RPS Group	0.24
Dr. Martens	0.23
RWS Holdings	0.23
Grainger	0.23
Science In Sport	0.23
Ibstock	0.23
888 Holdings	0.23
Dixons Carphone	0.22
Smart Metering Systems	0.22
IQE	0.22
Carnival	0.22
TT Electronics	0.22

Holding	Weight (%)
Ascential	0.22
Saga	0.21
PZ Cussons	0.21
Rangers International FC	0.21
Bango	0.21
Nichols	0.21
Great Portland Estates	0.21
Rotork	0.21
Pebble Group	0.21
Kin and Carta	0.20
Intertek Group	0.20
Speedy Hire	0.20
Moneysupermarket.com	0.20
IG Holdings	0.20
Learning Technologies	0.19
Severfield-Rowen	0.19
Just Eat Takeaway	0.19
Superdry	0.19
On the Beach Group	0.19
Everyman Media Group	0.19
Breedon Group	0.19
JD Wetherspoon	0.19
Ashtead	0.19
Tesco	0.18
Johnson Service	0.18
ConvaTec Group	0.18
Tribal	0.18
Cake Box Holdings	0.17
The Gym Group	0.17
Mondi	0.17
Standard Life Aberdeen	0.17
JD Sports Fashion	0.17
Ted Baker	0.17
Petrofac Limited	0.16
Senior	0.16
Costain Group	0.16
Trifast	0.16
Smiths News	0.16
Tyman	0.16
De La Rue	0.16
Mitie	0.15
Royal Mail	0.15
Inspired Energy	0.15
Hyve Group	0.15
DP Eurasia	0.14
Flowtech Fluidpower	0.14
Mortgage Advice Bureau	0.14
Schroder UK Public Private	0.14
Bodycote	0.14
Cenkos Securities	0.14
TI Automotives	0.14
Kier	0.14
Gamma Communications	0.14
Mind Gym	0.14
Intermediate Capital Group	0.14
Benchmark Holdings	0.13
MJ Gleeson	0.13
Drax	0.13
eEnergy Group	0.13
South32	0.12
Cairn Homes	0.12
Topps Tiles	0.12
Team17 Group	0.12
Carclo	0.12
IP Group	0.11
ADVFN	0.11
Ashmore Group	0.11
Persimmon	0.11
Cranswick	0.10
Helical	0.10

Source: River and Mercantile Asset Management LLP

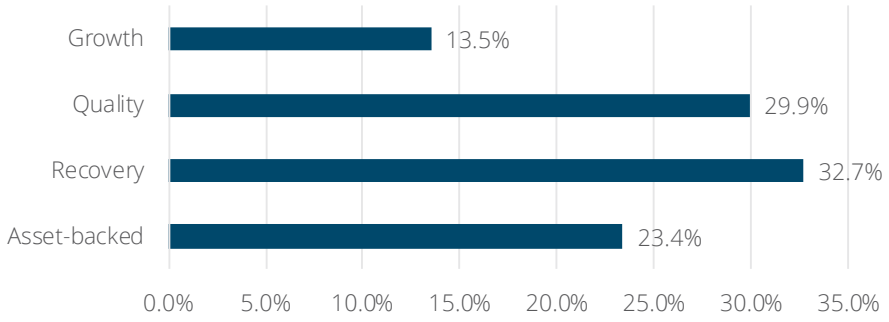
FUND HOLDINGS AND PORTFOLIO WEIGHT (CONTINUED)

Holding	Weight (%)
Spirax-Sarco Engineering	0.10
Impax Asset Management	0.10
Auto Trader	0.10
MaxCyte	0.10
Future	0.10
PageGroup	0.09
Morgan Advanced Materials	0.09
Grafton Group	0.09
Sigmaroc	0.09
James Fisher & Sons	0.09
OPG Power Ventures	0.07
Norcros	0.07
Joules	0.07
Kingspan Group	0.06
Kingfisher	0.05
Foresight Group	0.05
Balfour Beatty	0.05
Dunelm	0.05
Polar Capital	0.05
Trustpilot	0.05
B&M	0.05
Synthomer	0.05
S4 Capital	0.05
Keller	0.05
Conduit Holdings	0.05
DS Smith	0.05
Petra Diamonds	0.04
Intl Biotechnology Trust	0.04
Cairn Energy	0.04
Zotefoams	0.03
Travis Perkins	0.03
Candover Investments	0.00
Cash	0.45
Total	**100.00**

Source: River and Mercantile Asset Management LLP

PVT CATEGORIES OF POTENTIAL

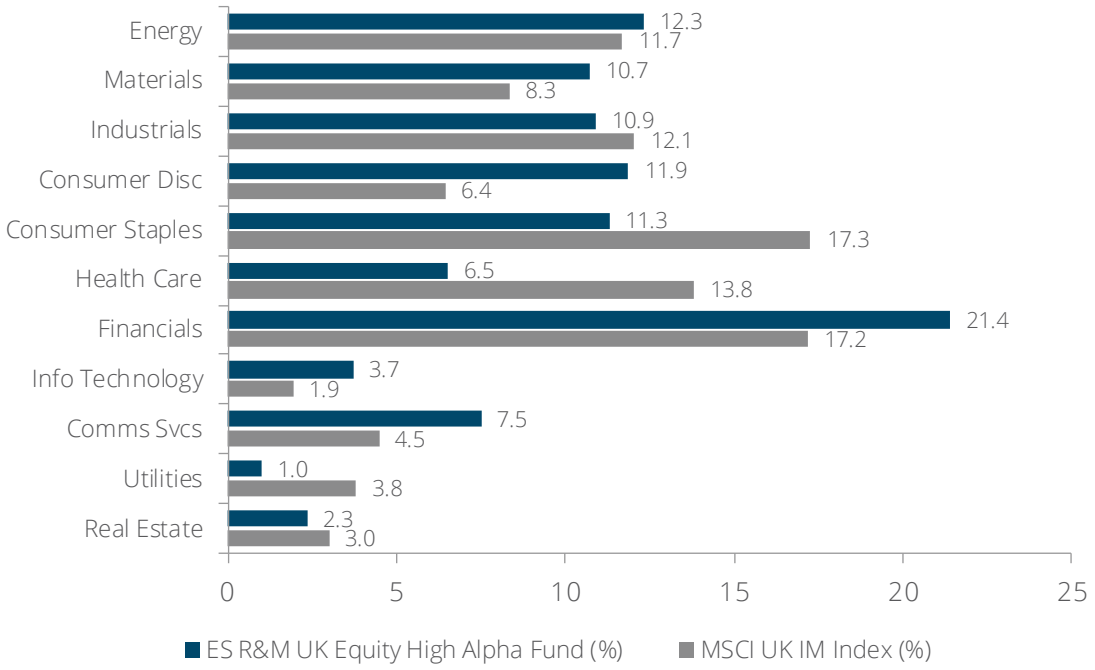
This chart shows the weighting of the fund's holdings across the four categories of Potential, related to the stages of a company's life cycle, as defined within the R&M investment philosophy known as 'PVT' – Potential, Valuation, Timing.



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

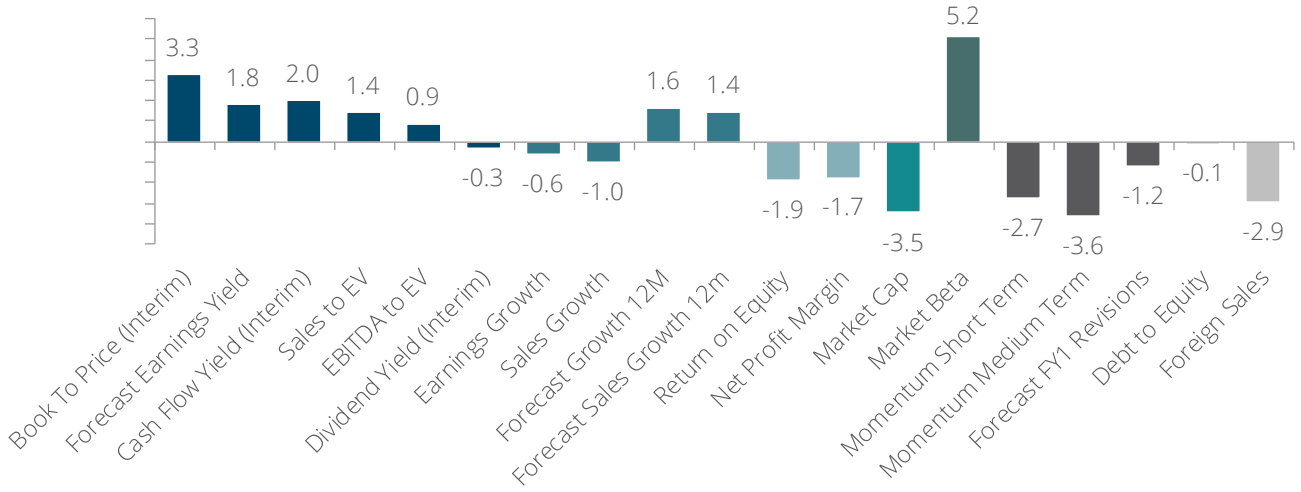
This table shows a comparison of fund and benchmark weightings across a range of company values

		Fund	Benchmark	Active
Mega Cap	£20bn +	41.2%	64.9%	-23.7%
Large Cap	£4bn - £20bn	15.0%	20.5%	-5.5%
Mid Cap	£2bn - £4bn	7.9%	6.7%	1.2%
Small Cap	£100m - £2bn	31.0%	7.9%	23.1%
Micro Cap	£0m - £100m	4.5%	0.0%	4.5%

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

TOP 10 ACTIVE POSITIONS VS THE BENCHMARK

This table highlights the securities in which the fund weight differs most from that of the benchmark, with the 'overweights' showing 10 securities with the greatest weight difference above the benchmark's position, and the 'underweights' showing 10 securities with the greatest weight difference below the benchmark's position. The difference is known as the 'active weight'.

Overweights	Sector	Fund	% Benchmark	Active
BP	Energy	4.52	3.58	0.94
Natwest Group	Financials	1.47	0.58	0.89
Somero Enterprises	Industrials	0.86	0.00	0.86
Barclays	Financials	1.98	1.21	0.77
Lloyds Bank	Financials	2.16	1.42	0.74
Prudential	Financials	1.95	1.32	0.63
Harbour Energy	Energy	0.65	0.08	0.57
Standard Chartered	Financials	1.32	0.76	0.56
Capital & Counties	Real Estate	0.57	0.05	0.52
BT	Communication Services	1.11	0.61	0.50

Underweights	Sector	Fund	% Benchmark	Active
AstraZeneca	Health Care	4.00	7.91	-3.91
Diageo	Consumer Staples	0.56	3.87	-3.30
GlaxoSmithKline	Health Care	0.98	4.24	-3.27
Shell	Energy	4.53	7.68	-3.15
RELX Group	Industrials	0.00	2.04	-2.04
National Grid	Utilities	0.00	1.81	-1.81
Reckitt Benckiser	Consumer Staples	0.62	2.09	-1.47
HSBC Holdings	Financials	3.85	5.13	-1.28
Unilever	Consumer Staples	3.23	4.51	-1.28
BAE Systems	Industrials	0.00	1.24	-1.24

Source: FactSet

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
Ashtead	-0.72%	0.22%
Standard Chartered	0.80%	0.18%
Segro	-0.64%	0.17%
Experian	-1.10%	0.16%
Diageo	-3.30%	0.14%
Renold	0.37%	0.12%
Savannah Energy	0.42%	0.10%
3i Group	-0.55%	0.08%
Ocado Group	-0.21%	0.08%
Ferguson	-0.96%	0.07%

Greatest Negative Contribution	Average Active Weight	Contribution to Active Return
AstraZeneca	-3.90%	-0.41%
GlaxoSmithKline	-3.10%	-0.36%
BAE Systems	-1.09%	-0.22%
Reach	0.40%	-0.20%
Shell	-3.05%	-0.17%
Unilever	-1.29%	-0.17%
Just Eat Takeaway	0.27%	-0.16%
ASOS Holdings	0.24%	-0.16%
Reckitt Benckiser	-1.41%	-0.16%
British American Tobacco	-1.09%	-0.15%

Source: FactSet

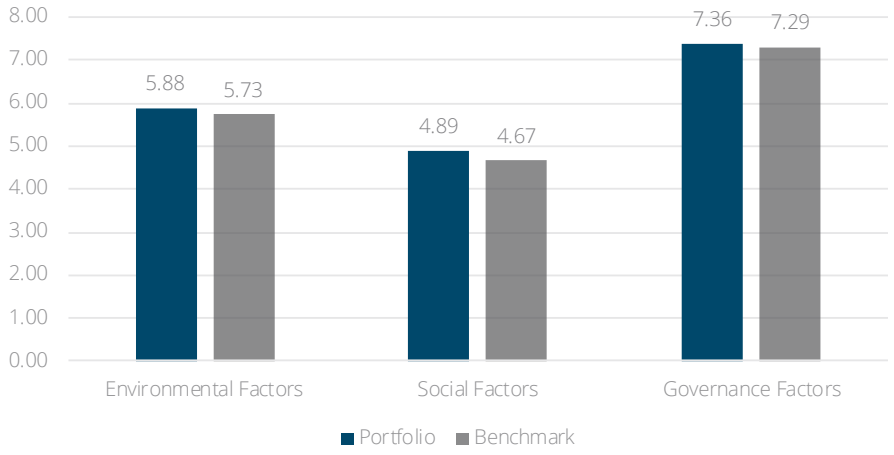
ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) FACTOR ANALYSIS

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	87.7%	99.7%
Assets scoring in the bottom decile	0.0%	0.2%

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
Legal & General	0.6%	0.7%	AAA	10.0
Diageo	0.6%	3.9%	AAA	10.0
Sage	0.4%	0.3%	AAA	10.0
Marks & Spencer	0.4%	0.1%	AAA	10.0
Burberry Group	0.4%	0.3%	AAA	10.0
British Land	0.4%	0.2%	AAA	10.0
CRH	0.3%	0.0%	AAA	10.0
ITV	0.3%	0.1%	AAA	10.0
SIG	0.3%	0.0%	AAA	10.0
Intertek Group	0.2%	0.3%	AAA	10.0

10 lowest rated ESG companies held by fund	Portfolio Weight	Benchmark Weight	Company Rating	Industry Adjusted Score
Carnival	0.2%	0.0%	B	1.7
Premier Miton Group	0.3%	0.0%	B	2.4
Int'l Cons. Airlines	0.4%	0.0%	B	2.8
Bank of Ireland	0.4%	0.0%	BB	2.9
Volex	0.4%	0.0%	BB	3.0
Tremor International	0.3%	0.0%	BB	3.1
SSP Group	0.4%	0.1%	BB	3.2
Hargreaves Lansdown	0.3%	0.1%	BB	3.2
IQE	0.2%	0.0%	BB	3.4
Dixons Carphone	0.2%	0.0%	BB	3.7

Source: MSCI ESG Research, ©2022 MSCI ESG Research LLC. Reproduced by permission.

BROKER COMMISSIONS ANALYSIS

Counterparty	Total (£)	Commission Paid (£)
		Execution Only
ABG SUNDAL COLLIER	0.00	0.00
ATLANTIC SECURITIES	0.00	0.00
BANCO ITAU	0.00	0.00
BARCAP	748,546.27	519.94
BERENBERG	404,309.24	323.47
BofA MERRILL LYNCH	0.00	0.00
BTG PACTUAL	0.00	0.00
CANACCORD ALGO	1,711,001.78	684.42
CANACCORD GENUITY	227,201.17	169.05
CENKOS	16,749.10	13.40
CITI PROG	0.00	0.00
CITIGROUP	143,001.54	91.48
CLSA	0.00	0.00
CREDIT SUISSE	83,390.00	56.20
DEUTSCHE BANK	0.00	0.00
EXANE	121,986.15	73.19
FINNCAP	126,841.10	101.49
GBM	0.00	0.00
GOLDMAN SACHS	0.00	0.00
GOODBODY	0.00	0.00
HSBC	168,670.00	109.65
ING	0.00	0.00
INSTINET	138,905.95	111.12
INVESTEC	1,627,645.27	1,274.26
ITG	130,619.53	78.37
ITG ALGO	0.00	0.00
J&E DAVY	66,249.40	53.01
JANE STREET	0.00	0.00
JEFFERIES	326,475.60	212.09
JEFFERIES ALGO	205,313.57	82.14
JPMORGAN CHASE	534,329.74	414.57
KEPLER CHEUVREUX	56,734.24	36.46
LIBERUM	377,065.31	244.20
LIQUIDNET	1,416,300.58	849.83
MEDIOBANCA	0.00	0.00
MIZUHO	0.00	0.00
MORGAN STANLEY	138,736.81	83.39
NORTHERN TRUST CORP	145,218.00	109.58
NPLUS1 SINGER	762,910.14	610.35
NUMIS	475,229.28	310.02
PANMURE GORDON	261,486.89	209.20
PEEL HUNT	1,866,240.87	1,453.36
RAYMOND JAMES	0.00	0.00
RBC	330,104.36	213.37
RBC ALGO	152,973.56	61.19
REDBURN	0.00	0.00
SANTANDER	0.00	0.00
SHORE CAPITAL	271,924.15	189.35
SOCIETE GENERALE	0.00	0.00
STIFEL EUROPE	65,665.65	52.54
STIFEL NICOLAUS	0.00	0.00
SUSQUEHANNA INTERNATIONAL	0.00	0.00
UBS	214,284.62	171.44
UBS PROG	4,861,539.80	1,945.33
WINTERFLOOD	493,157.94	394.52
FLOWTRADERS	0.00	0.00
CONFIRMED FUND PRICE	0.00	0.00
OPTIVER	0.00	0.00
LLOYDSCRE	0.00	0.00
BANK OF MONTREAL	0.00	0.00
BTIG	36,260.70	29.01
LIQUIDNET ALGO	7,007.54	2.10
JEFFRIES	0.00	0.00
	£ 18,714,075.85	£ 11,333.09

Firm Wide Comparators

All Equity Trading	£	728,291,722.26	£414,710.82
Trades:	£	18,714,075.85	£11,333.09
Average Firm-Wide Commission Rate (%)			0.06%
: Average Commission Rate (%)			0.06%

Source: River and Mercantile Asset Management LLP

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