RIVER AND MERCANTILE
ASSET MANAGEMENT

UK Equity Unconstrained Fund I Quarterly Report
March 2010

River and Mercantile

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UK Equity Unconstrained Fund – Quarterly Report

Fund Aim

The investment objective of the Fund is to achieve capital growth through investing in a concentrated portfolio which will primarily consist of UK equities. The Fund will not be restricted by reference to a benchmark, sector constraints or company size.

Portfolio Summary

Strategy AUM		£179m
Strategy Capacity		£1bn
Number of stocks		34
Largest Holding	Glaxo	5.67 %

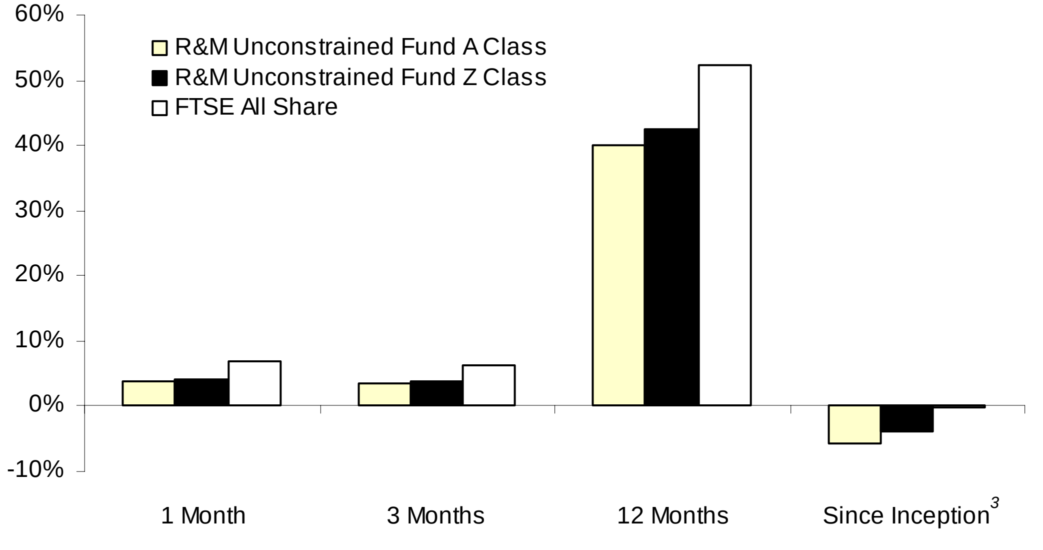
Risk Analysis Summary

Portfolio Volatility	15.90 %
Benchmark Volatility	16.97 %
Tracking Error	5.20 %
Portfolio Beta	0.89
Active Money	57.30 %

Performance to 31 March 2010

Retail "A" Class Shares	Fund[1]	Index *	Difference
1 Month	3.82%	6.76%	-2.94%
3 Months	3.37%	6.42%	-3.05%
12 Months	40.11%	52.30%	-12.19%
Since Inception[3] (%p.a.)	-5.56%	-0.19%	-5.37%

Institutional "Z" Class Shares	Fund[2]	Index *	Difference
1 Month	3.99%	6.76%	-2.77%
3 Months	3.81%	6.42%	-2.61%
12 Months	42.57%	52.30%	-9.73%
Since Inception[3] (%p.a.)	-3.91%	-0.19%	-3.72%



Source: River and Mercantile Asset Management LLP
**Index: FTSE All Share (Total Return)*
[1]Performance calculated on a mid to mid basis at close of business, net of annual management charge
[2]Performance calculated on a mid to mid basis at close of business, gross of annual management charge
[3]Inception date 22 March 2007

Quote for the Quarter

"Illiquidity in long term credit and international debt is the result of an entire generation's errors, excesses and follies and consequently takes a long time to correct".

Donald Hoppe, 1982

Market Background

Quarter

It has been another positive quarter for equities. Data has remained supportive with economies growing again, a combination of improving sales and lower costs are allowing corporate profits to grow robustly and equity prices are trending upwards. There is, of course, volatility around this trend, the most recent associated with the acute difficulties in Greece and general fears surrounding sovereign debt and threats of the Chinese moving to constrain their high growth rate. However, these have not been material enough to disrupt the upward path. In particular, global equities rose by 6.4% in March, their best performance since July 2009, leaving the Index up 2.7% year-to-date. Emerging markets were also strong with a gain of nearly 8%. In the UK, the FTSE All Share Index rose 6.4% with midcaps doing better at almost 10% and small caps lagging with a 4% gain.

Sectors

High beta stocks did particularly well during March, which is hardly surprising given the strong equity market performance. Valuation dispersion remains above average but investors started to buy into stocks with the greatest price momentum. March also saw the re-emergence of EPS momentum as a popular investment style. Resources and the General Industrial sectors were all strong. With the emphasis on gearing into a profit growth recovery, those sectors with low growth profiles and high dividend yields underperformed. Pharmaceuticals came bottom of the pack with a rise of just 1.5% as their defensive profile suffered.

Earnings Growth forecasts

Consensus earnings growth forecasts for the next couple of years are robust to say the least, with a 28% rise in ex-financial profit growth signalled for 2010 followed by 18% in 2011. This implies the consensus is expecting global equities to return to peak earnings by the end of 2011.

How did we perform and why?

Over the quarter

The UK Equity Unconstrained Fund returned 3.8% against the FTSE All Share Index gain of 6.4%. Best performing stocks in the Fund were **British American Tobacco, Amlin, Chemring** and **Wood Group**. Poorly performing stocks included mid caps **Xchanging**, **Connaught**, **Booker** and **Pace**. At a sector level, mining and banking stocks performed strongly during the quarter where we remain materially underweight and this had the biggest negative contribution to the Fund. Most miners are expensive, pricing in above peak ROEs and growth rates with the market focusing on the inflation threat from global monetary debasement. Banks are trading broadly at 1x book in the UK, rising to 2x book in Asia which is not expensive if one assumes their ROEs normalise. However, ongoing credit losses and continuing negative loan growth have dissuaded me from overweighting this area to date. Opaqueness in the financial services sector will likely ensure investors do not pay high multiples for lenders for some time.

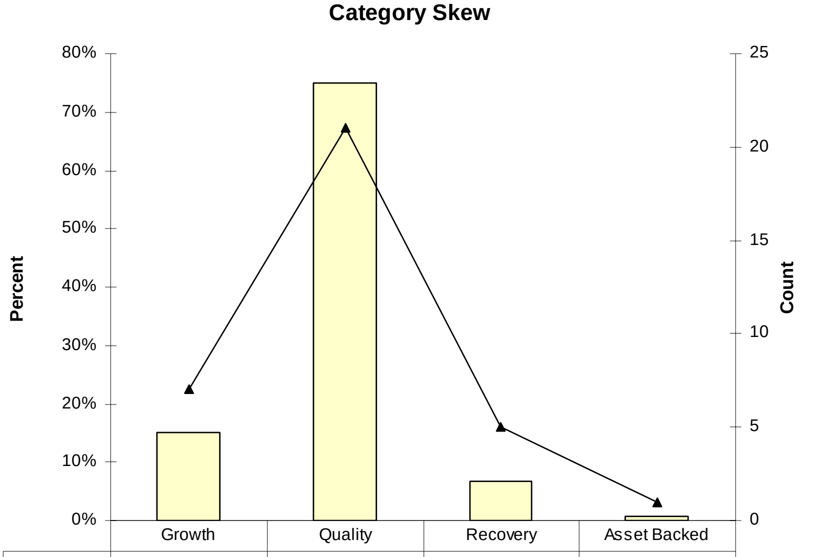
In our last quarterly report I suggested that our factors should begin working to a greater extent from here. We continue to believe this, although factor returns during Q1 were broadly unhelpful with quality, value and earnings momentum still not being rewarded. Cheap price/book and growth stocks with higher than average leverage and price momentum performed best where we are under represented. I am confident that the undervalued quality in our portfolios will ultimately be rewarded.

QUINTILES	UK	
	1 month	3 months
VALUE	**1%**	**-2%**
QUEST™ Valuation	1%	-1%
QUEST™ Mkt-To-Bk	4%	2%
EV/ Sales	1%	0%
Dividend Yield	-2%	-2%
P/E	-1%	-3%
QUALITY	**-2%**	**-3%**
CFROC Spread	-3%	1%
Capital Growth	-2%	-1%
Equil Growth	0%	3%
Fixed Charge Cover	-3%	-5%
CFROC Change	0%	-1%
MOMENTUM	**0%**	**3%**
9m Rel Trend	1%	7%
100/200 DS	1%	7%
12m Range	0%	4%
30/90 DS	-1%	2%
EPS Momentum	0%	-4%
triAngle™	**-1%**	**-1%**

Source: Collins Stewart Quest 3 months to w/c 29 March 2010

Does the portfolio reflect our Philosophy & Process?

The portfolio is currently tilted towards high quality undervalued companies which have the best chance of outperforming through an uncertain global economic outlook. During the quarter we made little change to the allocation of our four categories. We continue to rotate the portfolio in to strong PVT ideas where we see medium term potential for companies to create significant shareholder value, on low valuations and where earnings upgrades are sustainable in future rather than just a temporary cyclical pick up.



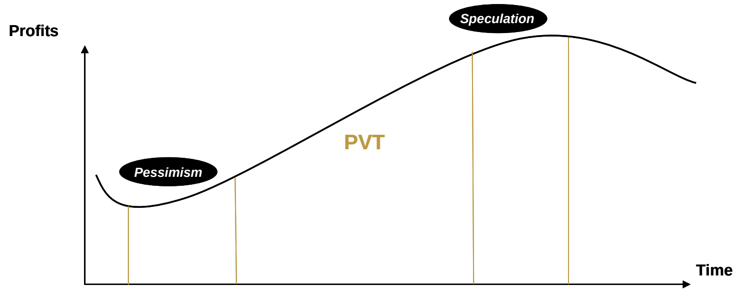
	Growth	Quality	Recovery	Asset Backed
Weight	15.09%	75.07%	6.79%	0.77%
Count	7	21	5	1

Source: River and Mercantile Asset Management LLP

What themes occupy us?

The stock market cycle

We continue to frame the current environment in the context of the stock market cycle.



	RECOVERY	TREND	LIQUIDITY	DECLINE
ECONOMY	Below Trend	Trend	Above Trend	Decelerating
MONETARY POLICY?	Loose	Neutral	Tightening	Loosening
RISK APPETITE?	Low	Normalised	High	Falling
VALUE SPREADS	High	Reducing	Low	Increasing
STYLE?	Value / Recovery	**PVT**	Risk Reduction	Quality

Source: River and Mercantile Asset Management LLP

Following much team discussion (and a formal review of the MoneyPenny returns since we launched the business) we have somewhat simplified the concept of the stock market cycle, to focus it even more on identifying the top (be cautious, focus on quality defensives) and bottoms (increase risk, maximise exposure to recovery stocks) of the cycle. In between the bottom and the top of the cycle, which represents the majority of time, we have the trend period of the cycle where economic growth, company profits and equity valuations move closer towards their long term averages. All three PVT factors should work during this trend period, complementing each other. We believe we are in this PVT stage of the cycle where a focus on stock selection should drive the greatest returns from here.

Markets

Tracking the path of the US 10 yr and long bond yield provides a useful insight in to the mindsets of equity investors with regard to inflation expectations and the stocks they are purchasing to reflect that view. The chart attached of the US 10yr Treasury Yield shows the path it has taken over the last 25-30yrs. Each time it has reached the top of the channel (circled) markets become focused on inflation, and each time it has reached the bottom (also circled) they become pre-occupied with deflation.

Source: Bloomberg

This is entirely understandable. Ever since Richard Nixon took the US off the Gold Standard in 1971 and abolished Bretton Woods, an on-going debate has been waged by those who believe the American economy is headed for a hyperinflationary breakdown and those who believe that a deflationary collapse is inevitable. Deflationists argue that the public and private debt will never be sustained or paid off; it will be liquidated by default. As bankruptcies mount, banks will fail and fearful investors will scramble to unload their stocks and bonds (as in 2008).

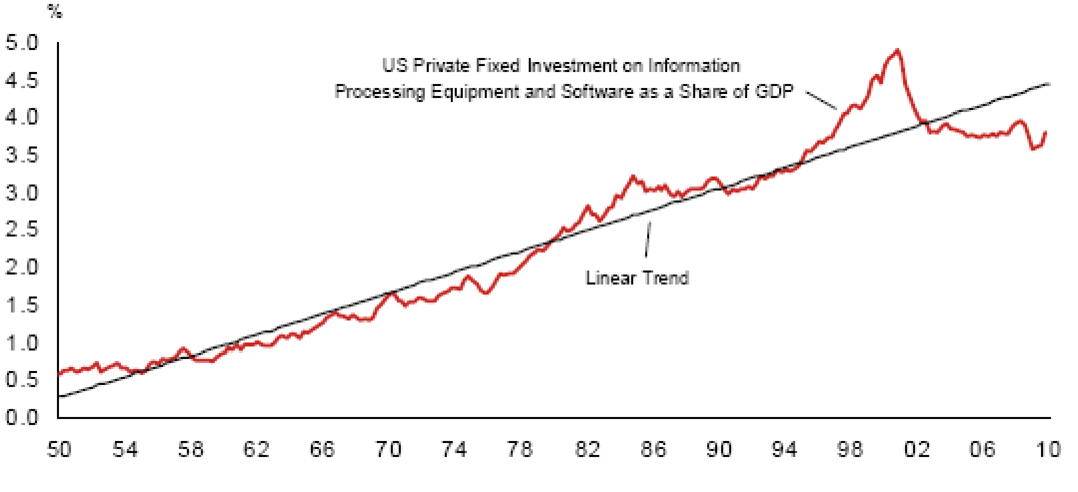
Inflationists paint a different picture. The Fed is forced to print money (monetize their debt) in ever increasing increments to keep the government in operation. This paper blizzard will find its way through the economy, pushing prices higher and higher. Exporters to the United States, particularly Oil exporters, will be forced to continuously ratchet up prices to receive real value for their oil. Since oil is the lifeblood of the economy, all prices will be pushed higher and inflation will begin to compound itself. The situation will become exacerbated and hyperinflation will ensue.

The 'Goldilocks' scenario lies somewhere between these two (growth in a low inflation environment) and this is what markets are now pricing in (with a greater eye, currently, on inflation). However, as I wrote in the last report, leveraged economies (low savings ratio and large government deficits) are inherently unstable and suggest continuing volatility in GDP growth expectations and, by definition, stock markets. This year looks to be no different with economies now vulnerable to any fall in stimulus. A deflationary shock remains a risk for 2010 and understanding the risks here, as well as recently widely reported risks of inflation from deficit spending and monetary debasement, remains paramount. Of course, with regard to a more widespread sovereign debt crisis, Greece is the least of our worries. Once again, markets appear to be pricing in a benign scenario which suggests the market from here should begin paying a premium for quality as we move through 2010.

Technology – ten years on from the bursting of the TMT Bubble

There is one cyclical area of the market we are happy to overweight. It is ten years since the biggest speculative investment frenzy of our generation, the TMT bubble, burst. Ten years on, and what is the outlook for technology stocks? We think it is positive for a number of reasons. Firstly, innovation waves as described by Joseph Schumpeter tend to take the form of two waves. Technology spending moves in long term cycles, the last of which peaked in 2000 with the TMT bubble, the bottom appears to have occurred in 2009, as companies slashed investment to ensure they had the financial strength to withstand the credit crunch. Spending on technology is currently at a generationally low level and the second investment wave should now commence.

US Spending on Technology as % of GDP



Source: Bureau of Economic Analysis, Datastream, Nomura Strategy Research

Secondly, after a ten year de-rating, technology stocks are now very attractively valued, trading at a Price to Earnings ratio that is little more than the overall market, this despite their robust profit outlook and superior cash characteristics:

Global Technology sector 12 month forward PE relative

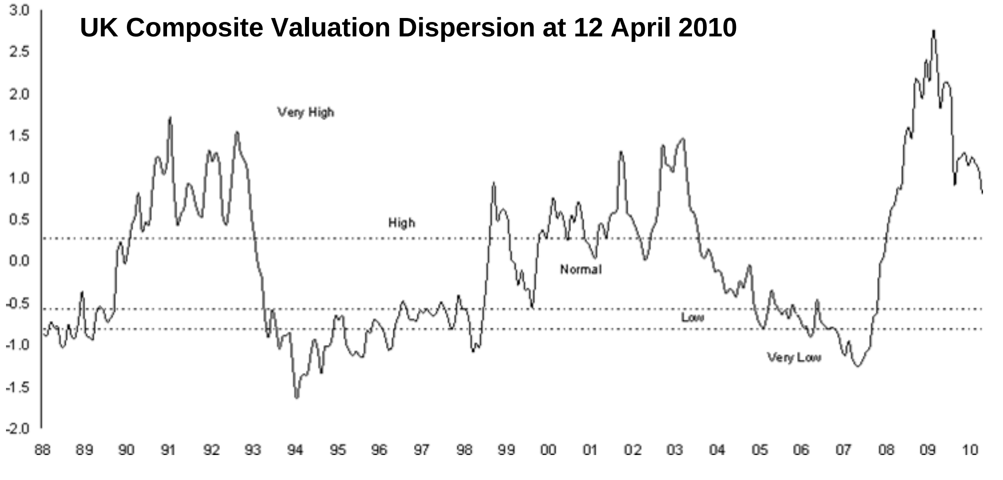
Source: IBES, Exshare, FTSE, Nomura Strategy Research

Thirdly, the Timing for Technology is supportive. Company profits and cash flow are now very robust making them more likely to invest in productivity enhancing technology, and also replacing dated hardware; consumers remain extremely attracted to new, functionally rich products with, for example, smartphones becoming a mass market product. The result is that the demand outlook is picking-up for technology companies; this combined with cost bases that were managed down during the credit crunch, and business models that often have reasonable operational gearing, points towards a strong profits outlook and likely positive earnings surprises.

As a result of these strong PVT characteristics, we are overweight the IT Hardware and Software Sectors, with notable positions in **Microfocus** (helps companies to improve the business value of their enterprise applications), and **Pace** (Global leading set top box provider to the pay TV channels).

Value Dispersion

Dispersion has reduced significantly during the market rally but remains reasonably high with the market still uncertain about future earnings trends. In the medium term this should favour a continued bias to cheap stocks from here.



Source: Bernstein

Portfolio Strategy

Despite a relatively poor start in Q1 we should see improvement from our PVT strategy this year. High scoring PVT stocks with overweights in defensives and defensive growth, as well as only selected exposure to deep cyclicals (energy and miners) is where we are positioned. We are underweight financials and consumer cyclicals.

Portfolio Activity

Key Purchases and additions

We added to **BG Group** (partly funded by reducing our holdings in Dana Petroleum and BP) with the desire to keep some exposure to oil despite the economic headwinds. The large integrated oil companies BP and Royal Dutch Shell are facing extremely difficult conditions in their refining businesses, not to mention their struggle to replace oil reserves through future discoveries. BG, on the other hand, has strong production growth of 6%+ out until 2020 as it brings on stream several major projects and has no refining business. This is a high class management team with market leading assets. BG's shares had underperformed the market by around 25% in the second half of 2009 and this gave us the opportunity to buy these growth shares on an attractive valuation.

Bunzl is a very high quality diversified FTSE 100 Support Services company with high RoCE, strong cash flow generation and consistent growth strategy. It supplies a wide range of paper and plastic disposable products many of which are relatively defensive (less cyclical) in nature and sits well in a basket of defensive growth stocks. The key potential lies in the relative pricing power of the group becoming increasingly favourable. Historically, Bunzl has had to deal with price deflation of around -2% year on year in its products but, despite this, has consistently raised margins and return on capital. This looks like it may be changing with pricing starting to move in their favour and therefore we are likely to see returns increase further with reasonable growth rates continuing. For such a high return business the valuation is very reasonable trading on a discount to the wider sector and market. Timing is supportive with a gradual ratcheting up of earnings forecasts over time (and I believe this will continue due to conservative growth forecasts in the analyst models).

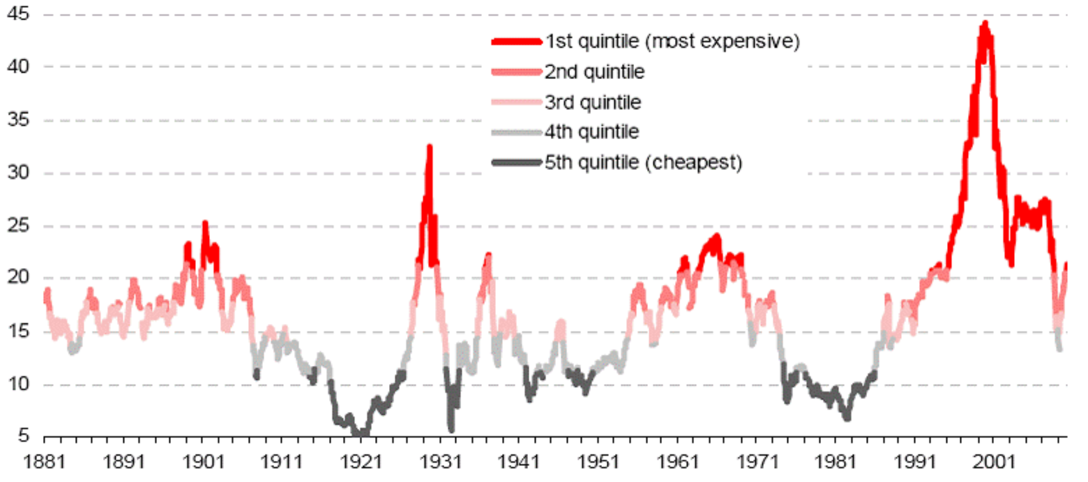
Key Sales and reductions

During the quarter we sold two of our more highly leveraged names. **Land Securities** was sold after commercial property yields tightened through the final quarter of 2009 and, with the shares trading at a small premium to book (asset backing), we felt the shares were unlikely to make much progress from here. Also, we exited **Firstgroup** (growth), a bus and rail company in the UK and US which, whilst recovering strongly from the profit warning 12 months ago, remains very geared and earnings estimates will continue to come under pressure.

Outlook

Once again low rates have had a more powerful effect in driving financial assets than economies, and markets have powered higher in the past 12 months. Whilst valuations do not give any indication of short term direction in themselves, they are helpful in predicting likely returns over a longer period. Following a 65% rally off the bottom they are no longer attractive, in fact on a Shiller PE we are again back in the top quintile of US stock market valuations looking back over the past 100yrs or so with the European markets only slightly cheaper.

Return-free risk? Shiller PE now shows S&P to be in top historical valuation quintile

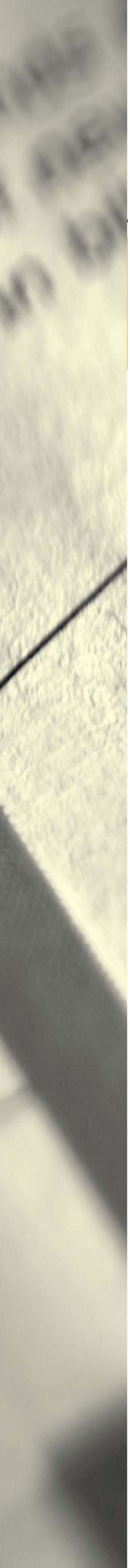


Source: Robert Shiller, SG Cross Asset Research

The love affair with Emerging Markets has continued for some time now, which should not be surprising given that the emerging market economies have just completed their greatest decade in history (markets are always most popular at the top of the cycle rather than the bottom). My view remains that better returns will be found elsewhere in the coming years but stocks exposed to emerging markets have continued to lead the pace through 2009 and into early 2010. Indeed, risk assets have had a very strong 12 months leaving many high quality companies looking relatively undervalued in the stock market. Defensive sectors are oversold and undervalued suggesting they could be major beneficiaries of future sector rotation and I believe blue chips will do well from here.

I expect PVT stock selection to improve and we own a portfolio of companies with strong prospects. In particular, Quality stocks with valuation support and earnings visibility to outperform as we move through the year. The focus is firmly on quality companies capable of growing on good valuations. I continue to be high conviction on Pharma and Healthcare stocks (Glaxo, Astra, Smith & Nephew), Non-Life (Amlin & Hiscox), defensive growth stocks like Booker and Tesco as well as high quality stocks on low valuations that have lagged the 2009 rally, such as BAE Systems, Reed Elsevier, Imperial Tobacco and, more recently, BG. This has to be balanced with the prospect of continuing global reflation. The narrowing market into Asian growth and Resources is reminiscent of early 2007 and, as such, I am focused on stock selection rather than being overweight this popular area of the market.

Dan Hanbury
Portfolio Manager



Fund Facts

Launch date	22 March 2007
Fund manager:	Dan Hanbury
IMA sector:	UK All Companies
Benchmark:	FTSE All-Share (Total Return)
Tracking error range:	N/A
Product capacity:	£1bn (pooled & segregated)
XD dates:	1 April & 1 October
Dividend/Accumulation payment date:	31 May and 30 Nov

Share class:	A	Z
Launch price (shares):	100.00p	500.00p
Share classification:	Retail	Institutional
Type of shares:	Income	Accumulation
Fund charges:		
Annual	1.75%	0.00%*
Initial (up to)	5.25%	5.25%
*AMC charged outside the Fund		
Minimum investment		
Initial	£1,000	£5 million
Subsequent	£500	£50,000
Sedol	B1NG829	B1NGCT4
ISIN	GB00B1NG8296	GB00B1NGCT49
Bloomberg	RIVMERA LN	RIVMERZ LN

Important Disclosure:

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 necessarily a guide to future performance. Changes in exchange rates may have an adverse effect on the value, price or income of investments. Please refer to the River and Mercantile UK Equity Unconstrained Fund principal prospectus for further details of the financial commitments and risks involved in connection with an investment in this Fund. The information and opinions contained in this document are subject to updating and verification and may be subject to amendment.

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