UK Equity Income Fund I Quarterly Report
June 2009

River and Mercantile

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UK Equity Income Fund – Quarterly Report

Fund Aim

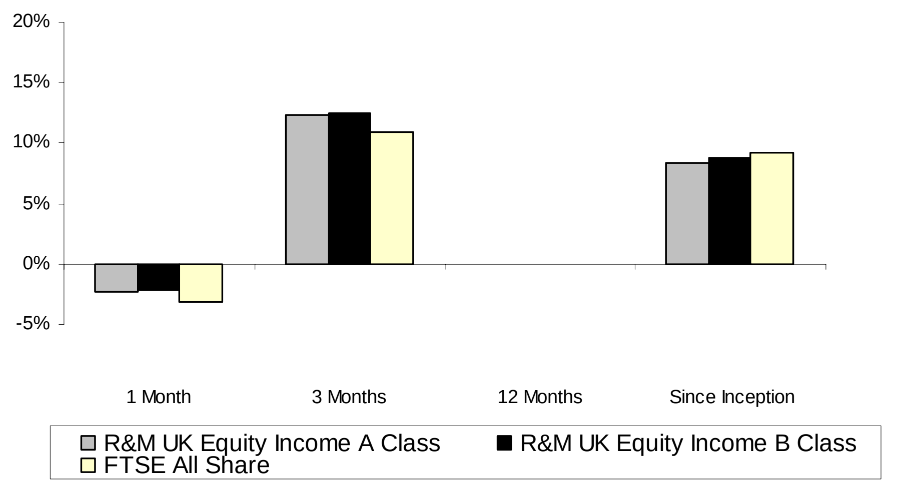
The investment objective of the Fund is to produce above average, growing income together with long-term capital growth ahead of all the FTSE All-Share Index.

Portfolio Summary			Risk Analysis Summary	
Strategy AUM		£4.3m	Portfolio Volatility	15.57%
Strategy Capacity		£1bn	Benchmark Volatility	14.83%
Number of stocks		78	Tracking Error	3.50%
Largest Holding	BP	7.53%	Portfolio Beta	1.02
Historic Yield		N/A	Prospective Historic Yield[3]	6.30%

Performance as at 30 June 2009

Retail “A” Class Shares	Fund[1]	Index *	Difference
1 Month	-2.28%	-3.21%	0.93%
3 Months	12.32%	10.88%	1.44%
12 Months	-	-	-
Since Inception[2]	8.40%	9.25%	-0.85%

Asset Manager "B" Class Shares	Fund[2]	Index*	Difference
1 Month	-2.22%	-3.21%	0.99%
3 Months	12.53%	10.88%	1.65%
12 Months	-	-	-
Since Inception[2]	8.72%	9.25%	-0.53%



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]Inception date 3rd February 2009
[3]Yield based on the historic dividends of the current holdings of the Fund.

Market Overview

During Q2 2009 the MSCI world index delivered the best quarterly returns since Q1 1986 up 19.7%. The FTSE All-share delivered 10.9%, a material gain relatively held back by the UK market's bias to defensive sectors such as Pharmaceuticals (+3.2%), Tobacco (+3.2%) and the Oil majors (+1.7%). However, strong performances were delivered by Financials, Technology, and Mining. Mid and small capitalisation shares did extremely well rising 17.5% and 28.8% respectively, as investors' risk appetite improved. A raft of macro-economic and market related data supported this sentiment shift, the least important being the fertility rate hitting a 35 year high in England and Wales, the rest I will discuss later, but the former aiding the fund's holding in Mothercare to reach a 5 year relative high.

1986 was when the film Topgun was released. I doubt the market's move to small cap is a salutation to Tom Cruise's impressive 5ft 7 inches. However, consensus for far too long has been that his naval aviator call sign "Maverick" was the only suitable description of smaller company investments. The F14 Tomcat, flown in the movie was withdrawn from service in September 2006 having been actively engaged since 1974. Just before they pulled it from service the US sold a huge batch to The Islamic Republic of Iran Air Force, who are still the only active users of the plane, and whose disputed election during the quarter was the main geo-political event. In tighter commodity price conditions events may have created material oil-price action, but US inventories remain stubbornly high.

Please note the 32 year service life of the Tomcat. Bae Systems, an important fund holding with long-term contracts for the new F-35 Lightening, soon to go into active service, has current known requirements of over 3000 planes. The shares languish on an attractive yield of 4.6%, two and half times covered by current cash flow. The main corporate news of the quarter was the bankruptcy of General Motors, for many years America's largest company and a fully underwritten rights issue at Rio Tinto, highlighting which industries and outlooks shareholders are willing to support post the bursting of the credit bubble.

Performance

The Fund delivered 12.5% during the quarter beating the benchmark return of 10.9%. Overall the portfolio is underweight defensive large-cap shares, which supported relative performance, in particular the Oil & Gas sector. Technology holdings helped performance, as did Miners such as Xstrata. The Funds overweight position in mid and small cap was very beneficial with holdings such as RPC and C&C being very positive. HMV, Mouchel and Management Consulting have been disappointing and the latter two have now been sold. The Value factor helped during the period whilst momentum measures were less effective.

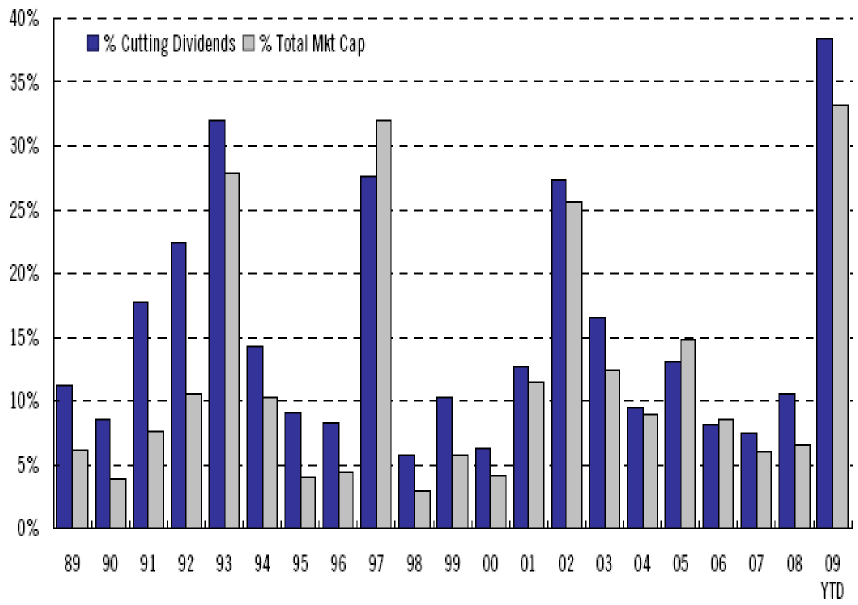
Philosophy & process

The majority of capital within the fund remains in the *Quality* category at 56%. These companies have strong franchises, and high, generally improving returns. The portfolio also remains biased to businesses with robust balance sheets, the best vaccine for dividend cuts, which are also critical in enabling the exploitation of others weaknesses during a time of depressed profits and valuations. The only Rights issue financed during the quarter was HSBC, an attractive global franchise now positioned to competitively exploit its industry. The dangers of leverage remain and from an investment style perspective, I am seeking 'Iron Maiden' *Quality*, a band which formed in 1975 and has now sold over 70 million albums and yet still won the Brit Award in 2009 for the Best Live Act. This is preferable to the larger *Quality* Michael Jackson franchise which has been in decline, was clearly over-leveraged financially and certainly won't win that award (being American). 32% of the portfolio is in *Recovery*, a category musically most akin to 'Take That', who written off 5 years ago, reformed in 2006 (with a new strategy and changed management; less dancing, no Williams) which has just sold over a million tickets for their Summer Tour. *Growth* allocation remains low. The category has too much of the 'Susan Boyle' to it currently: A short track-record, high expectations, achieving too much, too fast with potentially serious repercussions. A modest 1% increase to *Asset-backed* investments occurred during the quarter with my increasing confidence in the bottoming-out of the real estate sector's relative performance and the purchase of the high yielding, mainly French, real estate company, Alpha Pyrenees.

74% holdings are currently in the top 4 deciles indicating an improved skew to high scoring stocks. Style research continues to highlight a Value bias within the fund, which has been helpful as this style factor has been more positive for performance during the quarter. The exposure to small cap has increased during the quarter due to new best ideas and the outperformance of existing holdings.

Portfolio Income

The cuts to date of 2009 dividends are already the largest in over 20 years:



Source: Citi Investment Research and Analysis and DataStream

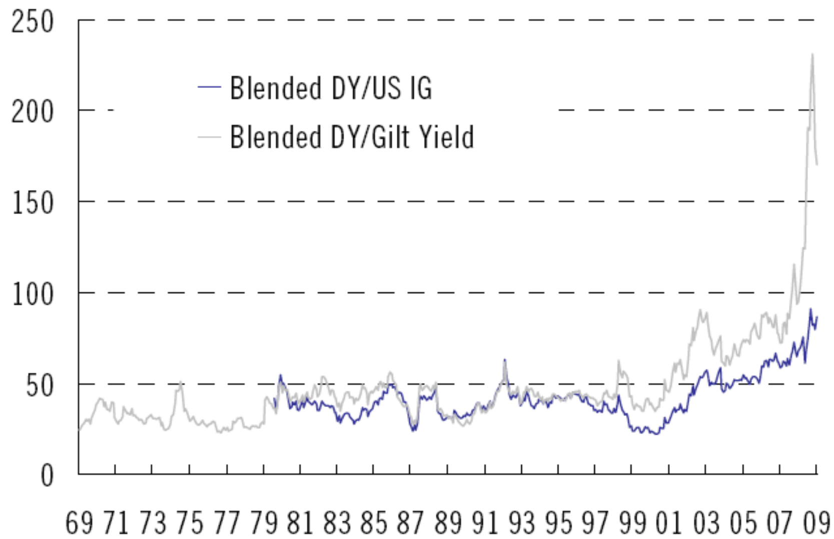
Further cuts are likely as the analyst community take their time to update forecasts, and deluded management teams realise the extent of the 2008 slowdown. It took an amazing 14 weeks for consensus broker expectations for Lloyds Bank's dividend to be cut to Zero following the public announcement by the company this would occur.

However, the bar-chart above should not depress unit-holders (such as myself) in the R&M UK Equity Income Fund. 46 of the holdings went ex-dividend during the quarter. Of these only 7 payouts fell (and only 1 was cut to zero, Xstrata), all of which have been in-line with expectations. 29 dividends were increased on 2008 payments, despite the backdrop and 2 companies chose to join the dividend list altogether namely Pace Micro Technology and Invensys. The rest of holdings maintained payments. I am highly encouraged by this outcome. The portfolio paid its maiden distribution during the quarter of 1.07p and at time of writing we have already accrued an estimated further 1.75p for the next payout in November. During the quarter I would highlight the +5p final distributions from both Cable & Wireless and Vodafone. Both companies have significant opportunities to increase shareholder value over the next few years, robust balance sheets and highly attractive dividend yields of 7.1% and 6.7% respectively. At the end of June the fund's prospective yield according to Reuters consensus was 5% vs. the FTSE All-share on 4.3%.

Portfolio Activity

New sales and purchases have been detailed in previous monthly reports. To summarise the quarter I have been selling mainly deteriorating PVT score, large cap, relatively leveraged, defensive companies on full valuations in order to purchase high PVT scoring, small cap recovery opportunities with strong balance sheets on cheap valuations. Examples of the former include Scottish & Southern Electricity, BSkyB, Reed Elsevier, Greene King and Qinetiq. Examples of the latter include Pace Micro Technology, C&C, Intec Telecom Systems and Fiberweb. A new addition in June was Delta, a top decile Asset-Backed international engineering products company with a strong competitive position in galvanising and infrastructure products. Under new management for the last few years, the business has gradually been restructured driving a material cash position of c. £60m. Pension Fund issues have been addressed recently. The shares now yield 5.8%, but are capitalised at only £180m driving an extremely low Enterprise Value to Sales ratio of 0.18x.

Within sector positioning, there have been no material changes. The total capital invested in Financials has grown. The nature of the mining weighting has shifted with the full sale of base metals and coal producer Xstrata and purchase of gold miner Peter Hambro. My conviction in the outlook for public and private sector Construction markets has fallen further leading to the sale of Costain, whilst higher conviction in Technology, driven by bottom-up stock picking opportunities, has increased the overweight. I remain well invested in secure dividends of mega-caps such as BP, Vodafone, GlaxosmithKline, Unilever and Bae Systems all boasting sound balance sheets, attractive prospects for improving returns and growth, on generationally cheap valuations. The chart below indicates the anomaly of a blended dividend yield of BP, HSBC, Vodafone and Glaxo over time versus Gilt and Investment grade Bonds



Source: Citigroup

Market Outlook

“The charm of history and its enigmatic lesson consists in the fact that, from age to age nothing changes and yet everything is completely different”. Aldous Huxley.

The Banking crisis and resultant world slowdown has caused some commentators to question the role or nature of capitalism going forward. It is understandable to search for blame and question the fabric of the system, given that almost everyone around hasn’t experienced anything quite as terrifying economically as the last 12 months. Capitalism has helped produce a massive rise in world living standards over the last 100 years (the greatest rise being to early adopters) and the current downturn looks unlikely to materially damage the increase in living standards achieved through that period. The main issue is that some have confused Capitalism with the Economic Cycle, forgetting that Capitalism isn't a free pass to riches, a 'license to leverage' and an asymmetrical risk–reward payoff strategy. Fortunately, as the FT concluded "Capitalisms worst crisis in 70 years has not prompted a serious alternative vision of society". Indeed the story of modern capitalism appears very much to be a rhythmic repetition of cycles harmonised by eerily similar crises. Although the details differ they are usually variations on the credit induced asset price inflating theme with a rapid build of euphoric, speculative behaviour ending in inevitable bust.

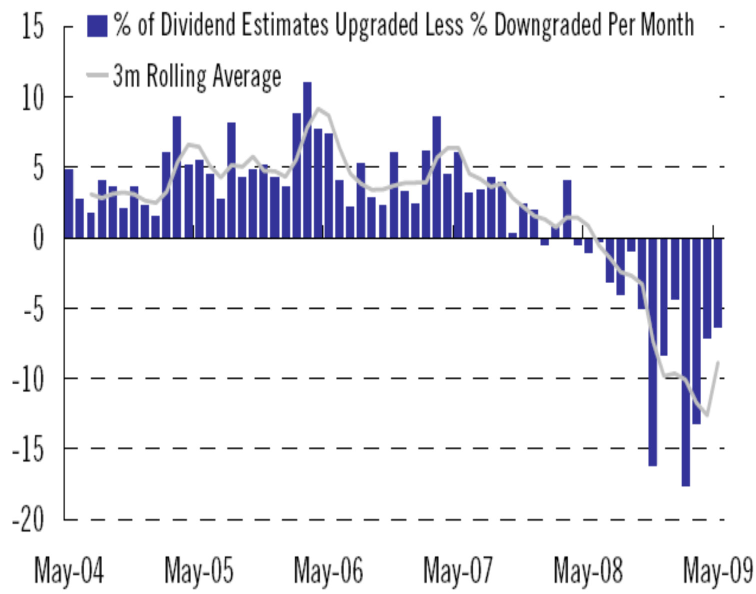
However, the tool-kit of capitalism has changed during the last century in particular through the broadly unchecked development of derivatives. The oversight function of markets and practitioners has morphed and lost its sense of purpose and direction. Greed has allowed credit yet again to fan the flames of the fire. It does seem recent developments principally started following the embracing of pro-market ideology by Reagan, Thatcher and Paul Volcker, then Chairman of the Federal Reserve in 1980, all critical in moving on from a mixed, Keynesian approach. However, other geo-political changes occurring at the same time were as important and are even more now for the development of Capitalism. Highly material was the collapse of Soviet communism and the shift in China from planned economy to market, allowing globalisation to accelerate and the benefits of trade to increase. Regarding credit this ideological shift helped fuel an unchecked explosion in debt with aggregate debt of the financial sector jumping from 22% of US GDP in 1981 to 117% in the Q3 '08 . In the UK the number exceeds 250%. Capitalism must develop the ability to allow non-political, objective oversight to restrict unchecked credit-expansion. This should be partly external via an enlightened, emboldened unified regulatory authority and should be partly mitigated by the improved standing of internal risk management functions and front-office incentive structures.

The risks to global financial markets from derivatives, Buffet's "financial weapons of mass destruction" continues. These products are often individually designed to "mitigate" risk, but merely shift risk elsewhere and encourage aggregate risk to increase. The key problem is that the obligations and responsibilities associated with transactions have in recent years become much harder to trace thanks to the rapid development of secondary markets. There is not enough transparency and current risk management structures remain insufficient. Authorities have yet to wholeheartedly tackle this issue.

Clearly, facing-off to derivatives markets and the vested interests of these markets requires regulation, oversight and courage (particularly when the opposition are mostly 'rocket scientists'). Unfortunately a creeping regulatory growth trend has been in place for far too long without any meaningful results given the events of the last 18 months. It is therefore the nature of regulation not the amount of it which needs to change. Andrew Haldane, the current Bank of England executive director for Financial Stability summarised reason for the banks failures. He blamed them on "disaster myopia" (the tendency to underestimate risks), a lack of awareness of network externalities (spillovers from one situation to another) and "misaligned incentives" (the upside to employees and the downside to shareholders and taxpayers). All these weaknesses seem addressable in my view.

I am convinced meaningful progress should be possible without significant incremental regulation or new oversight bodies, and the simplification of responsibilities should improve outcomes. The goal should be to tame, not abolish, the cycle, executed in the context the known limits of the market economy. Until truly addressed the weakest parts of the system will routinely clamour for economically unjustified support for their dying industries and business models under the cover of "failed capitalism". Bankruptcy is part of capitalism; it makes the system bear the costs of the risks taken on and helps price risk effectively. Economic support can then be channelled into genuine areas for the future where real comparative advantage can be built.

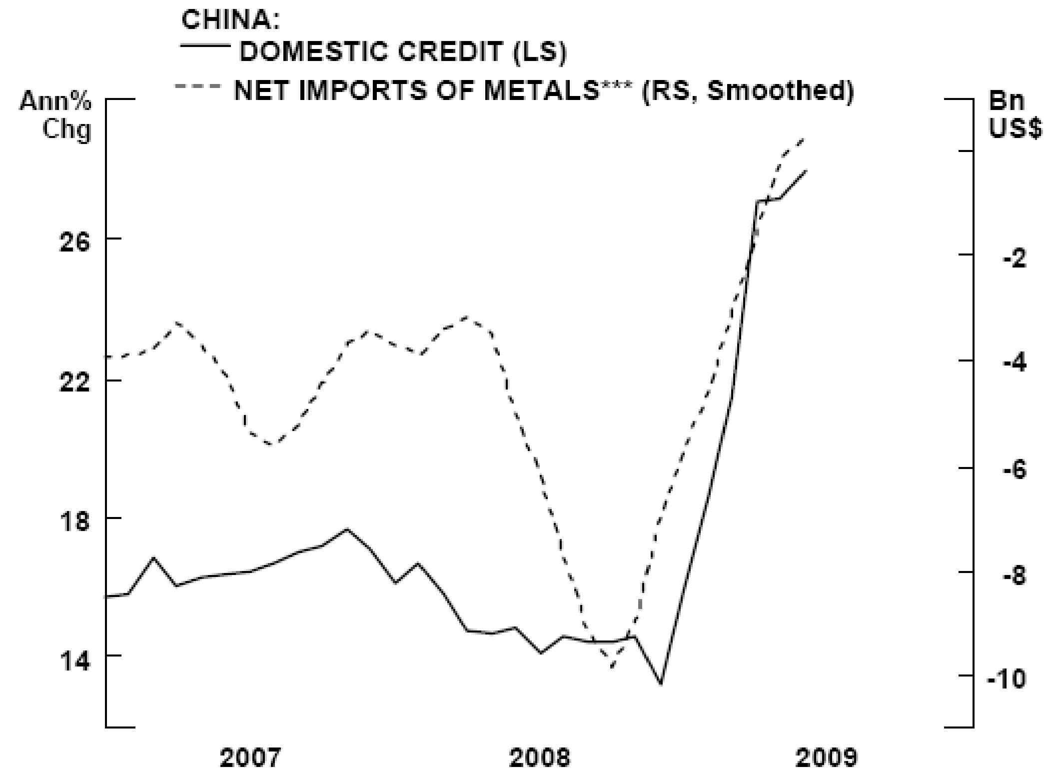
The backdrop to this regulatory challenge is the current economic cycle, historically high levels of western world private and public debt and China.



Source: Citigroup

The economic cycle is very much here to stay; its amplitude and length will continue to vary greatly. Nigel Lawson from one ex-chancellor to another in a hotter seat at present wrote “the economic cycle is endemic and inescapable and everyone (with the exception of Brown) has always known this”. Identifying where we are currently in this cycle will aid portfolio construction and mitigate risk in the second half of the year: Economic Surveys have picked up, including the ISM and IFO surveys. The yield curve has steepened, implying a pick up in inflationary expectations and a renewed confidence in monetary authority actions. Risk appetite has returned as highlighted by small cap performance, falling credit spreads and lower levels of volatility. Economies continue to contract, albeit at a slower pace, but still below trend. Markets may have also bottomed with consensus profit and dividend expectations picking up (see chart above), technical indicators turning positive (such as the Coppock) and cyclical adjusted trend PE ratios still remaining low.

Strong Chinese data, in particular the PMI has been coincidental with rising commodity prices suggesting sentiment on global growth is improving. However, I remain very wary of extrapolating Chinese data points into a thesis that commodity demand-supply is back in equilibrium, or that China has decoupled. China is in a better relative position than the US with the financial strength to afford its stimulus packages and robust urbanisation trends supporting the outlook for domestic demand, and many family-run businesses have the ability to take longer-term decisions. However, authorities are clearly buying commodities because the price is low relative to recent levels and in the anticipation of future demand. This is a very different dynamic to achieving equilibrium from order-backed demand-led buying. In fact Shanghai and Shenzhen handled 2m and 1.4m container boxes in June (-18%,-20% year-on-year), weaker than (-12% and -16%) in May. The Wall Street Journal reported China exports down 21.7% in H109. This translates to 21.2% slump in June (vs. -26% in May) and a worse 2Q (-23%) than 1Q (-20%). Thankfully they continue to buy US treasuries and the Dollar, but they have not decoupled.

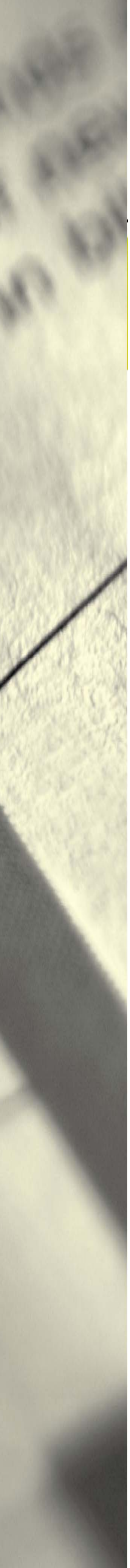


Source: BCA Research

Summary

Western Capitalism needs to adapt in order to ensure smoother, continued economic progress. The risks are higher than in the past because of the size of the financial sector and the levels of debt outstanding. Radical change is not required but acceptance of the economic cycle is a necessity. Regulatory reform is also necessary, but mainly of its nature and a reduction in its amount. Incentive structures must become more risk-based, time driven and intelligent. China's economic relevance has never been greater, but its current 'recovery' questioned. I remain underweight, for now, the resources complex. Some mega-cap shares offer outstanding risk-reward investment opportunities, however the Recovery phase in the UK market is nascent and existing overweight's in mid and small cap companies should continue to benefit performance. The market remains cheap and your portfolio cheaper.

Richard Staveley
Portfolio Manager



Fund Facts

Launch date	3 Feb 2009
Fund manager:	Richard Staveley
IMA sector:	UK Equity Income
Benchmark:	FTSE All-Share (Total Return)
XD dates:	1 April & 1 October
Dividend/Accumulation payment date:	31 May and 30 Nov
Product capacity:	£1 bn (pooled & segregated)

Share class:	A	B
Launch price (shares):	100.00p	250.00p
Share classification:	Retail	Institutional
Type of shares:	Income	Accumulation
Fund charges:		
Annual	1.50%	0.75%
Initial (up to)	5.25%	5.25%
Minimum investment		
Initial	£1,000	£2.5 million
Subsequent	£500	£25,000
Sedol	B3KQG33	B3KQG44
ISIN	GB00B3KQG330	GB00B3KQG447
Bloomberg	RMUKEIA	RMUKEIB

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