

RIVER AND MERCANTILE
ASSET MANAGEMENT

River and Mercantile Asset Management LLP

Environmental, Social and Governance Policy

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Environmental, Social and Governance Policy version control and updates

Amendment Number	Date of Change	Summary of change	Reference
1	31 st May 2017	First version	
2	31 st October 2018	Annual update	
3			
4			
5			

Environmental, Social and Governance Policy

Approach to Sustainable Investment and Environmental Social & Governance Factors (Long Form)

Introduction

The importance that many investors place on sustainable investing and a consideration of environmental, social and governance (ESG) factors has increased considerably in recent years. Within pension trustee boards and amongst many investors there is recognition that ESG issues can have a significant impact on the economic value of a company, something we agree with. In Clark, Feiner and Viehs 2015 report 'From the Stockholder to the Stakeholder', a meta-study from 200 different sources, they found '88% of reviewed sources find that companies with robust sustainability practices demonstrate better operational performance, which ultimately translates into cash flows.'

As an equities manager River and Mercantile Asset Management LLP (**RAMAM**) believes we are not only stewards of the assets entrusted to us by our clients, but that we also have a fiduciary responsibility to improve the management of companies for all stakeholders whilst not compromising our objective of achieving strong financial returns.

Since RAMAM was formed in 2006 we have always voted on behalf of our clients, both for UK companies and those stocks held in our global equity portfolios. We regard voting as an important aspect of active ownership: engaging with companies to encourage better corporate standards. Details of our General Principles in respect of corporate governance are included in our Corporate Governance Voting and Engagement Policy, which is available on request.

In combination with our fiduciary duty as owners, we believe it is important to include ESG factors in our company research process to mitigate risk and identify opportunities in stock selection. This document provides a summary of how quantitative and qualitative ESG research is incorporated into our PVT (Potential, Valuation and Timing) investment philosophy.

Selection of Material ESG factors

Below we have listed ESG factors that research has identified as being materially important. Depending on the company and industry, certain factors will be more or less important. As part of our research we aim to identify the most relevant for the company and industry we are analysing – the aim being to identify not only which companies are 'best in-class' but most importantly ones which are improving.

Figure 1: Selection of Material ESG Factors

Environmental	Social	Governance
Biodiversity/ Land use	Community relations	Accountability
Carbon emissions	Controversial business	Anti-takeover measures
Climate change risks	Customer relations/ product	Broad structure/ size
Energy usage	Diversity issues	Bribery and corruption
Raw material usage	Employee relations	CEO duality
Regulatory/Legal risks	Health and safety	Executive compensation schemes
Supply chain management	Human capital management	Ownership structure
Waste and recycling	Human Rights	Shareholder rights
Water management	Responsible marketing and R&D	Transparency
Weather events	Union relationship	Voting procedures

Source: Clark, Feiner and Viehs (2015) 'From the Stockholder to the Stakeholder': The data has been synthesized from several sources, including MSCI (2013), UBS (2013), Bonini and Goerner (2011), Sustainability Accounting Standards Board (2013), Global Reporting Initiative (2013a), and the academic papers reviewed in the report.

What we do

Voting

We use a third party, ISS Corporate Solutions, to implement our voting policy, overriding their recommended action when it differs from our General Principles on standards for good corporate governance and management of environmental and social issues.

Risk Mitigation

When we conduct our analysis on companies, apart from gaining an understanding of the business and financial management, we believe it is important to identify potential non-financial risks by assessing management's behaviour with regard to ESG related factors such as customers, employees, suppliers and the environment.

Examples of where we have identified ESG related risks in existing holdings or potential holdings and such risks have affected our investment approach include two Asian companies that had accounting irregularities – both stocks were sold; and a UK retail company with controversial employment practices, which we did not buy despite scoring highly on *MoneyPenny*, our initial stock screening tool.

Quantitative Scoring

We run an ESG Analysis report on a fortnightly basis, which provides a broad overview of the portfolio from an ESG perspective and allows us to identify companies with potential related risks for us to take into account when analysing. Figure 2 shows the highest rated and lowest rated companies across RAMAM's portfolios as at end-March 2018.

Figure 2: ESG Analysis report – Highest 10 & Lowest 10, March 2018

10 highest rated ESG companies held by fund	Portfolio Weight	Benchmark Weight	Company Rating	Industry Adjusted Score
Microsoft	0.88%	1.48%	AAA	10.0
Tiffany & Co	0.65%	0.03%	AAA	10.0
Banco Bilbao Vizcaya	0.18%	0.12%	AAA	10.0
Johnson Controls	0.46%	0.07%	AAA	9.7
Intesa	0.39%	0.11%	AAA	9.7
Baker Hughes	0.30%	0.03%	AAA	8.7
Novo Nordisk	0.20%	0.20%	AAA	8.6
Repsol	0.20%	0.05%	AA	8.5
Vivendi	0.28%	0.06%	AA	8.4
Caterpillar	0.20%	0.19%	AA	8.4

10 lowest rated ESG companies held by fund	Portfolio Weight	Benchmark Weight	Company Rating	Industry Adjusted Score
Transocean	0.42%	0.00%	CCC	0.0
Zillow Group	0.33%	0.00%	CCC	0.0
Hengan International	0.28%	0.01%	CCC	0.0
Anhui Conch Cement Co	0.24%	0.01%	CCC	0.0
CNOOC Group	0.33%	0.06%	CCC	0.5
Wells Fargo & Co.	0.87%	0.54%	CCC	0.6
Stericycle	0.20%	0.01%	CCC	0.6
JD.com	0.34%	0.06%	CCC	1.0
Haitong Securities	0.35%	0.01%	CCC	1.1
IJM Corporation	0.15%	0.00%	CCC	1.1

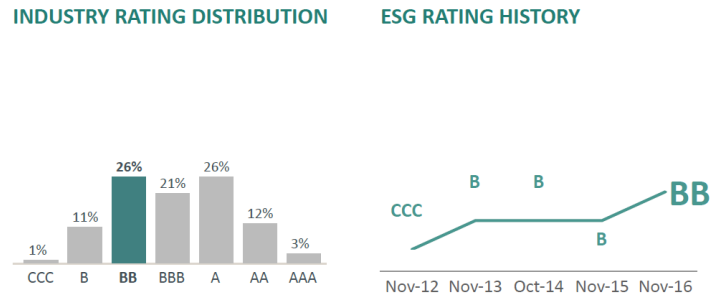
Source: MSCI ESG Research. ©2017 MSCI ESG Research LLC. Reproduced by permission.

In addition, we run a fortnightly report showing ESG rating moves both upwards and downwards, including reasons for the change. This brings monitoring of ESG issues arising and potential improvements within a company in line with our *MoneyPenny* fundamental screening tool, which highlights changes in the PVT decile ranking of stocks. Within the Investment Team, we regularly discuss ESG issues and changes in MSCI ESG scores reviewed during our fortnightly internal Global Equity Meetings.

A paper by MSCI on 'Can ESG add Alpha' showed that between February 2007 and February 2015 both a portfolio of stocks with higher ESG ratings and a second portfolio consisting of stocks that have improved their ESG ratings, outperformed the MSCI World Index. The greater out-performance coming from the stocks with improved ESG ratings, +2.2% per annum compared to +1.1% for those companies with the highest ESG ratings.

Two examples of stocks where the MSCI ESG Rating has increased from CCC to BB are Bank of America and Sinopharm Group (a Chinese pharmaceutical distributor). These two examples demonstrate how a company's share price performance can improve with an increase in its ESG ratings.

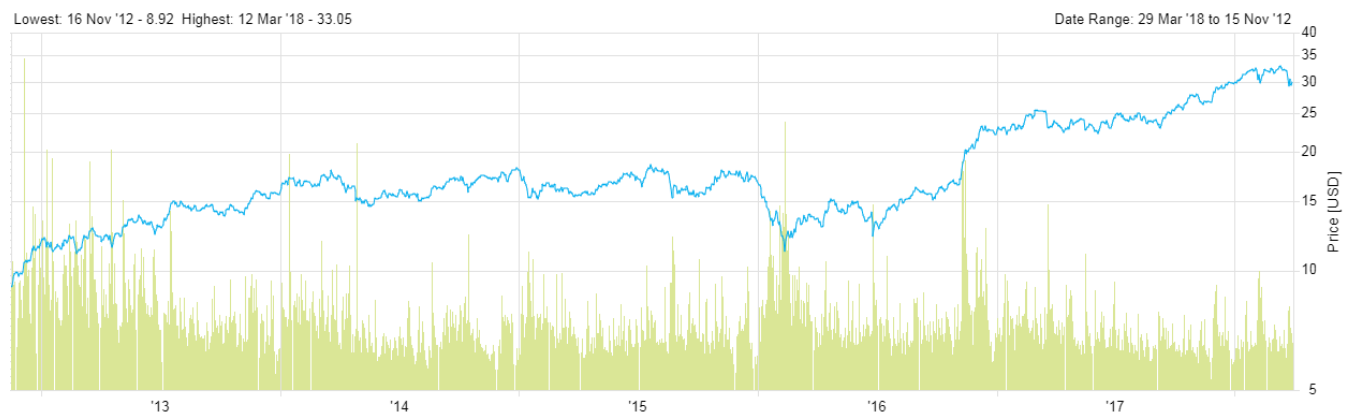
Bank of America



Source: MSCI ESG Research

Bank of America was rated CCC in November 2012 due to the threat of regulatory fines post the financial crisis. In November 2013 the rating improved to B following progress in improving internal controls. The most recent increase occurred in November 2016 when the bank adopted best practice guidance on its privacy and data security policies. Since November 2012 Bank of America's share price has increased three-fold (see Figure 3).

Figure 3: Bank of America share price 15th November 2012 to 31st March 2018

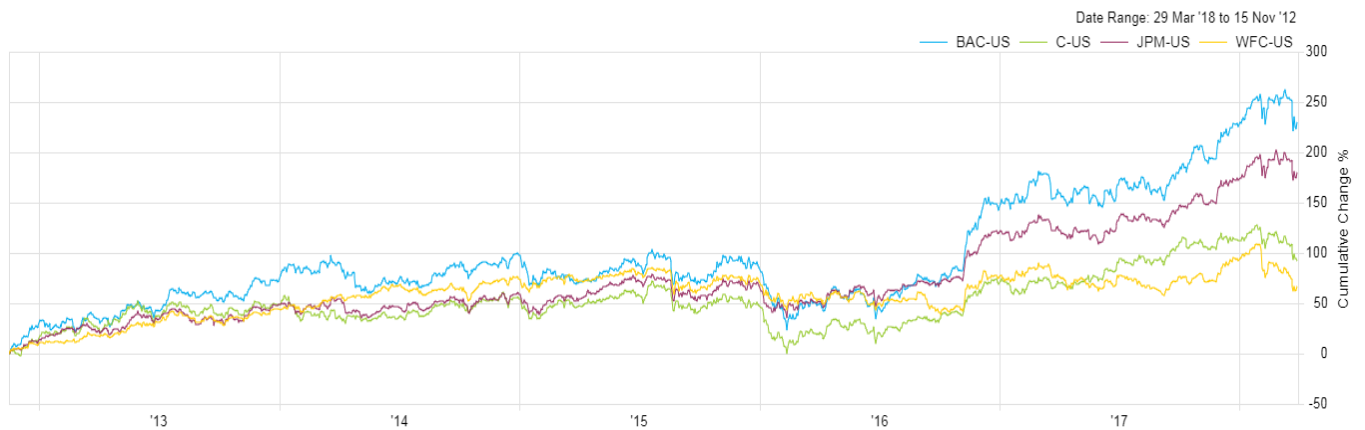


Source: FactSet

In respect of corporate governance the bank has made improvements regarding overboarding to improve the effectiveness of the board, but overturned a previous shareholder vote to combine the CEO and Chair roles. Executive pay, bonuses and poorly structured equity incentive plans require continued monitoring.

Figure 4 shows the performance of the four major US banks since November 2012. Both Bank of America (BAC-US) and JP Morgan (JPM-US) were similarly re-rated to BB from CCC, whilst Citigroup (C-US) was downgraded from BB to a B in 2015 (returned to BB in 2016 and BBB in 2017) and Wells Fargo WFC-US has fallen from a BB in 2014 to CCC currently. It is noticeable that Bank of America and JP Morgan have been the best performing of the four banks over the period.

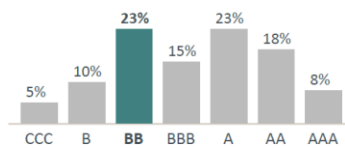
Figure 4: Performance of Big 4 US Banks 15th November 2015 to 31st March 2018



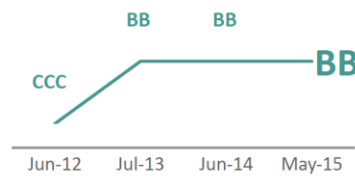
Source: FactSet

Sinopharm Group

INDUSTRY RATING DISTRIBUTION

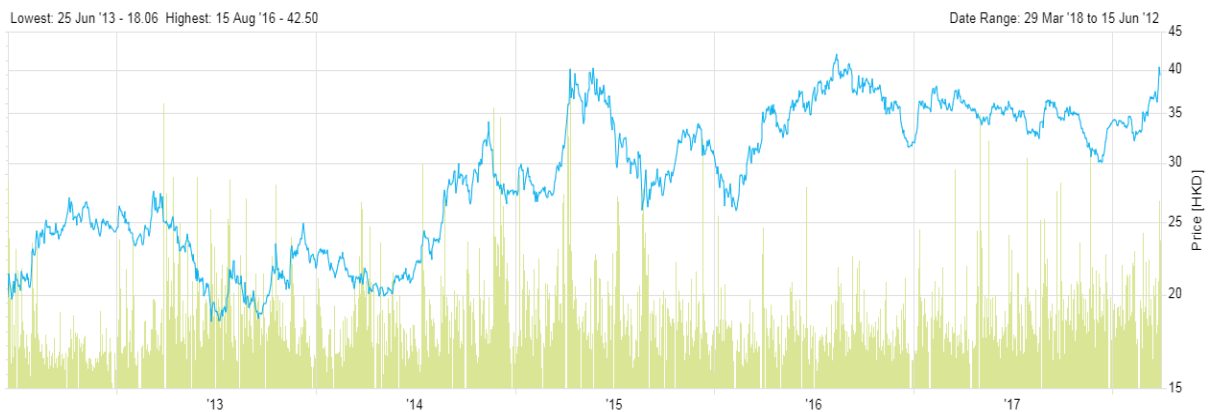


ESG RATING HISTORY



Source: MSCI ESG Research

Figure 5: Sinopharm Group share price 15th June 2012 to 31st March 2018



Source: FactSet

Sinopharm Group is a Chinese pharmaceutical distributor whose MSCI ESG Rating increased from CCC to BB in July 2013, since when the share price has doubled. The company has certified its operations to International Organisation for Standardisation (ISO) 9001 standards and has not had any significant drug recalls or regulatory warning letters since 2013. In May 2017, the rating increased to BBB following the introduction of a better compliance system through provision of employee training and whistle-blower protection.

The US bank example is a particularly good one to show how not only a change in the ESG Rating from the lowest score (CCC) can indicate better management action and improving share price, but also indicates where a down-grading can have an adverse effect. Rating downgrades occur after the event and will not change unless signs of improvement are occurring – as we increasingly incorporate ESG research into our

investment process our aim is to detect the risk of negative events occurring and identifying where a company is making improvements.

Qualitative Research

At RAMAM we are a small team, but there are certain actions we can take to identify ESG issues/risks within companies held and/or being considered. Apart from our quantitative screen, a section on our internal Company Analysis Verification Sheets covers ESG issues as part of identifying key risks to our PVT thesis.

When analysing companies, apart from gaining an understanding of the business and financial management, we believe it is important to identify potential non-financial risks by assessing management's behaviour with regard to customers, employees, suppliers and the environment. Where the MSCI ESG Rating and/or Carbon Emissions Score is low, this is a signal for further analysis. As part of our monitoring process, when MSCI ESG analysts raise issues or there is a significant change in the ESG rating, potential risks are assessed. In assessing these issues/risks we may adjust the weighting of a stock in the portfolio, decide to sell an existing holding or not invest in a new idea.

Greater attention to the impact of sustainable investment is leading to demand by investors for more information on ESG issues and how companies compare. This not only includes more disclosure by companies and specialist research (both buy and sell side), but also more information available on Bloomberg for example. More transparency will potentially lead to the 'best in class' companies in a sector being rated more highly. It also provides a comparator to monitor whether a company is making improvements. As part of our analysis we will compare a company to its peer group and monitor relative progress, then where possible address 'weak' areas directly with management or by supporting shareholder proposals at AGMs.

As part of our research into monitoring how a company is improving shareholder value by positive action on ESG issues, we collate information from Bloomberg and MSCI highlighting how our stocks compare to their peers on ESG disclosure.

See Figure 6 below showing MSCI Sector ESG disclosure. Large companies will generally score higher through having more resources to compile data, however this analysis can act as an indicator (warning) for areas that can be improved or need clarification with the company.

Figure 6: Table of MSCI Sector ESG disclosure

Industry	Security Name	Sedol	Ticker	Portfolio Weight	Benchmark Weight	Rating Change	Current Rating	IVA Adjusted Score	Environmental Score	Governance Score	Social Score	Previous IVA Rating	Previous Industry Adjusted Score	Previous Environmental Score	Previous Governance Score	Previous Social Score
Energy Equipment & Services	WORLEYPARSONS	6562474	WOR-AU	2.42%	0.11%		0 AAA	28.8	26.4	17.7	22.8	AAA	28.8	26.4	17.7	22.8
Energy Equipment & Services	BAKER HUGHES A GE CO A	BDHLT05	BHGE-US	2.58%	0.41%		0 AAA	139.2	139.2	92.8	126.4	AAA	139.2	139.2	92.8	126.4
Energy Equipment & Services	PETROLEUM GEO-SERVICES	B1L7YL5	PGS-NO	0.47%	0.04%		0 AA	42.5	39.0	31.5	39.0	AA	42.5	39.0	31.5	39.0
Energy Equipment & Services	AKASTOR	B1VLVW7	AKA-NO	0.00%	0.01%		0 AA	17.0	15.4	10.4	16.8	AA	17.0	15.4	8.8	16.8
Energy Equipment & Services	AKER SOLUTIONS	BQN1C50	AKSO-NO	0.00%	0.03%		0 AA	17.0	15.4	12.6	15.2	AA	17.0	15.4	12.6	15.2
Energy Equipment & Services	CORE LABORATORIES	2182531	CLB-US	0.00%	0.07%		0 AA	8.1	7.8	5.6	4.8	AA	8.5	7.6	6.6	4.8
Energy Equipment & Services	FUGRO CERT	B096LW7	FUR-NL	0.00%	0.05%		0 AA	15.8	14.4	10.0	20.0	AA	15.8	14.4	10.0	20.0
Energy Equipment & Services	WOOD GROUP (JOHN)	B5N0P84	WG-GB	0.00%	0.21%		0 AA	134.3	124.1	115.6	108.8	AA	134.3	124.1	115.6	108.8
Energy Equipment & Services	TECHNIPFMC	B0SFG98	FTI-US	0.00%	0.47%		0 AA	116.8	116.8	86.4	99.2	AA	116.8	116.8	86.4	99.2
Energy Equipment & Services	NATIONAL OILWELL VARCO	2624486	NOV-US	0.00%	0.51%		0 A	113.6	120.0	94.4	88.0	A	113.6	120.0	94.4	88.0
Energy Equipment & Services	TRICAN WELL SERVICE	2889984	TCW-CA	0.00%	0.03%		0 A	14.2	15.0	11.8	10.8	A	14.2	15.0	11.8	10.8
Energy Equipment & Services	TGS NOPEC GEOPHYSICAL CO	B15SLC4	TGS-NO	0.00%	0.10%		0 A	14.2	11.2	13.4	15.0	A	14.2	11.2	13.4	15.0
Energy Equipment & Services	HUNTING	0447889	HTG-GB	0.00%	0.05%		0 A	13.8	13.2	12.6	12.4	A	13.8	13.2	12.6	12.4
Energy Equipment & Services	TECNICAS REUNIDAS	B16FTB9	TRE-ES	0.00%	0.04%		0 A	13.8	16.8	7.0	12.6	A	13.8	16.8	7.0	12.6
Energy Equipment & Services	MULLEN GROUP	B4MMW16	MTL-CA	0.00%	0.05%		0 A	13.8	13.0	13.4	6.0	A	13.8	12.6	15.4	8.6
Energy Equipment & Services	PETROFAC	B0H2K53	PFC-GB	0.00%	0.08%		0 A	13.4	16.2	8.8	11.0	A	13.4	16.2	8.8	11.0
Energy Equipment & Services	BOURBON CORPORATION	5552993	BBB-FR	0.00%	0.01%		0 A	13.0	12.2	8.0	18.8	A	13.0	12.2	8.2	18.8
Energy Equipment & Services	VALLUREC	B197DR6	VK-FR	0.00%	0.07%		0 A	12.8	12.8	9.4	15.2	A	14.2	14.8	10.2	16.4
Energy Equipment & Services	MCDERMOTT INTERNATIONAL	2550310	MDR-US	0.00%	0.02%		0 A	6.0	6.3	5.1	8.1	A	6.0	6.3	5.1	8.1
Energy Equipment & Services	US SILICA HOLDINGS	B7QGN70	SLCA-US	0.00%	0.03%		0 A	6.0	5.6	6.0	6.9	A	6.0	5.6	6.0	6.9
Energy Equipment & Services	WEATHERFORD INTL	BLNN369	WFT-US	0.00%	0.03%		0 A	6.0	7.6	4.3	6.2	A	6.0	7.6	4.4	6.2
Energy Equipment & Services	SCHOELLER-BLECKMANN	7571305	SBO-AT	0.00%	0.05%		0 A	11.6	11.8	10.2	15.4	A	11.6	11.8	10.2	15.4
Energy Equipment & Services	OCEAN YIELD	BBH7MR1	OCY-NO	0.00%	0.02%		0 A	11.6	12.0	11.0	11.0	A	11.6	12.0	11.0	11.0
Energy Equipment & Services	SHAWCOR A	B9M2YJ3	SCL-CA	0.00%	0.06%		0 BBB	11.4	9.4	13.4	10.4	BBB	11.4	9.4	13.4	10.4
Energy Equipment & Services	SUBSEA 7 SA	5258246	SUBC-NO	1.25%	0.14%		0 BBB	56.0	62.0	52.0	61.0	BBB	56.0	62.0	52.0	61.0
Energy Equipment & Services	SBM OFFSHORE NV	B15T5T7	SBMO-NL	2.64%	0.11%		0 BBB	56.0	55.0	47.0	83.0	BBB	56.0	55.0	48.0	83.0
Energy Equipment & Services	OCEANEERING INTL	2655583	OIL-US	0.00%	0.03%		0 BBB	5.4	5.9	3.8	8.9	BBB	5.4	5.9	3.9	8.9

Source: MSCI ESG Research

Engagement NOT Exclusion

We strongly believe the best process to improve management attitudes is through engagement and peer group pressure, rather than solely excluding a company on 'ethical' grounds, unless specifically requested by a client. We mainly engage on Governance issues, but will do on 'E' and 'S' as appropriate. Even in 'dirty' or 'unethical' industries, we believe it is important for shareholders to assert pressure on companies to operate in the most ethical manner within the limitations of a particular sector. Only when a company is not addressing

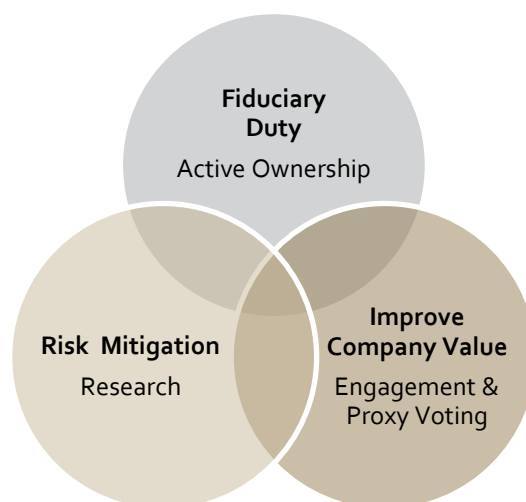
such issues, or management is 'ignorant' to change, would we consider selling a holding or not investing. Two examples shown below:

- Japanese Steel Company: A top decile *Asset Backed/Recovery* stock with ROE improving, which was the reason for buying. Following the announcement regarding the falsification of inspection data the holding was sold. The company's MSCI ESG Rating was downgraded from AA to BBB due to concerns about internal controls, business ethics and the failure of compliance management systems.
- US Luggage Company: Held as a *Growth* stock due to being a leading brand in the luggage sector. The holding was sold after concerns raised by a hedge fund report about the company's accounting practises. Although the company believe the report conclusions are incorrect, our analysis decided that there was enough substance to doubt some accounting practices as artificially supporting expanding margins. The CEO also falsely presented himself as a Dr. on some occasions and in versions of his CV included a PhD, which he did not obtain. The CEO subsequently resigned.
- UK Retail Company: We considered investing in this company, but ESG risks surrounding weak labour management policies linked to poor conditions for warehouse workers and use of zero hour contracts led us not to invest despite scoring highly on *MoneyPenny*, our initial stock screening tool.

Summary

Asset owners and asset managers approach to ESG is developing and expectations for companies are being raised. At RAMAM, we believe ESG is an important component of the investment process however, we also acknowledge that as a small company we have limited resources.

Since RAMAM's inception in 2006 we have taken our fiduciary responsibility seriously, implementing this through our General Principles in respect of corporate governance and voting on important issues and through engagement directly with companies and/or with other shareholders. In the majority of cases when appropriate we have been able to engage with companies, either directly or through voting, to influence change.



Our investment philosophy PVT (Potential, Valuation and Timing), targets these three factors when assessing a stock's potential to generate absolute and relative returns.

The **Potential** of a company represents its ability to create economic value for shareholders. Over the years we have found that the companies that can deliver above average potential divide into four categories; these relate to where a company is in its 'life cycle':

- **Growth** – the delivery of strong revenue and profits growth
- **Quality** – a business franchise that delivers a superior return on investment
- **Recovery** – the process whereby a company produces a recovery in profits to 'normal' levels following decline
- **Asset-backed** – the delivery of asset backed growth to a long-term investor.

The **Valuation** factor seeks to establish the pricing anomaly, the gap between the stock market's valuation of the company and its underlying economic worth.

Finally, **Timing** addresses the issue of when is the right time to buy and sell, thus reducing the risk of being too early into an investment, and optimising the period held and returns generated once an investment made.

Figure 7 shows the development of ESG within our investment process. ESG is now an integral part of the PVT process in identifying non-financial risks for a particular company and finding companies that are improving their operational efficiency through better management of ESG factors.

Figure 7: Environmental, Social & Governance – RAMAM Development

Stage 1	Stage 2 (2016)	Stage 3 (2017)	Stage 4 (2018)
Governance	ESG Quants	Integration into research	Director of ESG Appointed
Full Voting (ISS + RAMAM)	MSCI Data	Incorporation Into Company Verification Process and Note	Analysis of Carbon Emissions risks at company level increased
Engagement (Focus)	Portfolio Analysis Company Data Reporting to Clients	ESG 'Score' Plus Direction of Travel	More Engagement with companies where RAMAM major shareholder

Source: River and Mercantile Asset Management LLP

Gary Dowsett
Director of ESG
October 2018