DART CAPITAL

Investment Brief

July 2021

Introduction

Richard Whitehead
Chief Executive

Over the last quarter we have enjoyed a considerable return to normality at Dart Capital. The City of London remains quiet by historic standards but there has been a steady increase in footfall, particularly into our offices. There is a growing sense of optimism regarding booking holidays, eating out and seeing friends. This feel-good factor is infectious and is a welcome change from a lengthy period of uncertainty.

Over the last quarter we have witnessed Dart Capital's Assets Under Management grow to just under £650m, thanks in part to a period of significant outperformance from our portfolios and through bringing on board some new and very welcome clients. As Alex will write about later our early call on the global recovery last Autumn has helped our performance since then and especially this year.

It is not just new clients we welcome through our doors, we have used this opportunity to bring on board some fresh talent into the business and the latest three hires are highlighted later on.

We welcome back all of you at any point to our HQ in London, offices we took possession of two years ago before the pandemic. I also welcome feedback personally on our business, how we work for you and whether there are any aspects that we can improve on. You are all the best gauge of our business and the service we offer. My door is always open.

New Starters

Josh Loftus
Paraplanner

Josh graduated from the University of East Anglia with a joint honours degree in 2018 and has since been working in the financial services industry for three years. Josh joined our Financial Planning team as a Paraplanner in May and is currently studying towards the Chartered Insurance Institute's Diploma in Regulated Financial Planning. Outside of work Josh is a proud South African and is passionate about South African rugby as well as spending the odd weekend on the golf course.

Joe Healey
Research

Joe has recently joined our Investment Research team following a three year period at a stockbroker in Oxfordshire where he worked as an Investment Analyst. Prior to this, Joe graduated in 2018 with a BA Hons Business Management degree, and is currently studying towards CFA level 2. After hours, Joe is a keen sportsman, has a single digit golf handicap and enjoys football.

Alice Russell
Portfolio Management

Alice recently graduated from the University of Leeds with a Bachelors in Economics; having spent a year studying at two globally respected universities: Hong Kong UST and IE Madrid, and now newly joining the Portfolio Management team. Following the trend, Alice is also a keen sportswoman and outside of work enjoys traveling and spending time with friends and family.

Josh, Joe and Alice all complement the great team we have at Dart Capital and we look forward to helping them develop their skills and knowledge within our business.

House View

Alexander George, CFA
Associate Director
of Research

Whilst concerns over rising inflation did impact markets over the quarter, we believe the backdrop for equities remains supportive, aided by the ongoing upswing in the global economy and supportive relative valuation for stocks when compared to bonds. Having previously adjusted portfolios to benefit from the recovery in the world economy, we will look to trim exposure to more cyclical areas, and equities more broadly, as the global recovery matures, and increase exposure to assets with more defensive characteristics.

COVID-19 Update

The spread of the Delta variant across the UK has unfortunately demonstrated that widespread outbreaks can flare up even amongst nations that have vaccinated a significant proportion of its adult population, with the more contagious strain now dominant across many countries. Whilst the growth in cases is certainly concerning for the UK government, it is notable that hospitalisations are rising at a far slower pace than cases, with the advanced vaccination programme helping limit cases across older age groups that are at most risk of severe illness. Importantly, this should allow the UK government to continue with their re-opening plan, albeit likely with some subtle measures remaining in place.

Inflation

The strong bounce-back that we have seen in US inflation over recent months was largely expected, as rebounding commodity prices, which have increased significantly from their lows last April, and the re-opening of the American economy helping drive the surge in the year-on-year inflation figures. It is particularly notable that the re-opening of the economy has seen labour shortages across lower paid jobs, as workers seek higher wages to take on roles such as food service, whilst supply shortages have driven price rises across goods as diverse as second-hand cars and semiconductors.

Whilst there are few historical parallels for the global economy emerging from a pandemic as it is currently, and the future direction of inflation is not clear at this stage, we do expect many of the factors that have driven the recent surge in inflation to eventually moderate. In particular, inventories will eventually be re-stocked and the surge in demand will abate, whilst the structural forces of high debt levels, ageing populations and rapid technological advancement further imply that downward pressure on inflation will remain.

However, although it would be convenient to assume that the global economy will simply return to the disinflationary environment it was prior to the COVID crisis, we do note that the direction of government policy is changing across western economies and this has the potential to drive higher inflation for a more sustained period. In particular, the confluence of attempts to "level up" society and push towards carbon neutrality are likely to lead to more interventionist government policy than we have become used to over recent decades. The former is notable because periods when governments have attempted to reduce income inequality have tended to coincide with periods of higher inflation as governments resort to money printing to support wealth redistribution. With regards to the latter, US, Chinese and European governments alike are set to engage in huge "green spending" in order to meet their ambitious carbon emission reduction targets over coming decades. This spending is likely to put pressure on scarce resources and drive up input costs across the supply chain, the latter of which will likely also see further rising costs as companies "re-shore" some production which they had previously offshored to Asia.

Based on our assessment of these conflicting forces, we have been wary of having too much exposure to long maturity nominal assets, such as long-dated government bonds, which would see their value wilt in real-terms should this period of inflation last longer than markets are currently pricing in. Conversely, should markets become too emphatic in pricing in an inflationary outcome, we are also comfortable taking the other side of the argument and buying into areas such as profitable technology companies and selective areas of the government bond market which would do best should the disinflationary forces noted above eventually prevail.

Fixed Income

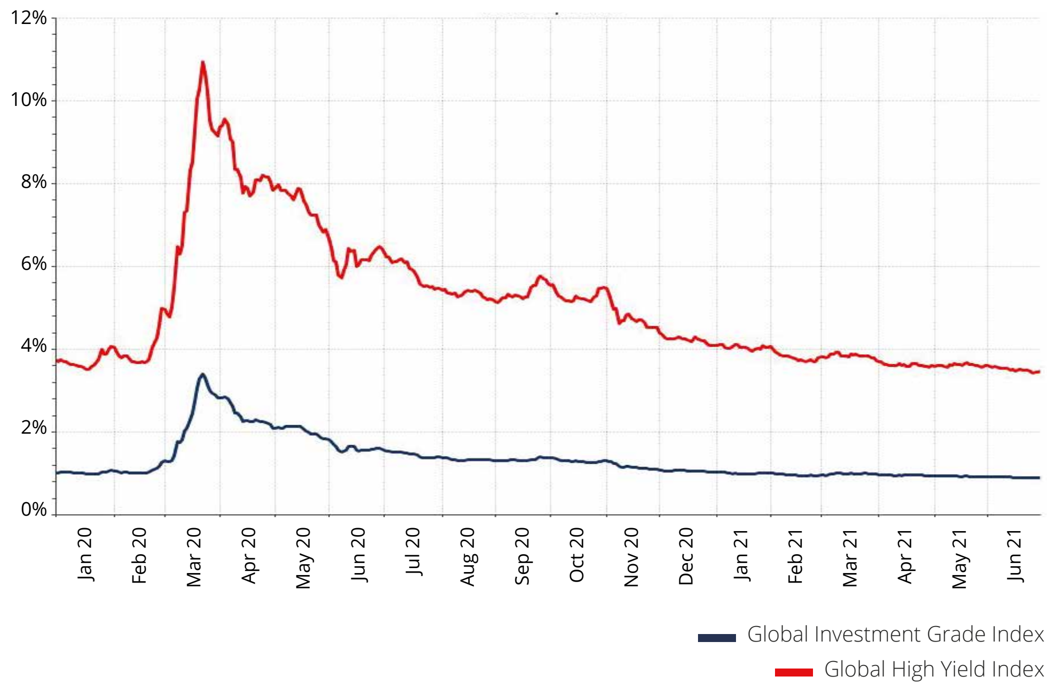
Motivated by the desire to support the nascent recoveries across their economies, we don't expect Central Banks to respond to rising inflation figures by raising interest rates until the economic recovery has become well established, with this stance reinforced by the high nominal debt levels across western economies which make rate rises particularly impactful on economic activity. Whilst the US Federal Reserve did use more cautious language in their June meeting and are now projecting two rate rises in 2023, in our view this is more likely an attempt to quell any concerns over high near-term inflation, and curb speculation across fringe, speculative asset classes, such as bitcoin, than the start of a prolonged tightening of policy.

Whilst we have benefitted from having no direct exposure to longer-dated government bonds as yields have trended higher this year, we have been actively monitoring opportunities in this area given the resilience developed market government bonds can provide during turbulent market environments. Given the higher levels of yield they offer, we continue to prefer US Treasuries within this space and we may look to buy into weakness should an opportunity present itself.

Whereas for much of last year we were very optimistic on the prospect for corporate bonds given the support provided by Central Bank bond buying and government support programmes, we have tapered this view more recently as credit markets have returned to the expensive valuation levels they traded at prior to the COVID pandemic. In particular, we have moved to reduce exposure to lower quality bonds which are most exposed to the eventual withdrawal of government support, such as the furlough scheme in the UK, in a post-COVID world. We have redeployed this capital into diversified Strategic Bond funds, managed by experienced teams that are able to carefully select the corporate bonds of worthy issuers, and combine this with selective government bond exposure which can deliver resiliency during periods when market sentiment weakens.

The additional yield available on Investment Grade and High Yield bonds has continued to decline

Credit spreads



Source: Refinitiv Datastream

Equities

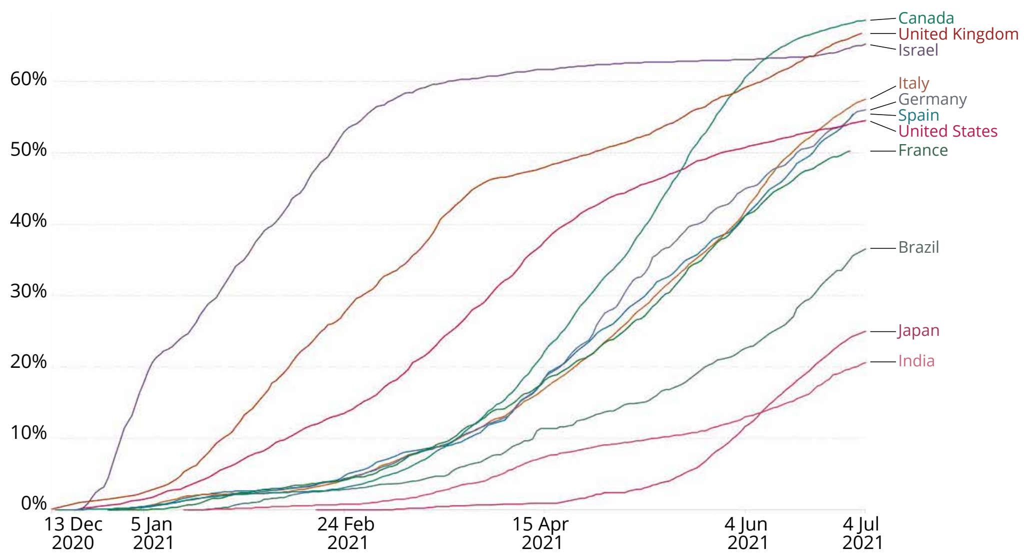
As we have discussed in our recent House View pieces, following the vaccine news of last November we moved swiftly to reposition portfolios towards those areas that tend to perform best during periods of global economic recovery. In doing so, we used the 2012/13 and 2016/17 periods as a useful – albeit certainly not all encompassing - guide to how different styles of fund could perform in such an environment and following due diligence we introduced several of these funds into portfolios over the November-January period. Whilst these moves have already started to benefit portfolios, we believe there is still further to run as institutional and retail capital filters down into areas such as smaller companies, Emerging Markets and domestically sensitive Japanese stocks, where sentiment remains relatively muted.

Having seen a steady stream of acquisition bids since the referendum vote in 2016, the second quarter saw an avalanche of bid activity across the UK market. The most high profile of these bids was for supermarket chain WM Morrisons - itself a longstanding top holding for one of our core UK equity funds, Threadneedle UK Equity Income – at a hefty premium to the prevailing share price. This move has subsequently seen multiple suitors making offers with the expected closing deal value likely to be over 50% above Morrisons share price prior to the initial bid. As we have discussed in this space previously, the low valuations available on many UK-listed companies when compared to their US and continental European counterparts – along with supportive government policy and strong property rights - make it attractive to overseas and Private Equity buyers. Private market buyers are particularly cash rich and deal hungry given they are unable to charge fees unless they carry out successful acquisitions, and we expect them to continue to provide a bid for UK small and mid-cap companies with solid businesses, many of which we have exposure to across our portfolios.

Within international equities, we moved to close our underweight position to European equities in early April, with the move financed by trimming exposure to the US market. At that time, whilst COVID cases were rising across the continent and this was depressing market sentiment, we believed that the acceleration of the vaccination programme across the region would provide a positive catalyst for European stocks later in the year and this has started to play out since we made this move. Looking ahead, we believe the push to increase spending on environmental technologies has the potential to increase revenue growth rates across traditionally cyclical industries, with the region's lead in this area standing in contrast to the biggest growth industry of the 2010s – software – in which the US has a dominant position.

The Eurozone has seen an acceleration in its vaccination programme

Share of people who received at least one dose of COVID-19 vaccine

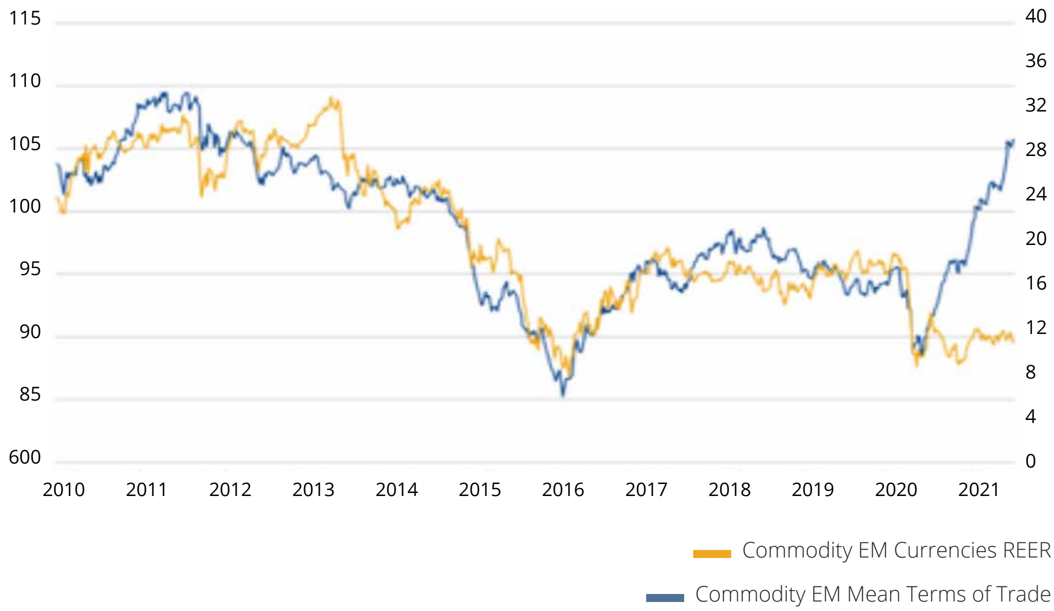


Source: Official data collated by Our World in Data

With the exception of Asian technology-focused funds, investor capital has gradually departed Emerging Markets over recent years in favour of Developed Markets, which we believe has left many attractively valued opportunities, particularly for our nimble manager who can take advantage of these inefficiencies. The medium-term outlook is further bolstered by weak local currencies following a decade of US Dollar strength, and strong commodity prices which are particularly beneficial for areas such as Latin America.

Commodity prices should be a huge boon for commodity exporters

Emerging Market currencies remain weak despite improving fundamentals



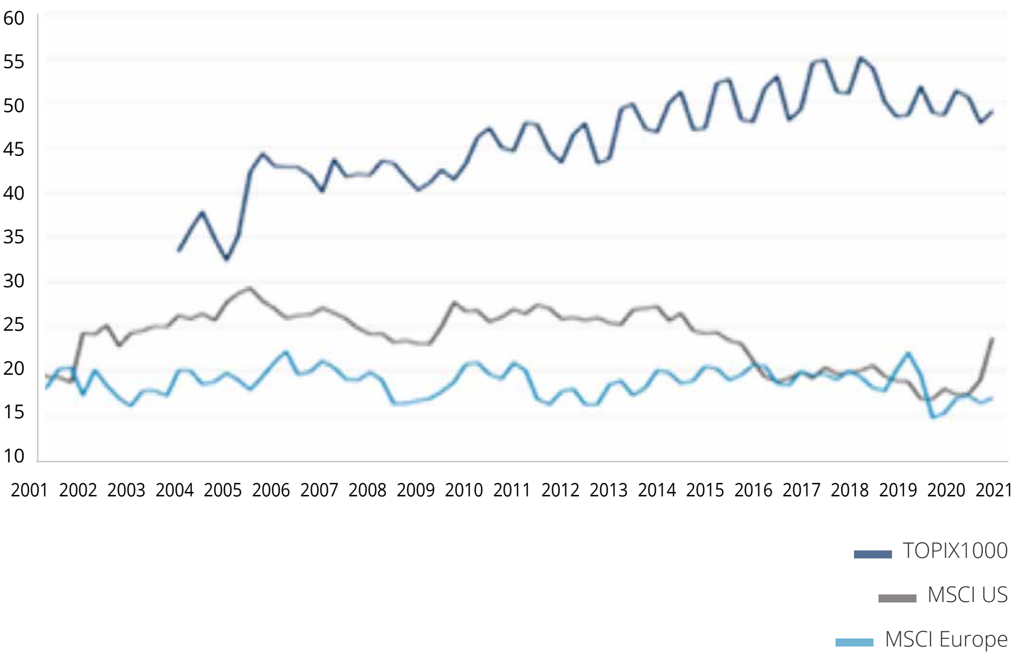
Source: Bloomberg, Allianz

Although Japanese stocks have lagged most other markets this year, we are optimistic for the prospects for our favoured fund in the country, Polar Capital Japan Value, given its exposure to reasonable quality businesses trading on low valuations, most of which have significant excess cash on their balance sheets. Whilst we see a pick-up in Japan's vaccination programme as one likely catalyst for Japanese stocks, we expect ongoing corporate governance change to provide a further boost to returns.

Most notably, Japanese government policy is increasingly focused on ensuring companies place greater importance on shareholder returns, with a new minimum 8% return-on-equity target, amongst other measures, helping to push companies to make their businesses more efficient. Importantly for shareholders, the easiest way for companies to meet this target is to reduce the huge amount of cash sitting on their balance sheets, through increased dividend payments and share buybacks. We see the greatest potential to be in the small and mid-cap area of the market where companies have – up until now – been slower to improve their corporate governance. Pleasingly, the Polar fund is already starting to benefit from this theme, with one of its largest holdings, Secom Joshinetsu, receiving a takeover bid from its parent company at a c.66% premium.

Many Japanese companies are sitting on stronger cash positions than their counterparts in the US and Europe

Percentage of net cash companies



*TOPIX1000 represents the Japanese market
Source: Polar Capital

We continue to retain a holding in a global mining fund across higher risk strategies which are best able to deal with the volatility associated with a direct holding in the sector. Whilst investors have started to embrace the mining sector's importance in facilitating the energy transition owing to the key role metals such as copper and nickel play in building electric vehicles, wind turbines and the like, we don't believe the valuation multiples across the industry sufficiently reflect the structural demand growth and tight supply the industry is facing. With the US and EU implementing their infrastructure spending plans over coming years, the onus will shift from China, which has been the biggest driver of global commodity demand over the last two decades, and valuations on mining companies could well re-rate as a result.

Commodities

With real (inflation-adjusted) interest rates likely to remain in negative territory and Central Banks intent on maintaining growth of the money supply, we believe the gold price should remain well supported as investors seek longstanding value which is largely free from government intervention.

Property

Within commercial property, we continue to favour closed-ended funds (known as REITs) that are better suited for the illiquid nature of property investment when compared their open-ended peers. Across our higher risk strategies that are best positioned to tolerate the volatility associated with owning a REIT, our holding in closed-ended REIT, BCPT, enjoyed a strong quarter. The stock was bolstered by a combination of a solid earnings report that showed that its net-asset value increased slightly over the first quarter of the year and the announcement of a share buyback, whilst the re-opening of the economy more broadly further boosted sentiment. Even following the share price gains, BCPT still trades at over a 20% discount to its net asset value, which, whilst understandable, we do not believe is justified given the good quality assets which the trust owns, including a prime office in Mayfair which has historically been highly sought after by overseas buyers.

Market Commentary – Q2 2021

Alexander George, CFA
Associate Director of Research

It was another strong quarter for equity markets, as accelerating vaccination programmes across western economies helped bolster market sentiment. Much market commentary, and attention, has been focused on inflation, where many developed economies have recorded a surge in inflation following the low year-on-year bases of last April.

UK

Aided by the loosening of lockdown restrictions, the UK economy has rebounded strongly, with the latest survey figures showing strong growth in both the manufacturing and services sectors, the latter posting the highest reading in 24 years. Against this buoyant backdrop, growth rates have been revised upwards for the remainder of the year by most economists, with the average forecast expecting 7% growth in GDP this year. The only significant limiting factor to the growing optimism is the continuing spread of the Delta variant, with COVID cases picking up throughout June which effectively forced the government to postpone the final stage of re-opening which was originally set for the 21st June. However, aided by the advanced vaccine roll-out across older generations, hospitalisations have been increasing at a far slower pace than cases, and we expect the government to proceed with the re-opening on the 19th July albeit with some restrictions remaining in place.

Inflation figures rose over the quarter topping the Bank of England's targets at 2.1% in May as the year-on-year impact of the bounce-back in the oil price reached its peak. The data emanating from the domestic labour market has remained stable albeit certainly aided by the government's furlough scheme that isn't set to end until September, with the unemployment rate actually falling slightly to 4.8% in May. Gilt yields were broadly stable over much of the quarter, before falling back slightly during June to end the period 13 basis points lower at 0.72%. UK equities continued their positive run, with MSCI UK All-Cap ending the month up 4.8% in sterling terms.

US

The US economic recovery continued to gain pace over the quarter, with the services sector showing a particularly strong pick-up in activity as households moved to spend pent-up savings and recently received stimulus cheques. Increasing economic activity has driven a decline in the unemployment rate, which fell to 5.8% in May, as employers added over 550,000 jobs.

Of all developed economies, inflationary pressures are building most clearly within the US economy, with inflation moving up to 5% year-on-year in May according to data released in June, although we do expect this to decline closer to 3% towards the end of the year as the year-on-year gain in commodity prices moderates. Having previously indicated that they won't tighten monetary policy until an economic recovery is further entrenched, the Federal Reserve's monetary policy committee did surprise markets in their June meeting by projecting that they could raise interest rates twice in 2023 whilst indicating that they will likely start to taper their asset purchase programme at some point later this year. This messaging helped drive a strengthening of the Dollar late in the quarter, and, somewhat counterintuitively, a fall in longer-dated Treasury yields as traders questioned whether the Federal Reserve tightening will have a damaging impact on the economic recovery. The yield on the 10 year Treasury ended the quarter 28 basis points lower to the end the period at 1.47%.

Having led the market higher up until that point, more economically sensitive sectors – particularly financials – lagged over the second half of the period as Treasury yields declined, whilst more defensive areas of the market – particularly large-cap technology stocks - outperformed. The S&P 500 gained 8.2% in US Dollar terms over the quarter.

Europe

The EU's vaccination programme picked up pace over the quarter and recent data showed that the region has already started to rebound from its contraction over the first quarter. In the same vein as other regions, inflation across the currency bloc picked up over the period, with growth in consumer prices of 2.0% year-on-year in the 12 months to May, based on official data. Having tapered their Quantitative Easing policies too early during previous recoveries, the European Central Bank (ECB) seemed intent on not repeating the same mistake, and committed to maintain their asset purchases at their current level despite the improving outlook for the economy as they wait for the recovery to become fully entrenched before tapering their stimulus. MSCI Europe ex-UK gained 5.6% in local currency terms over the quarter.

Asia

Despite the Chinese economy growing strongly over the first quarter when compared to the heavily COVID effected period a year ago, indications that the Chinese authorities are attempting to slow credit growth across the economy served to temper optimism towards the country's stocks over the quarter. MSCI China H ended the period down 2% in local currency terms.

Having seen far lower COVID cases and fatalities than most developed countries over 2020, Japan has struggled with a pick-up in cases over recent months which in-turn has forced regional governments to re-enforce lockdown restrictions. However, with the vaccine rollout picking up pace, the outlook for the Japanese economy and stock market is improving. MSCI Japan ended the quarter flat in local currency terms.

Commodities

Having fallen back amidst rising government bond yields over the first quarter, the gold price firmed over the period, gaining 3.7% in US Dollar terms to end the period at $1,770 per oz. Whilst demand for oil has picked up amidst a rebound in car and airline travel led by the US, this has not been met with increased supply with cartel OPEC yet to agree to supply increases. The oil price increased $12 over the quarter to end the period at $75 per barrel (based on Brent Crude).

Fund Spotlight River & Mercantile European

Launch Date:	02/10/2020
Fund Size:	£64.8m
Asset Class:	European Equity
Manager:	James Sym

James Sym

The River & Mercantile (R&M) European fund was added to our managed portfolios at the beginning of April prompted by the attractive opportunity to benefit from the recovery in corporate earnings across Europe. The fund manager, James Sym, joined R&M during 2020 and launched the European fund in October of last year. James was at Schroders prior to joining R&M where he had an impressive track record managing the Schroder European Alpha Income fund from 2012 to 2020.

The fund takes a different approach to many European funds that can be very narrowly positioned in very highly valued growth stocks, instead positioning the portfolio to take advantage of the current stage of the business cycle, applying a pragmatic contrarian view that lends itself to buying quality companies without paying excessive premiums or being deep value. James believes that each business cycle is unique and has identified three themes which he believes will be important to capture upside.

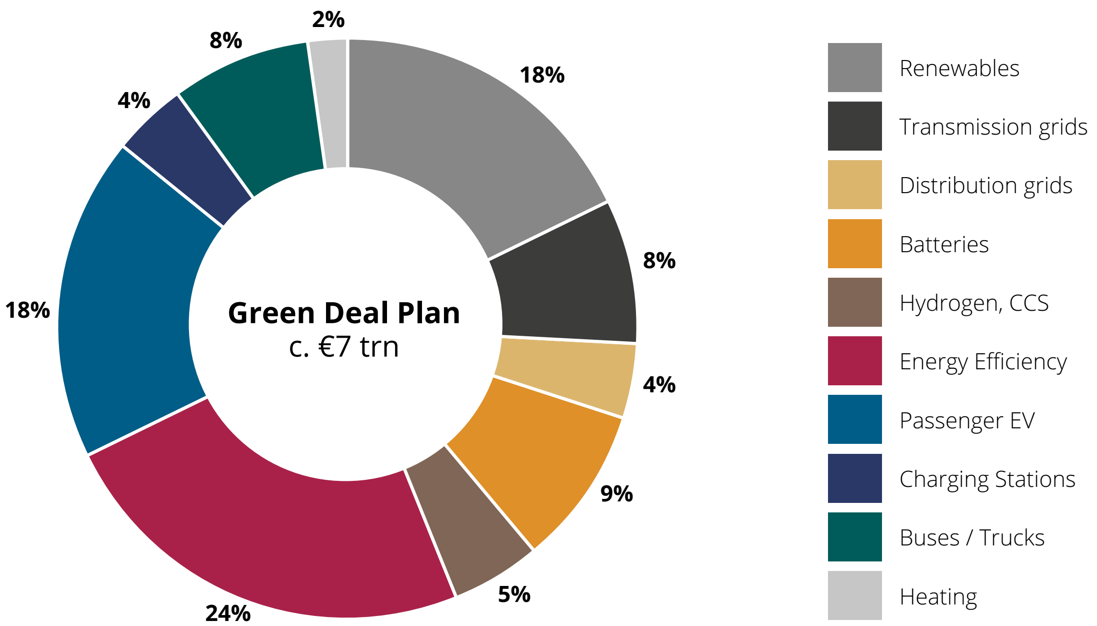
The first of these themes is recovery stocks. These are stocks that have experienced depressed earnings throughout the pandemic and are on low valuations relative to their fundamentals, but will be able to capitalise on improved positioning within their respective industries and increasing nominal GDP during a period of economic recovery. A bounce back in earnings alongside valuation re-rating can lead to strong returns in sectors such as industrials and financials.

The second theme is inflation protection. Real assets in the form of commodities, such as mining stocks, are traditionally regarded as inflation hedges, typically rising with inflation as the demand for resources in a growing economy increases. James has exposure to this through names such as Swedish mining and smelting company Boliden. However, James also sees opportunity in other forms of real assets such as salmon where supply is becoming constrained. Bakkafrost, a salmon farming company that produces some of the highest quality salmon is held in the portfolio and has potential to establish its brand in this market.

The third theme is ESG credentials where the fund places emphasis on companies which are expected to benefit from growing environmental spending over the coming years as the EU targets carbon neutrality by 2050. Typically direct exposure to ESG names in sectors such as renewable energy means a growth bias and high valuations, however James prefers exposure to these themes through a number of indirect beneficiaries of this structural trend. This is well demonstrated by exposure to glazing and insulation provider Saint-Gobain, a business which the fund manager believes is well positioned to benefit from a huge increase in spending as governments push to make buildings more energy efficient.

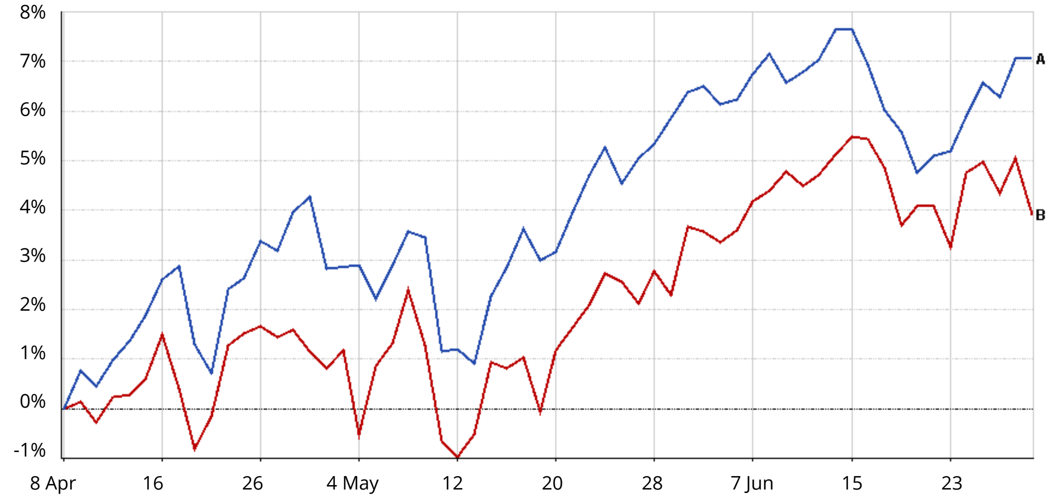
Having launched just 9 months ago, the fund remains nimble in size and has allowed James to rotate the portfolio since the vaccine announcement into stocks that he believes offer the best upside. Since its addition to model portfolios the fund has outperformed its benchmark, and performed well on an absolute basis capturing the delayed recovery European equities have experienced when compared to the US market.

Privately funded energy investments
c. €3 trn
(Renewables, Grids, Storage)



Source: River and Mercantile Asset Management

Performance of the R&M European fund vs its benchmark, MSCI Europe ex UK IMI, since its addition to managed portfolios in April.



A - R&M - ES River and Mercantile European F Inc TR in GB (7.07%)

B - MSCI Europe ex UK IMI TR in GB (3.90%)

08/04/2021 - 30/06/2021
Data from FE fundinfo 2021

Past performance is not a guide to future performance

Performance of R&M European fund vs its benchmark, MSCI Europe ex UK IMI, since the fund's inception in October 2020.

A - R&M - ES River and Mercantile European F Inc TR in GB (28.37%)

B - MSCI Europe ex UK IMI TR in GB (20.67%)

02/10/2020 - 30/06/2021
Data from FE fundinfo 2021

Past performance is not a guide to future performance

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