ROTHKO

ROTHKO INVESTMENT STRATEGIES

The Unprecedented Opportunity in Income-oriented Value Equities

April 2021

Many plans are either rebalancing towards value or were already overweight, having had a bruising 2020. It could be time to review these positions given the continuing rally in Income-oriented Value names, a trade which we believe may ultimately rival the reversal of 1999. It's just a question of selecting a high active share manager that can gain exposure to sustainable Income-oriented Value opportunities in a reliable and verifiable way. Enter Rothko.

In this piece:

1. **Income-oriented Value for the 2020s** – Recent yield volatility and uncertain inflation expectations are likely to remain the catalyst for the continued sustained outperformance of Income-oriented Value.

2. **Acute dislocations unwind in Q1 … with more to come** – the unwinding of acute dislocations in Income-oriented Value from 2020 are translating into strong performance this year, and we believe there is much more to come.

3. **The intrinsic value reversal** – while acute dislocations are unwinding in Income-oriented Value names, broader measures of intrinsic value still remain chronically undervalued based on historic and forward-looking valuation metrics. We believe that the conditions are in place to see a reversal of the decade-long, chronic underperformance of selected Value names.

4. **Rothko - Consistent, high realized yield –** The best investment approaches might be about truisms… and at Rothko we believe that by selecting stocks with the strongest ability to grow dividends, we will extract the strongest long-run income for investors. Please excuse the expression, but the "proof is in the pudding" – we are offering one of the highest realized yields in the business.

Income-oriented_Value_Decade_Q121_Rothko

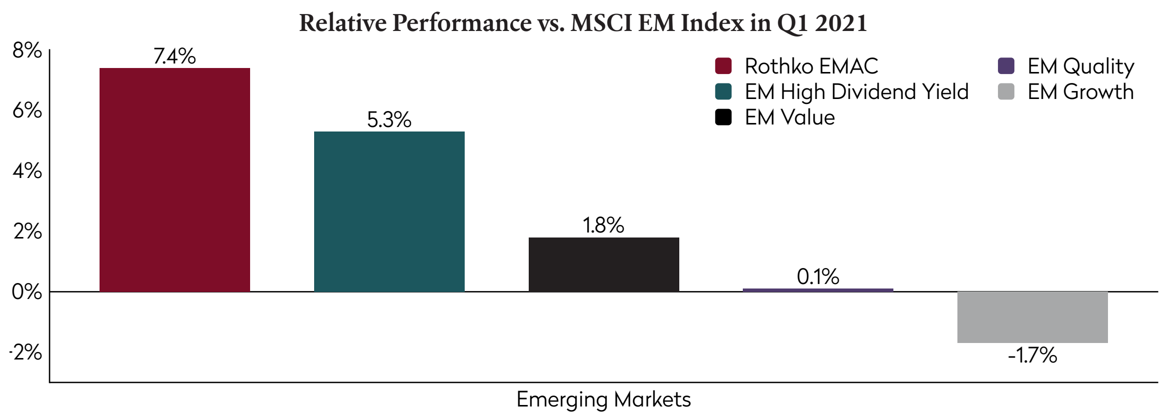
1. Income-oriented Value for the 2020s

Sustained reversal of Income-oriented Value

Major central banks plan to inject well over $8.5 trillion into the global financial system, which has stabilised markets but inflated asset values. However the bigger deal for the real economy will be fiscal stimuli, of which $1.9 trillion is expected in the US alone. The resulting elevation and volatility in rates, together with uncertain inflation expectations have rocked the Growth trade and have provided a catalyst that has so far caused the start of a sharp reversal in Income-oriented Value performance in Q1. We see these forces being less about fundamental actions between stimulus and asset prices, and more about a catalyst to correct dislocations in Growth versus Value. It could have been many different catalysts that propelled the markets to more efficiently price a stock's dividend income generating potential, but in this event it was volatile real rates.

This is especially evident in Emerging Markets (EM). While Income and Value did well, stock selection of superior income-oriented names added significantly to returns. Rothko's Income-oriented Value outstripped style benchmarks and generated a relative return vs the MSCI EM Index of +7.4% in Q1 (net of fees, see Exhibit 1). We see this as only the start of a secular rotation away from Growth as the real income streams underlying the names we hold still remain deeply undervalued. It seems likely that the market will continue to reward real income generating potential as government real yields around the world fluctuate in negative territory.

Exhibit 1: EM Growth Falters as Income-Oriented Value Surges in Q1 2021



Sources: MSCI, Rothko Investment Strategies. R-EMAC relative performance shown net of fees

2. Acute dislocations unwind in Q1 … with more to come

September 2020 represented a nadir for relative valuations for Income-oriented Value names, particularly in EM. Such extreme undervaluation levels have not been seen in recent history. They resulted from the acute Covid-19 dislocation added to the chronic long term undervaluation that has affected Value assets more broadly. The mean reversion of Income-oriented Value is now, we believe, in full swing.

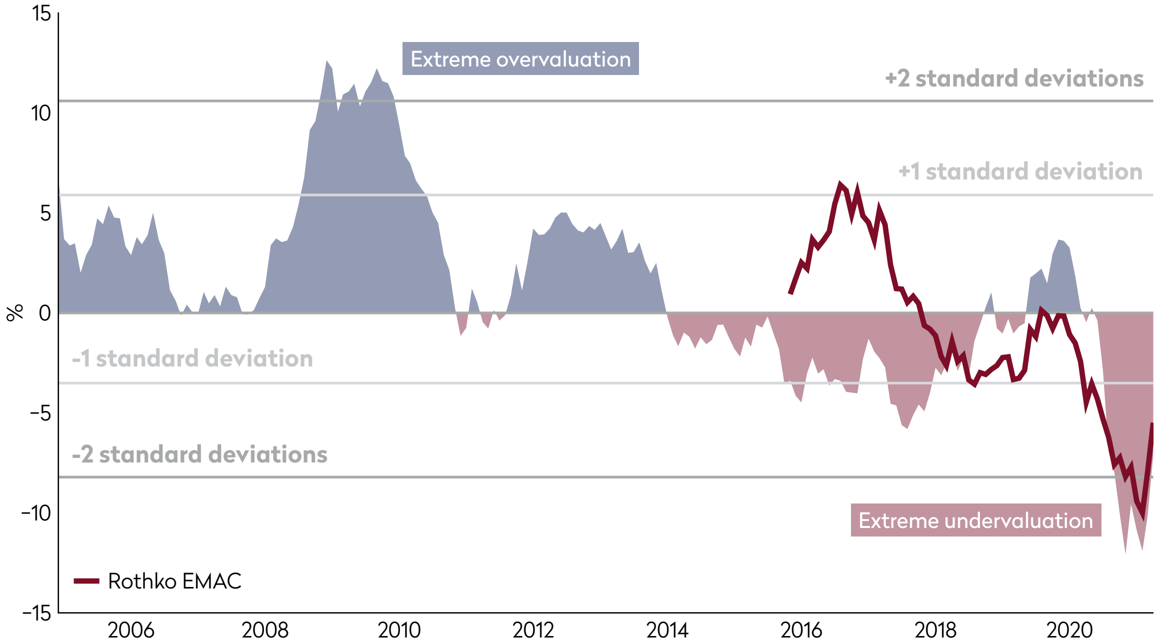
Outperformance expected to continue

Income-oriented Value names historically have a strong tendency to bounce back, showing strong mean-reversion when undervalued (Exhibit 2). The Rothko Emerging Markets All Cap strategy followed this familiar tendency with a sharp spike upwards in relative performance versus the MSCI EM Index (Exhibit 2, red line) this year. With the dual catalysts of elevated rates and uncertain inflation, we expect a strong bid for Income-oriented Value names to remain over 2021 and beyond. It is also quite possible that the mean reversion of Income-oriented Value names will overshoot, as it has in previous periods (see Exhibit 2). We expect this overshoot to happen to the point that we see a release of some of the pent up value built up over a decade of Value's underperformance. It feels like we could experience a slow motion replay of the 1999 reversal of fortunes for Growth names. Given the prevalence of lower active shares among "active" managers, we believe, as a high active share, Income-oriented Value manager, Rothko stands to be a key beneficiary.

Exhibit 2: Income-Oriented Value in EM Starts to Bounce

Rolling Two-Year Relative Return to 31 March, 2021

MSCI EM High Dividend Yield Index and Rothko EMAC vs. MSCI EM Index



Source: MSCI, Rothko Investment Strategies. R-EMAC net composite returns since inception

3. The intrinsic value reversal

2020's sell-off in Income-oriented Value was one of the most severe, and bizarre dislocations of the Coronavirus crisis. In a world where rates had plunged and revenue uncertainty dogged corporates across the world, the very names that were still able to increase dividend payments in a crisis year were still sold down in favour of names that, in many cases, had no intention of rewarding shareholders into the foreseeable future. It just did not stack up, and to this day, in our assessment, the differences in valuations still do not. This dislocation has started to strongly reverse, and there are many signs that this will continue.

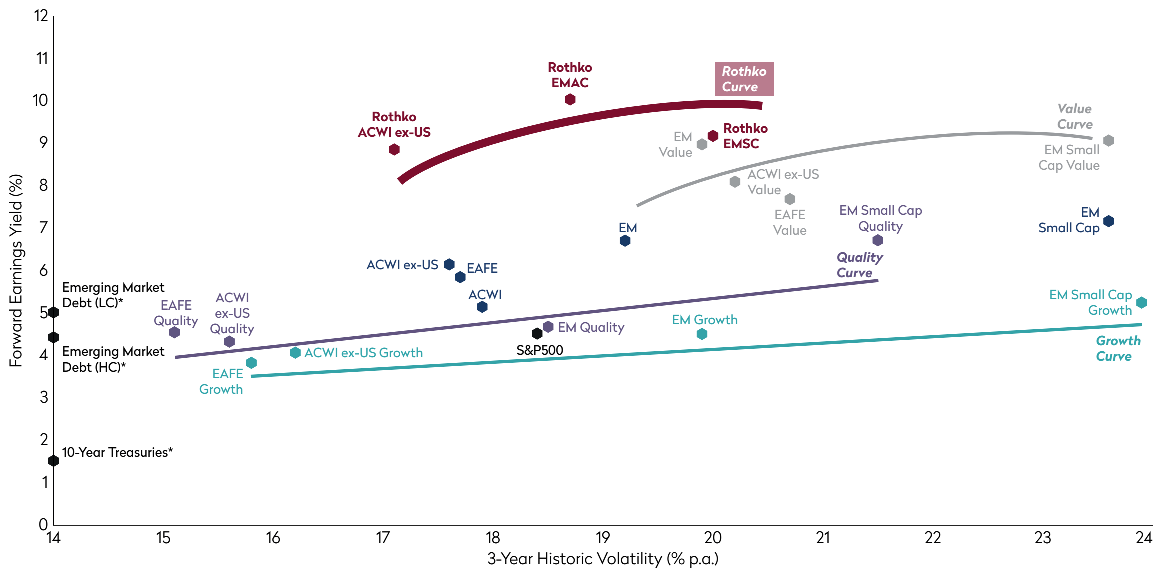
The efficient frontier is Rothko

One way to view the extent of these dislocations is in the mispricing of forward earnings (Exhibit 3) (which are, of course, linked to future dividend growth). The most striking observation is the curve created by Rothko's international and EM equities strategies. In fact, Rothko now represents the efficient frontier, offering a higher earnings potential for lower risk. When compared to MSCI's naïve definition of EM Value, Rothko Emerging Markets All Cap's (EMAC) forward earnings yield is considerably higher (10% vs 9%) whilst exhibiting significantly lower risk (note the upper left location of Rothko EMAC versus the MSCI EM Value Index in grey). Also notable is the unattractiveness of Growth on this measure, with not just historically low forward earnings yields, but also a relatively flat curve, showing that there is little to separate the more risky Growth assets from the less risky ones. This, in turn, raises questions as to the wisdom of investing far out on this Growth risk-curve.

If the sell-off of Income-oriented Value looked bizarre last year, the valuations these names still trade at today looks almost equally stretched. The conditions seem to be in place to see a continuation of the "great income reversal", and as a high active share, Income-oriented Value manager, we feel Rothko is well placed to benefit.

Exhibit 3: Rothko Remains the Efficient Frontier

Forward Earnings Yield vs. 3-Year Volatility



*All indices shown are MSCI with the exception of S&P500, Emerging market debt (LC and HC), 10-year treasuries. Forward earnings yield for Rothko calculated using analyst estimates for Earnings Per Share

For EMAC 25 stocks did not have EPS estimates so the portfolio earnings yield was calculated using the remaining securities and pro-rating their weights (88% of portfolio). For EMSC 41 stocks did not have EPS estimates so the portfolio earnings yield was calculated using the remaining securities and pro-rating their weights (74% of portfolio). For ACWI ex US 4 stocks did not have EPS estimates so the portfolio earnings yield was calculated using the remaining securities and pro-rating their weights (97% of portfolio). 10-year treasuries volatility = 5.5%, Emerging market debt (HC) volatility = 11%, Emerging market debt (LC) volatility = 13%.

Sources: MSCI, iShares, S&P, FactSet, Rothko

4. Rothko - Consistent, High Realized Yield

Rothko's approach systematically selects names, aiming to find those with strong fundamentals and high intrinsic value that are able to grow dividends in the future. Evidentially, Rothko's portfolios have consistently generated among the highest real income streams in each of our peer groups (Exhibit 5 and 6), consistently outperforming on this measure (Exhibit 4). The reason this is important is that a material portion of our relative returns come from the dividend component of the stocks in which we invest.

Rothko - high income, lower risk

The alternative to using a bottom-up, systematic approach like Rothko's is to use factors. Factors have disappointed over the past 10 years and particularly over this crisis. Viewing the world through the distorted lens of factors has caused many quant approaches to miss opportunities, and others to be sucked into value traps. We believe that investing in international equities is about bottom-up stock selection, high active share, and intrinsic value, not about the unreliable correlations that factor approaches tend to rely on to tilt portfolio exposures.

Rothko's systematic stock selection approach has generated a consistent and high realized yield since inception (i.e. the sum total of US$ dividend you actually receive, for every dollar you invested in the strategy). This is true of all of our strategies. The Rothko Emerging Market All Cap strategy, our longest track record, has a current realised US$ dividend yield of +4.5%. That means for $100m invested at March 31 2020 an investor would have received total net dividends of $4.5m (gross of fees) by March 31 2021.

Exhibit 4: Consistent, high realized yield

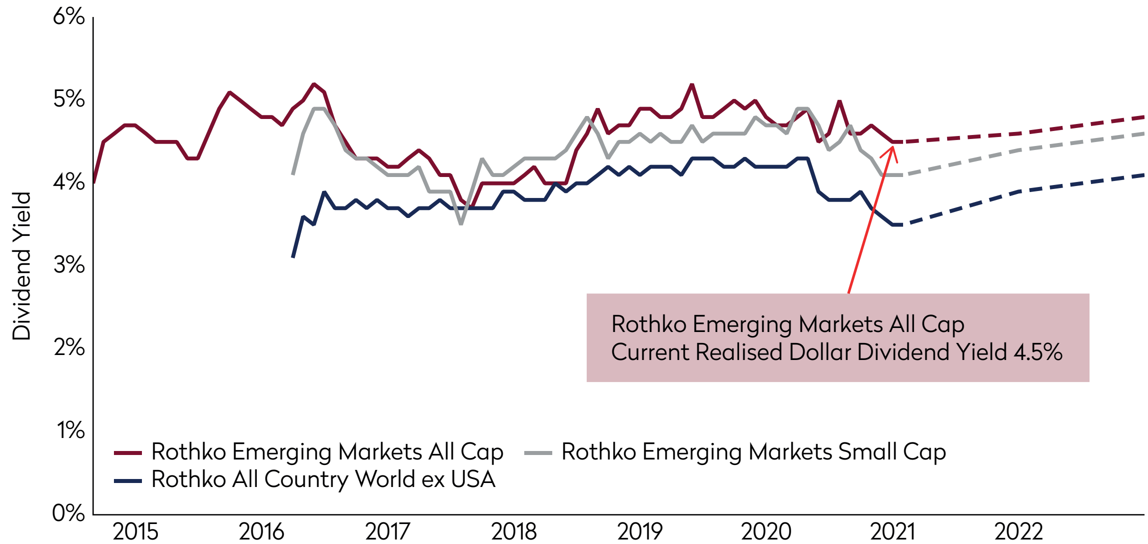


Exhibit 5: High Dividend Yield

December 31, 2020

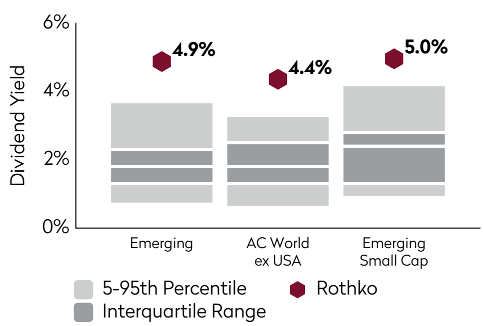
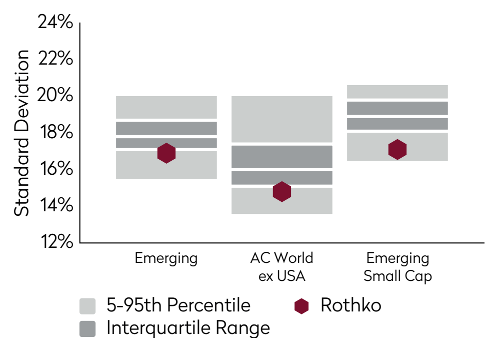


Exhibit 6: Low Relative Risk

Five Year Annualised Standard Deviation
December 31, 2020



Sources: eVestments and Rothko Investment Strategies.

All strategies, in the eVestment universes detailed, which had provided the relevant data (Q4 2020 dividend yield or full five years of monthly returns) were used in the box plots. Universes: Emerging - eVestment Global Emerging Mkts All Cap Equity (full universe, 313 strategies), AC World ex USA - eVestment ACWI ex-US All Cap Equity (134), Emerging Small Cap - eVestment Global Emerging Mkts Small Cap Equity (81). Realised Dividend Yield: sum of previous 12 months monthly net dollar dividend income received divided by the monthly market value of the fund.

Current and projected dividend yield is not a reliable indicator of future results.

The Unprecedented Opportunity in Income-oriented Value Equities

Income-oriented Value equities represent the most significant dislocation of the Covid-19 crisis and, in our view, provide the most compelling return opportunity of the 2020s. Performance has been excellent this year, but the real income streams underlying the names we hold remain deeply undervalued. There is potential for much, much more alpha to come.

A key question remains whether allocators can take advantage of this opportunity? The growth tilted "buy on the dips" philosophy could prevent full participation in this unfolding secular return story. At the same time, allocators who feel they are "all in" on Value, hurt by the 2020 experience, risk sitting on the side lines as their views start coming good. It is not an easy decision, but to miss out on a rotation of this magnitude would be more painful still.

Rothko's portfolios have consistently and evidentially generated among the highest real income streams in our peer groups, while being lower quartile in respect of risk (standard deviation). Time and again factors have disappointed and have proven no substitute for bottom-up stock selection in our view. Rothko remains a highly compelling opportunity for defensive, high active share participation in the Income-oriented Value reversal of the 2020s.

Disclosure

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Disclosure: Rothko Emerging Markets All Cap Equity Composite

Annual Performance

Year	Total Gross USD Return	Total Net of Fees USD Return	Benchmark USD Return	Composite Standard Deviation	Benchmark Standard Deviation	Number of Portfolios	Composite Dispersion	Total Composite Assets (USD m)	% of Firm Assets	Total Firm Assets (USD m)	Total Firm Assets and Advisory Assets (USD m)
2013	-1.15%	-1.32%	1.83%	N/A	N/A	1	N/A	8.1	0.01	70,356	75,081
2014	0.32%	-0.38%	-2.19%	N/A	N/A	1	N/A	8.1	0.01	64,102	69,429
2015	-10.92%	-11.54%	-14.92%	N/A	N/A	1	N/A	7.2	0.01	56,857	62,158
2016	18.52%	17.70%	11.19%	16.04%	16.07%	1	N/A	8.5	0.01	59,033	64,257
2017	28.56%	27.67%	37.28%	15.65%	15.35%	1	N/A	10.9	0.02	62,751	69,504
2018	-10.93%	-11.55%	-14.57%	13.61%	14.60%	1	N/A	6.1	0.01	47,789	53,740
2019	13.58%	12.79%	18.42%	12.10%	14.17%	2	N/A	12.6	0.02	54,401	61,316
2020	3.37%	2.65%	18.31%	18.93%	19.60%	1	N/A	7.2	0.01	54,894	58,974
2021 (to Mar 31)	10.13%	9.94%	2.29%	18.69%	18.89%	1	N/A	5.7	0.01	57,163	61,410

Accompanying Notes Concerning Performance Calculation and GIPS® Compliance

- This composite was created and incepted in October 2013.
- Past performance is not a guarantee of future results.
- A list of composite descriptions, pooled fund descriptions for limited and broad distribution pooled funds and the policies for valuing investment, calculating performance and preparing GIPS reports are available on request.

Mondrian Investment Partners Limited ('Mondrian') claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Mondrian has been independently verified for the period 1 January 1993 to 31 December 2019. The verification reports are available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

The Firm is defined as all discretionary portfolios managed by Mondrian. Mondrian is a value-oriented defensive manager seeking to achieve high real returns for its clients. Mondrian equity mandates apply one of two styles: 'Mondrian' portfolios invest mainly in securities where rigorous dividend discount analysis identifies value in terms of the long-term flows of income. Mondrian's methodology is applied consistently to markets and individual securities. 'Rothko' portfolios are designed to be value-orientated with defensive characteristics.

The Rothko Emerging Markets All Cap Equity Composite includes U.S. dollar based discretionary portfolios, measured against the Morgan Stanley Capital International EM or equivalent Index net of withholding taxes. The portfolios are invested primarily in publicly traded companies based in an Emerging Market, or deriving a majority of revenue within Emerging economies. Shares may, however, be listed on more developed exchanges.

Since inception to date, the Rothko Emerging Markets All Cap Equity Composite has consisted only of seed capital portfolios, which were non-fee paying and had no external investors.

Total Firm Assets are assets for which the firm has investment management responsibility. Composite assets are assets for composite qualifying portfolios for which the firm has investment management responsibility. Firm advisory assets are assets for all strategies within the firm for which Mondrian provides investment recommendations only; trading and implementation of the investment decisions is independent.

Portfolios are valued on a trade date basis using accrual accounting. Returns are calculated using the modified Dietz method and then weighted by using beginning-of-period market values to calculate the monthly composite returns. Portfolio returns are calculated net of irrecoverable withholding tax on dividend income. New portfolios are included in the first full month of investment in the composite's strategy. Terminated portfolios remain in the composite through the last full month of investment.

Composite and benchmark standard deviation are measured as the rolling 3 year annualised standard deviation of gross monthly returns. The dispersion of annual returns of portfolios within the composite (Composite Dispersion), is measured by the standard deviation of the equal-weighted returns of portfolios represented within the composite for the full year. When the composite consists of four or fewer portfolios for the full year, no dispersion measure is presented.

Performance results marked "Gross" do not reflect deduction of investment advisory fees. Investment returns will be reduced accordingly. For example, if a 1.00% advisory fee were deducted quarterly (0.25% each quarter) and the three year gross annual returns were 10.00%, 3.00% and -2.00%, giving an annualized return of 3.55% before deduction of advisory fees, then the deduction of advisory fees would result in three year net annual returns of 8.91%, 1.98% and -2.97% giving an annualized net return of 2.52%.

Performance returns marked "Net" reflect deduction of investment advisory fees and are calculated by deducting a monthly indicative fee from the monthly composite return. The indicative fee is defined as being the effective fee rate for a segregated account at the composite's minimum segregated account size as set out below. Actual net composite performance would be higher than the indicative performance shown because some accounts have sliding fee scales and accordingly lower effective fee rates.

Representative fee schedules and expense ratios as at December 31, 2020 for segregated accounts and pooled vehicles are provided below, although it is expected that from time to time the fees charged will differ from the below schedule depending on the country in which the client is located and the nature, circumstances and requirements of individual clients. The fees for segregated accounts will be charged as follows: the first US$50 million at 0.70%; the next US$50 million at 0.60%; thereafter at 0.50%. Minimum segregated account size is currently US$50 million. For Limited Partnerships, the following fees will be charged: the first US$25 million at 0.70%; the next US$25 million at 0.60%; thereafter at 0.50%. Minimum Limited Partnership account size is US$1 million.