ROTHKO

2021's Cascade of Alpha

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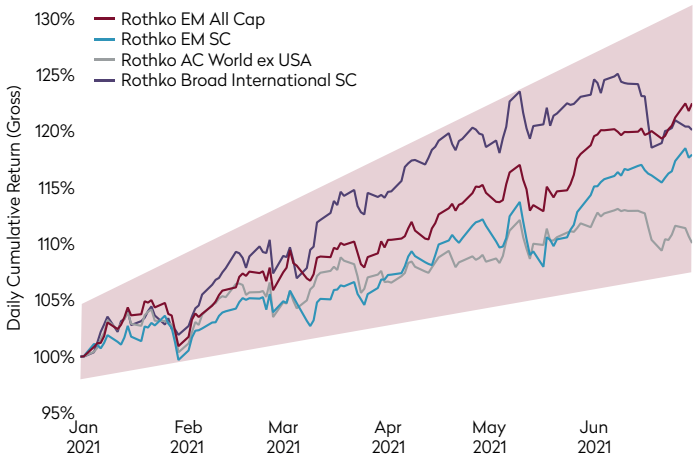
Income-oriented Value has staged a dramatic lift off as the acute dislocations from the early Coronavirus period more than unwind. That's the past… Next up we expect the delivery of long term returns to our strategies to be driven by the unwind of the chronic dislocations of the past decade.

In this piece:

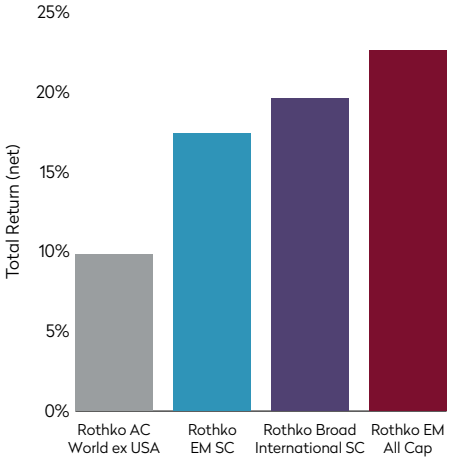
1. **Cascade of Alpha for Income-oriented Value:** We explain what happened, and why we believe it will continue.
2. **Winner takes 'Sm'all:** Small Cap has started to come good again, and we believe this is just the start.
3. **Avoid the "Honey-Pots", Focus on the Bottom-up:** The rise and fall of the "winner takes all" meme had an antidote - high active share and bottom-up stock selection. We explain how Rothko's models have added value by identifying opportunities within value chains of mega-caps, while avoiding the honey-pot names.

Exhibit 1: 2021 - The Staggered Lift Off

Income-Oriented Value Takes Off in International Equities
(Total Returns Plotted for Rothko Strategies)



Year to Date Returns



Sources: Rothko Investment Strategies.

Footnote: Left – Cumulative daily unaudited gross returns of Rothko's strategies (Dec 31, 2020 to Jun 30, 2021). Right – Net return of Rothko's strategies (Dec 31, 2020 to Jun 30, 2021). Please refer to the composite pages for complete performance periods.

1. Cascade of Alpha for Income-oriented Value

Chronic undervaluations yet to unwind

Strong returns from Rothko's Income-oriented Value have cascaded across our international equity strategies, in most cases outperforming both Value and Growth indices during the first six months of 2021. This has more than reversed 2020's acute performance dislocations versus Growth, but still leaves a chronic, long-term undervaluation of Income-oriented Value names that dates back over the last 10 years. The cascade started in October 2020, led by International, Developed Small Caps, and was then followed in early 2021 by Emerging Markets ('EM') and then EM Small Caps.

One by one:

1. October 2020, Rothko Broad International Small Cap: Significant excess returns started coming through in Rothko's names, especially those that had benefitted from consumption trends over 2020, and those that had been able to maintain or grow dividend payments.

2. January 2021, Rothko Emerging Markets All Cap: Our strategy did not fully participate in the broader Value rally in the Q4 of 2020, which we considered to be a low quality rally. From January though, we saw our stock selection start to perform strongly, particularly at the lower to mid end of the cap spectrum. Overlooked companies, trading at excessive discounts, many of which are embedded in the cash generative ecosystems of the largest EM names. Our stock selection in China has been a particular success story. The discounts available remain significant, as we expect the chronic mispricing of the last decade to unwind, continuing to deliver alpha over the medium term.

3. January 2021, Rothko Emerging Markets Small Cap: At a similar time to EM All Cap, this third strategy area started delivering strong returns. We identified EM Small Cap as a significantly undervalued asset class (EM Small Cap - Rising Stars of Tomorrow), and the events of January 2021 provided the catalyst to see value flood back into this area of the market. In rapidly rising markets, Rothko will tend to underperform, which has been the case in EM Small Cap year to date, but June saw a change with value being delivered from Income-oriented Value names. We expect this to be the start of a significant delivery of value for Rothko, and on top of strong, long-run, ongoing asset class returns.

Surge expected to continue

Rothko All Countries World Ex-US is yet to see the returns surges of our other strategy areas, and we believe this will be the next in the cascade. While the strategy has outperformed Value over most time periods, we have yet to see the acceleration in returns that our other strategies have benefitted from. We believe that the same catalysts that have driven Income-oriented Value in other asset classes will benefit International, Developed Equities, in a time delayed fashion.

Where did the resurgence in Income-oriented Value come from?

We note that markets become dislocated for many reasons and equally, as many reasons cause those dislocations to unwind. We believe that several important reasons catalysed a resurgence in rewards for intrinsic value and are likely to prevent a return to the unbridled Growth markets of the recent past.

Catalysts, not drivers, see value flood back

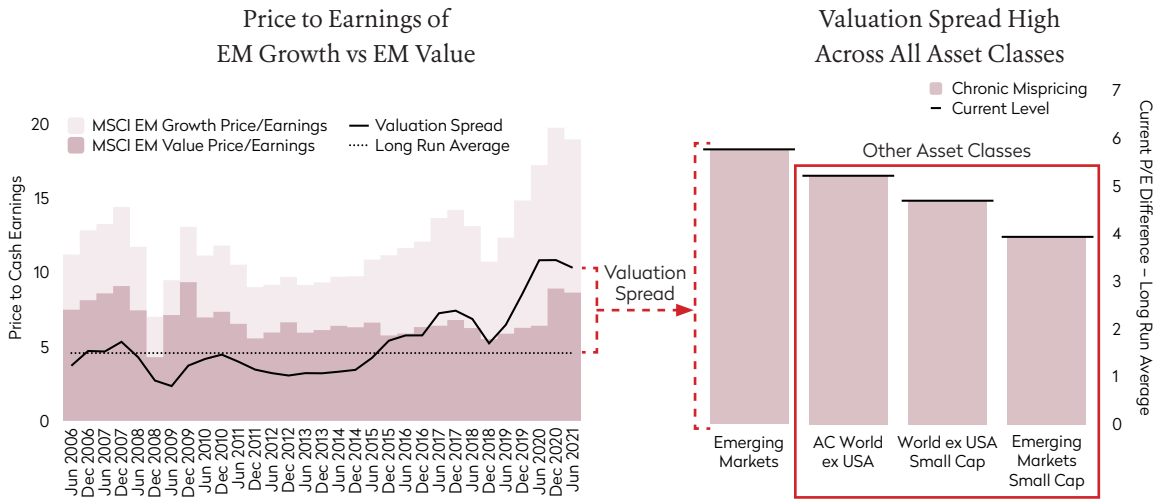
Firstly, volatility in the bond markets significantly related to budget positions, and the spectre of resurgent inflation seems to have been enough to rattle Growth investors, with implications for valuations coming from the potential for higher discount rates. (We are less worried about a sustained rise in inflation but we are happy to see a catalyst correct markets in our favour). Secondly, policy errors from central banks seem almost certain to occur again, either too much tightening or too little, and both would arguably be a greater risk to Growth investors. A taper tantrum would be damaging for growth prospects, and too much inflation would be negative for Growth also. Thirdly, the desperate hunt for (real) yield made 2020's sell-off in Income-oriented equities a bizarre phenomenon in a world of collapsing real yields and monetary repression; we believe this paradoxical situation was always bound to reverse (Income-Oriented Value Opportunity), and now this has indeed started. Fourth, large structured equity losses among investment bank originators (noting BNP and SocGen) indicated that levered distortions were rippling into the dividend derivatives markets, which saw open interest spike to the highest levels ever in Q1 2020, with knock on effects for cash equities. This again was bound to reverse as speculators rushed back to dividends.

Under-valuations remain chronic in the extreme

Growth Extremes Flashing "Sell"

2021 has been the year of the unwind of the acute market dislocations of 2020. From here on the 2020s as a decade will likely see the unwind of the deeper, chronic, long term undervaluations baked into Income-oriented assets. (See Exhibit 2). We believe this is just the start of a longer run reversal for Income-oriented Value returns. Exhibit 2 shows the extremes of valuation that Growth still trades at (left), and these extremes are evident across all of our strategy areas (right).

Exhibit 2: Chronic Mispricing Yet to Unwind



Sources: MSCI & Rothko Investment Strategies.

Footnote: Left – Price to Cash Earnings of MSCI EM Growth & Value Index. Valuation spread is P/E of Growth – P/E of Value. MSCI's calculation of price to cash earnings was used to provide a more stable result than price to earnings. Right – Difference between current growth and value price to cash earnings and the historical average. Historical average is the median spread in that asset class for the 15 years ending Jun 30, 2021.

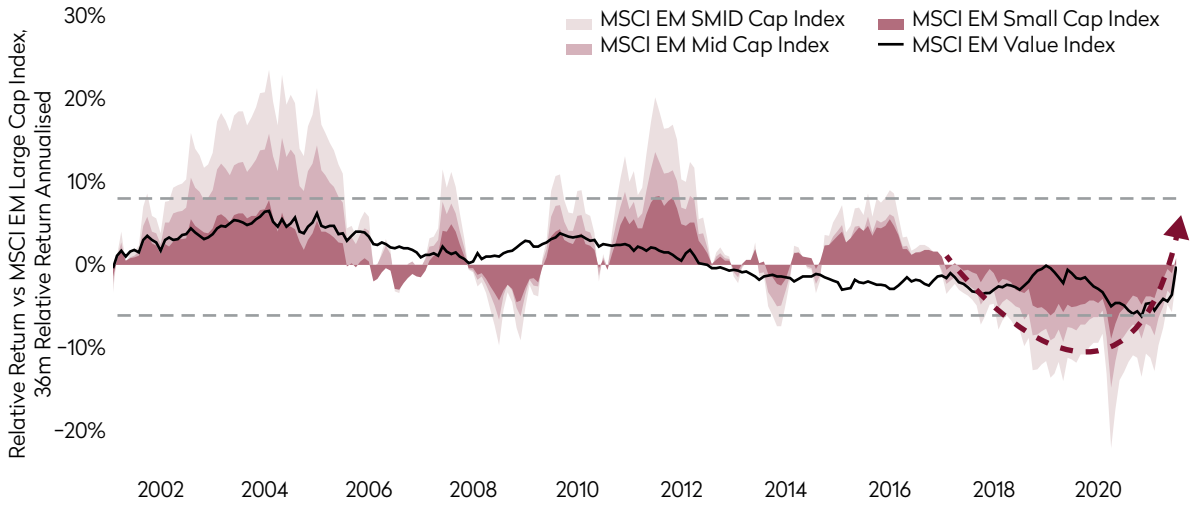
2. Winner Takes 'Sm'all

Rothko specialises in small and mid cap stock selection across Developed and Emerging Markets equities. Our Emerging Markets All Cap is what it says it is (All Cap), and we have seen value flood in from Income-oriented small and mid cap names both this year and last as we expected (EM Small Cap - Rising Stars of Tomorrow).

Rebound in Small Cap, with more expected

Small caps in many ways have been the perfect Value asset class over the recent past. Small caps in Emerging Markets particularly, have created excellent returns over time, and we believe the asset class has significantly more value to deliver in this episode, and into the future (see Exhibit 3). Alpha can be extracted from small cap by disciplined stock selection, focused on valuations and fundamentals. One of the main reasons such excessive under-valuations existed in high quality small cap names, is the preeminence of the "winner takes all" meme. The effect has been a herding into the larger names and greater alpha opportunities for stock selectors such as Rothko.

Exhibit 3: Emerging Markets Small Cap, Less Than Half Way There



Sources: MSCI & Rothko Investment Strategies.

Footnote: Rolling three year relative return vs the MSCI Emerging Markets Large Cap Index (Dec 31, 2000 to Jun 30, 2021).

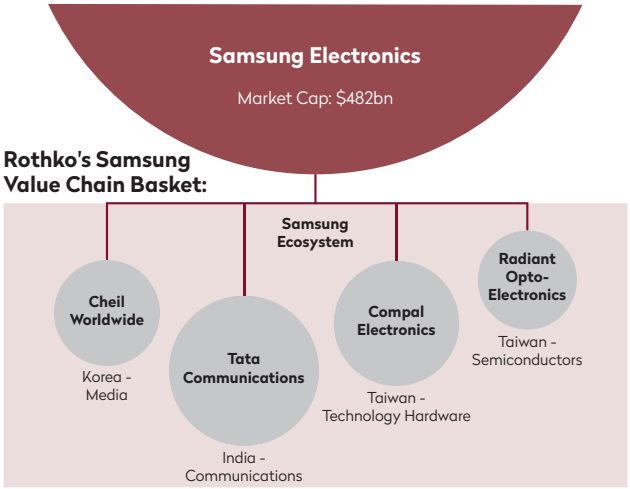
3. Avoid the "Honey-Pots", Focus on the Bottom-up

The "winner takes all" meme, used to describe anything but the thinnest of market segments or most outrageous of monopolies, is patently nonsense. This phrase is usually attached to the largest companies in the world, the "honey-pot" names we all know, that have vast ecosystems of suppliers and customers, each of whom survive or profit from the cash flows that circulate through the system. Some companies in these ecosystems are substitutable, others are not. Some provide rare and complex products or services, others may just be convenient geographically or otherwise. Rothko's investment approach often identifies, from the bottom up, those stocks that are effectively tapping these value chains, while avoiding behavioural biases and/or memes.

"Winner Takes All" meme stalls

The "winner takes all" has drawn many managers to honey-pot names in most equity asset classes over the past 10 years, and this is epitomized by Emerging Markets' "Big 4" (TSMC, Tencent, Alibaba and Samsung). It has led to a collapse in active share, with the EM All Cap median now around 75% (Fortune Favours the Different). Rothko is different. We have maintained one of the highest active shares in the peer group, at 95% and the reason is that our approach objectively drives returns from bottom-up stock selection, searching for solid companies and deep discounts which are invariably not the honey-pot names. In the current environment (and for some time now) our models have identified opportunities within the ecosystems of the honey-pots (not the mega caps themselves), especially in EM. For instance, why be drawn to Samsung when alternative routes to tapping the same value chains exists, but at more attractive valuations? Exhibit 4 shows an example of how Rothko has achieved this for a significant gain in alpha.

Exhibit 4: Aiming for Value, Avoiding the Honey-Pots



As at June 30, 2021:	Samsung	Rothko's Samsung Value Chain Basket (Weighted Average)
Market Capitalization	$482bn	$13.1bn
Earnings Growth (3 Yrs Cumulative)	-36%	+142%
Sales Growth (3 Yrs Cumulative)	-5.3%	-1.4%
Dividend Yield	1.8%	3.25%

Sources: Factset & Rothko Investment Strategies.

Footnote: The four names above are held on the Rothko Emerging Markets All Cap Strategy with allocations between 1% and 1.3%. For the illustration above the performance and fundamentals have been calculated as market capitalization weighted averages. The circles are scaled to represent the square root of the market capitalizations.

The Income-oriented Value Decade?

Rothko's strategies have reaped the benefits of our system's disciplined approach, truly active style, and focus on bottom up stock selection. Our strategies have seen a cascade of positive alpha, but more important to us is that we remain a defensive, diversified, Income-oriented Value manager. We hope, boring.

For Rothko, investment is all about stock selection; pure alpha. Indeed, 85% of our relative returns typically come from stock selection, and this year our selection in small and mid cap names in EM Asia has been particularly successful. The simple recipe of selecting undervalued names, that have the ability to sustain and grow hard currency dividend payments, has delivered again.

While returns have been strong so far in 2021, valuations of names across all our strategies remain at chronically undervalued levels, after almost a decade of Growth "on". This is the backdrop we expect to provide the tail wind for Rothko's alpha generation over the coming years, and to make the 2020s the decade of Income-oriented value.

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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 Jun 30)	22.98%	22.55%	7.45%	18.53%	18.52%	1	N/A	6.4	0.01	60,027	64,481

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.

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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.

Disclosure: Rothko Emerging Markets Small Cap Equity Composite

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2015	-11.56%	-12.19%	-10.07%	N/A	N/A	1	N/A	3.5	0.01	56,857	62,158
2016	16.24%	15.14%	2.28%	N/A	N/A	1	N/A	4.1	0.01	59,033	64,257
2017	27.59%	26.39%	33.84%	N/A	N/A	1	N/A	5.2	0.01	62,751	69,504
2018	-15.80%	-16.60%	-18.59%	12.58%	14.01%	1	N/A	4.4	0.01	47,789	53,740
2019	18.02%	16.91%	11.51%	12.64%	12.98%	1	N/A	5.2	0.01	54,401	61,316
2020	4.89%	3.91%	19.29%	20.28%	23.45%	1	N/A	7.1	0.01	54,894	58,974
2021 (to Jun 30)	17.94%	17.38%	19.78%	19.86%	23.04%	1	N/A	8.4	0.01	60,027	64,481

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Disclosure: Rothko All Countries World excluding U.S. Equity Composite

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2016	11.04%	10.38%	4.50%	N/A	N/A	1	N/A	5.0	0.01	59,033	64,257
2017	22.99%	22.25%	27.19%	N/A	N/A	1	N/A	6.2	0.01	62,751	69,504
2018	-11.97%	-12.50%	-14.20%	10.59%	11.38%	1	N/A	4.7	0.01	47,789	53,740
2019	15.37%	14.68%	21.51%	10.40%	11.34%	1	N/A	5.4	0.01	54,401	61,316
2020	-3.75%	-4.32%	10.65%	17.29%	17.94%	1	N/A	5.2	0.01	54,894	58,974
2021 (to Jun 30)	10.08%	9.76%	9.16%	16.98%	17.36%	1	N/A	5.8	0.01	60,027	64,481

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The Rothko All Countries World excluding U.S. Equity Composite includes U.S. dollar based discretionary portfolios, measured against the Morgan Stanley Capital International All Countries World excluding US Index or equivalent index, net of withholding taxes. The portfolios are invested in non-U.S. based equities with allowance for hedging and invesment in Emerging Markets.

Since inception to date, the Rothko All Countries World excluding U.S. Equity Composite has consisted only of a seed capital portfolio, which was 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 0.60%; the next US$50 million at 0.50%; thereafter at 0.40%. Minimum segregated account size is currently US$50 million. For Limited Partnerships, the following fees will be charged: the first US$20 million at 0.70%; the next US$30 million at 0.60%; the next US$50 million at 0.50%; thereafter at 0.40%. Minimum Limited Partnership account size is US$1 million.

Disclosure: Rothko Broad International Small 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)
2017	14.26%	13.54%	21.77%	N/A	N/A	1	N/A	5.7	0.01	62,751	69,504
2018	-16.91%	-17.61%	-18.07%	N/A	N/A	1	N/A	4.7	0.01	47,789	53,740
2019	21.49%	20.46%	25.41%	N/A	N/A	1	N/A	5.8	0.01	54,401	61,316
2020	7.75%	6.85%	12.78%	22.49%	20.79%	1	N/A	6.2	0.01	54,894	58,974
2021 (to Jun 30)	20.12%	19.61%	9.92%	22.58%	20.61%	1	N/A	7.4	0.01	60,027	64,481

Accompanying Notes Concerning Performance Calculation and GIPS® Compliance

- This composite was created and incepted in April 2017.
- 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 2020. 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.

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The Rothko Broad International Small Cap Equity Composite includes U.S. dollar based discretionary portfolios, measured against the Morgan Stanley Capital International World ex US Small Cap Index, or an equivalent Index net of withholding taxes. The portfolios are invested in non-U.S. based small capitalization publically traded companies based in a developed market, or deriving a majority of revenue within developed market economies.

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