JPMorgan European Smaller Cos

Long-term outperformance versus benchmark

Investment trusts

JPMorgan European Smaller Companies Trust (JESC) is a relatively concentrated portfolio of 60-80 stocks offering the potential for capital growth. The fund has well-established managers: Jim Campbell since 1995 and Franceso Conte since 1998, who draw on their experience to select high-quality companies with strong management teams, with positive stock price and earnings momentum, that they perceive to be undervalued. JESC has outperformed its benchmark over both short- and long-term periods and over 20 years has outperformed its nearest peer by 410pp.

12 months ending	Total share price return (%)	Total NAV return (%)	Euromoney Smlr Eur Cos ex-UK (%)	FTSE World Europe ex-UK (%)	FTSE All-Share (%)
30/04/12	(29.9)	(28.4)	(24.5)	(19.8)	(2.0)
30/04/13	23.7	22.9	23.6	28.1	17.8
30/04/14	47.3	36.1	29.2	14.8	10.5
30/04/15	3.0	3.7	3.7	7.0	7.5
30/04/16	11.1	11.8	5.8	(3.9)	(5.7)

Source: Thomson Datastream. Note: Sterling-adjusted total return basis.

Investment strategy: Quality, momentum and value

The managers, working within the wider J.P. Morgan Asset Management European equity team, select a portfolio of European smaller companies with potential for capital appreciation, aiming to outperform the benchmark Euromoney Smaller European Companies ex-UK index. The fund is actively managed leading to relatively high portfolio turnover and, although diversified by country and sector, exposure can diverge meaningfully from the benchmark. Frequent meetings with existing and potential portfolio companies are an important part of the process. Liquidity and gearing is actively managed; a range of 20% gearing to 20% net cash is permitted.

Market outlook: Potential relative outperformance

European small-cap stocks have performed relatively well over the last year in spite of a period of volatility in world markets as macroeconomic concerns, including slowing global growth, have affected investor sentiment. With a very modest valuation premium, based on a forward P/E multiple versus UK and global stocks, coupled with above-average earnings growth driven by an improving European economy and sentiment, there is the potential for further outperformance of European small-cap stocks.

Valuation: Discount on narrowing trend

Despite a recent widening in JESC's share price discount to cum-income NAV, the discount has been in a narrowing range on both a medium- and long-term basis. The current discount of 12.0% compares to an average of 9.0% over the last 12 months (range of 3.2% to 14.5%). This is narrower than the averages of the last three, five and 10 years of 11.3%, 13.0% and 14.8% respectively. The smaller average discount, despite global stock market volatility over the last year, could imply investor demand for the growth potential of European smaller companies.

24 May 2016

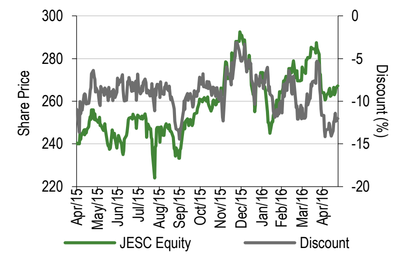
Price	**267.3p**
Market cap	**£428m**
AUM	**£556m**

NAV*	299.1p
Discount to NAV	10.7%
NAV**	303.8p
Discount to NAV	12.0%

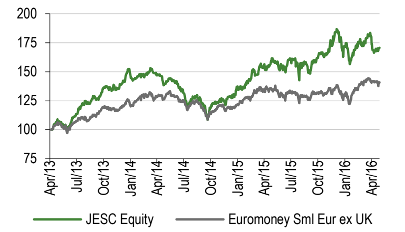
*Excluding income. **Including income. As at 20 May 2016

Yield	1.2%
Ordinary shares in issue	160.1m
Code	JESC
Primary exchange	LSE
AIC sector	European Smaller Companies

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low	292.5p	224.0p
NAV** high/low	313.2p	252.0p

**Including income.

Gearing

Net cash*	2.7%

*As at 30 April 2016

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Edison profile page

JPMorgan European Smaller Companies Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

JPMorgan European Smaller Companies Trust (JESC) aims to achieve capital growth from a diversified portfolio of shares in smaller European companies (excluding the UK). Liquidity and borrowings are actively managed (investments 80-120% of net assets) with a view to enhancing returns to shareholders. As JESC's investment policy emphasises capital growth, rather than income, the dividend is expected to vary from year to year. JESC is benchmarked against the Euromoney (formerly HSBC) Smaller European Companies ex-UK total return index in sterling terms.

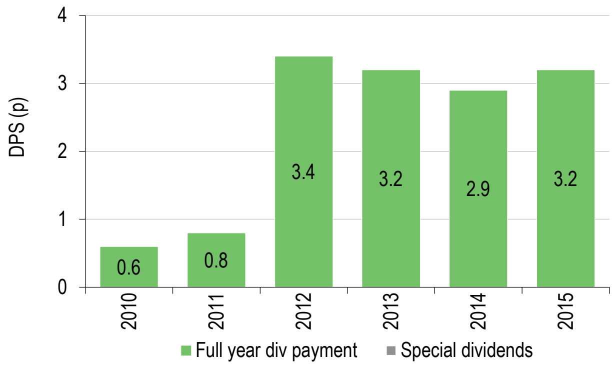
Recent developments

- 23 November 2015: Interim dividend of 1.2p declared for the six months ended 30 September, payable on 15 January 2016.
- 23 November 2015: Six-month results ended 30 September 2015. NAV total return of +2.4% compared with -3.8% for the benchmark Euromoney Smaller Europe ex-UK index. Share price TR +0.7%.
- 26 May 2015: Final dividend of 2.0p declared for the year ended 31 March, payable on 15 July.

Forthcoming		Capital structure		Fund details	
AGM	July 2016	Ongoing charges	1.32%	Group	JPMorgan Asset Mgmt (UK) Ltd
Annual results	May 2016	Net cash	2.7%	Managers	Jim Campbell, Francesco Conte
Year end	31 March	Annual mgmt fee	1.0% of net assets (see p7)	Address	60 Victoria Embankment, London EC4Y 0JP
Dividend paid	January, July	Performance fee	None		
Launch date	April 1990	Trust life	Indefinite	Phone	+44 (0)800 731 1111
Continuation vote	N/A	Loan facilities	€100m	Website	www.jpmeuropeansmallercompanies.co.uk

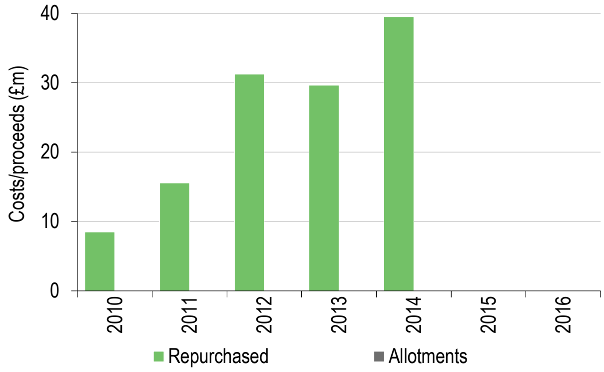
Dividend policy and history

Between zero and two dividends annually. Interims, when paid, are paid in January. Finals, when paid, are paid in July. Numbers below have been adjusted for stock split.

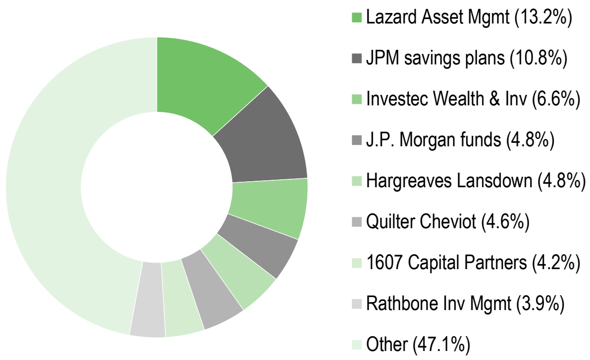


Share buyback policy and history

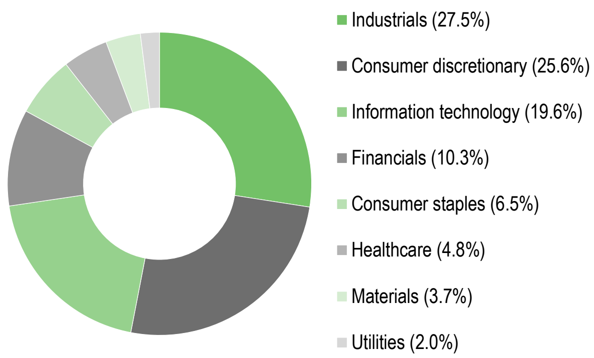
Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 5% of issued share capital. (Financial years shown.)



Shareholder base (as at 15 April 2016)



Portfolio exposure by sector (30 April 2016)



Top 10 holdings (as at 30 April 2016)

Company	Country of listing	Sector	Portfolio weight % 30 April 2016	Portfolio weight % 30 April 2015*
OVS	Italy	Consumer discretionary	2.9	N/A
Sopra Steria	France	Information technology	2.8	N/A
Intertrust	Netherlands	Financials	2.8	N/A
Aalberts Industries	Netherlands	Industrials	2.8	N/A
Flow Traders	Netherlands	Financials	2.6	N/A
IMCD	Netherlands	Industrials	2.3	N/A
Intrum Justitia	Sweden	Industrials	1.9	N/A
Huhtamaki	Finland	Materials	1.9	2.0
Alten	France	Information technology	1.9	N/A
Plastic Omnium	France	Consumer discretionary	1.9	N/A
Top 10 holdings			**23.8**	**19.1**

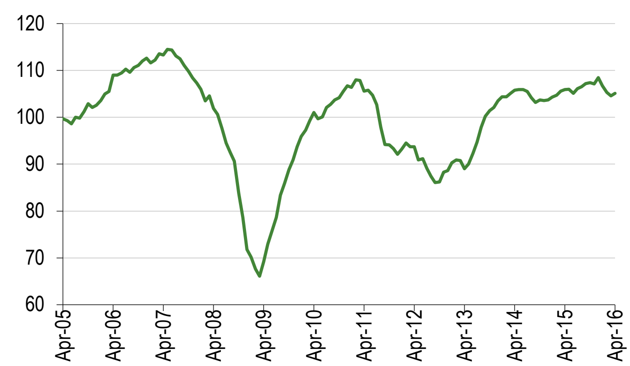
Source: JPMorgan Smaller Companies, Edison Investment Research, Morningstar, Bloomberg. Note: *N/A where not in 30 April 2015 top 10.

Market outlook: Good for European small-cap stocks

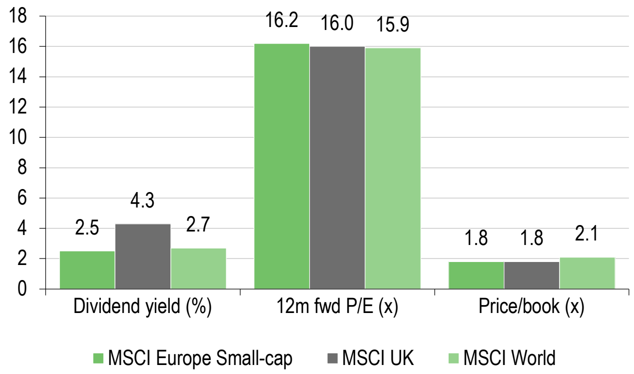
Despite the volatility in world markets in recent months as investors have focused on slowing global growth, potential interest rate increases and the forthcoming Brexit referendum, among other things, European smaller companies as measured by the Euromoney Smaller Europe ex-UK index have performed relatively well. Since the market sell-off in mid-August 2015 to 18 May 2016, European smaller stocks have outperformed both UK (FTSE All-Share index) and world (FTSE World index) stocks by 7.8pp and 2.1pp in sterling total return terms. This may be due to stable economic sentiment, shown in Exhibit 2 (left hand side), easy monetary policy in Europe or the fact that small caps generally have a more domestic focus that insulates them to a certain extent from weakness elsewhere in the global economy.

Exhibit 2: Performance and market valuation

European Union economic sentiment indicator for the last 10 years



Key valuation metrics for European small caps versus other indices



Source: Thomson Datastream, European Commission, MSCI, Edison Investment Research. Note: Valuation data at end-April 2016.

Looking at Exhibit 2 (right hand side), European small-cap companies are trading at a modest premium based on the forward P/E multiple to UK and world markets (0.2x and 0.3x respectively). However, this premium has been larger; at end-March 2016 the premium to the UK and world markets was 0.6x and 0.5x respectively. On a price-to-book basis, the stocks are in line or cheaper.

Fund profile: Diversified European small-cap exposure

JPMorgan European Smaller Companies Trust (JESC) was launched in 1990 and has been managed by Jim Campbell since 1995 and Francesco Conte since 1998. The managers aim to achieve capital growth rather than dividend income, from investing in a diversified portfolio of continental European small-cap stocks. This is an area of the market that is underresearched by sell-side analysts so the managers draw on the wider resources of J.P. Morgan Asset Management's European equities team, selecting quality stocks exhibiting positive momentum that are reasonably valued. Long-term performance of the fund is very strong; over 20 years its NAV total return of 1,029% is 410pp ahead of its nearest rival.

The fund managers: Jim Campbell & Francesco Conte

The manager's view: Looking for a stronger second half

Looking back over the last nine months, manager Francesco Conte said that in August 2015, it "felt like the wheels had come off" in emerging markets, especially in China. Poor investor sentiment continued in the first weeks of 2016 in the belief that if emerging market growth weakened further, US and European stock markets would not be able to sustain a recovery. However, market sentiment changed on 15 February, when ECB president Mario Draghi said that he would not hesitate to act to ensure the resilience of the euro area. The manager suggests there is no limit to quantitative easing (QE) despite suggestions that it is not working. Draghi's announcement ensured that US interest rate hikes have been pushed out, which has caused the US dollar to fall (the euro has rallied) and commodity prices have risen. He suggests that QE is not a silver bullet for a miraculous recovery, but has started a series of events. Volatility remains high at the individual stock (but not the overall market) level, but investor sentiment has improved.

The manager comments that there is an improving outlook for a European economic recovery. European service purchasing managers indices (PMIs) are fair and manufacturing PMIs are resilient despite weak exports, as domestic demand is picking up the slack. As PMIs are a leading indicator, the manager is positive on the outlook for the European economy in the second half of 2016. Measured by the Citigroup Eurozone Economic Surprise index, the European economy is showing signs of improvement; the index has rallied from the end-February 2016 low. Near term, the manager is not expecting the stock market to move higher, as May through to September is seasonally a weak period and there is a level of nervousness ahead of the Brexit vote in June. In addition, he is discouraged by the current level of volatility at the stock level.

On a bottom-up basis, the manager says that Q116 earnings reports have been broadly encouraging. As an example, some French companies are suggesting a better operating environment. Sopra Steria is the number three IT service company in the country and reported organic revenue growth in France of 7.7% on a constant currency basis. The manager has not seen this level of strength in IT services in France for many years; Italy and Spain have been improving for some time and France is now joining in the recovery.

The manager highlights the holding in OVS, an Italian apparel and accessories company. Business had been poor, but in 2015 retail confidence began improving and has recently reached levels not seen since 1998. The CEO is well known by the manager and has a history of turning around underperforming businesses. His success has continued at OVS, where he has incorporated the strengths of different leading competitors to create a product offering that is affordable and appealing to consumers. Despite a difficult economic climate, comparable sales remained positive before the company's IPO in February 2015 and have since accelerated.

Asset allocation

Investment process: Aided by extensive manager experience

The European small-cap universe is larger than the large-cap; the benchmark Euromoney Smaller European Companies ex-UK index comprises c 1,000 stocks across 15 countries. From this universe, JESC's managers aim to construct a portfolio of 60-80 stocks that have the potential for capital growth. Stocks are selected based on value, momentum and quality. Attractively valued stocks must also have a fundamentally sound business model; momentum is measured with regard to both earnings and positive stock price momentum and quality is defined as sustainable earnings growth and disciplined capital management. Smaller companies are generally less diversified and driven by more stock-specific factors and risk premiums than large-caps, which often trade more in line with the macroeconomic background. The managers' knowledge of stocks in their investment universe often dates back to when the companies were private or when they were initially listed in the stock market. The long tenure of both managers means that they have experience of investing in different economic environments and during defined historical periods in global stock markets such as the dotcom boom and bust and the financial crisis, as well as through periods of stress in the eurozone. The managers use their experience to identify when they believe that individual stocks are mispriced. Portfolio holdings tend to fall into one of three 'buckets': compounders that can grow organically regardless of the economic environment; secular growth companies that provide a product or service that addresses a specific need; and out-of-favour companies that the manager believes have no structural issues and the ability to turn the business around. Winning positions are allowed to run and only sold when there is a change in business outlook, the share price momentum has broken down or cash is required to fund a better idea.

Current portfolio positioning

At the end of April 2016, the top 10 holdings accounted for 23.8% of the portfolio. This was an increased level of concentration versus the end of April 2015, when the top 10 accounted for 19.1%. Versus the benchmark, the largest overweight exposure is to the Netherlands, while the largest underweight is Spain. Although still an overweight position, exposure to France has been reduced partly due to the sale of Ubisoft, whose share price rose significantly after Vivendi took a hostile stake in the company. The trust also held a c 3% position in Faiveley, which was taken over.

Exhibit 3: Portfolio geographic breakdown vs benchmark (at 30 April 2016)

	Trust weight end-April 2016 (%)	Benchmark weight (%)	Trust weight vs benchmark	Trust weight/ benchmark
France	20.5	13.6	6.9	1.5
Netherlands	15.7	4.7	11.0	3.3
Sweden	15.1	13.5	1.6	1.1
Italy	13.5	12.6	0.9	1.1
Germany	11.1	14.1	-3.0	0.8
Switzerland	6.7	10.3	-3.6	0.7
Norway	4.8	4.7	0.1	1.0
Finland	4.3	4.6	-0.3	0.9
Belgium	3.1	4.3	-1.2	0.7
Denmark	2.6	3.6	-1.0	0.7
Spain	1.5	7.5	-6.0	0.2
Ireland	1.1	1.5	-0.4	0.7
Austria	0.0	3.4	-3.4	0.0
Portugal	0.0	1.5	-1.5	0.0
UK	0.0	0.1	-0.1	0.0
	100.0	**100.0**		

Source: JPMorgan European Smaller Companies, Edison Investment Research. Note: Excludes cash.

Looking at the sector breakdown in Exhibit 4, the largest overweights are the consumer discretionary and IT sectors, while the largest underweight is financials. More recently, the manager has started to reduce exposure to defensives and is buying more cyclical stocks in response to encouraging global economic signals. There is no direct exposure to the energy sector as the manager believes that these companies have balance sheet problems. JESC is significantly underweight the financial sector as the banks are struggling to make money in a negative interest rate environment. Cost-cutting is the only way to improve earnings; banking software companies Sopra Steria and Temenos will be beneficiaries of this and are held in the portfolio.

Exhibit 4: Portfolio sector breakdown vs benchmark (at 30 April 2016)

	Trust weight end-April 2016 (%)	Trust weight end-April 2015 (%)	Change (%)	Benchmark weight (%)	Trust weight vs benchmark	Trust weight/ benchmark
Industrials	27.5	31.8	-4.3	24.6	2.9	1.1
Consumer discretionary	25.6	19.4	6.1	14.3	11.3	1.8
Information technology	19.6	14.5	5.1	8.5	11.1	2.3
Financials	10.3	10.2	0.1	21.1	-10.8	0.5
Consumer staples	6.5	6.4	0.1	6.6	-0.1	1.0
Healthcare	4.8	2.1	2.7	8.4	-3.6	0.6
Materials	3.7	8.5	-4.8	7.1	-3.4	0.5
Utilities	2.0	1.7	0.3	3.0	-1.0	0.7
Energy	0.0	0.0	0.0	3.5	-3.5	0.0
Telecoms	0.0	5.5	-5.5	2.9	-2.9	0.0
	100.0	**100.0**		**100.0**		

Source: JPMorgan European Smaller Companies, Edison Investment Research. Note: Excludes cash.

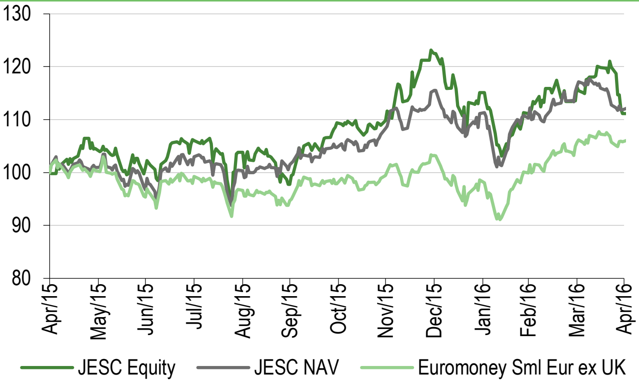
Performance: Long-term outperformance vs indices

JESC has outperformed its benchmark Euromoney Smaller European Companies ex-UK index in both NAV and share price terms over one, three, five and 10 years. As shown in Exhibit 7, despite a period of underperformance since the beginning of 2016, performance from late 2014 to the end of 2015 was particularly strong. The trust NAV has also outperformed versus the large-cap FTSE World Europe ex-UK index and the FTSE All-Share index over six months and one, three, five and 10 years, shown because of its relevance to UK investors.

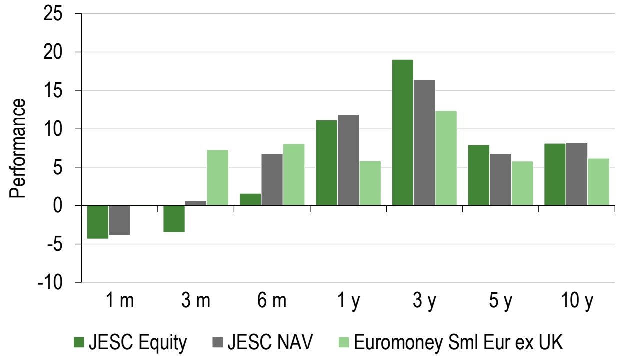
The manager notes that although performance in April 2016 was tough, May is looking better. In April, Flow Traders' (an electronic trading company) share price fell following the announcement of weak quarterly earnings and Intertrust (a trust company) was weak on the back of the Panama Papers data leak. However, the manager believes this is a high-quality company that will benefit from strong underlying growth in the business.

Exhibit 5: Investment trust performance to 30 April 2016

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Exhibit 6: Share price and NAV total return performance, relative to benchmarks (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to Euromoney Smlr Eur ex-UK	(4.5)	(10.0)	(6.0)	5.0	18.9	10.6	20.2
NAV relative to Euromoney Smlr Eur ex-UK	(4.0)	(6.2)	(1.2)	5.7	11.3	4.8	20.6
Price relative to FTSE World Eur ex-UK	(4.6)	(7.3)	(0.3)	15.7	42.9	20.7	35.2
NAV relative to FTSE World Eur ex-UK	(4.1)	(3.3)	4.8	16.4	33.7	14.4	35.7
Price relative to FTSE All-Share	(5.4)	(7.1)	1.6	17.8	50.6	13.1	37.8
NAV relative to FTSE All-Share	(4.9)	(3.2)	6.8	18.6	40.9	7.2	38.3

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-April 2016. Geometric calculation.

Exhibit 7: NAV performance relative to the benchmark over last three years (%)

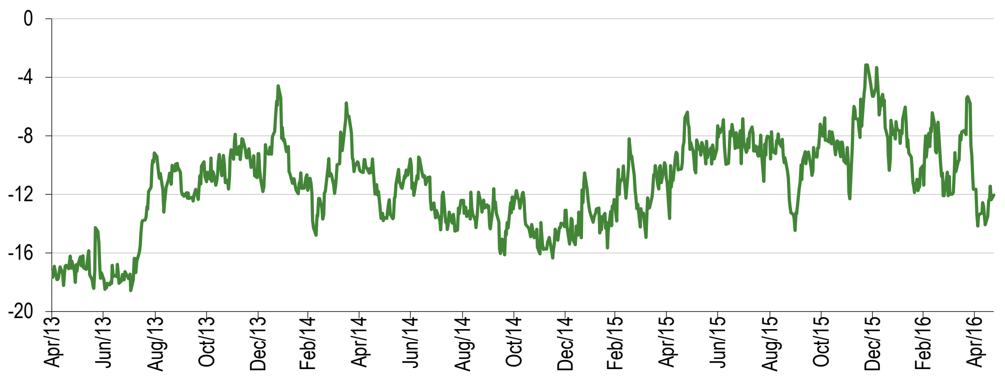
Source: Thomson Datastream, Edison Investment Research

Discount: Long-term narrowing trend

As shown in Exhibit 8, although JESC's share price discount to NAV has recently widened, it has been on a narrowing trend since late 2014. It has also narrowed over the longer term as the 9.0% average of the last 12 months (range of 3.2% to 14.5%) is narrower than the averages of the last three, five and 10 years of 11.3%, 13.0% and 14.8% respectively.

JESC has the authority to repurchase up to 14.99% and allot 5% of shares on an annual basis to manage a discount or premium. It may also allow shareholders to tender their shares periodically at an agreed discount. There have been no share repurchases since December 2013 and no tender offers since July 2013. The board continues to monitor the level of the discount and may decide to repurchase shares to minimise short-term discount volatility.

Exhibit 8: Discount to NAV (debt at fair value, including income) – past three years



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

JESC is a conventional investment trust with one class of share. There are currently 160.1m shares in issue following a five-for-one share split in July 2014, which was intended to improve liquidity and facilitate regular savings and dividend reinvestment. The trust has a €100m lending facility in place with Scotiabank split 50:50 fixed and floating rate. The permitted gearing range is between 20% gearing and 20% net cash; at end-April 2016, JESC had a net cash position of 2.7%.

The management fee was reduced from 1.3% to 1.0% of the market cap from 1 April 2015. For FY15 it was 30% paid out of revenue and 70% out of capital; it is calculated and paid monthly in arrears. There is no performance fee. The ongoing charge (based on the previous fee arrangements) was 1.32% for FY15 versus 1.31% in the previous year.

Dividend policy and record

JESC has an investment objective of capital growth rather than income generation. The board's dividend policy is to pay out the majority of income generated each year, but as the dividend is dependent on the level of income, there is no guarantee of an increase in the year-on-year payout. Dividends are paid in the form of an interim, paid in January and/or a final dividend paid in July. In FY15, an interim dividend of 1.2p was followed by a final dividend of 2.0p; the total 3.2p dividend represented a 10.3% increase on the previous year after taking into account a 5:1 stock split in July 2014. So far in FY16 an interim dividend of 1.2p has been declared; it was paid in January 2016. Based on the current share price, coupled with the final dividend in FY15, this equates to a dividend yield of 1.2%.

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Peer group comparison

JESC is the largest in a small peer group of four trusts in the AIC European Smaller Companies sector. It has the best NAV total return performance over one and 10 years, higher than the average over three years, while trailing over five years. In terms of risk-adjusted returns as measured by the Sharpe ratio, JESC is ahead of and in line with the weighted average over one and three years respectively. The peer group discount average is skewed by the European Assets Trust, which trades at a premium. Of the other three trusts, JESC has the lowest discount. Its ongoing charge is modestly higher than average (although set to fall, following the management fee reduction last year) and, given the mandate for capital growth rather than income, its dividend yield is below the peer group average; again skewed by European Assets Trust, which has a significantly higher yield than its peers.

Exhibit 9: European Smaller Companies investment trusts as at 18 May 2016

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
JPMorgan European Smaller Cos	426.4	9.9	49.5	45.0	143.2	0.2	0.9	(10.7)	1.3	No	96	1.2
European Assets Trust	340.2	(3.0)	39.9	76.5	113.5	(0.5)	0.9	0.1	1.3	No	100	5.5
Montanaro European Smaller	92.3	7.2	17.9	23.3		0.1	0.4	(11.6)	1.5	No	111	1.4
TR European Growth	313.8	3.0	50.1	44.8	93.3	(0.1)	1.1	(13.0)	0.8	Yes	112	1.5
Simple average	**293.2**	**4.3**	**39.4**	**47.4**	**116.7**	**(0.1)**	**0.8**	**(8.8)**	**1.2**		**105**	**2.4**
Weighted average		**4.1**	**44.4**	**52.4**	**119.4**	**(0.1)**	**0.9**	**(8.3)**	**1.2**		**103**	**2.5**
Rank	**1**	**1**	**2**	**2**	**1**	**1**	**2**	**2**	**3**		**4**	**4**

Source: Morningstar, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There are five non-executive directors on the board of JESC. Chairman Carolan Dobson was appointed in September 2010 and has been chairman since 2013. Federico Marescotti was appointed in December 2005, Stephen White in April 2012 and Ashok Gupta in January 2013. The newest member of the board is Nicholas Smith who was appointed in May 2015, replacing Anthony Davidson, who stood down with effect from the 2015 AGM. The directors have backgrounds in investment management, finance and business.

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