

The European Investment Trust

Europe specialist with strong valuation discipline

The European Investment Trust (EUT) is a focused portfolio of continental European companies chosen for their ability to outperform the market on a five-year view. Valuation is a key tenet of the investment process, with the manager working on the basis that the best-performing stocks will be those with a year five P/E ratio of 11x or less. Because of the strong valuation discipline, the portfolio may underperform peers in a bull market, although both NAV and share price total returns have been ahead of benchmark over most periods under the current management. While the main focus is on achieving capital growth, EUT also currently yields in excess of the peer group average.

12 months ending	Share price (%)	NAV (%)	FTSE AW Europe ex UK (%)	FTSE All-Share (%)	MSCI World (%)
31/05/12	(22.5)	(21.2)	(24.3)	(8.0)	(4.3)
31/05/13	37.5	37.5	42.0	30.1	30.5
31/05/14	32.1	21.2	12.5	8.9	8.0
31/05/15	9.4	3.8	4.1	7.5	16.8

Source: Thomson Datastream. Note: Total return figures.

Investment strategy: Selecting for value and growth

EUT's manager, Dale Robertson of Edinburgh Partners (EP), follows an investment process that hinges on the view that future earnings, not past performance, are the best predictor of share price total returns. The concentrated portfolio of 35-50 stocks is the product of rigorous financial analysis, with EP's investment team constructing a five-year inflation-adjusted earnings growth outlook and generating a year five P/E ratio for all prospective holdings. In formulating the process EP founder Sandy Nairn noted a clear relationship between price total return and earnings growth on a five-year view. As such, all stocks are bought on the basis of their five-year outlook, although some may achieve their valuation target sooner. The FTSE All World Europe ex UK index is used as a benchmark for performance comparison, although sector and geographic weightings are driven by bottom-up stock selection.

Market outlook: Less obvious value after QE rally

European markets have outperformed the UK and world indices since the announcement of eurozone QE in January. While the possibility of a Greek debt default has caused some investor jitters, at the time of writing it looks as though a compromise may be reached, removing a short-term source of uncertainty. However, forward P/E valuations in Europe are now c 25% above 10-year averages, similar to the US and UK, suggesting long-term investors would benefit from taking a valuation-focused approach, rather than seeking returns at any price.

Valuation: Discount narrowest in five years

At 22 June EUT's shares were trading at a 2.0% discount to cum-income net asset value, the narrowest discount in five years. Having historically traded at a wider discount than peers, the trust's shares have re-rated over the past two years to a level in line with the sector average.

Investment trusts

26 June 2015

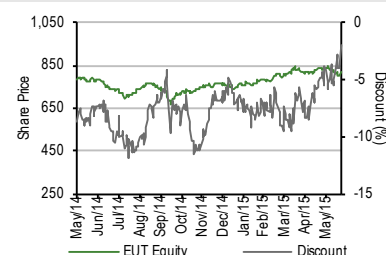
Price 820.0p
Market cap £345.0m
AUM £359.3m

NAV* 823.4p
Discount to NAV 0.4%
NAV** 836.8p
Discount to NAV 2.0%
Yield (incl. special dividend) 1.7%

*Excluding income. **Including income. Data to 22 June 2015.

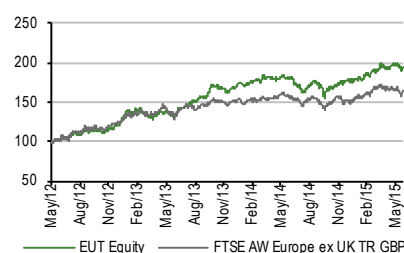
Ordinary shares in issue 42.1m
Code EUT
Primary exchange LSE
AIC sector Europe

Share price/discount performance*



*Including income. Positive values indicate a premium; negative values indicate a discount.

Three-year cumulative perf. graph



52-week high/low 843.5p 665.0p
NAV* high/low 909.1p 732.4p

*Excluding income.

Gearing

Gross 0.0%
Net -2.3%

Analysts

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[Edison profile page](#)

Exhibit 1: Trust at a glance
Investment objective and fund background

The European Investment Trust (EUT) seeks long-term capital growth through investment in a diversified portfolio of continental European securities. The trust was launched in 1972 and management was transferred to Edinburgh Partners on 1 February 2010 following a tender process. The manager follows a disciplined, long-term value management approach. The trust has an indefinite life and is not subject to a periodic continuation vote.

Recent developments

27 May 2015: Half-year results for the six months ended 31 March. NAV TR +10.8% compared with +9.3% for benchmark. Share price TR +9.9%.
30 January 2015: Dividend for FY14 paid, a total of 15.0p comprising a 14.0p final dividend and a 1.0p special.

Forthcoming

AGM	January 2016
Annual results	November 2015
Year end	30 September
Dividend paid	January
Launch date	1972
Continuation vote	None

Capital structure and fees

Ongoing charges	0.61%
Net cash	2.3%
Annual mgmt fee	0.55% of market cap
Performance fee	None
Trust life	Indefinite
Loan facilities	None

Fund details

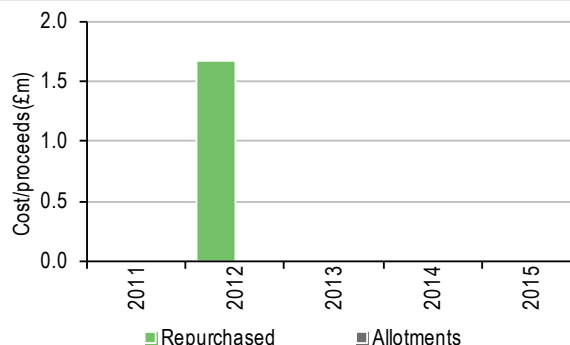
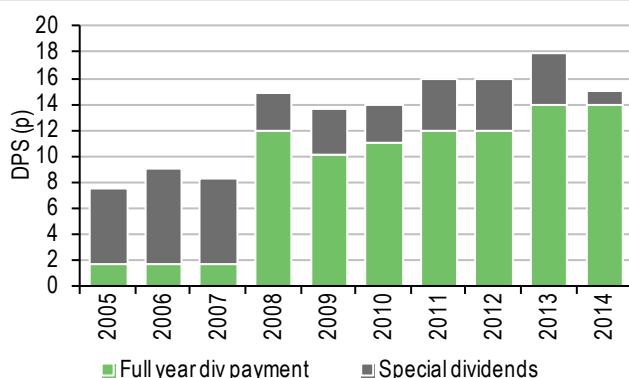
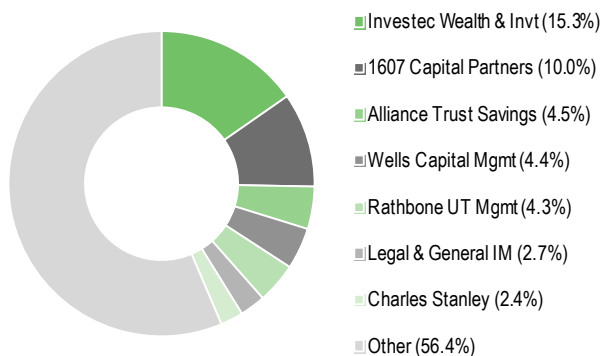
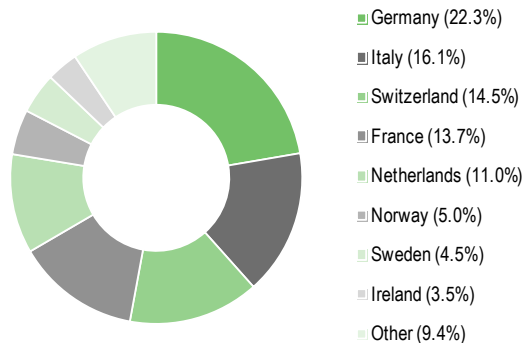
Group	Edinburgh Partners
Manager	Dale Robertson
Address	27-31 Melville Street, Edinburgh EH3 7JF
Phone	+44 (0) 131 270 3800
Website	www.edinburghpartners.com

Dividend policy and history

The company objective is to seek long-term capital growth so dividend yield is not the primary aim. Dividends are paid annually in January.

Share buyback policy and history

EUT is authorised both to repurchase up to 14.99% of its ordinary shares and to allot shares up to approximately 5% of the issued share capital.


Shareholder base (as at 1 June 2015)

Geographical exposures of portfolio (as at 31 May 2015)

Top 10 holdings as at end May

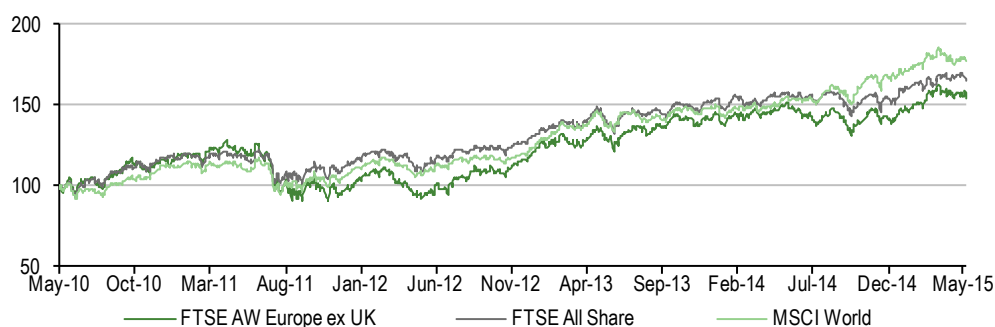
Company	Country	Sector	Portfolio weight %	
			31 May 2015	30 November 2014*
PostNL	Netherlands	Industrials	3.6	3.0
Telecom Italia	Italy	Telecoms	3.6	N/A
Ryanair Holdings	Ireland	Travel & leisure	3.5	3.0
Novartis 'R'	Switzerland	Healthcare	3.3	3.2
GAM Holding	Switzerland	Financial services	3.3	2.7
BNP Paribas	France	Banks	3.2	3.1
Prysmian	Italy	Industrials	3.2	2.6
Roche Holdings	Switzerland	Healthcare	3.1	3.2
Volkswagen	Germany	Automobiles & parts	3.0	2.9
United Internet AG	Germany	Technology	2.8	2.7
Top 10 (% of portfolio)			32.6	30.0

Source: European Investment Trust, Edison Investment Research, Morningstar, Bloomberg. Note: *Top 10 – N/A where not in portfolio at end November 2014.

Market outlook: Uncertain path after QE-fuelled upturn

European stocks have underperformed the UK and world indices over five years (Exhibit 2), with ground lost in the sovereign debt crisis of summer 2011 yet to be made good on a cumulative basis. However, since the announcement of eurozone quantitative easing in January, the FTSE All World Europe ex UK index is up 6.0% in sterling total return terms, compared with a return of 3.8% for the FTSE All-Share and 1.4% for the MSCI World index (all from 22 January to 22 June).

Exhibit 2: FTSE Europe ex UK, FTSE All-Share and MSCI World indices compared



Source: Thomson Datastream. Note: FTSE Europe ex-UK is trust benchmark. 31 May 2010 to 5 June 2015.

As return-seeking investors have migrated to Europe's equity markets in the face of negative yields on bonds and cash, company valuations have moved ahead of long-term averages (Exhibit 3). While Europe, the UK and US are all c 25-30% above the 10-year mean, European forward P/E's at 23 June were c 7% below 10-year highs, compared with c 1% for the UK and US, suggesting some headroom for further advances.

Exhibit 3: Valuation comparison

12-month forward P/E ratio	Last (x)	High (x)	Low (x)	10-year average (x)	Last % of three-year average
Europe ex UK	14.5	15.5	7.7	11.7	124%
UK	15.8	15.9	7.4	11.7	135%
US	17.5	17.8	9.4	14.1	124%
World	15.3	16.1	8.8	13.0	118%

Source: Thomson Datastream. Note: As at 23 June 2015. Uses Datastream indices.

At the time of writing it seems Greece may reach enough of a compromise with its creditors to unlock further bailout funding, albeit at the cost of tax rises that will sit uncomfortably with anti-austerity voters. This could settle investor nerves for the time being. While there will undoubtedly be bumps in the road to more normal monetary conditions worldwide, a focus on investing in quality companies at attractive valuations should stand investors in good stead over the longer term.

Fund profile: Valuation-driven European exposure

The European Investment Trust (EUT) has been managed since February 2010 by Edinburgh Partners (EP), having begun life in 1972 as Foreign & Colonial Eurotrust. Manager Dale Robertson joined EP in 2003, the year of the firm's launch, and runs an open-ended fund with the same approach. EP's philosophy is bottom-up, long-term and value-driven, based on principles posited by Sir John Templeton and developed by EP founder Sandy Nairn (see Investment process, below). The benchmark is the FTSE All World Europe ex UK index, although as a focused portfolio of 35-50 stocks its sector and country weightings tend to diverge quite widely from the index. EUT is permitted to gear up to 20% of net assets, but currently has a small net cash position. Currency exposure may be hedged, but this facility has not been used in practice. At 31 May its portfolio was 71.3% euro, 14.5% Swiss franc, 5.0% Norwegian krone, 4.5% Swedish krona and 2.3% Danish krone.

The fund manager: Dale Robertson

The manager's view: Contrarian stance in face of stretched P/Es

Following the introduction of quantitative easing in the eurozone at the start of 2015, Robertson notes that European stock markets are now further advanced in recovery terms than the European economy. The unsustainably low level of bond yields has seen liquidity flow into equity markets, pushing up P/E valuations to levels that Robertson views as the wrong side of fair value, although not yet egregiously so. A higher aggregate valuation means the year five P/E on the EUT portfolio is also on the high side of normal, at just under 11x compared with a range of 7-10x over the past five years. Therefore, the expected return over five years (which moves inversely with the year five P/E) is lower than hitherto, although Robertson believes the portfolio can still deliver a mid to high single-digit annualised real total return over the coming five years.

The lack of obvious value opportunities means Robertson is feeling relatively cautious, with c 5% of the portfolio in cash (including the position in Pirelli, which has agreed a takeover bid), a level that could rise modestly should it become harder to find stocks with year five P/Es below 11x.

The manager is currently finding the best opportunities in cyclical areas, including industrial, financial, consumer and telecoms stocks, and has been taking profits in highly valued defensive areas such as consumer staples to invest in companies with more margin of safety in their valuations. He has recently raised the portfolio weighting in oil and gas, taking positions in Norwegian stocks (see Current positioning section below) affected by both the lower oil price and a weakening of the Norwegian currency.

Another somewhat contrarian position is the high weighting in Italy (16.1% of the portfolio compared with 10.4% of the index). While mainly driven by the attractions of individual Italian stocks, Robertson is also optimistic about the ability of prime minister Matteo Renzi to implement his reform agenda and potentially achieve a second consecutive term of office (unusual in a country that has had 60 governments in 60 years). However, his optimistic view of one peripheral European economy does not necessarily read across to others, with political risk in Spain, where the outcome of this winter's election may be strongly influenced by how successful the anti-austerity Greek government is perceived to be in balancing reform with concessions from its creditors.

Asset allocation

Investment process: Disciplined, valuation-based approach

Edinburgh Partners (EP) was set up in 2003 by Sandy Nairn, previously of Templeton and Scottish Widows Investment Partnership. Its philosophy is based on the premise that earnings growth is the best predictor of share price returns. While working with Sir John Templeton, Nairn had investigated Templeton's hypothesis that five years is the optimum time frame over which to evaluate a share. He concluded that while there was a clear relationship between earnings growth and share price total returns over five years, no such correlation was observable over shorter periods. EP's investment team rigorously analyses potential investments, calculating a year five P/E ratio (Y5 P/E) for each stock based on five-year, inflation-adjusted earnings forecasts. The team works on the basis that a Y5 P/E of 11x or less is the ideal valuation at which to invest for superior long-term returns.

EUT manager Dale Robertson draws on stock ideas from EP's investment team, which comprises 12 analysts and portfolio managers with specific sector responsibilities, and a further four applied research specialists. The manager seeks to build a focused portfolio of 35-50 stocks and all investment ideas are debated at regular meetings. While all stocks are included on a five-year view,

in practice many reach their valuation targets more quickly, and Robertson is disciplined in selling holdings at this point.

Current portfolio positioning

At 31 May 2015 EUT held 39 stocks, with the majority of positions making up between 2% and 3% of the portfolio. The stock list is shorter than the peer group average of 80, although the concentration in the top 10 stocks, at 32.6%, is close to the 34.2% sector average.

The portfolio is broadly diversified by sector (Exhibit 4), with a bias to cyclical areas. Sector and geographical allocation are an output of stock selection, and there is currently no exposure to areas such as materials and construction, personal goods and retailers, utilities and real estate.

Exhibit 4: Sector breakdown at 31 May (% unless stated)

Sector	Trust weight 31 May 2015	Trust weight 30 Nov 2014	Change from Nov (% pts)	FTSE Europe ex UK weight 31 May	Active weight vs index (% pts)	Trust weight/index weight
Telecoms	10.1	7.8	2.3	4.2	5.9	2.4
Automobiles & parts	9.9	10.5	-0.6	4.8	5.1	2.1
Oil & gas	9.0	7.3	1.7	4.1	4.9	2.2
Industrial goods & services	15.8	16.5	-0.7	11.2	4.6	1.4
Financial services	5.2	4.9	0.3	1.3	3.9	4.1
Travel & leisure	3.5	3.0	0.5	0.6	2.9	5.8
Technology	5.1	4.9	0.2	4.1	1.0	1.2
Healthcare	14.1	17.0	-2.9	13.8	0.3	1.0
Media	1.7	1.8	-0.1	2.3	-0.6	0.8
Insurance	5.2	5.4	-0.2	5.8	-0.6	0.9
Banks	13.4	10.2	3.2	14.9	-1.5	0.9
Chemicals	2.6	0.0	2.6	7.9	-5.3	0.3
Food & beverage	2.0	7.4	-5.4	8.0	-6.0	0.3
Cash & other*	2.3	3.2	-0.9	17.2	-14.9	0.1
	100	100		100	0.0	

Source: The European Investment Trust, Edison Investment Research, FTSE. Note: Ranked by active weight (excluding cash & other). *'Other' includes basic resources, construction & materials, personal & household goods, retail, utilities and real estate.

Recent purchases include Hexagon, which makes precision measuring equipment; Rocket Internet, which incubates internet companies in emerging economies; two Norwegian stocks – oil services company Petroleum Geo-Services and oil-exposed bank DNB; Germany's Commerzbank (a play on the country's mid-cap sector through its subsidiary Mittelstand Bank); healthcare company Bayer, which has moved away from its origins as a chemicals firm; and Telecom Italia, which is reaping the benefits of a more transparent corporate structure. Sales include BB Biotech, a strong performer bought last year on a five-year view but which Robertson says achieved its valuation target in nine months, as well as media stock Vivendi, which has too much cash on its balance sheet, and Heineken, whose valuation as an 'expensive defensive' makes it less attractive. Purchases have been on Y5 P/Es of 6.1x to 10.7x while sales have been at Y5 P/Es of 11.0x to 14.5x, in keeping with the philosophy that a Y5 P/E of 11x or less is the optimum level for investments.

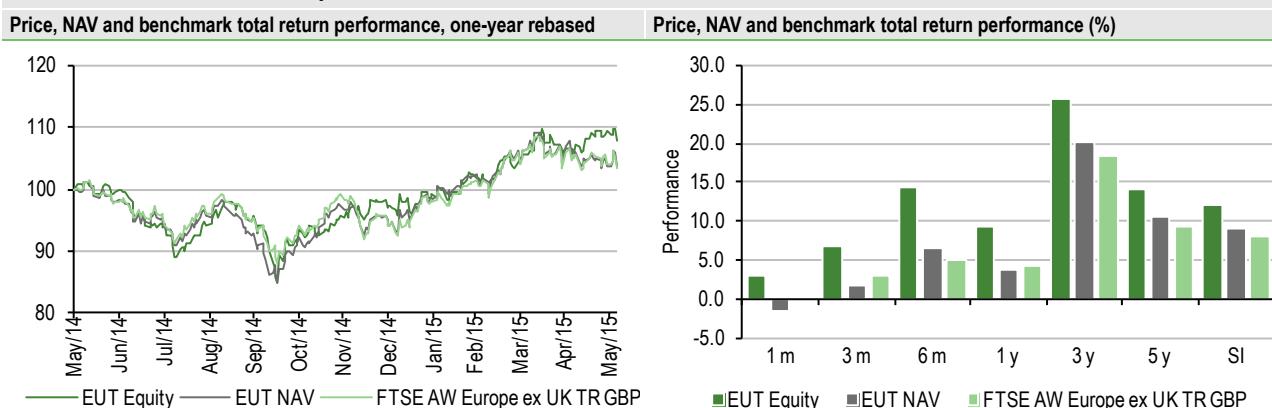
Exhibit 5: Portfolio sub-themes with average year five P/E ratios

Sub-theme or 'cluster'	Portfolio weight at 31 May (%)	Average year five P/E at 31 May (x)
Biotech/pharma pipelines	14.7	11.9
Regulated market repair (eg telecoms)	13.7	12.5
Oil/gas price	11.7	8.6
Technology trend	9.2	11.0
Utility banking	8.2	9.5
Euro auto cycle	8.0	10.5
Capex pick-up	7.7	10.9
Secular trend, various	7.5	12.6
Emerging markets	6.0	11.6
Bond-like equity	5.8	10.0
Peripheral economies	5.2	9.3
Cash	2.4	N/A
Weighted average year five P/E		10.9

Source: The European Investment Trust

Performance: Strong track record versus benchmark

Exhibit 6: Investment trust performance



Source: Thomson Datastream, Edison Investment Research. Note: Inception 1 February 2010. Three-year, five-year and since inception (SI) figures are annualised. All data to 31 May 2015.

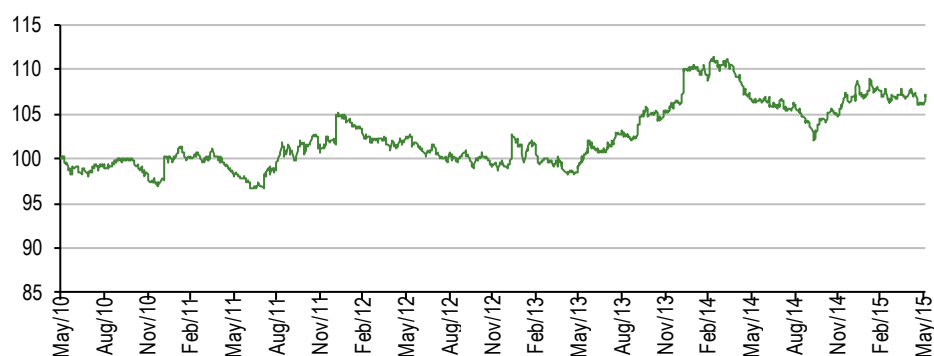
Exhibit 7: Share price and NAV total return performance, relative to indices

	One month	Three months	Six months	One year	Three years	Five years	SI*
Price relative to FTSE AW Europe ex UK	3.4	3.8	8.8	5.0	19.5	24.3	22.7
NAV relative to FTSE AW Europe ex UK	(1.2)	(1.2)	1.3	(0.4)	4.0	6.2	5.6
Price relative to FTSE All-Share	1.7	4.1	6.3	1.8	30.5	15.0	8.2
NAV relative to FTSE All-Share	(2.8)	(1.0)	(1.0)	(3.4)	13.6	(1.8)	(6.9)
Price relative to MSCI World	1.9	4.2	7.4	(6.4)	20.7	8.2	(2.9)
NAV relative to MSCI World	(2.6)	(0.9)	0.1	(11.2)	5.0	(7.5)	(16.5)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end May 2015 and indices £ adjusted. Geometric calculation. *Since inception (1 February 2010).

EUT is managed with a long-term, valuation-focused style that is somewhat at odds with market conditions under QE in Europe. The lack of yield on other assets has caused valuations on quality growth companies to become stretched beyond a level at which EUT's managers would invest, and more growth-orientated peers have outperformed as a result (Exhibit 10). That said, EUT's record versus the benchmark FTSE All World Europe ex UK index remains positive over all periods in share price total return terms, though NAV performance has trailed slightly over periods of one year and less (Exhibits 6 and 7). Edinburgh Partners now has a five-year track record in charge of EUT, an important factor as the EP investment process is built around a five-year horizon. Over this period performance is comfortably ahead of the benchmark. The managers point out that value-focused strategies tend to outperform strongly when bond yields rise, meaning that any move in bond yields from their current historically depressed level could see EUT perform better relative to peers.

Exhibit 8: NAV performance relative to benchmark over five years

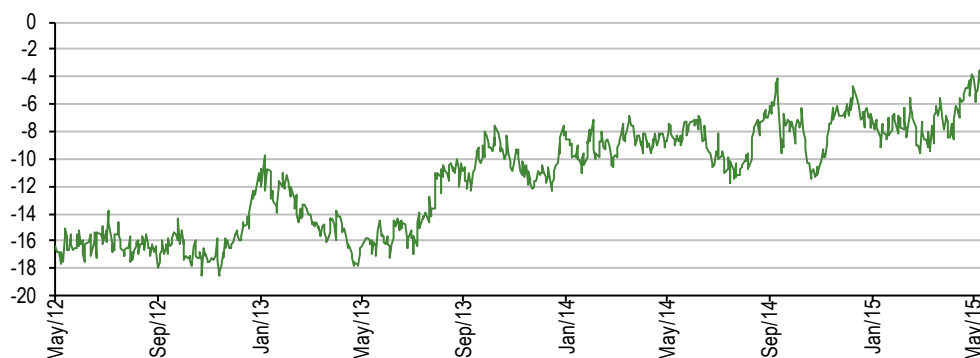


Source: Thomson Datastream, Edison Investment Research

Discount: Narrowest in five years as Europe re-rates

EUT's discount was wider than 10% when Edinburgh Partners began managing the trust and remained at that level until late 2013, since when a gradual narrowing has seen the valuation converge with the peer group (which in turn has seen discounts narrow as European equities have returned to favour). EUT's cum-income discount stood at a five-year narrowest point of 2.0% at 22 June 2015, compared with one-, three- and five-year averages of 7.7%, 11.3% and 12.9% respectively.

Exhibit 9: Discount over three years (including income)



Source: Thomson Datastream, Edison Investment Research. Note: Data to 17 June 2015.

Capital structure and fees

A conventional investment trust, EUT has one class of share, with 42.07m shares in issue at 22 June 2015. It has the authority to buy back up to 14.99% or allot up to 10% of shares to manage a discount or a premium, but in practice has made no buybacks since 2012. Having cancelled a €30m loan in summer 2014, EUT currently has no formal borrowing facility, and the manager says he would not look to employ gearing in the current market environment. A potential route to achieving some flexibility over the use of gearing would be for the trust to arrange an overdraft facility that could be deployed while longer-term borrowing was arranged.

Edinburgh Partners receives an annual management fee of 0.55% of EUT's market capitalisation. There is no performance fee, and ongoing charges for FY14 were 0.61%, the lowest in the AIC's Europe peer group by c 30bp.

Dividend policy and record

EUT aims to achieve long-term capital growth rather than income, but has maintained or grown its ordinary dividend each year since 2009 (the ordinary dividend may be supplemented with a variable level of special dividend dependent on portfolio income). Dividends are paid annually in January. For FY14 the total dividend was 15.0p (2013: 18.0p), made up of a 14p ordinary dividend (2013: 14.0p) and a 1.0p special (2013: 4.0p). This equates to a dividend yield of 1.7% based on the 22 June share price of 820p. For the first half of the financial year to 30 September 2015, the revenue return per share was 3.58p, 11% higher than in H14. The timing of European companies' dividend payments means revenue returns are weighted to the second half of the year, however, so at this stage it is hard to forecast the magnitude of any increase in the FY15 dividend (and particularly the level of any special dividend).

Peer group comparison

The Association of Investment Companies' European peer group has nine constituents (the newest, Sanditon IT, is yet to achieve a full year's track record). EUT has performed better in share price than in NAV terms over the past year (see Performance section, above), which is reflected in the NAV performance shown in Exhibit 10 below. Over 12 months the total return is the lowest in the group, while it is somewhat below average (but substantially positive in absolute terms) over three and five years. Risk-adjusted performance as measured by the Sharpe ratio is below average over one year, but broadly average over three years. Ongoing charges are the lowest in the peer group and EUT is one of only two trusts not to charge a performance fee. The yield is close to the sector average and EUT is the only trust in the peer group with a net cash position currently (Sanditon IT's low gearing figure is a result of its long/short investment strategy).

Exhibit 10: European investment trusts

% unless stated	Market cap £m	TR one year	TR three years	TR five years	Ongoing charge	Perf. fee	(Discount)/ premium	Net gearing	Yield	Sharpe NAV 1 year	Sharpe NAV 3 years
European Investment Trust	340.1	4.1	66.4	63.9	0.6	No	-6.5	98.0	1.8	0.3	1.6
BlackRock Greater Europe	263.9	6.6	65.1	69.5	1.0	Yes	-3.8	102.0	1.9	0.4	1.4
Fidelity European Values	755.4	12.3	64.2	75.7	1.0	No	-4.5	105.0	1.7	1.1	1.6
Henderson European Focus Trust	210.2	11.8	92.5	107.1	0.9	Yes	2.1	119.0	2.3	1.0	1.9
Henderson EuroTrust	189.3	8.0	74.4	84.0	0.9	Yes	2.1	105.0	2.0	0.7	1.8
JPMorgan European Growth	208.0	7.3	74.6	66.5	0.9	Yes	-6.6	108.0	2.7	0.5	1.5
JPMorgan European Income	109.0	7.0	76.2	81.6	1.1	Yes	-3.5	108.0	0.8	0.7	1.8
Jupiter European Opportunities	547.4	19.2	79.3	133.6	1.1	Yes	0.6	108.0	0.7	2.1	2.2
Sanditon Investment Trust	53.0					Yes	1.9	29.0	0.0		
Sector weighted average		11.1	72.0	88.2	0.9		-2.6	104.4	1.6	1.0	1.7
EUT rank in sector	3	8	6	8	8		8	8	5	8	6

Source: Morningstar, 23 June 2015, Edison Investment Research. Notes: TR = NAV total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show 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 shown here as total assets less cash/cash equivalents as a percentage of shareholders' funds (100 = ungeared). *Sanditon IT is a long/short fund; gearing figure refers to net exposure rather than borrowing.

The board

EUT has four directors, all non-executive. Douglas McDougall joined the board in 1999 and became chairman the same year. Michael Moule was appointed in 2004 and is the senior independent director. William Eason became a director in 2007, with Michael Woodward, the newest board member, joining in 2013. The directors all have backgrounds in investment management.

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