

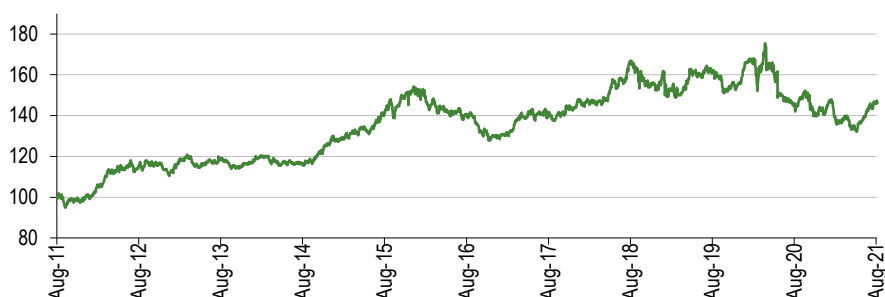
# European Opportunities Trust

Initiation of coverage

A 'fund for all seasons' targeting global winners

European Opportunities Trust (JEO) invests in European and UK companies offering good prospects for capital growth. Alexander Darwall has managed JEO since its inception in 2000. He aims to construct a 'fund for all seasons' comprising stocks capable of generating profits in all economic climates. Darwall is a high-conviction investor and JEO is a concentrated portfolio of 'special', globally focused companies that benefit from unique technologies or favourable industry structures and possess multiple growth channels. Performance in the year ended May 2021 was disappointing, in part due to JEO's bias towards high-quality companies, which lagged more economically sensitive stocks in late 2020, when the economic outlook was transformed by the arrival of viable vaccines. JEO also had exposure to the fraudulent German company Wirecard when it collapsed in June 2020. However, the trust's long-term performance has been positive in both absolute and relative terms. It has realised an annualised NAV total return of 14.1% over the past 10 years to end August 2021, compared to an annualised benchmark return of 9.9%. This track record attests to Darwall's ability to deliver sustainable capital growth, regardless of prevailing economic conditions.

NAV total return performance relative to MSCI Europe Index over 10 years



Source: Refinitiv, Edison Investment Research. Note: Total returns in sterling.

## The analyst's view

JEO's successful track record of capital growth and outperformance over the long term are evidence of Darwall's superior stock-picking skills. The trust's recent bout of disappointing performance has seen its discount widen to historically wide levels. This provides investors with a rare opportunity to buy high-quality, growth-oriented stocks at an attractive price.

## Discount may tighten if performance returns to form

JEO's share price is currently trading at a 9.4% discount to cum-income NAV, significantly above its long-term average of 3.3%, in part due to the trust's exposure to the 2020 Wirecard fraud. The board's consistent efforts to support the share price have scope to narrow the discount, especially if performance improves and/or investors come to appreciate the relative value offered by European equities at current levels.

Investment trusts  
European equities

7 September 2021

**Price** 867.0p  
**Market cap** £917.4m  
**AUM** £1,031.3m

NAV\* 957.3p  
Discount to NAV 9.4%

\*Including income. As at 3 September 2021.

Yield 0.4%  
Ordinary shares in issue 105.8m  
Code JEO  
Primary exchange LSE  
AIC sector Europe  
52-week high/low 875.0p 658.0p  
NAV\* high/low 963.4p 722.6p

\*Including income.

Net gearing\* 3.7%

\*As at 31 August 2021.

## Fund objective

The objective of European Opportunities Trust (JEO) is to invest in securities of European companies, in sectors or geographical areas that are considered by the investment manager to offer good prospects for capital growth, taking into account economic trends and business development.

## Bull points

- An investment process seeking to identify 'special' companies offering long-term growth, without reliance on cyclical factors.
- An active discount control policy, with 6.6m shares repurchased since end May 2020.
- An experienced, high-conviction manager with a track record of outperformance over the long term and a significant personal holding in the trust's shares.

## Bear points

- The manager needs to win back investor confidence after a recent, but rare, bout of poor performance. This may take time.
- The trust will underperform if cyclical value stocks continue to rally.
- A conservative use of gearing limits upside in a rising market.

## Analysts

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**European Opportunities Trust is a research client of Edison Investment Research Limited**

## Market outlook: Constant change is the challenge

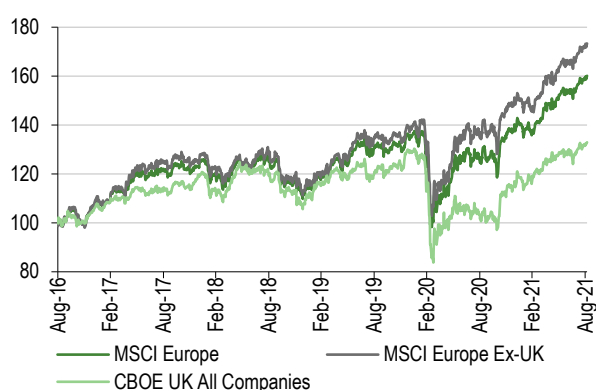
Global equity markets have welcomed the improving economic outlook and most markets are now trading well above their pre-pandemic levels; some, including the European market, are at all-time highs, despite some concerns about inflation risks and higher interest rates. As in other markets, European equities experienced a shift in market drivers in November last year. The arrival of several vaccines saw investors turn away from the high-value technology and other growth stocks that performed so strongly during the depths of the pandemic and move into economically sensitive cyclical and value stocks, which were expected to outperform as activity returns to normal. This so-called value rotation continued in the first quarter of 2021, but now appears to have run its course, as markets have fully discounted the favourable impact of the recovery on cyclical and value names.

However, for a fund such as JEO, shareholders are really investing in a very specific set of businesses, rather than in European markets as a whole. Hence, short-lived fluctuations in market sentiment are of limited relevance. Many of the kinds of companies targeted by JEO are clustered in innovative, globally orientated sectors such as pharmaceuticals and technology and their long-term prospects will be influenced most by structural trends such as advances in medical science and the rapid adoption of digital technology across most sectors of the global economy. Special, company-specific factors such as high barriers to entry, unique business models and medium-term supply constraints may also underpin the performance of some of these 'all weather' long-term growth stocks.

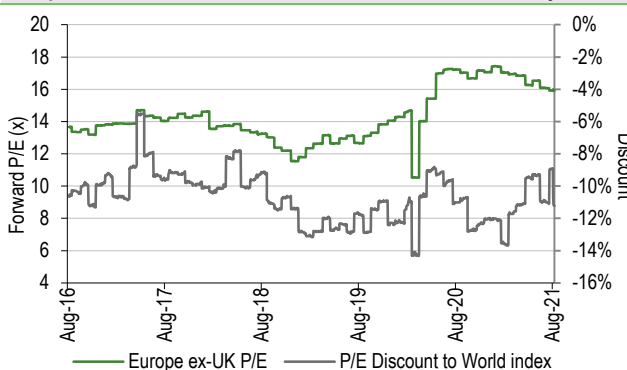
The challenge for investors is to identify these structural winners, a process that requires managers and analysts to stay abreast of myriad, rapid and often complex developments across many sectors. This is a very difficult and constant task, at which only a few skilled and experienced practitioners will succeed.

### Exhibit 1: Market performance and valuations

Total return of European and UK equity markets over five years



Europe ex-UK forward P/E and discount to World Index over five years



Source: Refinitiv, Edison Investment Research. Note: Valuations as at 3 September 2021.

## The fund manager: Alexander Darwall

### The manager's view: 'Special' companies deliver high returns

Alexander Darwall has been JEO's investment manager since the trust was launched 21 years ago by Jupiter Asset Management. When Darwall and two Jupiter colleagues established Devon Equity Management, the mandate moved to Devon at the time of its establishment (see Capital structure section for details). Darwall believes that the factor that differentiates his investment approach is that while other, larger institutional managers may pursue what he calls 'confused' agendas,

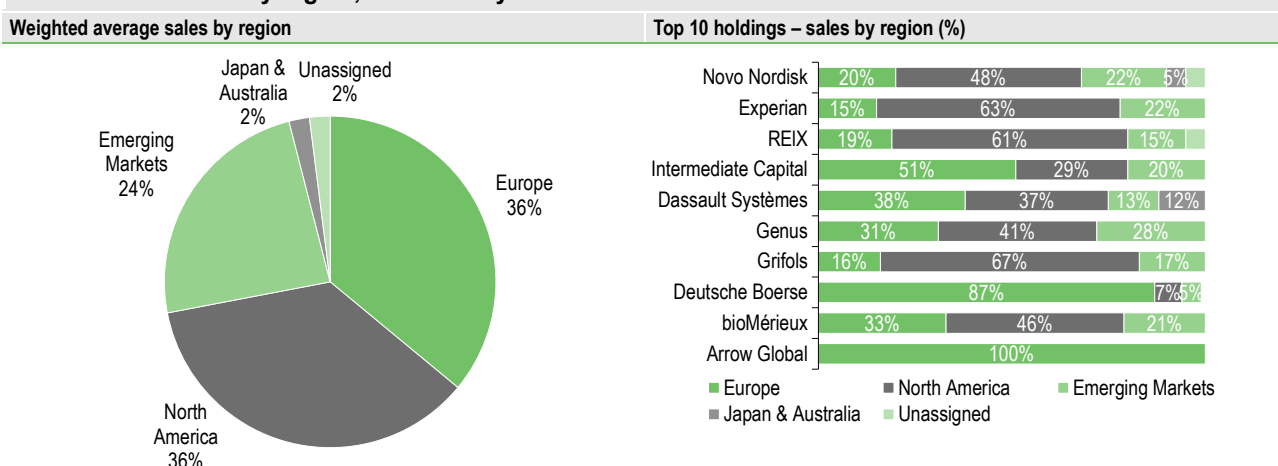
intended to meet political, personal or public service objectives, he is focused solely on maximising investment returns for his clients. 'Our only strategy is to make money for our shareholders' says Darwall.

JEO's manager wants the trust to be a concentrated 'fund for all seasons', capable of fulfilling his commitment to maximise returns over the long term, regardless of the political or economic backdrop. To this end, he targets 'special' companies that operate in large, lightly regulated markets, with favourable market structures such as high barriers to entry, strong and persistent demand and associated pricing power. Such companies tend to be highly innovative and capable of capitalising on the opportunities generated by disruption and change, while pricing power is especially important in an inflationary environment, as companies that can pass on price increases should outperform. Target companies also need to possess multiple growth channels.

The manager believes it is important that JEO's holdings have what he calls 'global reach', to maximise available growth opportunities and to strengthen the portfolio's resilience to the economic climate prevailing in any single country or region. His quest for such globally-focused companies is manifested in JEO's portfolio. While holdings may be listed in Europe or the UK, in most cases, they tend to be global leaders in their fields, so their non-European exposure usually exceeds European business; on average only 36% of portfolio holdings' sales come from Europe (Exhibit 2). Furthermore, all JEO's top 10 holdings operate globally (Exhibit 4).

Darwall cites the portfolio's second largest holding, Novo Nordisk, as an illustration of the kind of 'special' businesses he favours. This Danish pharmaceutical company has been held by the trust since its inception. It is one of only two companies, along with Eli Lilly, that supply most of the world's insulin. And as well as having duopolistic power in the insulin market, Novo Nordisk also satisfies the manager's criteria of possessing multiple growth channels: it is a world leader in the development of obesity drugs, and its biomedical arm is focused on finding new treatments for growth disorders and haemophilia.

**Exhibit 2: JEO sales by region, as at 31 May 2021**



Source: European Opportunities Trust Note: Not all percentages will add up to 100%.

Immunity to higher interest rates is another prerequisite for companies in Darwall's 'fund for all seasons', as he is concerned that the massive monetary and fiscal stimulus implemented over the past 18 months will lead to inflation and force central banks to raise interest rates, despite their current reluctance to countenance policy tightening. The manager cites the case of US cruise operator Carnival as an extreme example of the kind of corporate indebtedness he avoids. Darwall sold Carnival at the beginning of the pandemic, one of several disposals made to curtail losses as the pandemic took its toll on the travel industry. Although the prospects for this sector are now beginning to improve, Carnival is unlikely to feature among JEO's holdings again in the foreseeable future, as its efforts to survive the global lockdown have seen it accumulate over US\$30bn of debt,

which will be crippling to Carnival if rates rise faster than expected. Instead, the manager favours companies with low debt levels that should not only survive but outperform in a higher rate environment.

JEO's performance over the past financial year to end May 2021 was uncharacteristically poor and very disappointing relative to the benchmark (see the Performance section). However, despite this, the manager has maintained his longstanding focus on 'differentiated, high value added, capital light global, profitable companies with less debt than average', selling to 'reliable sources of demand'. He has refused to chase the market into the kind of low value-added, high-volume stocks that do not meet his rigorous selection criteria, for the sake of potential short-term returns. Instead, Darwall believes that his track record of long-term outperformance of the benchmark, his peers and the UK market provides ample evidence that his consistent and time-tested approach is the most effective way to maximise shareholder returns over longer periods, regardless of the prevailing economic conditions.

## Asset allocation

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### Current portfolio positioning

Given the manager's preference for companies at the forefront of innovation, it is not surprising that pharmaceutical and life science companies have the heaviest weighting in JEO's portfolio of 'special' companies (Exhibit 3), while four healthcare companies feature in the trust's top 10 holdings (Exhibit 4): Novo Nordisk; Genus, a UK animal genetics company; BioMerieux, a French diagnostics company; and Grifols, a Spanish blood plasma company.

In fact, the manager has recently added to JEO's holdings of Genus and Grifols. Genus is a world leader in its field and global demand for its products is increasing. There is scope for 'tremendous' medium-term growth in the Chinese market, according to Darwall. He is also optimistic that the company's efforts to develop a treatment for one of the main porcine respiratory diseases will soon succeed, opening a significant new commercial opportunity. Grifols' share price was hit by constraints on blood collection during the pandemic, and the manager took advantage of the dip to increase exposure, as he expects demand for Grifols' services to return and grow in the longer term.

The rapid encroachment of digital technologies into many aspects of daily life has ensured that technology stocks have the second largest sectoral weighting in JEO's portfolio, notably via exposure to several companies involved in the production of semiconductors. Global demand for semiconductors is currently outstripping supply, creating logjams in the production of some tech products, while the burgeoning growth of 'the internet of things' and wearable technology, has driven up demand for ever smaller and more efficient semiconductors. This has prompted the manager to increase JEO's positions in two semiconductor producers, Germany's Infineon and Dutch company ASML.

He has also opened a new position in French manufacturer SOITEC. This company produces energy efficient silicon wafers that increase the battery life of wearable tech, and its unique technology means that it is well-placed to benefit from the 5G rollout. Following the release of encouraging results, Darwall also recently increased exposure to Oxford Instruments, a UK company producing high-tech tools used in many specialist fields, including the production of semiconductors.

Elsewhere in this sector, the increasing sophistication of cyber criminals is generating demand for cyber security services. The manager has acquired exposure to this trend by participating in the initial public offering of UK-listed Darktrace, a company with a unique process that uses unsupervised machine learning to protect companies' systems from cyber threats. Darktrace's

recent partnership with Microsoft boosted market confidence in the company and JEO's acquisition has proved profitable.

**Exhibit 3: Portfolio sector exposure at 31 August 2021 (% unless stated)**

Sector	Portfolio weight end Aug 2021	Portfolio weight end Aug 2020	Change	MSCI Europe ex-UK	Active weight vs benchmark
Healthcare	29.4	28.1	1.3	14.5	14.9
Information Technology	26.4	20.0	6.3	8.6	17.8
Industrials	19.5	21.6	(2.2)	15.0	4.5
Financials	13.2	22.3	(9.2)	15.4	(2.3)
Energy	3.3	1.9	1.4	4.2	(0.9)
Consumer Staples	2.8	2.8	(0.0)	12.7	(9.9)
Communication Services	2.5	3.2	(0.7)	3.8	(1.3)
Consumer Discretionary	2.0	0.0	2.0	12.0	(10.0)
Materials	1.0	0.0	1.0	8.5	(7.4)
Utilities	0.0	0.0	0.0	4.2	(4.2)
Real estate	0.0	0.0	0.0	1.4	(1.4)
<b>Total</b>	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>	

Source: European Opportunities Trust, Edison Investment Research

The manager has also increased the portfolio's exposure to innovative alternative finance companies, including French credit services company Edenred, which provides prepaid corporate service vouchers. In addition, he has opened a new position in French digital payment services company Worldline, Europe's largest payment processor, which should benefit from the continued expansion of digital payments.

Other new names to the portfolio include the UK retailer Pets at Home. Demand for pet products increased during lockdown and the manager likes the company's uniquely integrated model, which includes pet food, toys, vet services and grooming and is helping the company gain market share. This holding was topped up in June following encouraging results.

A position in Norwegian sustainable salmon producer Mowi has been re-opened due to an increase in demand during lockdown and constrained supply, which will support prices. German sportswear company Adidas has also returned to the portfolio, following recent excellent results and the brand's rising popularity in China. Elsewhere, the manager has topped up existing holdings in video games publisher Ubisoft and in Gaztransport Et Technigaz (GTT), which provides engineering and design services to LNG carriers. This position is a play on expected growth in LNG demand. In Darwall's view, although European demand for LNG is diminishing, he sees 'good, sustainable demand' for LNG in Asia.

JEO's most significant disposal over the financial year ended 31 May 2021 was the closure of its large position in the German digital payments company Wirecard. JEO had held this company for 13 years. Portfolio exposure peaked at 14.3% in May 2019. At this point, the board requested that no further shares should be added to the Wirecard position. To limit excessively large exposures, the board also imposed a rule that no position should be acquired or added to if it represents more than 10% of total assets on the date of purchase. The manager began selling Wirecard shares, and by end May 2020, the position had fallen to 10.4% of the portfolio, although it was still JEO's largest position at the time. Concerns about the company had been circulating in the press for some time and shortcomings identified by KPMG in March 2020 led Darwall and his team to engage with Wirecard's management and supervisory boards, research analysts and fellow investors. These enquiries satisfied Darwall that the concerns raised by KPMG and others were being addressed.

However, in June 2020, Wirecard's auditors, Ernst & Young, declined to sign off on the year end accounts, due to serious accounting irregularities. Darwall sold JEO's entire holding on 18 June 2020, the day after this disclosure, although this did not prevent JEO's exposure to Wirecard from having a very significant adverse performance impact, as the share price plunged (see the following section). It is now clear that a small number of Wirecard's senior executives, in collaboration with third parties, perpetuated a significant, long-standing fraud. Despite the persistent rumours in the

market and press speculation about the company's accounts, this fraud avoided detection not only by the company's supervisory board, Ernst & Young, KPMG, business partners such as Visa and Mastercard, investors, brokers and journalists, but also by the German regulator (BAFIN), for several years.

Darwall concedes that it was a mistake to build up such a sizable position in the company and he is keen to stress that 'lessons have been learned' from this experience. The manager points out that he is not permitted to make any new purchases in holdings that comprise more than 10% of the portfolio, a rule imposed by the board in 2019 (as mentioned above). Furthermore, he intends to err more on the side of caution. As an example of this caution, Darwall cites the case of Grenke, a German financial and leasing firm servicing smaller companies. When Grenke was the subject of similar speculation about its internal controls in Q320, Darwall closed JEO's exposure as a precautionary measure. However, Grenke has since received an unqualified opinion from its auditors for its most recent annual report and Darwall subsequently repurchased a smaller holding of the stock on expectations that the stock will eventually recover strongly, although to date, the share price remains near its Q320 lows.

**Exhibit 4: Top 10 holdings (as at 31 August 2021)**

Company	Country	Main area of business	Portfolio weight %	
			31 August 2021	31 August 2020*
Experian	UK	Credit data provider	10.4	10.7
Novo Nordisk	Denmark	Pharmaceuticals	10.2	10.1
Dassault Systemes	France	Software	9.4	7.5
RELX	Netherlands	Publishing	8.6	8.7
Genus	UK	Animal genetics	8.4	4.4
Intermediate Capital Group	UK	Asset management	7.5	5.8
Deutsche Boerse	Germany	Stock exchanges	5.1	9.9
BioMerieux	France	Pharmaceuticals	5.0	7.5
Grifols	Spain	Pharmaceuticals	4.8	5.6
SOITEC	France	Semiconductor equipment	3.9	N/A
<b>Top 10 (% of holdings)</b>			<b>73.3</b>	<b>75.6</b>

Source: European Opportunities Trust, Edison Investment Research. Note: \*N/A where not in end-August 2020 portfolio.

The manager has also sold a position in UK asset manager Arrow Global following an agreed takeover and taken some profits on other top 10 holdings Novo Nordisk, UK publishing and information company RELX and Deutsch Boerse, the stock exchange owner. The proceeds of these sales have been used to fund the purchase of other, more attractive opportunities.

JEO's portfolio is more concentrated than those of all its close peers in the Association of Investment Companies (AIC) Europe sector. It currently has 31 holdings and its top 10 holdings comprised 73.3% of the portfolio at end August 2021 (Exhibit 4). It is also notable that the trust usually has a sizable allocation to UK-listed stocks (Exhibit 5) and at present three of JEO's largest holdings are UK-based. This also distinguishes JEO from its peers and is purely a function of stock selection. Darwall says he prefers to hold the best stock in the sector, even if it happens to be UK-listed. The trust's top 10 list is also testament to its relatively low turnover. Nine of the top 10 positions were in the portfolio at the same time last year and some holdings have been held much longer: Novo Nordisk, Dassault and RELX have all been in the portfolio since inception and JEO has owned more than half its holdings for more than six years (see the Investment process section below).



**Exhibit 5: Portfolio geographic exposure at 31 August 2021 (% unless stated)**

	Portfolio end-Aug 2021	Portfolio end-Aug 2020	Change (pp)
United Kingdom	29.7	32.5	(2.8)
France	26.1	26.8	(0.8)
Germany	13.1	18.9	(5.8)
Netherlands	12.0	3.4	8.7
Denmark	9.8	10.1	(0.2)
Spain	4.7	5.7	(1.0)
Switzerland	1.9	2.0	(0.2)
Norway	1.5	0.7	0.7
Finland	1.3	0.0	1.3
	<b>100.0</b>	<b>100.0</b>	

Source: European Opportunities Trust, Edison Investment Research

## Performance: Outpacing market and peers long term

**Exhibit 6: Five-year discrete performance data**

12 months ending	Share price (%)	NAV (%)	MSCI Europe (%)	MSCI Europe ex-UK (%)	CBOE UK All Cos (%)
31/08/17	23.7	23.2	22.1	25.4	14.3
31/08/18	31.0	20.5	2.4	1.9	4.3
31/08/19	(5.2)	0.5	4.2	5.2	0.3
31/08/20	(18.0)	(12.5)	(3.6)	0.6	(13.5)
31/08/21	27.2	26.1	26.3	27.0	27.1

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

Darwall's differentiated, active, benchmark agnostic investment strategy has remained unchanged since inception. This approach means that JEO's performance is likely to differ from the benchmark, the MSCI Europe Index, at times, although the trust has only underperformed its benchmark in three financial years over the course of its 21-year existence. In the year ended May 2009, the trust underperformed the benchmark by 4.6 percentage points, as it was relatively heavily geared (30% at end May 2008), in a falling market. The board took the decision to retain the gearing and unwind it as markets recovered. The trust also underperformed its benchmark by 1.8 percentage points in the year ended May 2017, due to the poor performance of Novo Nordisk, which was hit by a fall in insulin prices in the key US market.

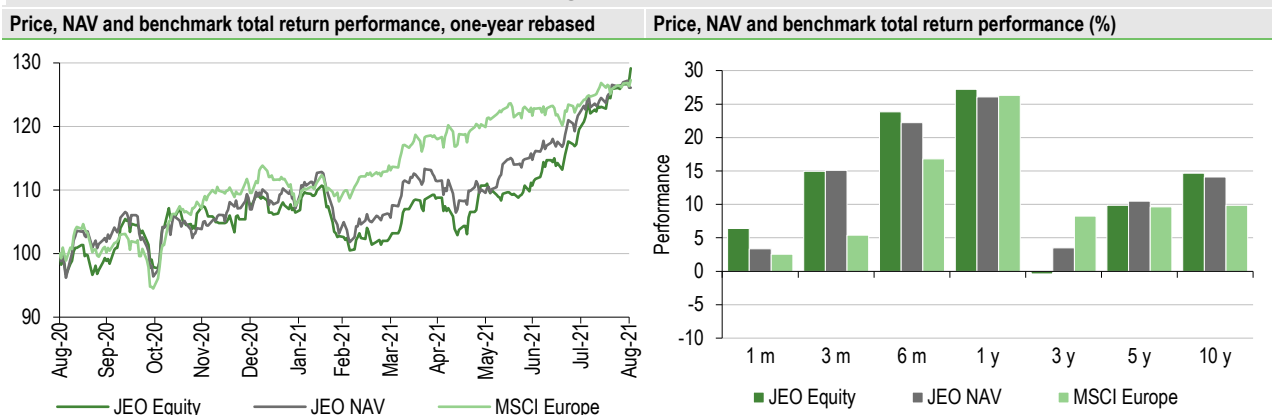
The financial year ended May 2021 was the third such rare year of underperformance, and the worst in the trust's history. JEO's total return on a net asset value (NAV) basis was 1.2%, and it returned 0.1% on a share price basis, compared to a return of 24.6% for its benchmark. This disappointing performance has dragged down returns on a three- and five-year basis. However, longer-term returns have been good in absolute and relative terms. JEO has outperformed its benchmark over 10 years, making an average annualised total return of 14.1% on an NAV basis and 14.7% on a share price basis over this period to end August 2021, compared to a benchmark return of 9.9% (Exhibits 7 and 8). JEO has also outperformed the average of its peers over the past 10 years (see the following section) and it has outpaced the UK market on an NAV basis over five and 10 years, an illustration of the benefits of diversification away from UK investors' home market.

The collapse of Wirecard is part of the explanation for JEO's poor performance over the financial year to end May 2021. It detracted 6.1 percentage points from absolute returns over the period, before the position was closed in June 2020. However, the trust's poor relative performance over the past financial year was also a result of the manager's investment style. JEO's portfolio of high-quality stocks lagged lower-quality cyclical and value stocks during the value rotation of late 2020 and early 2021 (discussed above).

Aside from Wirecard, the main detractor from performance over the financial year to end May 2021 was BioMerieux, which was hit when it warned that COVID-19 related demand had declined sharply in the US. This stock detracted 2.1 percentage points from returns. However, the manager believes

the market for other diagnostic services, aimed at reducing infectious diseases and the use of antibiotics, will continue to expand over the medium term, so the position has been retained. JEO's holding in Grenke, the company assailed by rumours of fraud (discussed in the previous section), also detracted 2.1 percentage points, before the position was closed as a precaution. When the company was cleared of all allegations by its auditors, Darwall opened a new, smaller position on the expectation that the stock will recover strongly.

#### Exhibit 7: Investment trust performance to 31 August 2021



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

Experian, now JEO's largest position, had a slight negative impact on returns. This UK-listed company is the world's largest credit data provider. Its share price was hurt by concerns that it would lose a significant share of its revenues if the Biden administration implements plans to set up a public credit reporting agency to improve credit access to lower income groups. However, despite such concerns, the manager is positive on this stock for several reasons. He argues that a previous US public credit agency, established during the Obama administration, did not damage the existing private players. In addition, he expects demand for credit data to grow in line with the burgeoning fintech market, and he likes the fact that Experian is diversified across regions and product lines.

In addition, the company has just purchased Arvato Financial Solutions' Risk Management Division, Germany's second largest credit agency and is having early success in challenging markets such as Brazil. It is also moving into banking and adding new services that empower consumers by improving their direct access to credit for cars and other consumer items. Darwall thinks the market is missing the scope of this business and he intends to maintain the position, to allow these developments to play out, to Experian's benefit. The share price has recently reached an all-time high.

These adverse influences on performance over the financial year ended May 2021 were partially offset by the favourable impact of several holdings. The largest positive return contribution came from UK asset manager Intermediate Capital Group, a top 10 holding which invests in private equity, credit and debt. Darwall expects this company to continue to deliver good returns, supported by increasing investor appetite for private equity assets. Another UK asset manager, Arrow Global, was the second largest contributor to returns, as the share price was boosted by a takeover offer. Genus, a UK animal genetics company, benefited from China's need to restock its pig industry after an outbreak of African swine flu. Infineon, a semiconductor producer, also contributed, as demand for its power semiconductors continues to rise in line with growth in automotive, wearable and other 5G applications that require efficient batteries.



**Exhibit 8: Share price and NAV total return performance, relative to indices (%)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI Europe	3.8	9.1	6.0	0.7	(22.1)	1.1	53.2
NAV relative to MSCI Europe	0.8	9.2	4.7	(0.2)	(12.6)	3.8	45.8
Price relative to MSCI Europe ex-UK	3.6	8.2	4.9	0.2	(26.4)	(6.7)	36.7
NAV relative to MSCI Europe ex-UK	0.6	8.4	3.6	(0.7)	(17.5)	(4.2)	30.1
Price relative to CBOE UK All Cos	3.9	11.6	9.2	0.1	(10.3)	21.9	87.6
NAV relative to CBOE UK All Cos	0.9	11.7	7.7	(0.8)	0.6	25.2	78.6

Source: Refinitiv, Edison Investment Research. Note: Data to end-August 2021. Geometric calculation.

Another positive contributor was Dassault Systemes, a top 10 holding which is one of JEO's longest held positions, having been in the portfolio since inception. Dassault is a French software company that provides 3D design, printing and related products and services to many sectors in the global marketplace. Darwall's ongoing support for this company is based not just on performance, but also on the company's efforts to expand its geographical and product reach, including via vertical integration into applications in the life sciences, city-planning and other high-tech sectors. The manager sees 'massive' potential for growth, as the high degree of R&D intrinsic in such a business means barriers to entry are formidable and the company faces few competitors.

Some of JEO's large healthcare holdings had a mixed year, as public health systems around the world prioritised the treatment of COVID-19 patients. However, Novo Nordisk made a modest contribution as it benefited from the US's Food and Drug Administration approval of its new obesity drug, a decision that gives it unique access to the massive obesity treatment market. Novo Nordisk is the only player currently in this market and will undoubtedly exploit its first-mover advantage.

There are signs that Darwall's long-term investment approach may be beginning to re-assert itself. JEO's performance has improved since the end of its financial year (Exhibit 9). In the three months to end August 2021, the trust has returned 15.1% in NAV terms (14.9% on share price basis), compared to a benchmark return of 5.4%. Recent returns have been supported by strong performances by several of the trust's holdings, including Experian, Novo Nordisk, Dassault and SOITEC.

**Exhibit 9: NAV performance versus benchmark over three years**


Source: Refinitiv, Edison Investment Research. Note: Benchmark is a broad global infrastructure index.

## Peer group comparison

JEO is a member of the AIC Europe sector, which has eight constituents. More than half of these trusts share JEO's focus on growth rather than income, but JEO is unique among its peers in several respects. Its high-conviction investment approach means portfolio concentration is relatively high, as it usually only holds around 30–40 stocks, lower than most of its peers, and its top 10 holdings represent over 70% of portfolio value (Exhibit 4), compared to around 40% concentration among its peers. In addition, JEO maintains a persistent and sizable exposure to UK-listed

companies, unlike most other members of the sector, which have little or no UK exposure. As a result of these factors, based on a comparison of top holdings, JEO's portfolio is markedly different from those of its peers, with virtually no stocks in common.

JEO is the second largest fund in its sector. Its NAV total return has slightly lagged the average of its peers on a one-year basis. Returns have trailed all peers over three and all but one over five years, but the trust ranks third among its peers, outperforming the average, over 10 years. The company's discount is higher than the sector average. Its ongoing charge is slightly above the average, and, like all its peers, it does not charge a performance fee. JEO's gearing level is in line with the average of its peers and its dividend yield is at the lower end of the range, as is to be expected given its focus on capital growth rather than income.

**Exhibit 10: Selected peer group as at 6 September 2021\***

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum fair)	Ongoing charge	Perf fee	Net gearing	Dividend yield
European Opportunities Trust	917.4	30.2	11.1	66.7	292.9	(9.4)	1.0	No	104	0.4
Baillie Gifford European Growth	617.6	42.9	76.3	133.0	265.5	(1.6)	0.4	No	106	0.2
BlackRock Greater Europe	675.9	52.0	87.1	160.0	380.6	1.4	1.0	No	103	0.9
Fidelity European Trust	1,352.2	27.5	41.5	92.5	260.9	(7.1)	0.9	No	112	2.0
Henderson European Focus Trust	344.3	28.7	36.2	77.5	276.9	(10.1)	0.8	No	100	1.9
Henderson EuroTrust	329.4	24.4	47.5	93.8	294.0	(10.6)	0.8	No	97	1.6
JPMorgan European Growth Pool	267.3	30.8	30.1	69.6	215.0	(12.1)	1.0	No	103	1.2
JPMorgan European Income Pool	134.7	29.3	11.7	48.0	189.8	(10.2)	1.0	No	109	4.3
<b>Simple average</b>	<b>579.8</b>	<b>33.2</b>	<b>42.7</b>	<b>92.6</b>	<b>272.0</b>	<b>(7.4)</b>	<b>0.9</b>		<b>104</b>	<b>1.6</b>
<b>JEO rank in peer group</b>	<b>2</b>	<b>4</b>	<b>8</b>	<b>7</b>	<b>3</b>	<b>4</b>	<b>4</b>		<b>4</b>	<b>7</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance as at 3 September 2021 based on ex-par NAV. \*\*Ordinary shares only. TR = total return. TER = total expense ratio. Net gearing is total assets less cash and equivalents as a percentage of net assets.

## Dividends: Capital growth aim means modest dividend

JEO's objective is to achieve capital growth rather than income, and it therefore pays only a modest annual dividend, representing 85% of investment income, which is sufficient to meet the legislative requirements necessary for the trust to maintain its investment trust status. In the financial year ended 31 May 2020, the company declared a final dividend of 3.5p per share. Based on this dividend and the current share price, this represents a current yield of 0.4%.

## Discount: Historically wide, with scope to narrow

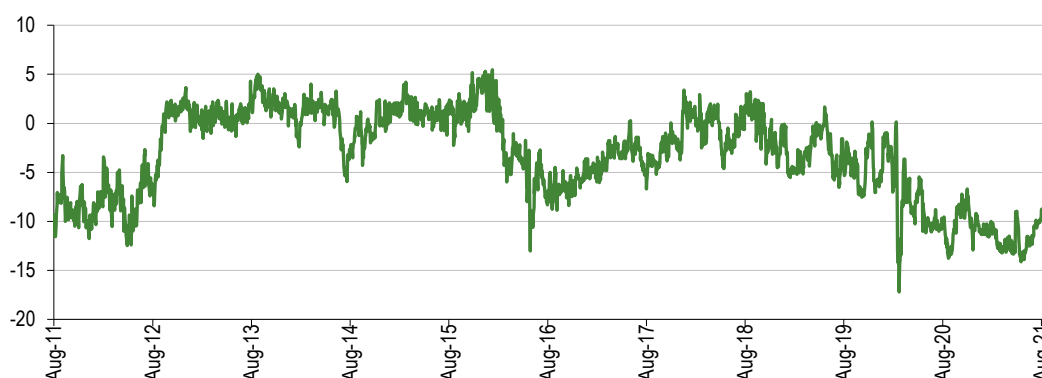
JEO's share price has traded at a modest discount to cum-income NAV over the longer term, averaging 5.1% over five years and 3.3% over 10 years. The discount remained within its five-year trading range following news of the transfer of the mandate to Devon Equity Management in November 2019 (see Capital structure section for detail). However, in line with the experience of most investment companies, JEO's discount widened sharply for a brief period in March 2020, at the start of the pandemic. Since then, it has established a new discount trading range around 10% (Exhibit 11), significantly wider than historical averages. The discount is currently 9.4%. This is most likely due to a combination of factors, including the adverse impact of JEO's exposure to the Wirecard fraud and its poor performance over the financial year ended 31 May 2021.

JEO's board is committed to the active management and minimisation of discount and premium risk, via the use of share buybacks and new share issuance. It believes that this will improve liquidity for both buyers and sellers of the trust's shares. The board has the authority, renewed annually, to purchase up to 14.99% of issued shares. In the annual report for the year ended May 2020, the board stated its policy to maintain the discount within single digits, in normal market conditions. To this end, the board repurchased a total of 11,020 shares in the financial year ended

31 May 2020 and a further 6.3m shares during the fiscal year ended 31 May 2021. These were the first share buybacks the board has undertaken since 2011. At the end of the financial year ended 31 May 2021, there were 106.1m shares in issue. Since then, the board has repurchased a further 0.3m shares.

The board's consistent efforts to support the share price have scope to narrow the discount over time, especially if performance improves and/or investors come to appreciate the relative value offered by European equities at current levels.

**Exhibit 11: Premium/discount over 10 years (NAV including income)**



Source: Refinitiv, Edison Investment Research

## Fund profile: Consistent, high-conviction strategy

JEO was launched by Jupiter Asset Management in November 2000 and is now managed by Devon Equity Management (see the Capital structure section for details). Alexander Darwall, Devon's chief investment officer, has managed the fund since its inception, first at Jupiter and subsequently at Devon, under the same investment strategy adopted at the trust's launch.

JEO's objective is to invest in securities of European and UK companies and in sectors or geographical areas that are considered by the manager to offer good prospects for capital growth, taking into account long-term economic trends and business development. JEO's benchmark is the MSCI Europe TR GBP Index and the MSCI Europe ex-UK TR GBP Index is used as a secondary benchmark, although the manager is not tied to investing in constituent companies of the benchmark.

JEO invests primarily in equity and equity-related securities of issuers that have their registered office in Europe or exercise the predominant part of their economic activities in Europe (including the UK). Darwall employs an active, bottom-up approach to selecting investments. The portfolio is relatively concentrated, consisting of around 30–40 high-conviction investments. Its top 10 holdings usually represent over 70% of assets under management. The company is a member of the AIC Europe sector. It uses gearing tactically and has access to an unsecured committed £125m multi-currency revolving credit facility with Scotiabank, at 65bp above Libor.

## Investment process: Targeting maximum returns

JEO's investment team comprises four members. Alexander Darwall, Devon's chief investment officer, has ultimate responsibility for investment decisions. Luca Emo, JEO's senior fund manager, has worked alongside Darwall as a manager of European equity portfolios since 2009, at both Jupiter Asset Management, which launched JEO, and then Devon Equity Management, which took over the mandate in November 2019 (see the Capital structure section for details). Charlie

Southern, who has 11 years' investment research experience, joined the Devon team as fund manager in 2020 and James Bird joined the team as a junior research analyst in mid-2021. The four work closely on all aspects of the management process.

Darwall's overriding philosophy is to act in the collective interest of JEO's shareholders. He defines 'collective interest' by the singular criterion of maximising investment returns. To this end, he adopts a stock-picking approach in the belief that a company's fundamentals will ultimately prevail, and that a thorough analysis and understanding of a company is therefore the best way to identify superior long-term growth prospects. In the manager's view, a target company's ownership structure and management team are key to the success of this process. Company management teams should have a strong track record and a demonstrated ability to capitalise on opportunities created by disruption. They must also be willing to communicate clearly with stakeholders regarding their actions and intentions. The company's incentive structures must align managers' interests with those of shareholders.

For Darwall, it is also essential that companies offer something 'special' – a distinctive characteristic – that is difficult to replicate and likely to deliver a sustainable competitive advantage, for example, unique intellectual property or technology, or industry positioning that creates barriers to the entry of competitors and hence a sustainable competitive advantage and associated pricing power. Target companies must also possess a large market share, ideally in the global marketplace, with multiple growth options. And for Darwall, profitability is 'the glue that holds everything together', so it is also essential that target companies' business models are sustainable, with strong balance sheets, low debt, ample free cash flow and solid returns that will grow steadily over the long term. Darwall believes all these factors are central to a company's ability to realise superior growth over the long term. Price is also a consideration. He is looking for companies whose longer-term earning power has been overlooked and underappreciated by the market. The resultant stock selections comprise what Darwall calls 'a fund for all seasons' – a concentrated portfolio of structural winners, diversified across activity and sector, with uncorrelated risks and returns, capable of surviving in all environments.

In addition to constant oversight of JEO's existing holdings, the team monitors about 30 potential investments at any one time and in pre-COVID-19 times, Emo conducted over 200 company meetings a year. This number has doubled during the pandemic, thanks to video conferencing, although Emo prefers face-to-face meetings as a better way to get to know people and their businesses and he is looking forward to resuming 'real life' meetings later this year. As well as meeting the management of potential investments, the team also talks to its suppliers, customers and employees, to build a fuller picture of the company. These broader conversations can also generate other investment ideas. For example, during the time that JEO owned Ryanair, Emo would talk to the airline about its catering services, maintenance businesses, airport providers and inflight entertainment, in an effort to identify other interesting investment opportunities.

Each potential investment is subject to rigorous fundamental analysis. The team employs differing valuation techniques, depending on their relevance to the business characteristics of a particular company. Whatever the valuation method however, the underlying feature will be the sustainability and growth of free cash flow in the long term. However, the manager is wary of placing too much confidence in precise valuations, especially over medium- to long-term time horizons, because he thinks such analysis provides a misleading sense of accuracy and underplays the uncertainties that inevitably surround such forecasts.

While Darwall is responsible for final stock selection decisions, Emo and Southern have vetoes over investment decisions. Initial investments tend to be small, usually around 0.5–1.0% of portfolio value, depending on the margin of safety and the level of the team's conviction, although purchases may be larger if the team is familiar with the company. For instance, the team's recent reacquisition of Adidas amounted to 3% of the portfolio, as it knows the company well, having held it in the past.

Position size will be increased over time if the investment thesis proves sound. If it does not, the position will be closed.

Holdings will also be sold outright if valuations begin to look excessive or if the business model is disrupted by technology or changes in consumer demand. Darwall cites as an example JEO's position in Pearson, a UK publishing conglomerate, which he closed in 2015, when the company moved its newspaper business online. The manager will also close, or trim, positions to lock in profits on successful investments, to reduce the size of large holdings or to generate cash to fund other, more attractive investment opportunities, as he always seeks to be fully invested and aims to keep gearing low. As evidence of the efficacy of JEO's sell discipline, Emo points to the fact that 22 of the 38 companies sold in recent years (58%) have subsequently underperformed the benchmark, suggesting the decision to sell was justified.

However, Darwall is a long-term investor, so JEO's average holding period is around five years and average turnover since inception is around 35%, although holding periods can be much longer. Novo Nordisk, Dassault and RELX, which together comprised 28% of the portfolio at end August 2021, were purchased at launch and 53% of the portfolio has been held for over six years. These statistics, combined with the trust's long-term outperformance, attest to the consistency of JEO's investment process since inception.

The investment process aims to deliver uncorrelated returns, so that the poor performance of one stock does not affect the performance of others. A clear illustration of this is the impact of the fraudulent demise of Wirecard, which, while very painful in absolute returns, had no impact on other holdings, which have completely different drivers. The uncorrelated nature of JEO's returns helps ensure NAV volatility is in line with its peers, despite the relative concentration of its portfolio.

JEO does not use derivatives or currency strategies, although a portion of JEO's assets is denominated in currencies other than sterling, so the NAV can be significantly affected by currency movements.

## **JEO's approach to ESG**

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Given that JEO's sole objective is to realise long-term capital growth, the manager does not explicitly target environmental, social and governance (ESG) investments, or have specific ESG or sustainability objectives. However, the manager considers many ESG issues to be indistinguishable from core business considerations and a vital part of investment success. So, the team's assessment of a company's long-term prospects necessarily takes into account environmental, social and political factors, as they will have a material impact on future financial performance. ESG considerations are thus integrated into the investment process, in the belief that better practices lead to better outcomes.

In Darwall's view, the recent increase in market focus on ESG investing simply serves to formalise considerations that have been at the core of his investment process for over 20 years. He cites as an example JEO's long-term structural underweights to commodity companies and banks, due to his concerns about the nature of these industries and aspects of their business practices.

The manager believes that, thanks to the power of social media, consumers are becoming increasingly powerful arbiters on environmental and ethical matters related to the production and marketing of goods and services. Companies need to meet the standards imposed by their customers, to protect market share and nurture future growth prospects. The team engages with target companies' management on ESG issues, to understand potential risks, the management's planned response to such risks and associated threats to the investment case.

As mentioned above, Darwall places great emphasis on a company's corporate culture and management integrity and the team analyse these elements of a business extensively prior to investment. This work includes an assessment of employee satisfaction, which, if high, by definition precludes exploitative, dangerous or corrupt business practices. However, JEO's experience with Wirecard shows that even the most careful monitoring may not necessarily protect investors from systematic, well-disguised fraud. Since the exposure of Wirecard's fraud, Devon has instigated additional internal controls and reporting in connection with its risk analysis of all holdings.

As a further safeguard, JEO's manager uses third-party ESG research on current and prospective investments to identify risks that may have been overlooked or underestimated by the team's proprietary research. However, Darwall does not use ESG scores or negative screens. JEO's annual report provides investors with an ESG report, which includes discussion and analysis of companies with high ESG risks, details of the team's active engagement with management teams to understand and improve shortcomings and a summary of their voting history, highlighting votes against management resolutions.

Devon Equity Management is a signatory of the United Nations Principles of Responsible Investing (UNPRI), which emphasises the same active engagement principles that sit at the core of Darwall's investment philosophy.

## **Gearing**

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JEO uses gearing tactically and has access to a low cost £100m multi-currency revolving credit facility with Bank of Nova Scotia. The manager has scope to use gearing amounting to a maximum of 20% of total assets. However, over the past three years, the level of gearing has ranged between 0% and 12%. In general, the manager expects to increase gearing when market valuations are low and decrease it in stronger markets. In June 2020, at the beginning of the last financial year, soon after the onset of the COVID-19 crisis, the company had no gearing, but gearing has subsequently increased modestly and at end August 2021 it stood at 3.7%.

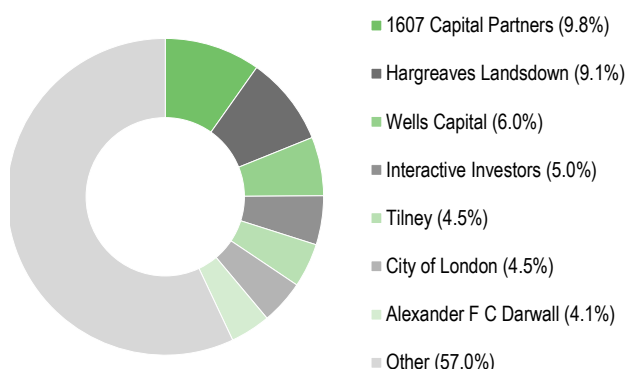
## **Capital structure, life of the company and ownership**

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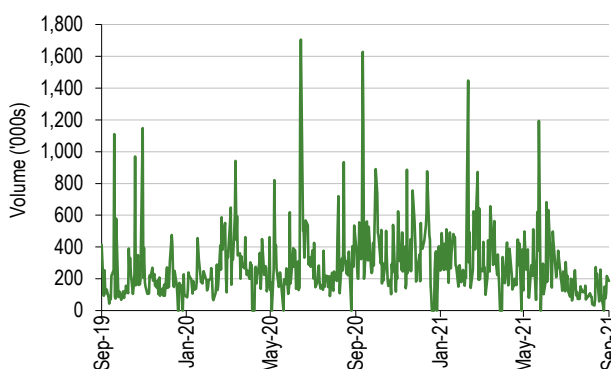
JEO was launched by Jupiter Asset Management in November 2000 and has been managed by Alexander Darwall since its inception. In November 2019, Darwall and two other longstanding employees of Jupiter, Luca Emo and Richard Pavry, founded Devon Equity Management and JEO's board transferred the mandate to Devon at the time of Devon's establishment.

JEO is structured as an investment trust, with one class of ordinary shares. There are currently 105.8m shares in issue. Between them, Devon's three founders own 5% of JEO's shares and intend to reinvest a proportion of any profits into JEO. The intention is to ensure they maintain a high degree of motivation to deliver outstanding investment performance to Devon's clients. Darwall has recently increased his personal investment in the fund to 4,539,772 shares (as at 17 June 2021), a holding representing 4.3% of total voting rights in the company, up from 3.2% the previous year. This holding makes Darwall JEO's seventh largest shareholder (Exhibit 12). He has committed to remaining at Devon for a period of at least five years and the company is focused on building a pipeline of talent to ensure the long-term continuity of the firm. JEO's shareholders are given the opportunity to vote on the continuity of the company at every third AGM. The next vote is due at the 2023 AGM.



**Exhibit 12: Major shareholders (ordinary shares)**


Source: European Opportunities Trust, as at 30 June 2021

**Exhibit 13: Average daily volume (ordinary shares)**


Source: Refinitiv. Note: Two years to 3 September 2021.

## Fees and charges

With effect from 15 November 2019, FundRock has acted as JEO's alternative investment fund manager (AIFM) under the AIFM Directive, replacing Jupiter Unit Trust Managers Limited. Under the terms of the Portfolio Management Agreement, FundRock has delegated certain portfolio management functions to Devon Equity Management, as delegated investment manager to FundRock, in substitution for the company's former investment manager, Jupiter Asset Management Ltd. Under the early termination arrangements agreed with Jupiter, a base management fee (of 0.75% of total assets, including drawn down borrowings under the company's loan facilities) continued to accrue to Jupiter after termination, up to 31 May 2020. In the period from 15 November 2019 to 31 May 2020, in addition to the fee payable to Jupiter, the company paid a fee of 0.03% per annum of net assets (excluding drawn down borrowings) to FundRock and a management fee of 0.10% per annum of net assets to Devon.

With effect from 1 June 2020, FundRock and Devon are paid aggregate management fees of 0.90% per annum of net assets up to £1.0bn and 0.80% on asset above this amount. In the past, performance fees represented a significant proportion of the company's costs. However, no performance fee will be payable to Devon or FundRock going forward. JEO's ongoing charge was 0.99% at end May 2020.

## The board

**Exhibit 14: JEO's board of directors**

Board member	Date of appointment	Remuneration from 1 June 2020	Shareholdings at end-FY20
Andrew Lang Sutch (chairman)	10 October 2011*	£38,500	9,618
Sharon Brown (audit committee chair)	1 August 2019	£31,500	2,354
Philip Edward Fraser Best	12 May 2009**	£27,500	43,750
The Rt Hon Lord Lamont of Lerwick	24 June 2015	£27,500	14,660
Virginia Holmes	7 November 2017	£27,500	13,000
Mathew Dobbs	1 September 2021	£27,500	20,000***
Jeroen Huysinga	1 September 2021	£27,500	11,000

Source: European Opportunities Trust. Note: \*Due to retire at 2022 AGM. \*\*Due to retire at 2021 AGM. \*\*\*A further 6,000 shares are held by a close family member.

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