EDISON

The European Investment Trust

Maintaining disciplined valuation-based approach

Investment trusts

The European Investment Trust (EUT) has been managed by Edinburgh Partners (EP) since 2010. Lead manager Craig Armour employs EP's strict valuation-driven investment process, aiming to generate long-term capital growth from a diversified portfolio of continental European equities. Following a period of outsized equity returns, Armour says that investors will once again pay more attention to individual company fundamentals and valuations. Since July 2017, EUT pays semi-annual, rather than annual dividends. While the focus is on capital rather than income growth, the ordinary distribution has increased every year since 2009. EUT's current yield, including indicated and special dividends, is 2.5%.

12 months ending	Share price (%)	NAV (%)	Benchmark (%)	FTSE All-Share (%)	MSCI World (%)
30/11/13	45.3	33.8	25.8	19.8	24.3
30/11/14	3.3	4.0	4.6	4.7	14.5
30/11/15	(2.3)	(5.9)	0.0	0.6	3.9
30/11/16	2.5	12.8	13.0	9.8	25.0
30/11/17	32.9	23.9	24.5	13.4	14.8

Source: Thomson Datastream. Note: All % on a total return basis in GBP.

Investment strategy: Seeking attractive valuations

EP's in-house analysis shows that share prices correlate with inflation-adjusted five-year earnings performance, but share price moves are less correlated over shorter periods. The manager and his team undertake thorough fundamental research, with a particular focus on five-year earnings estimates. They aim to invest in companies that are trading on a five-year (5Y) P/E multiple of less than 11x. The resulting 35-45 stock portfolio is diversified by sector and geography, but the manager is unconstrained by the weightings of the FTSE Europe ex-UK index benchmark. Gearing of up to 20% of net assets is permitted; at end-October 2017 EUT had a net cash position of 1.1%.

Market outlook: Equity valuations looking fuller

Since early 2016, global equities, including those in Europe, have appreciated significantly against a backdrop of a synchronised global economic recovery. As a result, company valuations are looking less attractive. On a forward P/E multiple basis, both European and world equities are trading at a c 20% premium to their 10-year averages. However, in absolute terms, European equities look significantly more attractively valued than US equities.

Valuation: Discount in a narrowing trend

EUT's discount has been in a narrowing trend since late 2016. Its current 10.7% share price discount to cum-income NAV is towards the low end of the 7.1% to 17.8% range of the last 12 months. It compares to the averages of the last one, three, five and 10 years of 12.2%, 10.2%, 10.6% and 12.8% respectively. There is scope for the discount to narrow further if there is increased investor appetite for European equities, or if there is an improvement in EUT's relative investment performance.

7 December 2017

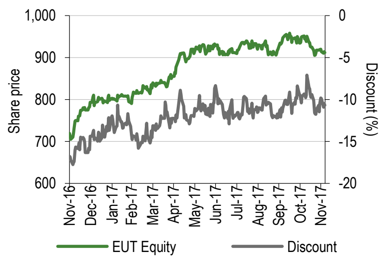
Price	**912.0p**
Market cap	**£383m**
AUM	**£432m**

NAV*	1,006.6p
Discount to NAV	9.4%
NAV**	1,021.3p
Discount to NAV	10.7%

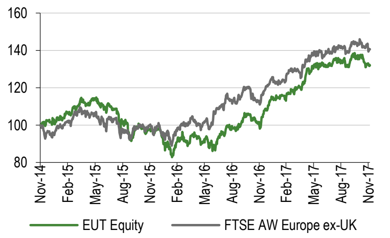
*Excluding income. **Including income. As at 5 December 2017.

Yield (inc indicated and special dividends)	2.5%
Ordinary shares in issue	42.0m
Code	EUT
Primary exchange	LSE
AIC sector	Europe
Benchmark	FTSE Europe ex-UK

Share price/discount performance



Three-year performance vs index



52-week high/low	958.0p	732.5p
NAV** high/low	1,066.1p	886.9p

**Including income.

Gearing

Gross*	0.0%
Net cash*	1.1%

*As at 31 October 2017.

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Edison profile page

The European Investment Trust is a research client of Edison Investment Research Limited

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 investment approach. The trust has an indefinite life and is not subject to a periodic continuation vote.

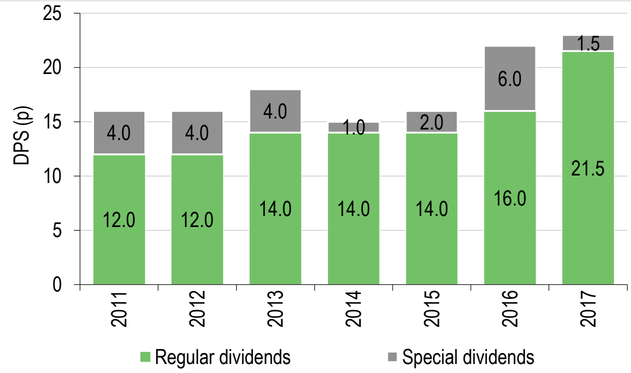
Recent developments

- 30 November 2017: Annual report for 12 months ending 30 September 2017. NAV TR +29.9% versus benchmark TR +22.6%. Share price TR +32.2%. Announcement of 13.5p final dividend.
- 3 November 2017: Confirmation of delisting of ordinary shares from the New Zealand Stock Exchange. EUT's shares will continue to trade on the Main Market of the London Stock Exchange.

Forthcoming		Capital structure		Fund details	
AGM	January 2018	Ongoing charges	0.59%	Group	Edinburgh Partners
Interim results	May 2018	Net cash	1.1%	Manager	Craig Armour
Year end	30 September	Annual mgmt fee	0.55% of market cap	Address	27-31 Melville Street, Edinburgh EH3 7JF
Dividend paid	July, January	Performance fee	None		
Launch date	1972	Trust life	Indefinite	Phone	+44 (0) 131 270 3800
Continuation vote	None	Loan facilities	€30m	Website	www.edinburghpartners.com

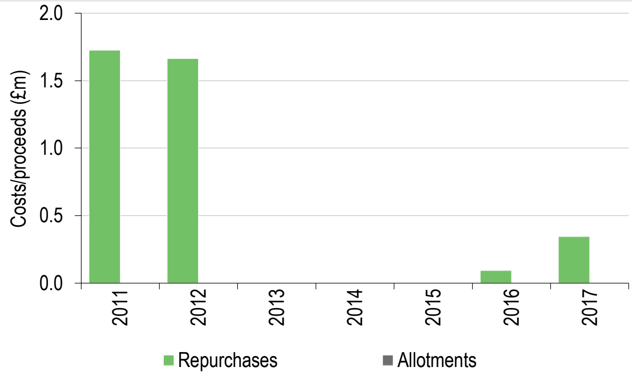
Dividend policy and history (financial years)

The investment objective is to seek long-term capital growth so dividend yield is not the primary aim. Historically, annual dividends were paid in January, but starting in July 2017 an interim dividend will also be paid. Note: 13.5p of the regular dividend in FY17 has been declared but not yet paid.

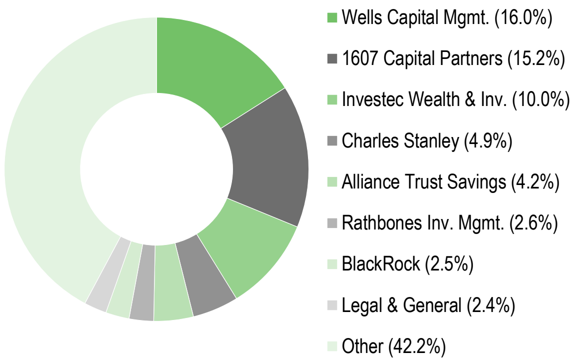


Share buyback policy and history (financial years)

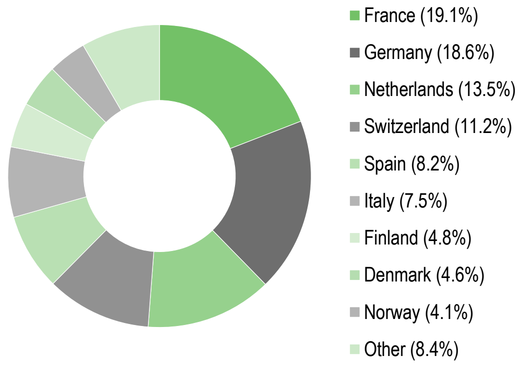
EUT is authorised both to repurchase up to 14.99% of its ordinary shares and to allot shares up to 5% of the issued share capital.



Shareholder base (as at 2 November 2017)



Portfolio exposure by geography (as at 31 October 2017)



Top 10 holdings (as at 31 October 2017)

			Portfolio weight %	
Company	**Country**	**Sector**	**31 October 2017**	**31 October 2016**
PostNL	Netherlands	Industrial goods & services	3.8	5.2
Bayer	Germany	Chemicals	3.4	3.2
Novartis 'R'	Switzerland	Healthcare	3.3	N/A
Royal Dutch Shell 'A'	Netherlands	Oil & gas	3.3	3.8
BBVA	Spain	Banks	3.2	3.3
Sanofi	France	Healthcare	3.2	3.3
Total	France	Oil & gas	3.1	3.6
Commerzbank	Germany	Banks	3.1	N/A
ENI	Italy	Oil & gas	3.1	3.3
BNP Paribas	France	Banks	3.0	4.0
Top 10			**32.5**	**36.7**

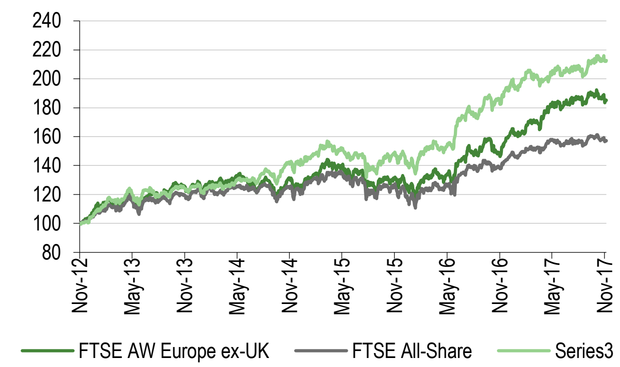
Source: The European Investment Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in October 2016 top 10.

Market outlook: Time to be more selective?

As shown in Exhibit 2 (LHS), the performance of global equities, including those in Europe, has been particularly strong since early 2016. Investors have focused on the synchronised global economic recovery, rather than dwelling on a variety of macroeconomic and political concerns over the period. As a result, equity valuations are looking somewhat stretched. On a forward P/E multiple basis, using Datastream indices, global equities are trading towards the high end of their 10-year range and c 20% above the 10-year average. While European equities are also trading at c 20% above their 10-year average forward P/E valuation multiple, they are relatively cheaper than both US and world equities. Following the global financial crisis, the European economy was slower to recover than other developed markets, such as the US. However, there is now firm evidence of improvement, such as strength in purchasing manager indices and the European Union Economic Sentiment Indicator, and corporate earnings growth is robust. With valuations looking less attractive, investors seeking exposure to European equities may wish to consider a fund that has a disciplined, valuation-based approach to stock selection.

Exhibit 2: Market performance and valuation

Performance of indices, last five years (in £ terms)



Forward P/E multiples of Datastream indices

	Last (x)	High (x)	Low (x)	10-year average (x)	Last as % of 10-year average
Europe ex-UK	14.2	15.6	7.4	11.7	121
UK	14.0	15.6	7.4	12.1	116
US	18.8	18.9	9.4	14.6	129
World	15.8	16.0	8.8	13.1	121

Source: Thomson Datastream, Edison Investment Research. Note: Data to 6 December 2017.

Fund profile: Bottom-up, value approach

EUT was launched in 1972 as Foreign & Colonial Eurotrust. Since February 2010, the trust has been managed by Edinburgh Partners (EP), which currently has £7.4bn of assets under management, including £1.5bn in European mandates. All strategies are long-only and unconstrained, and adhere to EP's value-driven process, developed by the company's founder Sandy Nairn, on the understanding that stock markets are efficient over the long term, but behave more randomly over shorter periods. Therefore, stocks should be valued on their ability to generate future profits over the course of a business cycle, rather than valued on their past performance.

Manager Craig Armour aims to generate long-term capital growth from a relatively concentrated portfolio of 35-45 European (ex-UK) equities. He employs EP's bottom-up approach to stock selection, seeking stocks that are reasonably valued based on five-year earnings forecasts. The trust is benchmarked against the FTSE All-World Europe ex-UK Index. No more than 10% of the portfolio may be held in countries that are not included in the benchmark, and any investment in unquoted companies requires prior board approval. While EUT has the ability to hedge against currency movements, this facility has historically not been utilised. Gearing of up to 20% of net assets is permitted, although at end-October EUT had a net cash position of 1.1%.

The board has proposed a change to EUT's investment objective from 'to achieve long-term capital growth through a diversified portfolio of continental European securities' to 'to achieve attractive investment returns over the long term from a diversified portfolio of European securities'. This proposal will be voted on by shareholders at the January 2018 AGM. On 3 November 2017, the company confirmed its shares had been delisted from the NZX (New Zealand) Main Board, its shares continue to be listed on the Main Market of the London Stock Exchange.

The fund manager: Craig Armour

The manager's view: Fears of deflation abating

Armour says that following several years of widespread fears of deflation, there are now signs of inflation, which he believes will become more prevalent in 2018. As a result, he believes that other countries will follow the US lead and continue or start to increase interest rates. The manager says that while inflation started in the commodity sector, it is now more broad based, as is evidenced in higher food and labour costs. He cites the UK, where there is pressure from the low-paid 'gig economy' and the government is under pressure to improve the living conditions of the poorer members of society. Due to a weak economy and ultra-low interest rates, labour costs have been suppressed, while asset prices have risen; Armour expects this balance of power to shift. He believes that while economic growth in Europe is robust, equity valuations in general are looking quite full, with the improving economy broadly reflected in share prices.

The manager argues that "earnings are starting to matter". He notes that there appear to be outsized share price moves for companies reporting earnings either above or below expectations, which is what he would expect when valuations are reasonably full. Due to anticipated higher interest rates, Armour suggests that investors are in a transition period. He believes that they will begin to focus more on company valuations, and there will be greater investor emphasis on fundamental research.

Asset allocation

Investment process: Long-term valuation based

EP's disciplined, valuation-based investment approach assumes that future earnings growth is the best predictor of share price returns. The belief is that the stock market is rational over the long term, but due to investor short termism, over shorter time periods there are less rational share price moves. EUT has been managed by Armour since August 2016. He is able to draw on EP's well-resourced investment team of 12 portfolio managers/analysts and two applied research specialists (reduced from three following a retirement), who conduct detailed bottom-up analysis on companies to derive five-year inflation-adjusted earnings forecasts for potential investments, resulting in a Y5 P/E. EP's analysis shows that above-average real returns can be generated when companies are purchased at a Y5 P/E below 11x. Over the last 20 years, the average Y5 P/E of EUT's portfolio has ranged between 7x and 11x and is currently close to the high end at c 10.5x.

The trust typically has 35 to 45 positions, holding fewer stocks when valuations are high and more when valuations are more attractive. At end-FY17, EUT had 37 names in the portfolio. EP's investment team uses a standard research template, which along with a five-year profit forecast, includes valuation metrics and an ESG (environmental, social and governance) rating. Given the disciplined valuation-based investment approach, there may be periods when EUT underperforms the benchmark, so investors should be prepared to have a long-term investment horizon. Given the long-term approach, EUT has low portfolio turnover; in FY17 it was 22%. At the end of the period, its active share was 79%, which was indicative of the level for the whole financial year. Active share is a measure of how a portfolio differs from its benchmark, with 100% representing no commonality and 0% representing full index replication.

Current portfolio positioning

At end-October 2017, EUT's top 10 positions made up 32.5% of the portfolio, which is a modest decrease in concentration versus 36.7% at end-October 2016; eight holdings were common to both periods. Over the last 12 months, the largest increase in sector exposure is in banks, and the trust now has a 1.5x weighting versus the index. While this adds to EUT's cyclical exposure, the manager says that banks' earnings volatility has been reduced due to stronger balance sheets, less trading activity and more focused business models. He says that it has been difficult for banks to make money in an environment of low growth and low interest rates, and they will benefit from increased economic activity, while higher interest rates will improve their net interest margins. Armour says that 18 months ago banks were viewed by some investors as 'uninvestible', but opinions have now shifted.

Exhibit 3: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-October 2017	Portfolio end-October 2016	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Banks	21.6	17.3	4.3	14.2	7.4	1.5
Industrial goods & services	18.2	22.2	(4.0)	12.1	6.1	1.5
Healthcare	12.1	11.5	0.6	11.8	0.3	1.0
Oil & gas	11.1	12.6	(1.5)	5.5	5.6	2.0
Telecoms	7.7	7.2	0.5	3.6	4.1	2.1
Personal & household goods	4.4	2.9	1.5	6.8	(2.4)	0.6
Retail	4.1	2.8	1.3	2.6	1.5	1.6
Technology	3.8	2.5	1.3	4.9	(1.1)	0.8
Chemicals	3.4	3.2	0.2	6.6	(3.2)	0.5
Utilities	2.6	2.5	0.1	4.1	(1.5)	0.6
Travel & leisure	2.5	2.6	(0.1)	0.5	2.0	4.7
Automobiles & parts	2.5	4.1	(1.6)	4.4	(1.9)	0.6
Financial services	2.4	2.6	(0.2)	1.6	0.9	1.5
Media	2.4	2.0	0.4	1.6	0.8	1.5
Basic resources	0.0	3.6	(3.6)	1.6	(1.6)	0.0
Construction & materials	0.0	0.0	0.0	3.3	(3.3)	0.0
Food & beverages	0.0	0.0	0.0	7.6	(7.6)	0.0
Insurance	0.0	3.6	(3.6)	5.9	(5.9)	0.0
Real estate	0.0	0.0	0.0	1.5	(1.5)	0.0
Cash & others	1.1	(3.0)	4.1	0.0	1.1	N/A
	100.0	**100.0**		**100.0**		

Source: The European Investment Trust, Edison Investment Research

Since our last report was written in June 2017, EUT has initiated four positions – Deutsche Post, Nordea, Mediobanca and Ontex, while three have been sold; all on valuation grounds – Piaggio, SKF and Stora Enso. Deutsche Post is a German postal operator that also owns international carrier DHL, whose business is particularly strong in Europe and Asia. Like other industry participants, Deutsche Post is experiencing lower mail volumes, but higher parcel volumes in both business-to-business (B2B) and business-to-consumer (B2C). Customers are increasingly paying a premium for express, rather than standard delivery, which is very profitable for carriers. Deutsche Post also has alliances with other operators in Europe, bringing the benefits of growing cross-border mail. In 2016, the company increased its dividend and undertook its first share repurchase; the manager considers that both of these events are very positive for shareholders.

Mediobanca is a financial conglomerate, which has a strong commercial banking franchise in Italy. Its retail bank is advanced in terms of digital capabilities, with a lack of problem consumer and small and medium enterprise (SME) loans. Historically, it has held stakes in other Italian companies but these positions are being unwound, with capital being reinvested into its growing wealth management operations. The manager says that the investment in Mediobanca broadens out EUT's bank exposure at an attractive price.

Nordea is a well-managed pan-Scandinavian bank with a high capital base. It is midway through a major IT project to consolidate its four individual country platforms, which the manager believes will lead to significant cost savings. The company is well along the path to digitalisation and has been reducing the number of its branches. Nordea is moving its domicile from Sweden to Finland, which will lead to lower capital requirements; the excess cash could be returned to shareholders. Nordea currently offers a dividend yield in excess of 6%.

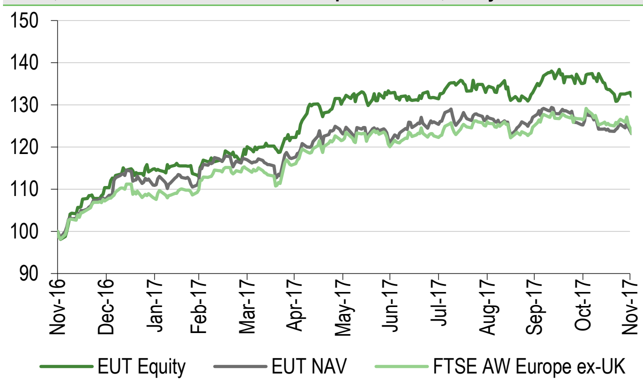
Ontex is a Belgian personal hygiene products company. Its largest business is in Western Europe, supplying private label products. The manager says that this business is solid but has limited margin uplift potential. Ontex has since expanded into Eastern Europe and has also acquired two branded businesses, one in Brazil and one in Mexico as underlying growth in emerging markets is much higher than in Western Europe, helped by an expanding middle class. The company's strong cash flow can be used for further accretive acquisitions.

Performance: Near-term impact from weak October

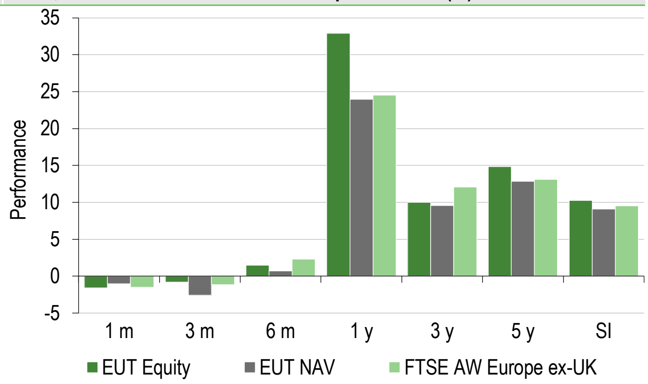
EUT's absolute returns are shown in Exhibit 4. Over the last 12 months, its NAV and share price total returns of 23.9% and 32.9% respectively compare to the benchmark's 24.5% total return. The largest contributors to performance include: French video game manufacturer Ubisoft; German cable and harnessing manufacturer Leoni; and Germany's second-largest bank, Commerzbank. EUT's short-term results have been affected by a poor period of performance in October 2017, when its NAV lagged the benchmark by c 3%; the manager contributes this to a variety of factors including growth rather than value leadership in the stock market, weakness in certain sectors such as banks, healthcare and telecoms, and the trust's under-representation in certain technology names that performed well.

Exhibit 4: Investment trust performance to 30 November 2017

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



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: SI is since the move to EP (1 February 2010). Three, five and SI performance figures annualised.

Exhibit 5 shows EUT's relative performance. Over one year its NAV total return is broadly in line with the benchmark, while its share price total return is meaningfully higher, which has resulted in a narrower discount over the period. In NAV terms EUT has lagged over the other periods shown (with the exception of one month), but in share price terms it has also outperformed over three months, five years and since the move to EP in February 2010. Of interest to UK shareholders, EUT has outperformed the FTSE All-Share index over the majority of periods shown.

Exhibit 5: Share price and NAV total return performance, relative to indices (%)

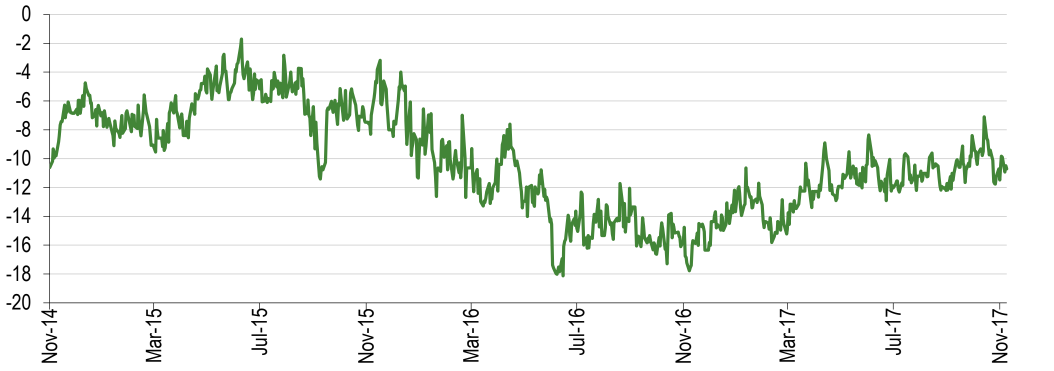
	One month	Three months	Six months	One year	Three years	Five years	SI
Price relative to FTSE AW Europe ex-UK	(0.1)	0.3	(0.8)	6.8	(5.4)	7.8	5.4
NAV relative to FTSE AW Europe ex-UK	0.5	(1.5)	(1.6)	(0.5)	(6.6)	(1.3)	(3.0)
Price relative to FTSE All-Share	0.1	(0.6)	1.7	17.3	6.3	27.1	7.3
NAV relative to FTSE All-Share	0.6	(2.4)	0.9	9.3	5.0	16.4	(1.2)
Price relative to MSCI World	(1.9)	(2.2)	(3.1)	15.8	(10.7)	(5.9)	(20.4)
NAV relative to MSCI World	(1.3)	(4.0)	(3.8)	8.0	(11.8)	(13.8)	(26.7)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-November 2017. Geometric calculation.

Discount: Narrowing trend since late 2016

As shown in Exhibit 6, EUT's share price discount to cum-income NAV has been in a narrowing trend since late 2016. The 10.7% current discount is towards the low end of the 7.1% to 17.8% range of the last 12 months. It compares to the averages of the last one, three, five and 10 years of 12.2%, 10.2%, 10.6% and 12.8% respectively. There is scope for the discount to narrow further if there is an improvement in EUT's relative investment performance.

Exhibit 6: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

EUT is a conventional investment trust with one class of share and there are currently 42.0m ordinary shares outstanding. It has authority to buy back up to 14.99% or allot up to 5% of shares to manage a discount or premium. EUT has a €30m overdraft facility with Northern Trust, but at end-October 2017, the trust was ungeared and running a net cash position of 1.1%

EP receives an annual management fee of 0.55% of EUT's market cap, and no performance fee is payable. In FY17, ongoing charges were 0.59%, which was 3bp lower than in FY16. As shown in Exhibit 7, the trust has a very competitive fee structure compared to its peers in the AIC Europe sector (36bp lower than average). Historically, all expenses were charged to the revenue account but following a review by the board, starting in the current financial year two-thirds of fees and financing costs will be charged to the capital account. The two-thirds, one-third split between the capital and revenue account reflects the board's expected breakdown of future returns between capital and income, and should increase the revenue available for dividend payments.

Dividend policy and record

While EUT focuses on capital growth rather than income, ordinary annual dividends have grown or been maintained since 2009, compounding at an annual rate of c 10%. Special dividends are also paid, which are dependent on the level of income (see Exhibit 1). During FY17, EUT's revenue return rose by 35.8% to 25.8p; the primary reasons for the increase were the receipt of historic overseas withholding tax reclaims and the strength of the euro relative to sterling.

In FY17, the ordinary dividend of 21.5p was 34.4% higher than 16.0p in FY16. Taking special dividends into account, the FY17 total payout of 23.0p is 4.5% higher than 22.0p in FY16; it was 1.1x covered by income. At the end of FY17, EUT had revenue reserves of £9.9m, which is equivalent to 23.5p per share (0.5p higher than the latest annual distribution). The trust historically paid dividends once a year in January; however, starting in 2017 an interim dividend will also be paid in July. Based on EUT's current share price, its dividend yield (including indicated and special dividends) is 2.5%.

Peer group comparison

EUT is the third-largest of eight investment trusts in the AIC Europe sector. Following a tough period of performance in October 2017, which affected its previously improved one-year record, EUT's NAV total return is below average over all periods shown. Although EUT's discount has narrowed meaningfully since late 2016, it remains one of the widest in the sector. The trust has a competitive ongoing charge: it is 36bp cheaper than the peer group average, and no performance fee is payable. EUT is currently the only trust in the sector with a net cash position and its dividend yield ranks second of eight trusts, c 0.5pp above average.

Exhibit 7: AIC Europe sector peer group as at 6 December 2017*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
European Investment	383.1	24.1	31.0	81.2	(9.4)	0.6	No	99	2.5**
BlackRock Greater Europe	290.3	26.3	46.2	88.7	(4.1)	1.1	No	103	1.7
Fidelity European Values	935.5	27.0	44.2	89.3	(6.2)	1.0	No	115	1.9
Henderson European Focus Trust	293.3	22.4	44.4	112.3	2.9	0.9	Yes	100	2.2
Henderson EuroTrust	248.0	25.3	53.5	111.9	(2.0)	0.9	Yes	100	2.1
JPMorgan European Growth Pool	249.5	29.0	49.6	108.6	(8.2)	1.1	No	108	2.1
JPMorgan European Income Pool	151.0	25.3	49.4	117.2	(10.1)	1.1	No	106	3.1
Jupiter European Opportunities	802.8	34.2	55.5	117.1	(1.2)	1.0	Yes	105	0.9
Average	**419.2**	**26.7**	**46.8**	**103.3**	**(4.8)**	**1.0**		**104**	**2.1**
EUT rank in sector	**3**	**7**	**8**	**8**	**7**	**8**		**8**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance data to 5 December 2017. **Includes indicated and special dividends. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There are four members on EUT's board; all are non-executive and independent of the manager. Chairman Michael MacPhee was appointed to the board in January 2016 and assumed his current role in January 2017 following the retirement of Douglas McDougall. The senior independent director is Michael Moule (appointed in 2004). Dr Michael Woodward is chairman of the audit committee (2013). The fourth director is William Eason (2007). All board members have backgrounds in investment management and investment trusts.