Jupiter US Smaller Companies

Market volatility providing more opportunities

Investment trusts
US small-cap equities

18 June 2019

Jupiter US Smaller Companies (JUS) is continuing to deliver improved investment performance following a tightening up of its investment process in October 2017. The trust has outperformed its small-cap equity benchmark over the last one and three years in both NAV and share price terms. Increased stock market volatility in recent months has presented manager Robert Siddles with an increasing array of attractive investment opportunities across a range of industries; although this has increased portfolio turnover, the manager continues to invest with a long-term view, aiming to generate capital growth while preserving capital during periods of stock market weakness.

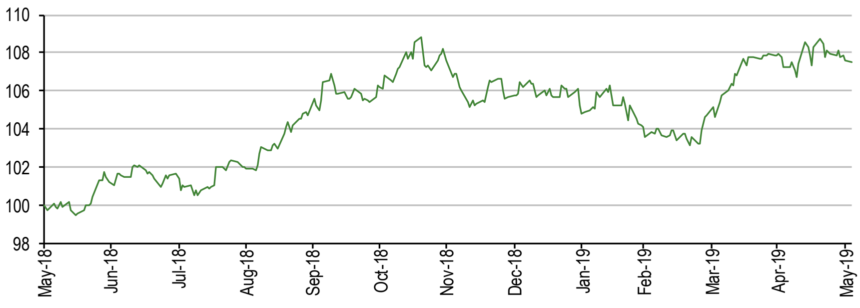
Price	**1,035.0p**
Market cap	**£145m**
AUM	**£162m**

NAV*	1,138.0p
Discount to NAV	9.1%

*Including income. As at 14 June 2019.

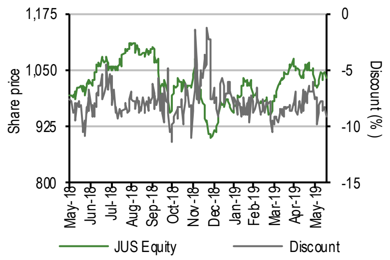
Yield	0.0%
Ordinary shares in issue	14.0m
Code	JUS
Primary exchange	LSE
AIC sector	North America Smaller Companies

JUS's NAV is outperforming its benchmark during a more volatile stock market environment

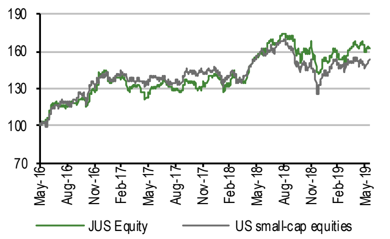


Source: Refinitiv, Edison Investment Research

Share price/discount performance



Three-year performance vs index



52-week high/low	1,112.5p	901.0p
NAV** high/low	1,206.0p	930.2p

**Including income.

Gearing

Net*	4.8%

*As at 31 May 2019.

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Edison profile page

Jupiter US Smaller Companies is a research client of Edison Investment Research Limited

The market opportunity

There is a wealth of smaller-cap US equities available, providing investors with exposure to a very wide range of operations. However, it should be noted that the US market has delivered above-average total returns in recent years and is now trading on a forward P/E multiple that is at a higher premium to the world market than its five- and 10-year averages, suggesting investors may benefit from a more valuation-aware approach.

Why consider investing in JUS?

- Very experienced manager who has delivered long-term outperformance from a diversified portfolio of smaller-cap US equities.
- Disciplined investment process, which was enhanced in late 2017, leading to a demonstrable improvement in performance.
- Focus on capital preservation as well as long-term capital growth.

Active discount management, scope for rerating

JUS is currently trading at a 9.1% discount to NAV, which compares with its average discounts of 7.8%, 9.0%, 9.1% and 6.2% over the last one, three, five and 10 years respectively. There is scope for the discount to narrow given the notable benefits of the enhancements to the strategy, which are driving improved investment performance. The trust may gear up to 20% of total assets (net gearing of 4.8% at the end of May 2019). It does not pay a dividend.

Exhibit 1: Trust at a glance

Investment objective and fund background

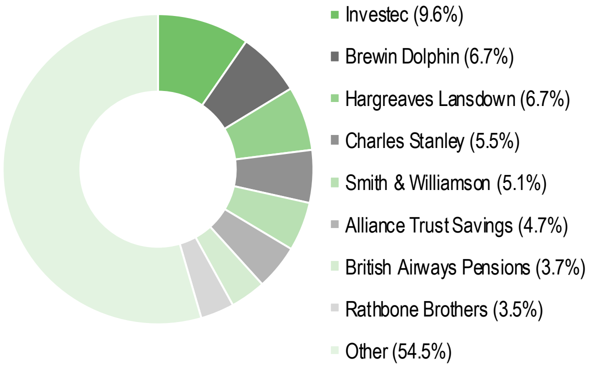
Jupiter US Smaller Companies' objective is to achieve long-term capital growth by investing in a focused yet diversified portfolio primarily of quoted US smaller and mid-sized companies. It uses a 2,000-stock US small and mid-cap index (capital returns, sterling adjusted) as its benchmark.

Recent developments

- 15 March 2019: half-year report for the period ended 31 December 2018. NAV -11.1% and share price -11.1% versus -14.9% capital return for the benchmark (all in sterling terms).
- 27 September 2018: annual results for the year ended 30 June 2018. NAV +21.1% and share price +23.8% versus +14.2% capital return for the benchmark (all in sterling terms).
- 9 May 2018: special resolution passed at general meeting to renew JUS's share buyback authority.

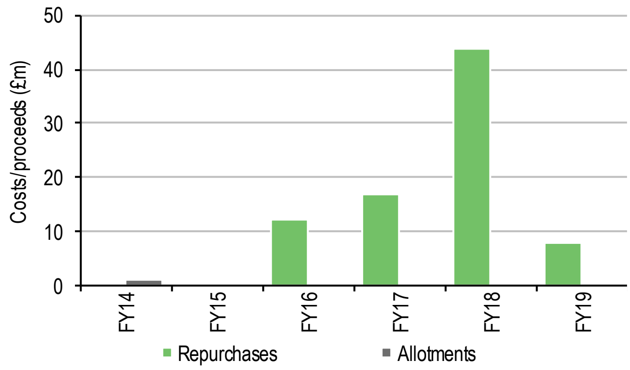
Forthcoming		Capital structure		Fund details	
AGM	November 2019	Ongoing charges	0.97% (as at H119)	Group	Jupiter Unit Trust Managers
Final results	September 2019	Net gearing	4.8%	Manager	Robert Siddles
Year end	30 June	Annual mgmt fee	Tiered (see page 8)	Address	The Zig Zag Building, 70 Victoria Street, London SW1E 6SQ
Dividend paid	N/A	Performance fee	No		
Launch date	10 March 1993	Trust life	Indefinite, subject to vote	Phone	+44 (0)20 3817 1000
Continuation vote	Three-yearly, next 2020	Loan facilities	£20m with Scotiabank	Website	www.jupiteram.com/JUS

Shareholder base (as at 17 June 2019)

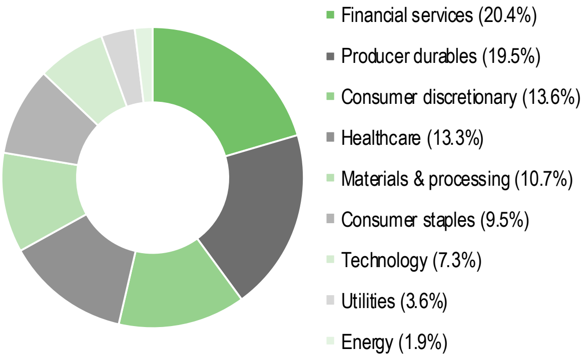


Share buyback policy and history (financial years)

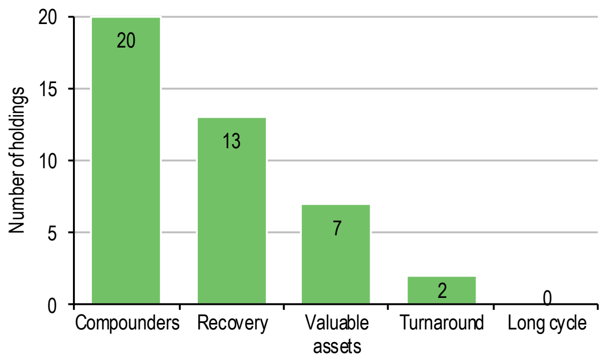
JUS has the authority to allot up to 10% and buy back up to 14.99% of shares annually, to manage a premium or a discount. Buybacks are employed with the aim of maintaining the discount at a maximum of c 8%.



Portfolio exposure by sector (net of debt as at 31 May 2019)



Portfolio exposure by theme (as at 30 April 2019)



Top 10 holdings (as at 31 May 2019)

			Portfolio weight %	
Company	**Exchange**	**Industry**	**31 May 2019**	**31 May 2018***
Ensign Group	NASDAQ	Healthcare facilities	5.4	3.4
Chef's Warehouse	NASDAQ	Food products wholesaler	5.3	4.1
Genesee & Wyoming	NYSE	Rail freight	4.9	3.7
America's Car-Mart	NASDAQ	Auto retailing	4.8	3.2
Alleghany	NYSE	Reinsurance	4.0	3.2
Covanta	NYSE	Waste management	3.7	3.3
Ollie's Bargain Outlet	NASDAQ	Retailing	3.7	5.1
MSC Industrial Direct	NYSE	Industrial tool distributor	3.3	3.9
Old Dominion Freight Line	NASDAQ	Trucking	3.0	3.2
Sanderson Farms	NASDAQ	Poultry production	3.0	N/A
Top 10 (% of holdings)			**41.1**	**36.6**

Source: Jupiter US Smaller Companies, Edison Investment Research, Bloomberg, Morningstar, Refinitiv. Note: *N/A where not in end-May 2018 top 10.

Market outlook: More selectivity required?

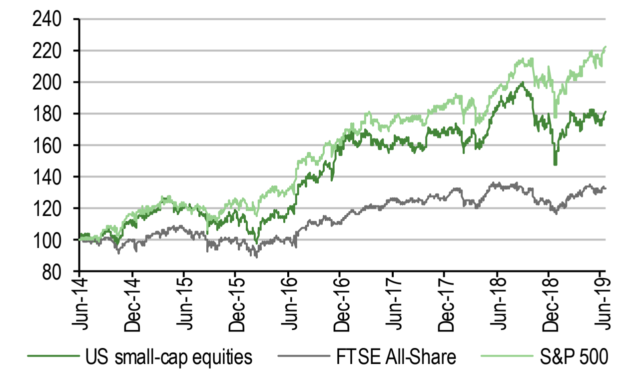
Over the last five years, in sterling terms, the US market (both large and small caps) has meaningfully outperformed the domestic FTSE All-Share index (Exhibit 2, LHS). This is partially due to the UK's currency weakness but also reflects a highly entrepreneurial culture in the US, along with a reduction in corporate tax, which, in aggregate, have enabled American companies to deliver superior earnings growth.

In terms of valuation, US companies (measured by the Datastream US index) are trading on a forward P/E multiple of 17.3x, which is a 17.2% premium to the world market, somewhat higher than the 15.9% and 13.3% average premiums over the last five and 10 years respectively.

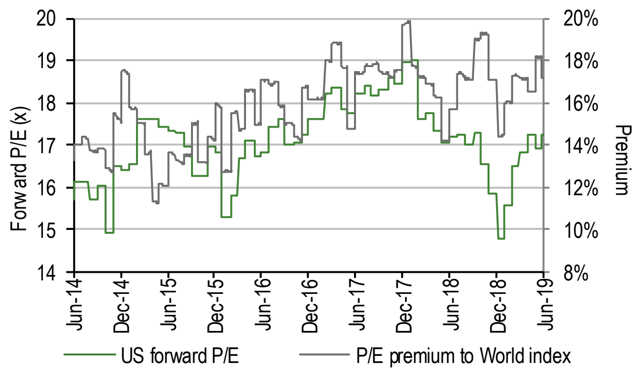
Along with the risk inherent in above-average valuations, there is potential for further reductions in earnings estimates as the escalating trade dispute between the US and its trading partners begins to have a more visible effect on corporate profitability. With this uncertain backdrop, investors may be rewarded by being more selective; a fund investing in niche businesses aiming to generate capital growth in rising markets while preserving it in more volatile times could hold some appeal.

Exhibit 2: Market performance and valuation

Performance of US and UK indices (past five years, £)



Valuation of US equities (using US Datastream index, at 17 June 2019)



Source: Refinitiv, Edison Investment Research

Fund profile: Smaller-cap US equities with value bias

JUS was launched in March 1993 as the F&C US Smaller Companies Trust. In 2014, manager Robert Siddles moved from F&C Asset Management to Jupiter Asset Management, taking the trust with him. He aims to generate long-term capital growth from a diversified portfolio of quoted US mid- and small-cap companies. The manager employs a risk-averse approach, aiming to preserve capital in periods of stock market weakness by investing in high-quality companies whose share prices reflect limited downside risk.

The trust's portfolio typically has c 40–50 holdings (primarily in the $100m to $10bn market cap range), which can broadly be considered as one of two types of value stock: firms that can grow and compound over the long term, and recovery and turnaround situations, which are held with a shorter-term, two- to three-year view. JUS does not pay dividends. Since end-September 2017, it has had the ability to employ gearing up to a maximum of 20% of total assets (net gearing of 4.8% at end-May 2019). Data from Jupiter show the potential relative benefits of considering investing in US small-cap companies. Between 1970 and 2016, the asset class generated total sterling returns of 13.3% pa, which is meaningfully higher than 11.7% pa from UK stocks and 10.9% pa from US large-cap stocks.

The fund manager: Robert Siddles

The manager's view: Taking advantage of market volatility

Siddles says the US economy remains reasonably strong; while the key ISM Purchasing Managers Index has fallen from its cyclical high point, it is still indicating good growth. The manager explains that at the end of 2018 there were concerns about slowing economic activity, principally outside the US, although domestically there were signs of a slowdown in the volatile auto, housing and energy sectors. Global stock market weakness in Q418 was exacerbated by an escalation in the trade dispute between the US and China; however, the US, along with other markets, rallied strongly in Q119 as investors gained confidence in a resolution to the trade issue and the US Federal Reserve adopted a more dovish approach to monetary policy, suggesting no interest rate hikes in 2019. The manager says the catalysts for a market rally in Q119 were in place at the end of 2018: more confidence in earnings growth, a favourable monetary environment and weak investor sentiment. Siddles has taken advantage of stock market volatility in recent months to both initiate and sell out of a selection of JUS's holdings (highlighted in the Current positioning section); he says all of the trades were undertaken on a stock-specific basis, rather than as a result of focusing on certain themes within the portfolio.

The manager highlights a potential changing feature of the US stock market that could provide a tailwind to JUS's performance – relative weakness in technology shares. He notes this segment of the market has been particularly strong for the last decade and sector leadership typically runs in 10-year cycles; at the end of this period, there are no more bears left to convert to bulls, sceptical investors either capitulate or lose their jobs. Siddles suggests there are now greater question marks over the technology industry's fundamentals, such as mobile phone growth having peaked, and a slowdown in the US auto industry, which is a large user of semiconductors.

Asset allocation

Investment process: More concentrated portfolio

There are myriad smaller-cap US companies available to invest in, many of which are relatively immature, either financially or operationally, or in terms of management experience or market position. To mitigate these risks, the manager focuses on companies with a strong franchise that generate significant amounts of free cash flow, have high insider ownership and are trading on reasonable valuations. He notes that many smaller US companies are under-researched, offering the potential for undiscovered value.

Siddles employs a rigorous three-stage, bottom-up stock selection process, aiming to generate long-term capital growth while limiting downside risk. Stage one is a quantitative screen of the investible universe of c 3,000 stocks with market caps between \$100m and \$10bn, seeking companies that have suffered share price weakness (either short or long term). Stage two is a qualitative risk assessment, aiming to identify and avoid value traps, which are shares that look attractively priced but are unlikely to appreciate in value. There are certain sectors that the manager favours, such as those providing essential goods and services, and areas he largely avoids, including technology and restaurants. He also considers industry cycles, including past bubbles, global capital flows and sector-specific problems. Siddles employs a 'good company test'; a potential investee company must pass all five elements of this to be considered for inclusion in the fund. They are: a strong franchise; robust levels of free cash flow; a high level of insider ownership; potential pricing flexibility; and a cheap valuation (at least 50% upside potential). Very few companies make it to stage three of the investment process, which is in-depth fundamental analysis, including a detailed financial model.

Portfolio holdings broadly fit into two main categories: compounders (companies that can grow consistently and be held for many years); and recovery stocks, where the manager has a shorter-term time horizon.

There are three disciplines for selling a stock: for fundamental reasons, such as a deterioration in growth prospects; a market sale if a company has grown too large or lacks the potential for further upside; or for portfolio considerations – if a holding exceeds 10% of the fund, an industry exposure rises above 15%, or if there is a more attractive opportunity available.

In October 2017, the manager announced enhancements to JUS's investment process, including holding a more concentrated portfolio, running winning positions for longer and being more willing to sell underperforming stocks. This strategy has proved very successful, as highlighted in the Performance section on pages 6 and 7.

In keeping with other Jupiter fund managers, Siddles has a keen focus on corporate governance. There are three pillars to the analysis:

- Leadership – a company management's strength and experience, and whether the business strategy is easy to understand.
- Alignment – the manager believes it is very important that a company's management team has 'skin in the game' through significant shareholdings.
- Stakeholders – Siddles tends to favour firms that provide the essentials of life and have recurring revenues, such as companies in the autos, food, gaming and waste disposal industries. An investee company has to be clean of controversies; for example, no ongoing investigations by the Department of Justice or the Securities and Exchange Commission.

Current portfolio positioning

Siddles has continued to concentrate JUS's portfolio; at end-May 2019, the top 10 positions made up 41.1% of the fund, 4.5pp higher than 36.6% a year earlier. The trust's sector exposures are shown in Exhibit 3, with the most notable changes over the past year being higher weightings in healthcare (+4.7pp) and consumer staples (+3.9pp).

Exhibit 3: Portfolio sector exposure (% unless stated)

	Portfolio end-May 2019	Portfolio end-May 2018	Change (pp)
Financial services	21.4	23.9	(2.5)
Producer durables	20.5	19.7	0.8
Consumer discretionary	14.3	15.9	(1.6)
Healthcare	14.0	9.3	4.7
Materials & processing	11.2	8.0	3.2
Consumer staples	10.0	6.1	3.9
Technology	7.7	10.0	(2.3)
Utilities	3.8	1.5	2.3
Energy	2.0	3.9	(1.9)
Cash & (gearing)	(4.8)	1.7	(6.5)
	100.0	**100.0**	

Source: Jupiter US Smaller Companies, Edison Investment Research. Note: Numbers subject to rounding.

Higher stock market volatility has led to an increase in portfolio turnover as Siddles seeks to capitalise on a wide range of investment opportunities; over the last six months, it is running at an annualised rate of c 40%, which is broadly double the typical level. The manager highlights the main portfolio changes that have been undertaken since our last report was published in November 2018, starting with the new positions:

- **Colliers International**: a large international commercial real estate services company, with a highly entrepreneurial management team. One of the top five players in a very fragmented market, with plenty of room for future growth.
- **GreenSky**: operates a proprietary technology platform providing mobile, online and in-store point-of-sale finance. The firm has a high percentage of recurring revenues, low customer

acquisition costs and high merchant retention rates; it is trading on a very low valuation for a high-growth company.

- **GTT Communications**: provides data connectivity for companies to link offices worldwide. The company has a highly entrepreneurial management team. Share price weakness due to slower than expected growth from a recent acquisition provided a good buying opportunity.
- **Healthcare Services Group**: supplies housekeeping and dining services to nursing homes. The company has a dynamic culture focused on nurturing internal talent. It has a small market share and significant growth opportunities.
- **ICU Medical**: a major provider of intravenous healthcare products, which has had problems digesting a major acquisition. The firm benefits from robust demand growth, helped by an aging population and a large percentage of high-margin recurring revenues.
- **LCI Industries**: a leading supplier of recreational vehicle assemblies. The company is benefiting from demand growth for caravans by the millennial generation. LCI's business is not capital intensive; its high levels of free cash flow are used to make acquisitions.
- **Limoneira**: a vertically integrated lemon producer, benefiting from rising demand due to the fruit's health benefits and growing middle classes globally. There has been very little increase in lemon yields in recent decades, which provides a stable supply environment compared with other agricultural products. The company owns valuable Californian real estate, which can be used to finance acquisitions of other farms and packaging facilities.
- **United Rentals**: a major US equipment rental company, growing both organically and via acquisitions. It is benefiting from the long-term trend towards rental rather than ownership. The firm generates high levels of free cash flow, which increase towards the end of a cycle.
- **Univar**: a leading chemical distributor. The company is undergoing a restructuring and investment programme, which should bear fruit over the next couple of years.

Positions that have been sold in recent months include: CatchMark Timber Trust (timber price weakness due to higher harvests and slow recovery in the housing sector); Civitas Solutions (bid for by a private equity firm); Gray Television and LiveRamp (both on valuation grounds); Michaels Companies (craft retailing is a very competitive market); Netgear (competitive threat from Amazon); RPC (oversupply in the pressure pumping market); and Wabtec (a major acquisition clouds the investment case).

Performance: Tightened process bearing fruit

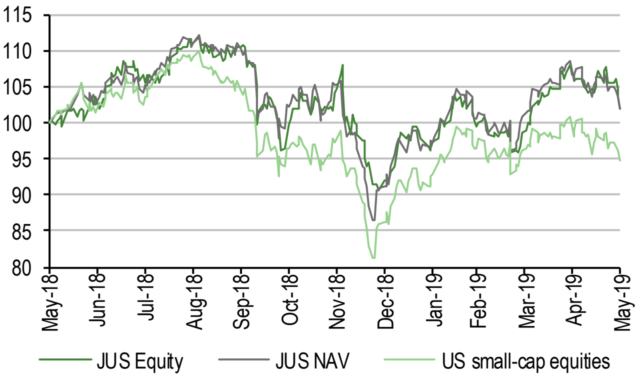
Exhibit 4: Five-year discrete performance data

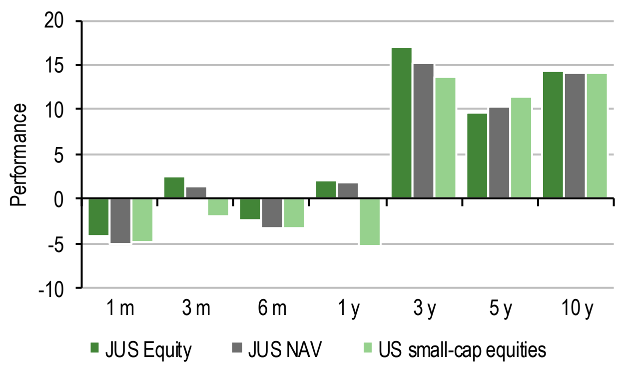
12 months ending	Share price (%)	NAV (%)	US small-cap equities (%)	FTSE All-Share (%)	S&P 500 (%)
31/05/15	5.0	10.4	20.8	7.5	22.9
31/05/16	(5.9)	(3.7)	(2.9)	(6.3)	6.6
31/05/17	23.1	23.5	33.8	24.5	32.4
31/05/18	27.1	21.8	15.7	6.5	11.0
31/05/19	2.1	1.9	(5.3)	(3.2)	9.6

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

Over the last 12 months to the end of May, JUS has solidly outperformed its benchmark, with NAV and share price total returns of +1.9% and +2.1% respectively versus a -5.3% index total return. Strong contributors to performance in recent months include holdings in America's Car Mart (auto retailing), DMC Global (metalworking) and Ensign Group (healthcare facilities), while positions such as Bottomline Technologies (electronic payments) and Brookdale Senior Living (assisted living facilities) have detracted from returns. The trust has generated solid absolute performance over the long term (Exhibit 5, RHS). Over three, five and 10 years, NAV and share price total returns are between 9.6% and 16.9% a year.

Exhibit 5: Investment trust performance to 31 May 2019





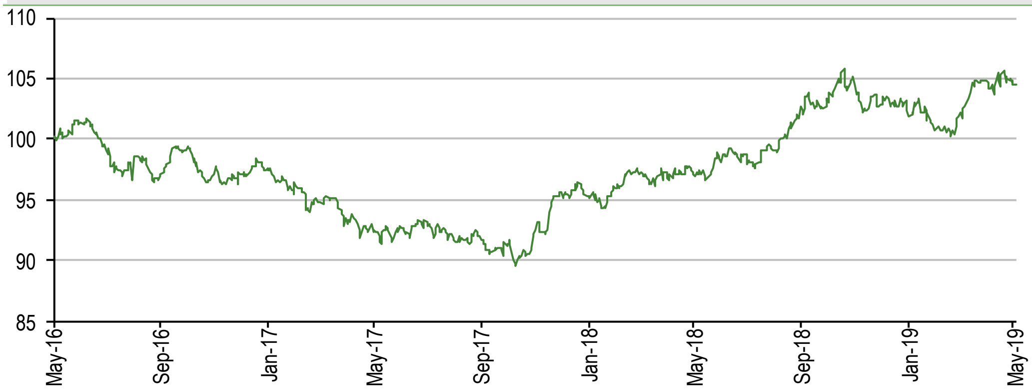
Source: Refinitiv, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Exhibit 6: 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 US small-cap equities	0.5	4.4	0.9	7.8	9.0	(8.2)	3.1
NAV relative to US small-cap equities	(0.2)	3.3	0.0	7.6	4.6	(5.2)	(0.7)
Price relative to S&P 500	(1.1)	(2.2)	(4.3)	(6.8)	(0.8)	(25.2)	(18.4)
NAV relative to S&P 500	(1.9)	(3.2)	(5.1)	(7.0)	(4.8)	(22.8)	(21.4)
Price relative to FTSE All-Share	(1.3)	0.3	(7.0)	5.5	24.3	22.1	54.5
NAV relative to FTSE All-Share	(2.0)	(0.8)	(7.7)	5.2	19.3	26.1	48.8

Source: Refinitiv, Edison Investment Research. Note: Data to end-May 2019. Geometric calculation.

Exhibit 7: NAV total return performance relative to benchmark over three years



Source: Refinitiv, Edison Investment Research

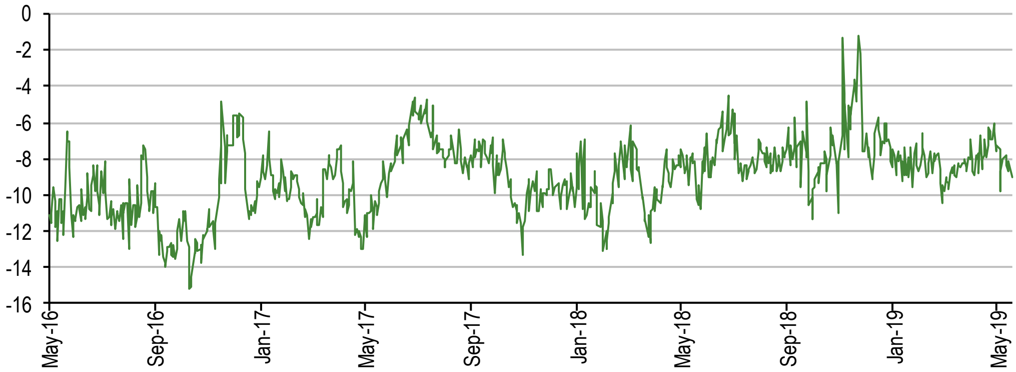
JUS's relative returns are shown in Exhibit 6. It has outperformed its benchmark in both NAV and share price terms over one and three years, while lagging over five. Over 10 years, its NAV is broadly in line, while its share price has outperformed. The trust has generated markedly superior returns versus the FTSE All-Share index over one, three, five and 10 years. Looking at the three-year NAV relative performance in Exhibit 7, the benefits of tightening up the investment process, including a more concentrated portfolio and running winning positions for longer, are clear to see. Since October 2017, JUS has outperformed its benchmark by c 15pp.

Discount: Targeting a maximum 8% discount

JUS's shares are currently trading at a 9.1% discount to NAV. This compares with a range of discounts between 1.2% and 11.4% over the last 12 months, and average discounts of 7.8%, 9.0%, 9.1% and 6.2% over the last one, three, five and 10 years respectively.

The board actively repurchases the trust's shares, aiming to keep the discount at or below 8% in normal market conditions. During H119, the board bought back a modest 0.2m shares at an average discount of 8.5%. There is scope for JUS's discount to narrow, given the manager's improved performance since the investment process was enhanced in October 2017.

Exhibit 8: Share price discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

Capital structure and fees

JUS is a conventional investment trust with one class of share; there are 14.0m ordinary shares in issue. It historically did not employ gearing, but since 29 September 2017 has had a flexible loan facility with Scotiabank (Ireland). JUS is permitted to gear up to a maximum 20% of total assets; $15m is currently drawn (increased from $10m in March 2019 to fund new purchases), and net gearing was 4.8% at end-May 2019.

Jupiter Unit Trust Managers receives a management fee of 0.75% of net assets up to £150m, 0.65% between £150m and £250m, and 0.55% above £250m. (Before 1 October 2017, there was a flat management fee of 0.80% of NAV and there is no longer a performance fee.) In H119, JUS's ongoing charge was 0.97%, which was 5bp lower than 1.02% in FY18.

Dividend policy and record

US smaller companies are not a high-yielding asset class and JUS focuses on long-term capital growth rather than income; therefore, it does not pay a dividend. In FY18, JUS's £1.4m revenue income was more than offset by management fees and other expenses.

Peer group comparison

JUS is one of just two trusts in the AIC North American Smaller Companies sector; they are not directly comparable as JUS has a value bias, while JPMorgan US Smaller Companies has a growth bias. JUS has a higher NAV total return over the last 12 months, but its performance has lagged over the other periods shown, which have been characterised by the outperformance of growth rather than value stocks. The trust has a lower ongoing charge, a higher level of gearing, but unlike its peer, JUS does not pay a dividend.

To enable a broader comparison, in Exhibit 9 we also show the sterling share classes of open-ended US smaller companies funds. JUS has outperformed the average of the open-ended funds over one year, while lagging over three, five and 10 years.

Exhibit 9: Selected peer group as at 17 June 2019 (all in sterling)*

% 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
Jupiter US Smaller Companies	145.3	4.3	55.1	70.7	273.3	(8.2)	1.0	No	105	0.0
JPMorgan US Smaller Companies	181.4	2.0	60.8	115.3	428.3	(3.9)	1.3	No	103	0.8
Peer group average	**163.4**	**3.1**	**58.0**	**93.0**	**350.8**	**(6.1)**	**1.2**		**104**	**0.4**
JUS rank in sector	**2**	**1**	**2**	**2**	**2**	**2**	**2**		**1**	**2**
Open-ended funds										
Allianz US Small Cap Equity	2.6	(1.4)	47.9				2.1	No		0.0
Artemis US Smaller Companies	386.8	10.5	89.2				0.9	No		0.0
BMO US Smaller Companies	72.7	1.5	46.9	83.3	282.3		0.8	No		0.0
GS US Sm Companies CORE Eq	219.2	(3.6)	54.3	94.4	376.4		0.8	No		0.2
Hermes US Smid Equity	731.3	6.5	44.9	96.5			0.8	No		0.0
JPM US Smaller Companies	217.6	4.2	104.1	142.2	427.6		0.8	No		0.0
Legg Mason IF Royce US Smlr Cos	186.4	(0.5)	48.3	55.0	194.0		1.0	No		0.3
Legg Mason RY US SmCp Opp	498.7	(13.7)	44.8	51.3	283.6		1.9	No		0.0
Neuberger Berman US Sm Cap	284.1	7.5	55.1	92.7			1.9	No		0.0
Schroder US Smaller Comp	809.0	5.8	54.5	100.3	312.4		0.9	No		0.0
T. Rowe Price US Smlr Cos Eq	1,094.1	14.0	70.7	126.7	493.7		1.1	No		0.0
Threadneedle AmerSmlrComs	345.6	5.3	55.6	94.6	347.4		0.9	No		0.1
Peer group average	**404.0**	**3.0**	**59.7**	**93.7**	**339.7**		**1.2**			**0.1**

Source: Morningstar, Edison Investment Research. Note: *Performance data to 14 June 2019 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

The board

There are five directors on JUS's board, all of whom are non-executive. The chairman is Gordon Grender, who joined the board at the trust's inception in 1993 and assumed his current role in October 1998. Norman Bachop joined the board in February 1999 and has been the senior independent director since June 2007. The other three directors and their dates of appointment are Peter Barton (February 1998), Clive Parritt (January 2007) and Lisa Booth (September 2015). Changes in corporate governance rules mean directors that have served more than nine years are no longer considered to be independent. The directors have experience in financial services, including investment management, private equity, corporate finance, investment banking, law and accountancy.

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