EDISON

TR European Growth Trust

Finding small-cap value opportunities

Investment trusts
European smaller companies

18 June 2019

TR European Growth Trust (TRG) has seen its share price de-rate substantially over the past 18 months, from a c 3% premium to NAV to a c 15% discount, following a period in which its small-cap value style of investing has been out of favour with investors. However, its NAV has risen c 13% year to date, with lead manager Ollie Beckett taking advantage of depressed valuations in smaller European companies whose growth potential he believes is underappreciated by the wider market. The portfolio is diverse, with c 140 holdings broadly spread by country and industry sector. TRG has a more value-oriented investment approach than its peers and is more exposed to stocks at the lower end of the market capitalisation spectrum, which have greater potential to grow exponentially. The largest positions rarely exceed c 2%, which limits stock-specific risk, while a well-covered c 2.5% dividend yield provides support for total returns in periods of market volatility.

12 months ending	Share price (%)	NAV (%)	EMIX Smaller Europe ex-UK (%)	FTSE World Eur ex-UK (%)	FTSE All-Share (%)
31/05/15	15.9	8.3	2.7	4.7	7.5
31/05/16	2.3	6.7	6.3	(3.7)	(6.3)
31/05/17	61.4	55.7	39.9	35.7	24.5
31/05/18	0.7	2.5	6.2	0.9	6.5
31/05/19	(16.1)	(14.4)	(4.9)	1.8	(3.2)

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

The market opportunity

There are more than 2,000 quoted companies in Europe (excluding the UK) with a market capitalisation of less than €4bn, spread across multiple geographies and industry sectors. European smaller companies have outperformed their larger brethren by c 60pp over the past decade (to 31 May 2019) but remain under-researched and under-owned. Many also offer attractive dividend yields.

Why consider investing in TRG?

- Value investment style has outperformed over the long term, although FY18 and H119 disappointed after a stellar FY17.
- True small-cap (rather than small- and mid-cap) focus differentiates TRG from peers – around two-thirds of the portfolio is sub-£1bn market cap.
- Well-diversified portfolio limits stock-specific risk.
- Active approach to gearing allows the managers to take advantage of attractively valued stocks without having to sell holdings in volatile periods.
- Significantly higher dividends since FY18, fully covered by income.

Discount somewhat narrower as share price picks up

TRG's current 14.6% discount to NAV is close to its widest point in the last 12 months (14.7%, on 12 June 2019) and remains higher than both medium- and long-term averages (c 10–13% over three, five and 10 years). It is also broadly in line with the peer group average discount. The NAV has recovered well year to date (up c 13%) and the share price has begun to follow suit, suggesting investors may be beginning to look more favourably at European small-caps.

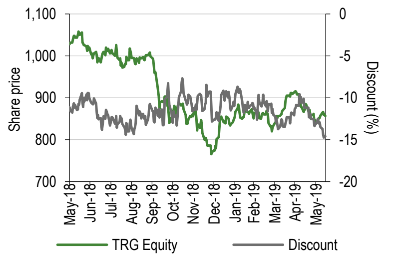
Price	**857.0p**
Market cap	**£429.4m**
AUM	**£544.6m**

NAV*	987.4p
Discount to NAV	13.2%
NAV**	1,003.5p
Discount to NAV	14.6%

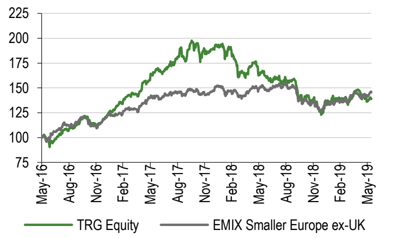
*Excluding income. **Including income. As at 14 June 2019.

Yield	2.5%
Ordinary shares in issue	50.1m
Code	TRG
Primary exchange	LSE
AIC sector	European Smaller Companies
Benchmark	EMIX Smaller Europe ex-UK

Share price/discount performance



Three-year performance vs index



52-week high/low	1,056.0p	765.0p
NAV* high/low	1,170.9p	859.9p

*Including income.

Gearing

Gross*	9%
Net*	9%

*As at 31 May 2019.

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TR European Growth Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

TR European Growth Trust's objective is to achieve capital growth by investing in smaller and medium-sized companies that are quoted, domiciled, listed, or have operations in Europe (excluding the UK).

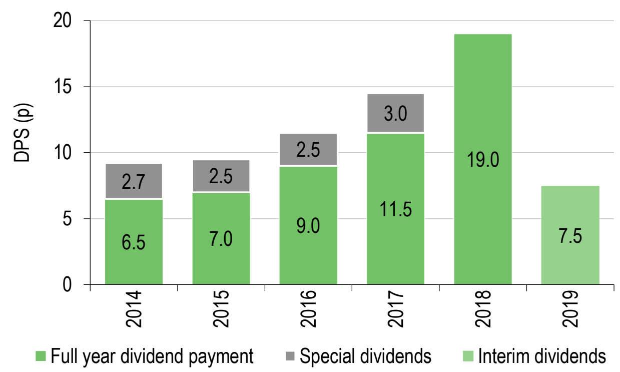
Recent developments

- 26 February 2019: results for the half-year ended 31 December 2018. NAV TR -21.6% and share price TR -22.9%, versus a 13.2% decline in the EMIX Smaller Europe ex-UK index. Interim dividend of 7.5p declared (up 50% on 5.0p for H118).
- 19 November 2018: all resolutions passed at AGM.

Forthcoming		Capital structure		Fund details	
AGM	November 2019	Ongoing charges	0.71%	Group	Janus Henderson Investors
Annual results	October 2019	Net gearing	9.0%	Manager	Ollie Beckett and team
Year end	30 June	Annual mgmt fee	Tiered (see page 9)	Address	201 Bishopsgate,
Dividend paid	April, November	Performance fee	Yes (see page 9)		London, EC2M 3AE
Launch date	1990	Trust life	Indefinite, subject to vote	Phone	+44 (0) 20 7818 6825
Continuation vote	Three-yearly, next 2019	Loan facilities	£100m overdraft	Website	www.treuropeangrowth.com

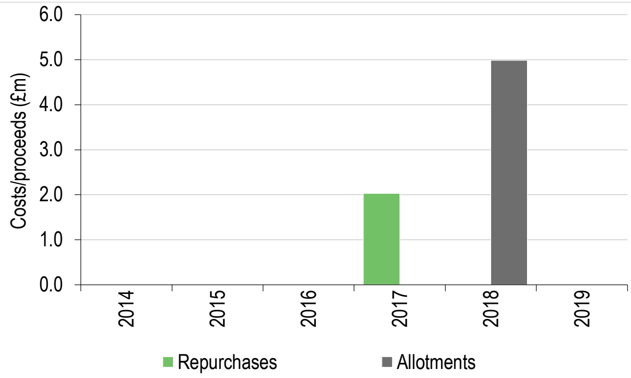
Dividend policy and history (financial years)

From FY18, an interim and a final dividend are paid in April and November (previously a final dividend was paid in November). While the primary aim is to achieve capital growth, the board also hopes to maintain and grow the dividend. Special dividends were historically paid alongside the final dividend; however, the move to paying two dividends a year means these are less likely in future.

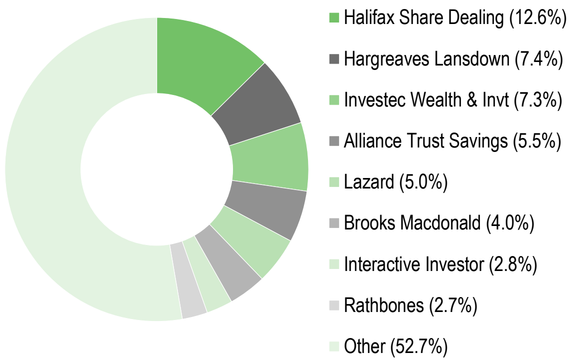


Share buyback policy and history (financial years)

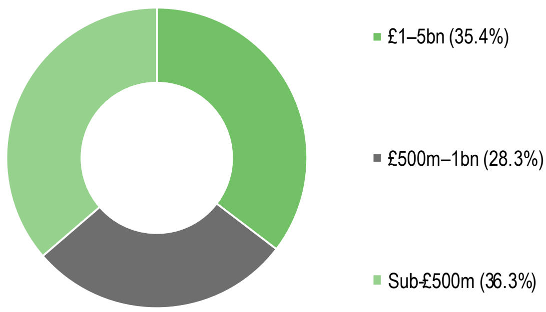
TRG has the authority, renewed annually, to buy back up to 14.99% of shares and allot up to 10% of shares to manage a discount or a premium. Buybacks are at the board's discretion following the removal in 2010 of an obligation to repurchase if the discount exceeded 10%.



Shareholder base (as at 20 February 2019)



Portfolio exposure by market cap (as at 30 Sept 2018, adjusted for gearing)



Top 10 holdings (as at 30 April 2019)

Company	Country	Sector	Portfolio weight %	
			30 April 2019	30 April 2018*
Van Lanschot Kempen	Netherlands	Banks	2.5	2.3
TKH Group	Netherlands	Electronic & electrical equipment	2.3	1.1
DFDS	Denmark	Industrial transportation	1.9	1.2
Nexans	France	Electronic & electrical equipment	1.8	N/A
Dermapharm	Germany	Pharma & biotech	1.6	1.2
Gaztransport & Technigaz	France	Oil services & distribution	1.6	1.2
Karnov Group	Sweden	Media	1.5	N/A
Tarkett	France	Construction & materials	1.5	N/A
Banca Farmafactoring	Italy	Banks	1.4	N/A
Conzzeta	Switzerland	Industrial goods	1.3	N/A
Top 10 (% of portfolio)			**17.4**	**13.8**

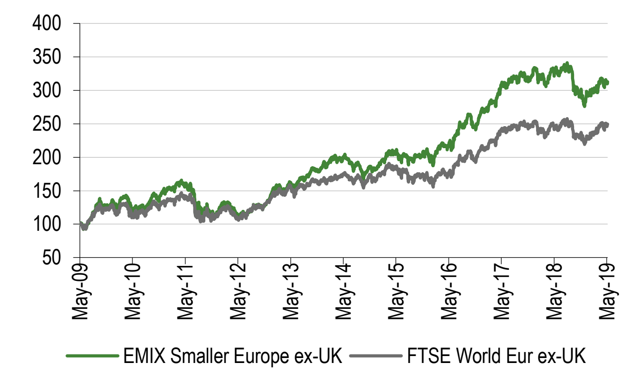
Source: TR European Growth Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-April 2018 top 10.

Market outlook: Short-term pain but long-term gain?

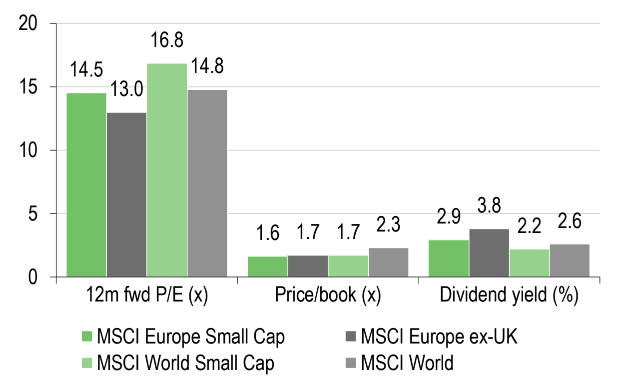
Until the global market sell-off in the last quarter of 2018, European equity markets had produced solid gains in sterling terms from the low point that followed the eurozone sovereign debt crisis in 2011. As shown in Exhibit 2 (left-hand chart), smaller companies in Europe have outperformed their larger brethren over the past decade (the EMIX Smaller Europe ex-UK index produced a total return of c 210% compared with c 150% for the FTSE World Europe ex-UK index), although they declined in value more sharply as risk aversion increased in Q418. Investors should be mindful of the risks that remain in the near term: according to the latest World Economic Outlook from the International Monetary Fund (April 2019), economic growth is expected to slow in the eurozone in 2019 (to 1.3% versus 1.8% in 2018) before picking up again (to 1.5%) in 2020. Particularly sluggish growth is forecast in Germany and Italy (0.8% and 0.1%, respectively, in 2019), with France and Spain relatively better at 1.3% and 2.1%. The European Central Bank has limited firepower to stimulate the economy, given interest rates remain at historic lows, whereas the uncertainty arising both from the Brexit saga and the slowdown in China (a key export market) may induce investors to remain on the sidelines until the picture is clearer. However, as shown in the right-hand chart, European equity valuations for both small- and large-cap stocks look reasonable compared with the rest of the world, providing a potentially attractive entry point for long-term investors, and dividend yields – an important support for total returns in periods of share price volatility – are also higher.

Exhibit 2: Market performance and valuation

Small versus large-cap European equity performance over 10 years



Valuation metrics for European and global large- and small-cap indices



Source: Refinitiv, MSCI, Edison Investment Research. Note: Total return performance in sterling terms. Valuation data at end-May.

Fund profile: European small-cap value portfolio

TRG, launched in 1990, invests for long-term capital growth in a diversified portfolio of smaller European (ex-UK) companies that its managers believe are good value. Lead manager Ollie Beckett of Janus Henderson Investors has run the fund since 2011 and is assisted by Rory Stokes and Julia Scheufler, who joined the team in 2013 and 2018, respectively. The managers have an unconstrained, bottom-up approach to portfolio construction. TRG measures its performance against the EMIX Smaller Europe ex-UK index (in sterling terms) and is a member of the Association of Investment Companies' European Smaller Companies sector.

The portfolio is biased towards the smaller end of the small-cap universe, with c 65% of TRG's assets invested in companies with a market capitalisation below £1bn. Because smaller companies may carry a higher risk of failure and can be illiquid, TRG's managers prefer to hold a relatively long list of stocks (c 120–150) to mitigate stock-specific risk. There is a maximum individual position size of 7%, although in practice few holdings exceed 2% of the total. The trust is permitted to hold unquoted investments (prior board approval is required), but currently has no such positions following the sale of longstanding unlisted holding Brainlab towards the end of 2018.

Gearing of up to 30% of net assets is permitted (with a normal working range of up to 15%) and is used flexibly in response to investment opportunities. The trust may also hold up to 20% in cash and/or fixed income. While TRG's main aim is to achieve capital growth, it also has a long record of year-on-year dividend growth and since FY18 has paid an interim as well as a final dividend to spread income more evenly through the year.

The fund managers: Beckett, Stokes and Scheufler

The managers' view: Opportunities in mispriced securities

After a difficult period of performance for TRG (following an exceptionally strong FY17, with NAV and share price total returns of 54.0% and 75.5%, respectively, compared with 35.8% for the benchmark), lead manager Beckett says he is finding many opportunities in attractively valued, under-researched small-cap stocks across Europe. Although a value-oriented investment approach has outperformed over the long term, Beckett points out that during the decade since the global financial crisis, investors have favoured highly valued 'quality' stocks, continuing to back those companies that have already performed strongly, even at forward P/E valuations that suggest severe limitations on future appreciation. From January 2018 to May 2019, small-cap stocks in Europe have underperformed large- and mid-caps, with small-cap value underperforming by more than small-cap growth. The manager explains that in a climate of uncertainty such as that surrounding the US trade dispute with the rest of the world, investors have become more risk averse, which tends to translate into a preference for larger stocks that are perceived to be safer.

Beckett admits the TRG team was too early in moving further into low-valued stocks at the end of 2017, as expensive names continued to perform better for the first three quarters of 2018; however, from a style perspective, quality and momentum both underperformed in the Q418 sell-off, with value stocks falling by less than the broad MSCI Europe Index.

The manager says that the climate of volatility, together with ongoing concerns over the impact of Brexit on the rest of Europe, has led to a number of attractive smaller stocks, in which he and the team have a high level of conviction, trading at levels 'where the price is just wrong'. He gives the example of Paris-listed Nexans, a top 10 holding, which makes cables for construction, telecoms and high-voltage power lines. Following the sudden departure of its CEO and delays to several high-voltage cable projects, its share price fell sharply; with a new CEO in place, it has rallied by c 23% since its low point in November 2018, yet still trades on a forward P/E valuation of less than 10x. Beckett says the team significantly increased TRG's position in the stock in October and November to reflect a high level of conviction. 'All these projects will come good, but they are on a different cycle to the rest of the economy,' he adds.

The team actively manages the portfolio, a strategy illustrated by the holding in Danish ferry and shipping company DFDS, TRG's third-largest position. Having previously owned and sold the holding, Beckett and the team have been building the stake back up at a single-digit forward P/E valuation, despite the company generating a more than 20% return on equity. The manager says being one of two Dover-Calais ferry operators means DFDS is seen as 'the ultimate Brexit stock', although it also has routes in the Mediterranean, the Baltic and the North Sea, which will be less exposed to the UK's future trading relationship with the EU, whatever form that takes. Even in the most extreme no-deal Brexit scenario, which would adversely affect the English Channel route because of a lack of space for carrying out customs checks in Kent, the impact on DFDS could be lessened by a switch in shipping routes to the North Sea coast, where ports have more storage capacity. Beckett says that even if there were a Brexit-induced reduction in UK GDP of a similar magnitude to that of the global financial crisis (c 5%), which could hit shipping demand and reduce DFDS's EBITDA profits by c DKK400m (c 15%), the stock would still be undervalued.

Gearing is also managed actively in response to available investment opportunities. Beckett raised TRG's gearing close to the maximum 15% working level in the Q418 sell-off, as he felt valuations were attractive, further deterioration in the political situation was unlikely and a recession was not inevitable. Along with not being a forced seller in a falling market because of redemptions, the manager says the ability to use gearing to buy stocks at depressed levels is a key advantage of TRG's closed-ended structure. The level of gearing was reduced to 8% at end-February after the market rallied, before increasing again to 11% at 31 March 2019. At 31 May, net gearing was 9%.

Asset allocation

Investment process: Bottom up, diversified and valuation aware

TRG's investment universe covers c 2,000 small- and mid-cap companies across Europe with a market capitalisation below €4bn, from which the managers build a diversified portfolio of c 120–150 stocks. Beckett, Stokes and Scheufler begin by using quantitative screens to help identify attractive companies whose valuations do not reflect their long-term growth prospects. Each year they meet hundreds of companies to assess the durability of their business models, quality of management, drivers of growth and catalysts for revaluation. They also take account of in-house and external company research. The managers build financial models for potential investee companies, using a range of valuation metrics to gain an understanding of the relationship between a company's current valuation and its growth potential. The portfolio is built on a bottom-up basis, with no constraints on country or sector weighting, and position sizes are based on the managers' degree of conviction, although they rarely exceed c 2%.

Beckett, Stokes and Scheufler view their investment universe in terms of a company lifecycle with four stages:

- **Early cycle** – the managers look for young companies with growing returns on capital, a clear strategy and operating leverage. The key valuation metric is enterprise value to sales (EV/sales).
- **Quality growth** – companies with high returns on capital, growing revenues, sustainable margins and strong competitive positions. The team uses valuation metrics including P/E multiples, EV/EBIT (earnings before interest and tax) and EV to invested capital (EV/IC).
- **Mature** – cash-generative companies with steady returns on capital, whose shares are trading cheaply versus the value of their assets. Valuation metrics include EV/IC, EV/EBIT and free cash flow (FCF) yield.
- **Turnarounds** – companies that may have suffered declining growth or a specific setback, but where management cost cutting or asset disposals may spark an improvement in margins. Companies are valued on EV/IC, EV/EBIT and FCF yield.

Exhibit 3: Portfolio characteristics

Metric	TRG	Index
Dividend yield forecast (%)	3.6	3.3
P/E forecast (x)	11.9	13.4
Return on equity (%)	14.9	12.7
Historic EPS growth (last three years) (%)	17.7	17.4
Forecast EPS growth (next 12 months) (%)	28.1	18.2

Source: TR European Growth Trust, Edison Investment Research. Note: As at 31 October 2018.

Beckett says most investors concentrate on the quality growth and mature segments of the market and are not willing to go down the market cap scale to the 'early cycle' companies such as 'internet of things' solutions provider S&T, or to consider turnaround situations such as Puma, which was transformed following the appointment of ex-Pandora CEO Bjørn Gulden in 2013.

As shown in Exhibit 3, TRG's holdings on average trade at lower forward P/E valuations than the benchmark average, with higher prospective dividend yields, higher returns on equity, and higher historical and projected earnings growth.

Portfolio turnover averages c 50% a year (53.8% in FY18), implying a holding period of around two years, although many companies are held for much longer than this. Stocks may be sold when they reach the managers' assessment of fair value (as with Carl Zeiss Meditec in FY18), if worsening fundamentals call the original investment thesis into question (as with Swedish online retailer Boozt), or where the managers see better-value opportunities elsewhere.

Current portfolio positioning

At 30 April 2019, there were 143 holdings in TRG's portfolio, a slight decrease from 146 a year earlier. The portfolio remains very broadly diversified, although concentration in the top 10 holdings has risen to 17.4% of the total, compared with 13.8% at 30 April 2018.

Exhibit 4: Portfolio geographic exposure (% unless stated)

	Portfolio end-April 2019	Portfolio end-April 2018	Change (pp)
Germany	19.9	17.8	2.1
France	12.3	11.8	0.5
Switzerland	10.4	9.5	0.9
Netherlands	9.7	11.1	(1.4)
Sweden	8.7	7.7	1.0
Italy	7.9	7.3	0.6
Finland	6.9	11.4	(4.5)
Norway	4.2	6.2	(2.0)
Belgium	3.9	4.9	(1.0)
Denmark	3.1	3.1	0.0
Other	13.0	9.2	3.8
	100.0	**100.0**	

Source: TR European Growth Trust, Edison Investment Research

As shown in Exhibit 4, the geographical allocation has not dramatically changed over the past 12 months, with the exception of a 4.5pp reduction in Finland (a combination of performance and portfolio activity) and a 3.8pp increase in 'other'. Germany remains the largest country weighting, with a 2.1pp increase in exposure over the year. Beckett says he struggles to find appealingly valued stocks in Spain and TRG had no exposure there at 31 December 2018 (end-H119).

Exhibit 5: Portfolio sector exposure (% unless stated)

	Portfolio end-April 2019	Portfolio end-April 2018	Change (pp)
Industrial goods	25.6	23.2	2.4
Basic materials	15.1	16.2	(1.1)
Financials	13.8	15.1	(1.3)
Business providers	13.4	12.8	0.6
Consumer goods	13.2	11.6	1.6
Technology	12.9	13.9	(1.0)
Retail providers	3.7	6.0	(2.3)
Natural resources	2.4	1.2	1.2
	100.0	**100.0**	

Source: TR European Growth Trust, Edison Investment Research

In sector terms (Exhibit 5), industrial goods remains the largest weighting, illustrating the broad opportunity set in attractively valued smaller industrial companies across Europe. Again, the sector weightings have not substantially changed over the 12 months to 30 April 2019. There is relatively little exposure to consumer goods and services (retail).

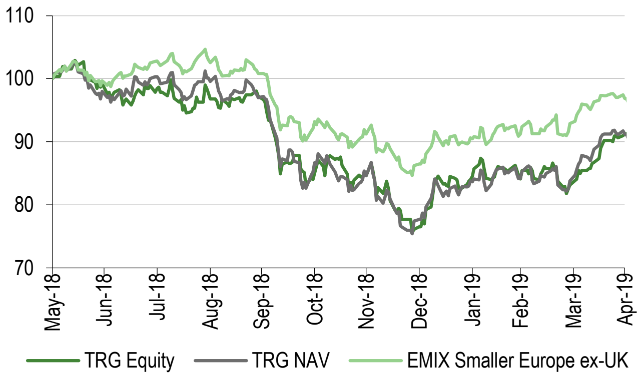
New purchases in the past year include German non-prescription drugs company Dermapharm and Dutch dredging and marine infrastructure firm Boskalis Westminster (both now in the top 10 holdings), as well as Norwegian liquefied natural gas shipper Flex LNG and Germany-listed online lifestyle and home furnishings retailer Westwing. Flex LNG is part of a mini-theme alongside Gaztransport et Technigaz (GTT), which owns the technology for producing LNG container liner membranes. Beckett says new emissions standards for container ships being introduced in 2020 mean that for some operators it will make sense to switch to powering their vessels with LNG, which would be a source of opportunity for both Flex LNG and GTT. The manager sometimes buys stocks at initial public offering (IPO), and in April 2019, Scandinavian professional information services provider Karnov Group was purchased at IPO, immediately entering the top 10 holdings.

The most significant recent exit is from Brainlab, a longstanding unquoted holding that had been in the TRG portfolio since before Beckett began managing the trust. He had been looking to exit the position for some time and found a willing buyer in a German family office that was already familiar with the management of the image-guided surgery firm. Other recent sales include Puma, which had become highly valued and was at the top of TRG's market capitalisation scale, and Showroomprivé, a flash sales website that had underperformed in a competitive market. XXL (a Norwegian sports retailer) and Vaisala (a Finnish weather equipment maker) were both sold on concerns over capital discipline, whereas the position in German 3D printing machinery firm SLM Solutions, which had failed to deliver on promised growth, was also exited.

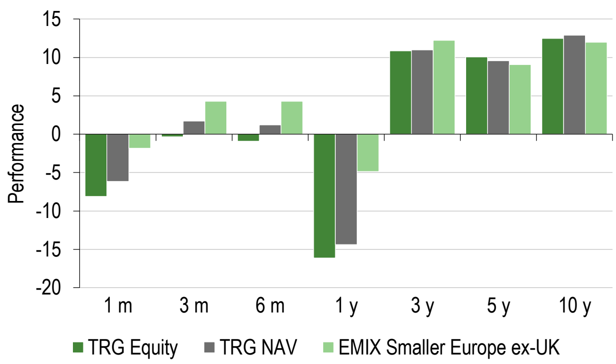
Performance: Long-term good; short-term wobbles

Exhibit 6: Investment trust performance to 31 May 2019

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



Price, NAV and benchmark total return performance (%)



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

Exhibit 7: 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 EMIX Smaller Europe ex-UK	(6.4)	(4.4)	(5.0)	(11.9)	(3.6)	4.7	4.6
NAV relative to EMIX Smaller Europe ex-UK	(4.4)	(2.5)	(3.0)	(10.0)	(3.3)	2.3	8.5
Price relative to FTSE World Eur ex-UK	(6.5)	(5.0)	(5.9)	(17.6)	(2.2)	14.9	31.8
NAV relative to FTSE World Eur ex-UK	(4.5)	(3.0)	(3.9)	(15.8)	(2.0)	12.3	36.7
Price relative to FTSE All-Share	(5.2)	(2.5)	(5.5)	(13.4)	6.1	24.9	30.1
NAV relative to FTSE All-Share	(3.2)	(0.5)	(3.5)	(11.6)	6.4	22.1	34.9

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

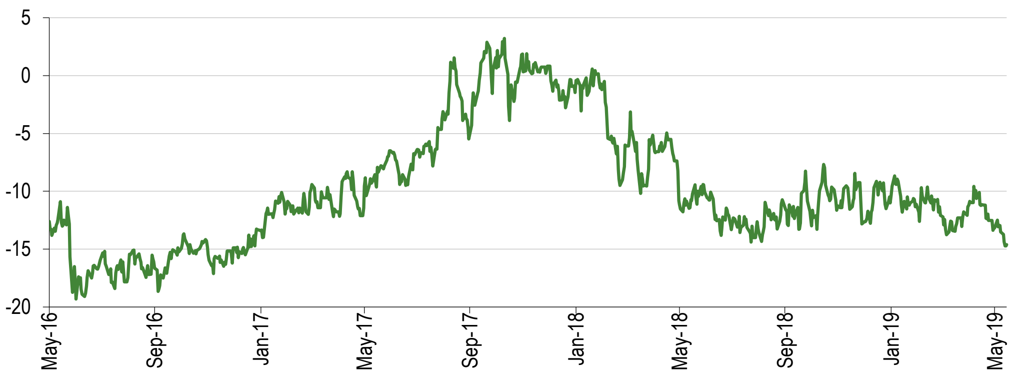
As shown in Exhibit 6, TRG has posted negative sterling returns over one and 12 months to 30 April 2019, underperforming the benchmark EMIX Smaller Europe ex-UK index in both NAV and share price total return terms. However, year-to-date (to 14 June), TRG has outperformed the benchmark, producing a respectable NAV total return of c 14.2%, versus 13.3% for the index. Its longer-term performance record remains compelling, with annualised absolute returns of c 10–13% over three, five and 10 years. It has also outperformed the benchmark in both share price and NAV total return terms over five and 10 years. As shown in Exhibit 7, longer-term returns have also been strong versus European large-cap stocks and the broad UK equity markets. Beckett says that any stabilisation in economic data, with an associated reduction in investor risk aversion, would be a positive support for TRG's performance.

TRG's performance has suffered in the more volatile market conditions over the last 12 months, for a number of reasons. In the early part of the period (and also in the recovery from the Q418 sell-off), investors continued to back highly valued companies with earnings momentum and eschew those on lower ratings with recovery potential. As fears began to emerge over a slowing global economy, an end to ultra-loose monetary policy and the potential impact of US-driven trade disputes, a 'flight to safety' meant that smaller companies – particularly those at the smallest end of the market cap scale – underperformed, as did more cyclically exposed stocks. TRG's value cyclical slant, coupled with its smaller-company focus, therefore weighed on performance, although Beckett says stock selection also had a significant impact. In H119 (to 31 December 2018), positive contributors to performance included French engineering technology firm Gaztransport et Technigaz, Swedish holdings Ambea (care homes) and JM (housebuilding), Germany-listed UK company Dialog Semiconductor, Finnish software firm Basware and newly listed Italian tech stock Carel Industries. However, these were outweighed by negative contributions from stocks including Finnish names Lehto (housebuilding) and Outotec (mining services), Norwegian sports retailer XXL (sold during the period), Dutch oil services company Fugro, and Germany-listed home and lifestyle retailer Westwing, whose IPO Beckett says was poorly managed.

Discount: Wider than average but close to peers

At 14 June 2019, TRG's shares traded at a 14.6% discount to cum-income NAV. This was somewhat wider than both short- and longer-term averages (11.5% over one year, 9.8% over three years, 10.4% over five years, and 12.8% over 10 years). After widening in the aftermath of the 2016 Brexit referendum, TRG's discount steadily narrowed over the following 12 to 18 months alongside a particularly strong period of NAV performance, and from September 2017 to January 2018, the shares frequently traded at a premium to NAV. However, as volatility began to return to global equity markets from February 2018 onwards, TRG's discount reverted to a level more in line with both its history and most of its peers. It had narrowed somewhat from a 12-month high of 14.4% in August 2018, but strong NAV performance brought it back to near this level in early April, before narrowing again as the share price began to reflect the NAV upturn, and then widening amid widespread market volatility in May.

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



Source: Refinitiv, Edison Investment Research

Capital structure and fees

TRG is a conventional investment trust with one class of share. There were 50.1m ordinary shares in issue at 14 June 2019. Until 2010, the trust had a hard discount control mechanism, which obliged the board to buy back shares if the discount to NAV exceeded 10%. Although it retains the authority to repurchase up to 14.99% of shares or allot shares up to the equivalent of 5% of the share capital, in order to manage a discount or a premium, TRG uses these powers sparingly and the only repurchases in the last seven years were in the months following the UK's vote to leave the EU in 2016. With the shares moving to a premium to NAV in the second half of 2017, 395,000 shares (0.8% of the share base) were allotted in FY18, raising £5.0m.

Gearing is permitted up to 30% of net assets and is available via a £100m multicurrency overdraft facility with HSBC Bank. If fully drawn, this would represent gross gearing of c 19.9% (based on 14 June 2019 net assets). Net gearing stood at 9.0% at 31 May 2019, up from 8% at 28 February, which was the joint-lowest month-end level in the last 12 months, having ranged up to 15.0% with an average of 10.5%.

Janus Henderson Investors is paid an annual management fee of 0.6% of TRG's net assets up to £500m and 0.5% thereafter. The new tier was introduced with effect from 1 October 2018. A performance fee may also be paid if TRG's NAV total return outperforms the benchmark EMIX Smaller Europe ex-UK index by more than 1.0% on a rolling three-year basis. The fee is set at 15% of the outperformance, subject to a cap on total fees at 2.0% of net assets. For FY18, ongoing charges were 0.71% (FY17: 0.75%) and a performance fee of 0.20% (FY17: 0.70%) was paid, bringing total fees to 0.91% (FY17: 1.45%).

Dividend policy and record

Although it invests primarily for capital growth, TRG's investments have generated sufficient revenue income for the trust to pay a small annual dividend over many years. Until FY17, dividends were paid annually in November, made up of a steadily growing final dividend and supplemented by a special dividend of varying size. Since FY18, the trust has moved to paying an interim and a final dividend, in April and November, respectively. Total dividends of 19.0p (5.0p interim and 14.0p final) for FY18 were 31.0% higher than the 14.5p (11.5p final and 3.0p special) paid in respect of FY17. So far in FY19, a 7.5p interim dividend has been declared, a 50.0% increase on H118. Dividends have been fully covered by income for more than a decade (c 1.2x covered in FY18). TRG has a large revenue reserve, equal to 41.9p per share after accounting for the FY18 final dividend, which is sufficient to fund the dividend at the same level as in FY18 for more than two years. Based on the current share price and the last two dividends, TRG has a yield of 2.5%.

Peer group comparison

Exhibit 9: AIC European Smaller Companies peer group as at 14 June 2019*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (cum-fair)	Net gearing	Dividend yield
TR European Growth	**429.4**	**(13.2)**	**43.6**	**65.7**	**241.3**	**0.7**	**Yes**	**(14.6)**	**109**	**2.5**
European Assets Trust	397.6	(0.6)	35.4	64.0	293.9	1.5	No	(6.3)	105	5.7
JPMorgan European Smaller Cos	570.9	(9.1)	40.2	72.4	255.9	1.1	No	(13.8)	100	1.9
Montanaro European Smaller	166.0	7.4	78.2	100.3	310.6	1.2	No	(9.7)	101	0.0
Sector average (4 funds)	**391.0**	**(3.9)**	**49.4**	**75.6**	**275.5**	**1.1**		**(11.1)**	**104**	**2.5**
TRG rank in sector	**2**	**4**	**2**	**3**	**4**	**4**		**4**	**1**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance to 13 June 2019. TR: total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

TRG is a member of the Association of Investment Companies' European Smaller Companies sector, a small peer group of four well-established funds. The trust is the second-largest in the group. In NAV total return terms, TRG's performance is somewhat below the sector average over one, three, five and 10 years, ranking fourth, second, third and fourth, respectively. However, absolute returns have been positive over three, five and particularly 10 years, with annualised total returns of c 13% pa or more over all these periods. The trust's underperformance of the sector in the recent market sell-off reflects its geared exposure (the other funds are largely ungeared), as well as its value bias and its focus on companies further down the market capitalisation scale than its peers, which have more of a small- to mid-cap approach versus TRG's micro- to small-cap focus. TRG has the lowest ongoing charges but is the only one of the four peers to charge a performance fee. Its discount is currently the widest in the sector. TRG has the second-highest dividend yield in the group, although it is worth noting that the highest-yielding fund, European Assets Trust, has a high distribution policy paying out a fixed 6.0% of NAV (which may come as a partial return of capital), whereas TRG's dividend is fully covered by income.

The board

There are five independent, non-executive directors on the board of TRG. The chairman, Audley Twiston-Davies, joined the board in 2000 and took up his current role in 2002. Christopher Casey was appointed in 2010 and is chairman of the audit committee, while Andrew Martin Smith has been a director since May 2008. Two of the directors – Alexander Mettenheimer (appointed in 2011) and Simona Heidempergher (appointed in 2014) – are resident in continental Europe. The directors' professional backgrounds are in investment management, accountancy and banking.