

# Jupiter UK Growth Investment Trust

Depressed UK equities may present opportunities

Investment trusts

**Jupiter UK Growth Investment Trust (JUKG) aims to deliver long-term capital appreciation, primarily through investing in UK equities. The fund has few constraints against the benchmark, and the manager, Steve Davies, is highly selective in his bottom-up approach, investing in 30–35 companies with recovery or growth potential. The portfolio and its performance can therefore diverge significantly from the FTSE All-Share index. Davies believes UK equities are currently unloved, and investors are excessively pessimistic and focused on the short-term outlook. While he expects the UK market to remain out of favour over the near term, as a natural contrarian investor with a long-term horizon, he says he is finding exciting investment opportunities.**

12 months ending	JUKG* share price (%)	JUKG* NAV (%)	Blended benchmark <sup>^</sup> (%)	FTSE All-Share (%)	FTSE All-World (%)
30/09/14	35.5	11.9	4.0	7.7	6.1
30/09/15	8.5	(1.1)	0.6	(1.3)	(2.3)
30/09/16	12.0	6.6	3.8	19.4	16.8
30/09/17	(7.4)	12.0	10.6	11.9	11.9
30/09/18	13.7	2.0	0.9	5.9	5.9

Source: Thomson Datastream, Jupiter UK Growth Trust. Note: All % on a total return basis in pounds sterling. \*JUKG track record is for Jupiter Primadonna Growth (JPG)/Jupiter Global Trust until 18 April 2016. <sup>^</sup>Blended benchmark is 75% FTSE All-Share and 25% FTSE World ex-UK until 17 April 2016, and FTSE All-Share thereafter.

## Investment strategy: Fundamental and engaged

JUKG's investment approach is bottom-up and rigorous. In addition to applying fundamental analysis to companies, Davies also seeks a broader perspective to help him understand businesses and build conviction in an investment case. This involves personal engagement with chairmen of investee companies and deep dives into understanding their industries (a recent research trip to the US focused on its shale oil industry). A relatively small number of portfolio investments means the manager has the capacity to undertake this labour-intensive approach.

## Market outlook: Investors underweight UK equities

Market conditions for equities in general have turned more challenging this year as central banks unwind quantitative easing, resulting in less abundant liquidity and rising interest rates. Uncertainties surrounding Brexit outcomes present additional headwinds for UK equities, which are very out of favour, and the consensus position for global investors is to be underweight. Broader UK market valuations are now below the 10-year average in P/E and price to book terms, and the manager is finding plenty of interesting, long-term investment opportunities.

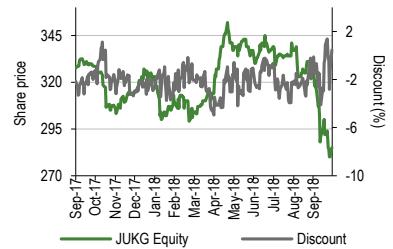
## Valuation: Trades close to NAV

JUKG currently trades at a 0.5% premium to its cum-income NAV, which is modestly below the three-year average discount of 2.0%. The board has a nil-discount policy and JUKG is the only trust in the AIC UK All Companies sector to follow such a policy.

30 October 2018

Price	285.0p
Market cap	£52.9m
AUM	£69.9m
NAV*	280.9p
Premium to NAV	1.5%
NAV**	283.7p
Premium to NAV	0.5%
Yield	2.5%
Ordinary shares in issue	18.6m
Code	JUKG
Primary exchange	LSE
AIC sector	UK All Companies
Benchmark	FTSE All-Share

## Share price/discount performance



## Three-year performance vs index



52-week high/low 352.0p 288.0p

NAV\*\* high/low 355.4p 283.7p

\*\*Including income.

## Gearing

Gross\* 6.8%

Net\* 6.0%

\*As at 30 September 2018.

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

Jupiter UK Growth Investment Trust aims to achieve capital appreciation by holding predominantly listed investments. It invests in a concentrated portfolio made up of the manager's best ideas from any sector, with typically a bias towards FTSE 100 stocks. The trust was known as Jupiter Global Trust from November 2015 until April 2016 and was previously Jupiter Primadonna Growth Trust. It adopted its new name, fund manager, investment strategy and FTSE All-Share benchmark on 18 April 2016.

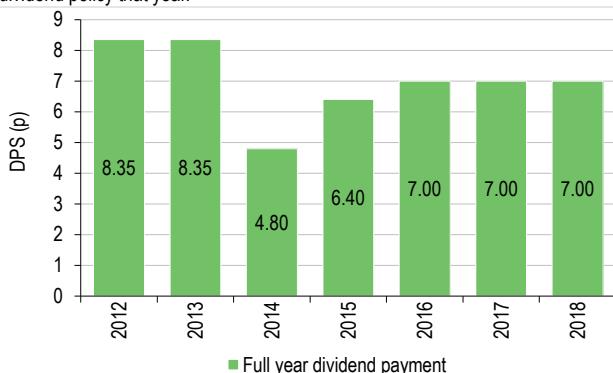
**Recent developments**

- 20 September 2018: annual report for the year ending 31 December 2018. NAV TR+4.0% versus benchmark FTSE All-Share index TR +9.0%.
- 20 September 2018: declaration of annual dividend for FY18 of 7p per share.
- 29 March 2018: interim report for six months ending 31 December 2017. NAV TR -0.7% versus benchmark FTSE All-Share index TR +7.2%.
- 28 March 2018: announcement that Keith Bray appointed as independent non-executive director with immediate effect.

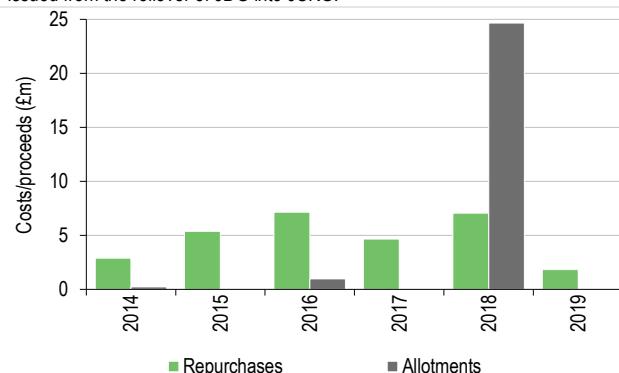
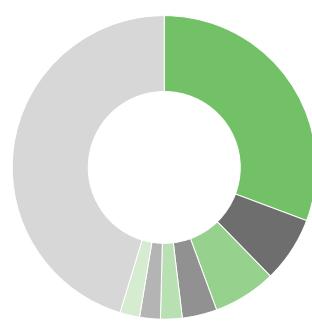
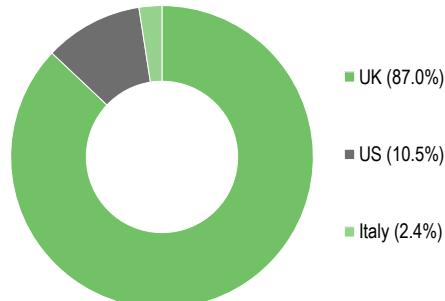
Forthcoming		Capital structure		Fund details	
AGM	November 2018	Ongoing charges	1.14%	Group	Jupiter Unit Trust Managers
Interim results	March 2019	Net gearing	6.0%	Manager	Steve Davies
Year end	30 June	Annual mgmt fee	0.5% (see page 7)	Address	The Zig Zag Building, 70 Victoria St, London SW1E 6SQ
Dividend paid	Annually	Performance fee	Yes (see page 7)	Phone	+44 (0) 20 3817 1000
Launch date	June 1972 (April 2016 for new strategy)	Trust life	Indefinite	Website	<a href="http://www.jupiteram.com/JUKG">www.jupiteram.com/JUKG</a>
Continuation vote	No	Loan facilities	£17m with Scotiabank		

**Dividend policy and history (financial years)**

Dividends, historically paid quarterly, have moved to a single annual dividend from FY17. Only three dividends were paid in 2014, owing to a change in dividend policy that year.


**Share buyback policy and history (financial years)**

The board aims to maintain the share price close to NAV through the use of share buybacks and allotments. Allotments in 2018 include 7.8m new shares issued from the rollover of JDG into JUKG.


**Shareholder base (as at 9 October 2018)**

**Portfolio exposure by geography, adjusted for net gearing (as at 30 September 2018)**

**Top 10 holdings (as at 30 September 2018)**

Company	Sector	Portfolio weight %	
		30 September 2018	30 September 2017*
Sirius Minerals	Basic materials	6.6	4.9
Legal & General	Financials	6.2	6.6
Lloyds Banking Group	Financials	6.0	7.3
Experian	Industrials	4.9	N/A
Barclays	Financials	4.8	6.4
International Airlines Group	Consumer services	4.2	4.2
Talktalk Telecom	Telecommunications	4.1	4.5
Manchester United	Consumer services	4.0	N/A
WH Smith	Consumer services	3.8	4.2
Inmarsat	Telecommunications	3.8	N/A
<b>Top 10 holdings</b>		<b>48.4</b>	<b>51.1</b>

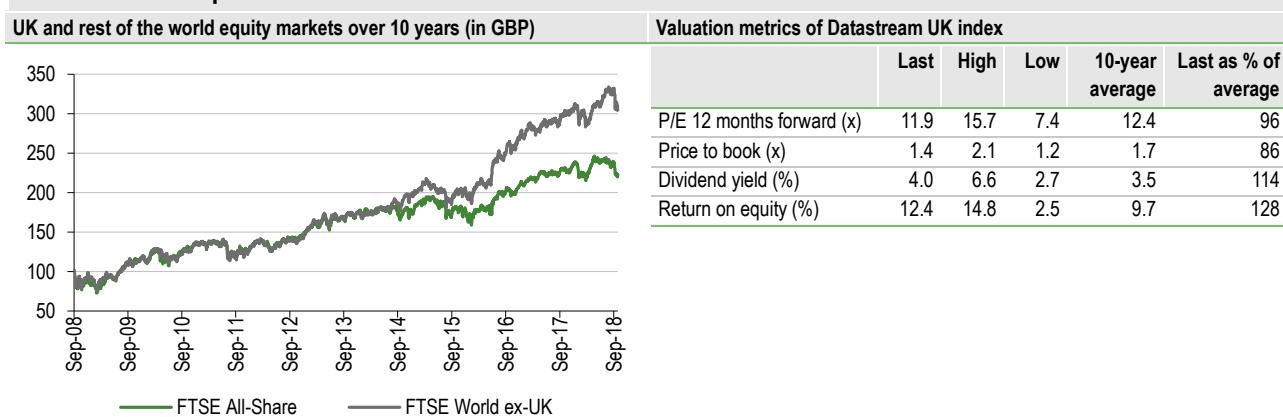
Source: JUKG, Edison Investment Research, Bloomberg, Morningstar. Note: \*N/A where not in end-September 2018 top 10.

## Market outlook: UK equities out of favour

UK equities have enjoyed a near-decade of appreciation since early 2009 to a peak in May 2018, fuelled by an exceptionally prolonged period of low interest rates, abundant liquidity, and more recently, synchronous global growth. Market conditions have since become more challenging as central banks have started to unwind quantitative easing, resulting in a reduction in liquidity and rising interest rates. Since early 2018, global investors have also become more sensitive to risk, as indicated by an increase in the volatility index (VIX). Escalating geopolitical tensions in Europe and the Middle East, and a growing trade war between the US and China are among the prevailing issues acting as a headwind for equity markets.

The broader UK equity market is unloved and under-owned. As shown in Exhibit 2 (LHS), the FTSE All-Share index has lagged the FTSE World index meaningfully since 2014. Around that time, international fund managers started to reduce allocations to UK equities, a trend that accelerated after the EU referendum result in June 2016. According to the Bank of America Merrill Lynch Global Fund Manager Survey, allocations to UK equities are currently back to the levels last seen during the global financial crisis, when the banking system was in peril. This suggests the market is very out of favour, and expectations for Brexit outcomes low. The FTSE All-Share index has fallen around 12% since its May 2018 peak, which has helped to moderate valuations. Exhibit 2 (RHS) shows UK equities' valuations are now below the 10-year average in terms of forward P/E and price to book multiples, while an earnings recovery over the past two years has resulted in returns on equity significantly above the average. The dividend yield on UK equities is also above the 10-year average.

**Exhibit 2: Market performance and valuation**



Source: Thomson Datastream, Edison Investment Research. Note: Index valuations at 29 October 2018.

## Fund profile: Highly selective and patient

JUKG was launched in 1972 as Jupiter Primadonna Growth Trust (JPG), and renamed the Jupiter Growth Trust in November 2015. It took on its current name in April 2016 when the trust changed its mandate to a UK growth strategy, and appointed Steve Davies as its new manager. JUKG largely mirrors the strategy of the £1.4bn Jupiter UK Growth Unit Trust, which has been managed by Davies since 2015 (he was deputy manager between 2009 and 2015). In November 2017, the Jupiter Dividend & Growth Trust was rolled up into JUKG, which resulted in an increase in assets of £24.6m and the issue of 7.8m shares. James Moir was appointed as an analyst dedicated to the UK growth strategy in December 2017. The fund's objective is to generate capital growth, primarily from investing in UK-listed equities. The investment approach is bottom-up and highly selective, to build a diversified portfolio of c 30–35 stocks. There are no constraints versus the benchmark and

the manager favours taking a contrarian stance that can bear fruit over the long term; therefore, JUKG's performance can diverge significantly from the FTSE All-Share index.

## The fund manager: Steve Davies

### The manager's view: Pessimism creates opportunities

Davies believes investors' expectations for UK equity returns, and domestic stocks in particular, to be excessively pessimistic. This is somewhat understandable, given Brexit negotiations seem to be at an impasse, creating uncertainty, a feature that investors find unattractive. However, Davies sees this as short-termism, providing interesting opportunities for those with a long-term horizon. He believes his view is supported by the increase in mergers and acquisitions activity, highlighting that many companies are under-appreciated in terms of their potential. So far in 2018, five holdings within JUKG's portfolio have already been taken over, or received bid approaches. These include GKN, CityFibre and ZPG (which operates Zoopla, Prime Location and uSwitch). Furthermore, Davies notes increased management buying activity in out-of-favour domestic names such as Topps Tiles, Dixons Retail and Carpet Right. The manager believes that poor sentiment towards UK equities can continue for some months and the market is extremely sensitive to disappointments, with sharp falls in the share prices of companies that fail to meet earnings expectations, which favours opportunistic investors. The manager is willing to accept somewhat higher shorter-term volatility in pursuit of longer-term capital appreciation, in keeping with the trust's mandate, and he believes investment prospects for 2019 and beyond are very exciting.

## Asset allocation

### Investment process: Bottom-up focus on recovery and growth

The manager follows a bottom-up approach to build a relatively concentrated portfolio of c 30–35 stocks, with good long-term capital appreciation potential. There are no benchmark constraints and JUKG invests principally in companies listed in the UK to build a well-diversified portfolio.

Davies' favours a contrarian approach and he focuses on two broad categories of stocks: recovery and growth, currently constituting c 43% and 51% of the portfolio, respectively. Recovery stocks are those that have been 'written-off' by the market or deemed uninvestable, perhaps following a sharp fall in profits or share price. The manager looks to identify catalysts such as industry restructuring, new management or change in a company's strategy that could trigger a rerating. These stocks often have substantial share price upside, trade on P/E multiples of less than 10 and free cash flow yields in excess of 10% (or below book value for banks). Cineworld and Merlin Entertainment are portfolio examples of recovery stocks. Growth stocks are companies that can deliver sustained growth over the medium term, with forecastable business models (not 'black boxes'), and are reasonably valued. Within the portfolio, Experian, WH Smith and Inchcape fall under this category.

Engagement is a key part of the investment process, not only with management, but with company directors and chairmen. In 2017, Davies met with the chairmen of 90% of JUKG's companies, and he aims to meet all of them in 2018. The nature of the engagement is active and co-operative, rather than activist, involving discussions on issues including remuneration and succession planning, as well as strategic decisions such as mergers and acquisitions. Davies undertakes these engagements personally, which he believes differentiates JUKG from its peers, and this helps him to build better insights into its investments. This labour-intensive, direct approach is possible because of the relatively small number of predominantly UK-based holdings in the portfolio.

## Current portfolio positioning

As shown in Exhibit 3, the portfolio's largest exposure is to the consumer services sector, with a weight of 37.3%, which is c 12pp above the index weight. Davies believes that UK domestic stocks are very unloved and, taking a long-term view, many look attractively valued. Unemployment is low and wages are rising, which bode well for consumption. JUKG recently purchased Cineworld, which has become the second-largest cinema operator in the world by number of screens, following its recent acquisition of US cinema chain Regal Entertainment. Davies believes there are synergistic benefits to be gained from the acquisition and significant improvements can be made to the US cinema offering; these factors should help to raise the growth profile of the company. Box office revenues so far in 2018 are indicating growth of 10% over a relatively disappointing 2017. Cineworld is cash-generative and attractively valued with a free cash flow yield of 10–11%.

JUKG's second-largest sector exposure is to financials (27.3%), including three of its largest holdings: Legal & General, Lloyds Bank and Barclays. Davies believes that the worst of the UK banks' problems, which stymied growth for a decade, are now behind them. The underlying domestic businesses are doing well, banks' balance sheets are now much stronger and they have started to pay dividends again. He finds UK domestic banks' valuations to be "eye-wateringly cheap", now back to levels seen in 2008 and 2011, with significant rerating potential.

However, Davies expects the UK equity market to remain out of favour over the short term, reflecting continued uncertainty surrounding Brexit outcomes and the potential for further sterling weakness. As a result, he has been de-risking the portfolio slightly by reducing the exposure to domestically exposed stocks (including the banks, Taylor Wimpey and International Airlines Group), in favour of names with international earnings exposure (such as Ferrari, Formula 1, Experian and BP). The reductions have tactically targeted the more liquid names in the portfolio and do not reflect a change of view on these companies' underlying longer-term prospects.

The purchase of oil and gas major BP represents JUKG's first investment in this sector for some years, and acts as a hedge against sterling weakness as well as potential oil price appreciation; although Davies has a long-held negative view on the oil price. This view has been reaffirmed during a recent shale industry research trip to the US by analyst James Moir. However, he also concludes there are short-term pipeline capacity issues that will likely constrain production growth until late 2019, lending support to the oil price for the time being.

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

	Portfolio end-Sept 2018	Portfolio end-Sept 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Consumer services	37.3	39.2	(1.9)	12.1	25.2	3.1
Financials	27.3	31.2	(3.9)	25.3	2.0	1.1
Industrials	12.7	8.5	4.2	11.3	1.4	1.1
Telecommunications	7.8	8.7	(0.9)	2.8	5.1	2.8
Basic materials	6.6	4.9	1.7	7.5	(0.9)	0.9
Consumer goods	6.1	8.4	(2.3)	13.8	(7.7)	0.4
Healthcare	4.3	2.6	1.7	9.3	(5.0)	0.5
Technology	3.3	2.9	0.4	0.9	2.4	3.7
Oil & gas	1.0	0.0	1.0	14.5	(13.5)	0.1
Others, cash & gearing	(6.5)	(6.4)	(0.1)	2.5	(9.0)	(2.6)
	100.0	100.0		100.0		

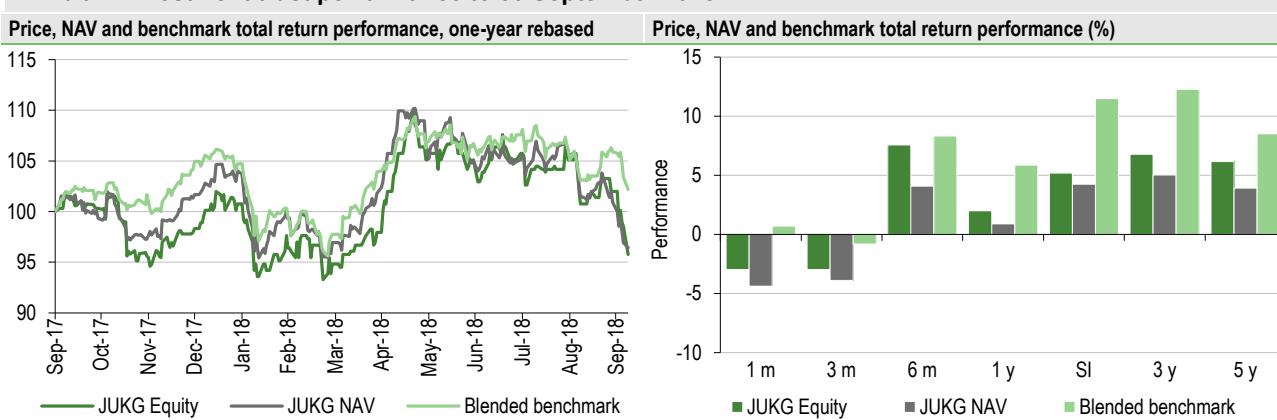
Source: Jupiter UK Growth Investment Trust, FTSE Russell, Edison Investment Research

Davies expects UK and global interest rates to be in a rising trend, and JUKG is well-placed with its large exposure to financials, and low holdings in bond proxy sectors, such as consumer staples and utilities. He also sees an economic slowdown in China and its escalating trade tensions with the US as potential risk factors to equities prices and, accordingly, JUKG has no exposure to big mining companies and limited exposure to industrials. The portfolio is also less exposed to stocks with stretched valuations, such as the technology sector, where Davies has been reducing its weighting in Apple. Around 44% of JUKG's holdings currently trade on a P/E multiple of less than 10x.

## Performance: Pulled down by negative UK sentiment

JUKG focuses on investing in a concentrated portfolio of growth and recovery stocks, with the objective for capital gain over the long term. As a result, performance can diverge from the benchmark over shorter-term periods. The current investment mandate was adopted in April 2016, and therefore the most relevant performance periods to consider are one, three and six months, one year and since inception (SI). As shown in Exhibits 4 and 5, JUKG's NAV has underperformed the FTSE All-Share index over these periods. The SI underperformance is the most pronounced and reflects the portfolio being poorly positioned for the EU referendum result in June 2016, which happened shortly after Davies was appointed manager (Exhibit 6). Since then, he has positioned JUKG as a concentrated portfolio of high-conviction stocks, which he believes can perform well should sentiment towards UK equities, and domestic companies in particular, improve.

**Exhibit 4: Investment trust performance to 30 September 2018**



Source: Thomson Datastream, Edison Investment Research. Note: Three- and five-year performance figures annualised. Blended benchmark is 75% FTSE All-Share and 25% FTSE World ex-UK until 17 April 2016 and FTSE All-Share thereafter. SI = since JUKG strategy inception, 18 April 2016.

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

	One month	Three months	Six months	One year	SI	Three years	Five years
Price relative to FTSE All-Share	(3.6)	(2.2)	(0.7)	(3.7)	(13.2)	(12.1)	(6.1)
NAV relative to FTSE All-Share	(5.1)	(3.1)	(3.9)	(4.7)	(15.2)	(16.3)	(15.5)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-September 2018. SI = since JUKG strategy inception, 18 April 2016. Geometric calculation.

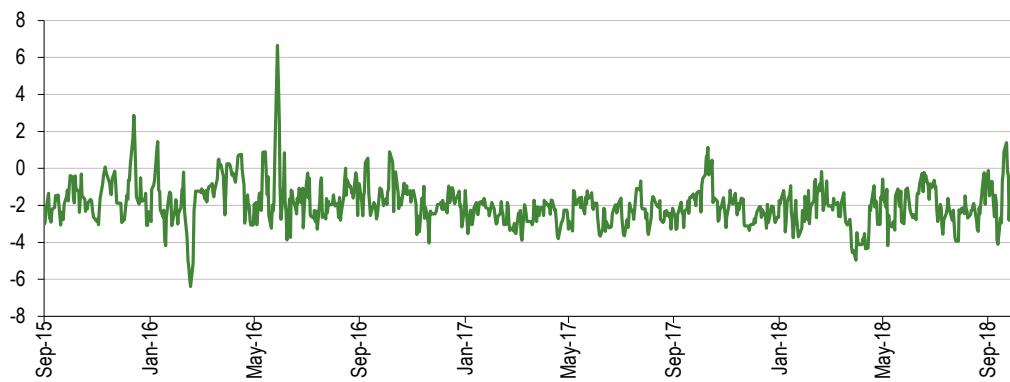
**Exhibit 6: NAV total return performance relative to benchmark over three years**



## Discount: Effective nil-discount policy

The board adopted a nil-discount policy in February 2014 and JUKG is the only trust in the UK All Companies sector to have this commitment. As shown in Exhibit 7, this has been effective in maintaining the NAV discount within a fairly narrow range, with significant share price deviations to NAV short-lived. It uses share buybacks and new issuances to ensure that, in normal market conditions, the price of JUKG's shares closely tracks the trust's NAV. It currently trades at a premium of 0.5% to its cum-income NAV, below the three-year average of 2.0%.

**Exhibit 7: Share price premium/discount to NAV (including income) over three years (%)**



Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

JUKG is a conventional investment trust with one class of share. The reconstruction of Jupiter Dividend & Growth Trust on 30 November 2017 resulted in the issue of 7.8m new shares at 315p per share, increasing assets by £24.6m. During FY18, the board repurchased 2.2 m shares at a total cost of £0.1m and there are currently 18.7m shares in issue.

Jupiter Asset Management is paid an annual base fee of 0.5% of net assets up to £150m, reducing to 0.45% between £150 and £250m, and 0.40% above £250m. A performance fee may also be payable subject to a 2% hurdle over the FTSE All-Share index total return, above which JUKG is entitled to 15% of the outperformance, with a high watermark of the NAV as at the end of the prior year. The combined fee is capped at 2% of year-end adjusted net assets. As at end-June 2018, the ongoing charge was 1.14%, down from 1.20% the previous year, reflecting the benefit of an enlarged asset base. The trust has a £17m loan facility with Scotia Bank, and at end-September 2018, had net gearing of 6.0%.

## Dividend policy and record

In April 2016, the board changed the dividend policy to pay an annual dividend (previously quarterly). It aims to at least maintain the dividend at the prior year's level and grow it over time. For FY18, the board announced a dividend payment of 7p per share, the same as the previous year, representing a dividend yield of 2.5%.

## Peer group comparison

Exhibit 8 shows the 16 members of the AIC UK All Companies sector, of which JUKG is one of the smaller trusts. The most meaningful performance period to consider is one year, which captures the current manager's tenure. Over this period, JUKG's NAV total return ranks 11th. Reflecting its small size, the trust's ongoing charge is above the peer group average; however, as the only fund with a nil-discount policy, it has one of the narrower discounts to cum-fair NAV, ranking fourth.

**Exhibit 8: AIC UK All Companies investment trusts as at 29 October 2018**

% unless stated	Market cap/ fund size £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 (%)
<b>Jupiter UK IT</b>	52.9	(8.9)	(0.7)	5.5	137.6	(1.0)	1.1	Yes	106	2.5
Artemis Alpha Trust	120.5	(2.4)	15.4	11.2	131.4	(16.6)	0.9	Yes	100	2.1
Aurora	110.3	(2.8)	28.0	17.4	127.6	0.1	0.5	Yes	100	1.3
Crystal Amber	243.5	(8.1)	11.6	4.3	253.2	(10.3)	0.6	No	100	3.7
Fidelity Special Values	206.2	11.7	40.4	55.3	203.8	(2.4)	2.0	Yes	100	2.3
Henderson Opportunities	665.0	(5.2)	25.8	43.7	286.9	0.6	1.1	No	114	2.3
Invesco Perp Select UK Equity	78.7	(6.9)	19.8	40.6	370.8	(15.5)	0.9	Yes	109	2.1
JPMorgan Mid Cap	57.9	(11.6)	7.8	35.0	250.5	0.8	0.8	Yes	144	3.9
Keystone	237.5	(13.6)	13.4	51.4	358.8	(9.2)	0.9	No	111	2.8
Manchester & London	209.5	(10.0)	0.7	19.8	190.7	(13.1)	0.6	Yes	113	3.5
Mercantile	112.6	10.3	78.8	70.3	160.1	(6.9)	1.0	No	100	1.3
Sanditon Investment Trust	1,486.3	(8.9)	16.4	44.0	326.4	(12.1)	0.5	No	101	3.0
Schroder UK Growth	42.0	1.5	(3.3)			(12.5)	1.2	Yes	100	0.6
Schroder UK Mid Cap	174.2	(9.9)	15.1	30.6	347.4	(16.0)	0.9	No	100	2.7
Woodford Patient Capital Trust	689.7	2.3	2.4			(15.9)	0.2	Yes	116	0.3
<b>Sector weighted average</b>	<b>299.1</b>	<b>(4.2)</b>	<b>18.1</b>	<b>33.0</b>	<b>241.9</b>	<b>(8.7)</b>	<b>0.9</b>		<b>108</b>	<b>2.4</b>
<b>JUKG rank in sector</b>	<b>14</b>	<b>11</b>	<b>14</b>	<b>12</b>	<b>11</b>	<b>4</b>	<b>3</b>		<b>7</b>	<b>7</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance to 26 October 2018. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

## The board

Following the appointment of Keith Bray in March 2018, the board has five independent non-executive directors. Bray was a former director of Jupiter Dividend and Growth Trust, which was rolled into JUKG last year. Chairman Tom Bartlam was appointed in July 2013 and assumed his current role in November of that year. The other board members and their years of appointment are Lorna Tilbian (2001), Jonathan Davis (2011) and Graham Fuller (2013).

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