JPMorgan European Smaller Cos

Finding exciting investment opportunities

Investment trusts

JPMorgan European Smaller Companies Trust (JESC) aims to generate long-term capital growth from a portfolio of European (ex-UK) small-cap equities. Despite a period of underperformance versus the Euromoney Smaller Europe ex-UK benchmark in 2016 due to conservative portfolio positioning, JESC's longer-term performance record remains intact. It has outperformed the benchmark over three, five and 10 years. The managers believe that the European economic backdrop is favourable, political risk has been reduced and they are finding plenty of investment opportunities, across a range of industries, including companies that are adapting in a period of rapid technological change.

12 months ending	Share price (%)	NAV (%)	Euromoney Smaller Europe ex-UK (%)	FTSE World Europe ex-UK (%)	FTSE All-Share (%)
31/05/13	44.2	41.6	42.7	43.3	30.1
31/05/14	32.8	28.6	24.9	13.4	8.9
31/05/15	12.4	5.8	2.7	4.7	7.5
31/05/16	10.5	14.7	6.3	(3.7)	(6.3)
31/05/17	38.6	35.1	39.9	35.7	24.5

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

Investment strategy: Value, quality and momentum

There are three pillars to JESC's investment process: value, quality and momentum. The trust's three highly experienced managers use a proprietary multi-factor model to screen the 1,000 companies in the benchmark. Potential investments then undergo thorough fundamental research with the managers seeking companies that are attractively valued, high quality (which may be assessed in terms of market leadership, high returns or disciplined capital allocation), and which have positive operating momentum. The resulting portfolio of 50-75 stocks is diversified by sector and geography, and the managers are unconstrained by benchmark allocations. JESC may employ gearing or run a net cash position up to a maximum of 20%.

Market outlook: Favourable economic environment

The European economic backdrop is becoming more favourable, as evidenced by the European Union Economic Sentiment Indicator and global purchasing manager surveys. Despite a positive rerating of global equities in recent months, including European small-cap companies, for investors wishing to gain exposure to the region, a fund with a good investment track record over the long term may appeal.

Valuation: Near-term narrowing discount

JESC's current 10.3% share price discount to cum-income NAV is narrower than the average discounts of the last one, three, five and 10 years (range of 12.1% to 14.8%). The discount has narrowed meaningfully since late 2016 and there is scope for it to narrow further if JESC can build on its positive medium- and long-term investment track record or if there is greater investor appetite for European small-cap equities.

22 June 2017

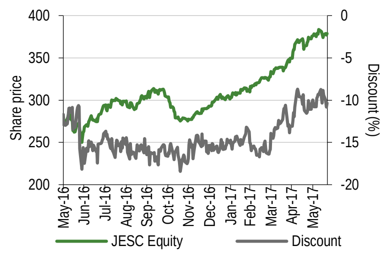
Price	**379.0p**
Market cap	**£606m**
AUM	**£708m**

NAV*	417.3p
Discount to NAV	9.2%
NAV**	422.7p
Discount to NAV	10.3%

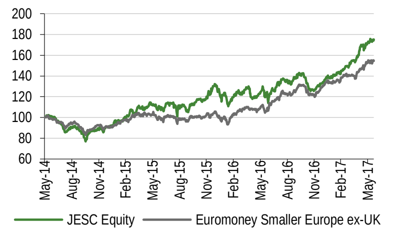
*Excluding income. **Including income. As at 20 June 2017.

Prospective yield	1.2%
Ordinary shares in issue	160.0m
Code	JESC
Primary exchange	LSE
AIC sector	European Smaller Companies
Benchmark	Euromoney Smaller Europe ex-UK

Share price/discount performance



Three-year performance vs index



52-week high/low	383.8p	250.0p
NAV** high/low	424.2p	304.0p

**Including income.

Gearing

Net cash*	3.6%

*As at 31 May 2017.

Analysts

Mel Jenner +44 (0)20 3077 5720
Sarah Godfrey +44 (0)20 3681 2519
investmenttrusts@edisongroup.com
Edison profile page

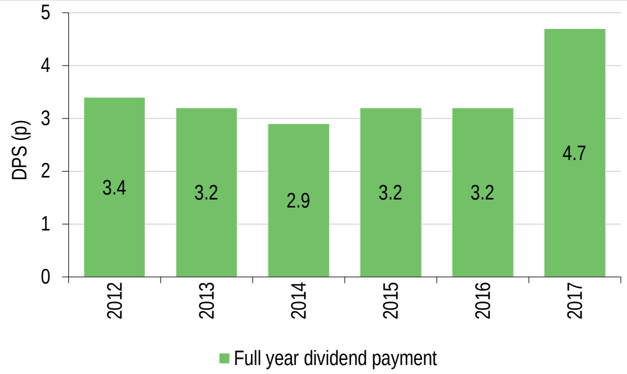
JPMorgan European Smaller Companies Trust is a research client of Edison Investment Research

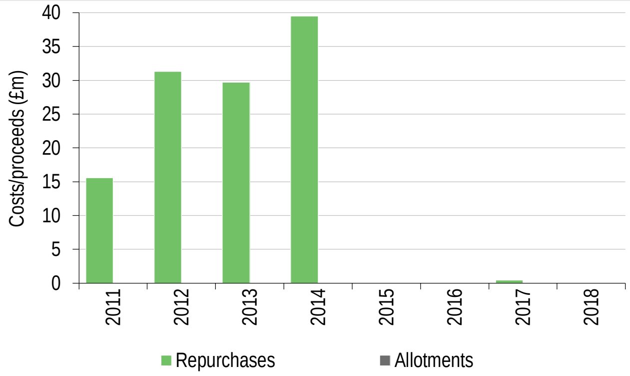
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
JESC aims to achieve capital growth from a diversified portfolio of shares in smaller European companies (excluding the UK). Liquidity and borrowings are actively managed (investments 80-120% of net assets) with a view to enhancing returns to shareholders. As JESC's investment policy emphasises capital growth, rather than income, the dividend is expected to vary from year to year. JESC is benchmarked against the Euromoney (formerly HSBC) Smaller European ex-UK total return index in sterling terms.	■ 2 June 2017: final results to 31 March 2017. NAV TR +26.7% versus benchmark TR +29.0%. Share price TR +22.4%. Declaration of 3.5p final dividend. ■ 21 March 2017: announcement that co-portfolio manager Jim Campbell is currently on personal leave. ■ 23 February 2017: change to investment management fee: 1.0% on first £400m of net assets and 0.85% of net assets in excess of £400m.

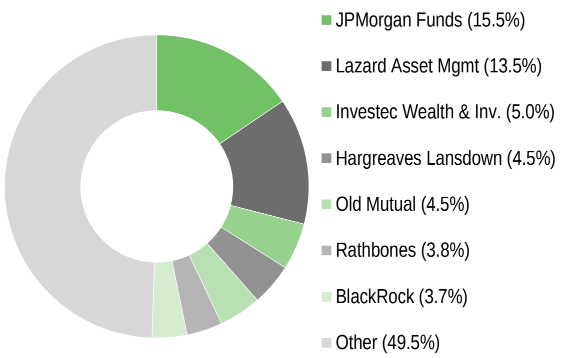
Forthcoming		Capital structure		Fund details	
AGM	July 2017	Ongoing charges	1.18%	Group	JPMorgan Asset Management (UK) Ltd
Interim results	November 2017	Net cash	3.6%	Manager	Jim Campbell, Francesco Conte, Edward Greaves
Year end	31 March	Annual mgmt fee	Tiered (see above and page 7)	Address	60 Victoria Embankment, London EC4Y 0JP
Dividend paid	January, July	Performance fee	None		
Launch date	April 1990	Trust life	Indefinite	Phone	+44 (0)800 731 1111
Continuation vote	None	Loan facilities	€100m	Website	www.jpmeuropeansmallercompanies.co.uk

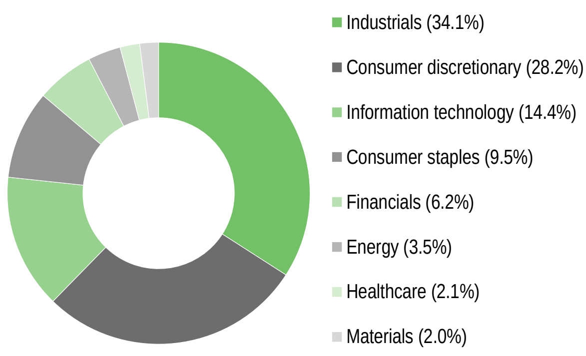
Dividend policy and history (financial years)	Share buyback policy and history (financial years)
Between zero and two dividends annually. Interims, when paid, are in January. Finals, when paid, are in July. Numbers below have been adjusted for stock split.	Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 5% of issued share capital.





Shareholder base (as at 31 May 2017)	Portfolio exposure by sector (excluding cash, as at 31 May 2017)





Top 10 holdings (as at 31 May 2017)

			Portfolio weight %	
Company	Country	Sector	31 May 2017	31 May 2016*
Ipsos	France	Consumer discretionary	2.2	1.9
Ubisoft Entertainment	France	Information technology	2.1	N/A
SalMar	Norway	Consumer staples	2.1	N/A
Stabilus	Germany	Industrials	2.1	N/A
Metso	Finland	Industrials	2.0	N/A
Tarkett	France	Industrials	2.0	N/A
Alten	France	Information technology	2.0	2.0
Interpump Group	Italy	Industrials	2.0	N/A
ams	Austria	Information technology	2.0	N/A
Maisons du Monde	France	Consumer discretionary	2.0	N/A
Top 10			20.5	23.5

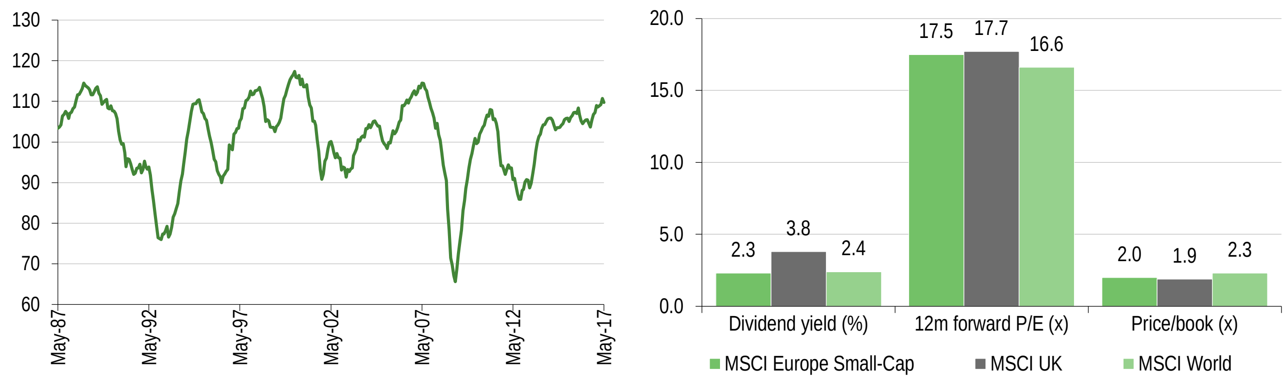
Source: JPMorgan European Smaller Companies, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in May 2016 top 10.

Market outlook: Positive economic backdrop

Since early 2015, the Euromoney Smaller Europe ex-UK Index has outperformed the FTSE World Europe ex-UK Index by c 20% in sterling terms. This may be as a result of an improving economic backdrop, which is illustrated by the European Union Economic Sentiment Indicator in Exhibit 2 (left-hand side). European equities have experienced a positive rerating in recent months as investors shook off a series of macro concerns such as Brexit and European political uncertainty. European small-cap equities continue to trade at a forward P/E premium to global equities, have a modestly lower dividend yield, but a lower price-to-book multiple. However, for investors wishing to gain exposure to smaller European companies that have the potential to benefit from an improving economic backdrop, a fund with a good medium- and long-term performance track record may be of some interest.

Exhibit 2: Market performance and valuation

European Union Economic Sentiment Indicator for the last 30 years | Key valuation metrics for European small caps versus other indices



Source: Edison Investment Research, MSCI, European Commission. Note: valuation data as at 31 May 2017.

Fund profile: Small-cap European equity investment

Launched in April 1990, JESC aims to generate long-term capital growth from a diversified portfolio of European small-cap equities (excluding the UK). It is benchmarked against the Euromoney Smaller Europe ex-UK Index, which comprises 1,000 companies (with market caps up to c €5.5bn as at end-May 2017) across 14 countries. JESC has been managed by Jim Campbell since 1995, Francesco Conte since 1998 and Edward Greaves since 2016 (Campbell is currently on personal leave). Small-cap European equities tend to be under-researched by sell-side analysts, so the managers are able to draw on the wide resources of J.P. Morgan Asset Management's European equities team. Over the last 20 years to the end of March 2017, JESC's NAV has achieved annualised total returns (net of fees) of 14.1%, which is 4.2pp per annum ahead of the benchmark's annual total return. There are no individual stock or geographical constraints and a maximum 35% of the portfolio may be invested in a single sector. Currency exposure is not hedged. JESC may gear up to 20% or run up to a 20% net cash position; as at end-May 2017, the trust had a net cash position of 3.6%.

The fund managers: Campbell, Conte and Greaves

The managers' view: Exciting time for investing

The managers are positive on the macro environment for European equities. They point to global purchasing manager indices, which indicate that there is a synchronised upswing in global economic activity. They comment that this is especially important for Europe given that it is an “exporting powerhouse”. The economic improvement is reflected in corporate earnings; the managers state that Q117 was the strongest quarter in the last five years and one of the best on record. They point to strength in both sales and earnings, in addition to positive estimate revisions across the board, especially for cyclical companies. The managers suggest that this improving economic environment is especially positive for European small-cap equities. They also highlight that European political risk has diminished following the success of Emmanuel Macron in the French presidential election. While there were huge political concerns in late 2016, the managers suggest that Europe has taken a step back from the brink with the election of more pro-European candidates. As a result, the backdrop, both politically and economically, is viewed as very attractive, although the managers acknowledge the strong performance of European equities since late 2016, which means that economic momentum will need to be maintained for the investment backdrop to remain supportive.

Conte comments that it is a very exciting time to invest in European small-cap equities, as so much is changing due to technological advancement. He cites Italian company Datalogic, which is a world leader in barcode readers for retailers. Its business was growing steadily at 2-3% per year but following the introduction of new technology, which it is selling to logistics experts such as DHL and UPS, Datalogic is now growing revenues in the high single-digit range. The manager also points to the dramatic changes in the retail industry due to the shift to online rather than bricks-and-mortar operations. Companies such as Ikea are revamping their warehouses to enable fulfilment of online orders, which benefits companies such as German forklift manufacturer Jungheinrich. Like Datalogic, Jungheinrich has seen a material uptick in its revenue growth, helped by offering more high-end products such as warehouse-management systems. The managers are focusing on companies that are embracing technological change and say they are finding investment opportunities across a wide range of industries.

Asset allocation

Investment process: Bottom-up stock selection

JESC’s investment philosophy is that attractively valued, high-quality companies with positive operating momentum have the potential to outperform the broader stock market. The managers employ a bottom-up stock selection process, starting with a screen of the benchmark using a proprietary multi-factor model. Stocks that pass the screen are subject to rigorous fundamental analysis. The resulting portfolio of 50-75 holdings is diversified by sector and geography. Holdings tend to fall into three buckets: companies that can grow organically regardless of the economic environment; those that are benefiting from secular growth; or companies that are currently out of favour, where the managers believe that the business can be turned around. Position sizes are determined by the level of the managers’ conviction and a company’s trading liquidity. Positions are sold if a company’s market cap has significantly outgrown the benchmark index, on valuation grounds, or if the outlook for a company’s operating environment has deteriorated.

Current portfolio positioning

At the end of May 2017, JESC’s top 10 positions comprised 20.5% of the portfolio, which was a lower concentration than 23.5% at the end of May 2016. The managers state that portfolio holding Stabilus is a good illustration of the investment process as the company possesses value, quality and momentum attributes. Stabilus is an automobile supplier with a dominant global leadership position in its market niches. For instance, Stabilus controls c 70% of the global automotive gas spring market and is c 15x larger than the number two player. Stabilus’s scale and high degree of production automation allows the company to benefit from lower costs than its peers, and its high quality is illustrated by its leading return on invested capital. Strong operational momentum is driven by increasing vehicle penetration of its products as customers demand additional safety/comfort features such as automatic tailgates. Stabilus is also growing in adjacent industrial end-markets, such as woodworking and printing machines, which is helping to diversify sales further. In addition, the company has financing capacity to continue selectively adding bolt-on acquisitions. Its valuation is attractive as a result of Stabilus's strong free cash flow generation, especially given the high quality and growth prospects of the company.

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

	Portfolio end-May 2017	Index weight	Active weight vs index (pp)	Trust weight/index weight (x)
France	19.0	12.5	6.5	1.5
Italy	17.1	12.2	4.9	1.4
Germany	13.4	14.7	(1.3)	0.9
Switzerland	12.0	10.5	1.5	1.1
Sweden	10.1	14.1	(4.0)	0.7
Norway	8.3	4.4	3.9	1.9
Netherlands	7.3	4.5	2.8	1.6
Finland	6.3	4.6	1.7	1.4
Denmark	6.3	4.3	2.0	1.5
Spain	0.0	7.8	(7.8)	0.0
Belgium	0.0	4.3	(4.3)	0.0
Austria	0.0	3.7	(3.7)	0.0
Portugal	0.0	1.4	(1.4)	0.0
Ireland	0.0	0.9	(0.9)	0.0
United Kingdom	0.0	0.1	(0.1)	0.0
	100.0	100.0		

Source: JPMorgan European Smaller Companies, Edison Investment Research. Note: Excludes cash.

Exhibit 4: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-May 2017	Portfolio end-May 2016	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Industrials	34.1	32.1	2.0	24.1	10.0	1.4
Consumer discretionary	28.2	26.0	2.2	14.6	13.6	1.9
Information technology	14.4	20.2	(5.8)	9.8	4.6	1.5
Consumer staples	9.5	6.3	3.1	6.6	2.9	1.4
Financials	6.2	6.0	0.2	12.4	(6.2)	0.5
Energy	3.5	0.0	3.5	2.8	0.7	1.2
Healthcare	2.1	5.1	(3.0)	8.1	(6.0)	0.3
Materials	2.0	3.6	(1.6)	6.9	(4.9)	0.3
Real estate*	0.0	N/A	N/A	7.7	(7.7)	0.0
Utilities	0.0	0.7	(0.7)	3.7	(3.7)	0.0
Telecommunication services	0.0	0.0	0.0	3.3	(3.3)	0.0
	100.0	100.0		100.0		

Source: JPMorgan European Smaller Companies, Edison Investment Research. Note: Excludes cash. *Real estate was included in the financials sector in May 2016.

The managers were defensively positioned in Q416, as they were concerned about political risks. As a result, investment performance lagged the index as cyclical stocks meaningfully outperformed. As political risks have dissipated and the outlook for cyclical companies' earnings has improved, the managers have increased JESC's cyclical exposure. It is the first time in many years that they have invested in areas that had underperformed for a long time, such as offshore oil services. Other new positions in sectors that had been cyclically depressed include Danish cement plant manufacturer FLSmidth & Co, and Swiss agricultural machinery manufacturer Bucher Industries.

The managers have increased their exposure to the financial sector in recent months following signs of stabilisation in the industry. One of the new holdings is Skandiabanken, which is a Swedish challenger bank. It does not have legacy concerns unlike many of its competitors; the company is digitally enabled, cost efficient and has modern IT systems. Skandiabanken has very high customer satisfaction ratings and is able to undercut traditional banks. Low pricing plus high customer satisfaction means that the company has a growing market share. JESC's managers believe that Skandiabanken's stock is looking very attractive.

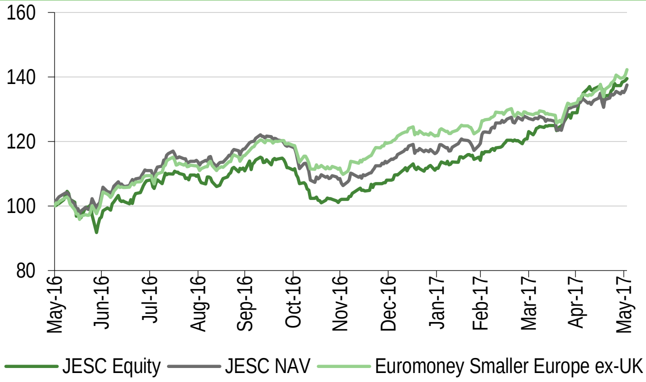
Recent sales include defensive companies that became too large as a result of outperformance, such as pharmaceutical companies Recordati and Ipsen. Other companies with limited growth prospects and more defensive business models that were sold include Swedish retailer, KappAhl, Finnish information technology services company, Tieto, and Swedish bus operator, Nobina.

Performance: Behind the index over one year

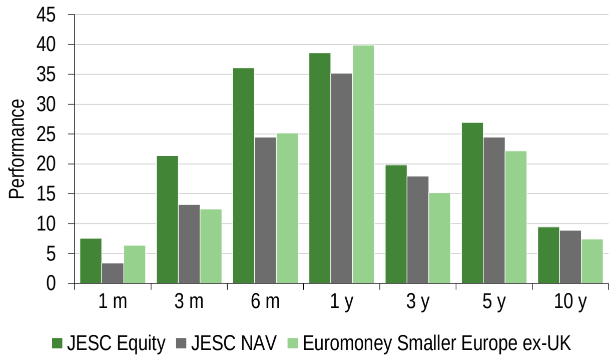
Over the last 12 months, absolute total returns for UK-based investors in overseas assets have been boosted by sterling weakness (Exhibit 5). JESC's share price and NAV total return of 38.6% and 35.1% respectively are behind the benchmark's 39.9% total return. Factors include conservative portfolio positioning due to political uncertainties and some stock-specific weakness, such as Flow Traders (a Dutch financial company, where investors were concerned about market share losses) and Beter Bed (a Dutch bedroom furnishing retailer, which had weakness in its German operations due to a poor portfolio of products). Top contributors to performance include Oriflame (a Swedish cosmetics retailer, which has benefited from emerging market demand) and Maisons du Monde (a French furniture maker, which has been successfully operating its multi-channel distribution strategy since its IPO in May 2016).

Exhibit 5: Investment trust performance to 31 May 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: three, five and 10-year performance figures annualised.

In relative performance terms, JESC's long-term positive record remains intact. Its NAV and share price total returns have outperformed the benchmark over three, five and 10 years. Of interest to UK investors, JESC has significantly outperformed the FTSE All-Share Index over one, three, five and 10 years. Its NAV has also outperformed the FTSE Europe ex-UK Index over three, five and 10 years, while performing broadly in line over one year.

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 Euromoney Smaller Europe ex-UK	1.1	8.0	8.7	(0.9)	12.7	21.2	20.7
NAV relative to Euromoney Smaller Europe ex-UK	(2.7)	0.7	(0.5)	(3.4)	7.5	9.8	14.3
Price relative to FTSE World Europe ex-UK	1.9	9.0	11.2	2.1	25.7	48.1	38.2
NAV relative to FTSE World Europe ex-UK	(2.0)	1.6	1.7	(0.4)	19.8	34.2	30.9
Price relative to FTSE All-Share	3.0	15.3	19.8	11.3	37.3	85.6	44.1
NAV relative to FTSE All-Share	(0.9)	7.5	9.6	8.5	30.9	68.2	36.5

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

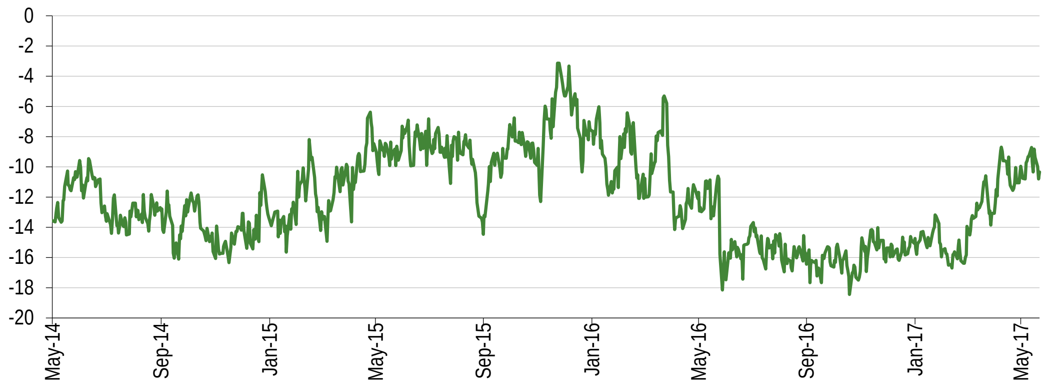
Exhibit 7: NAV total return performance relative to benchmark over three years

Source: Thomson Datastream, Edison Investment Research

Discount: Recent narrowing trend

JESC's current 10.3% share price discount to cum-income NAV compares to the 8.7% to 18.4% range of the last 12 months. It is narrower than the averages of the last one, three, five and 10 years of 14.5%, 12.1%, 12.8% and 14.8%. There has been a noticeable narrowing in the discount since mid-November 2016 and there is scope for it to narrow further if JESC can build on its positive medium- and long-term investment track record, or if there is greater investor appetite for European small-cap equities.

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



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

JESC is a conventional investment trust with one class of share; there are currently 160.0m ordinary shares in issue. The trust has a €100m lending facility with Scotiabank, which is split 50:50 between a fixed and floating rate. The board's policy is to limit gearing within the range of 20% net cash to 20% geared; at the end of May 2017, JESC had a net cash position of 3.6%.

Over time, the management fee has been reduced. Prior to 1 April 2015 it was 1.3% of net assets, which was then reduced to 1.0%. On 23 February 2017 it was announced that the fee structure would be reduced further. Effective from 1 April 2017, the management fee is 1.00% of net assets up to £400m and 0.85% of net assets above £400m. In FY16, the ongoing charge was 1.18%, which was a 14bp reduction versus the prior financial year.

Dividend policy and record

JESC's investment objective is capital growth rather than income; however, the board's dividend policy is to pay out the majority of income, which will fluctuate from year to year. Between zero and two dividends are paid each year; interims, when paid, are in January and finals, when paid, are in July. In FY17 (if the final dividend of 3.5p is approved at the July 2017 AGM), the annual dividend of 4.7% will be a 46.9% increase versus the prior year, while FY16 was flat with FY15. Based on its current share price, JESC has a prospective dividend yield of 1.2%.

Peer group comparison

JESC is the largest trust in the relatively small AIC European Smaller Companies sector. Its NAV total return is ranked highest out of the four funds over 10 years, second over three and five years and third over one year. JESC has one of the widest discounts in the sector and the second-highest ongoing charge, although no performance fee is payable. Reflecting its mandate for capital growth rather than income, JESC has a lower than average dividend yield; however, the average is skewed by European Assets Trust, which pays out an annual distribution of 6% of year-end NAV.

Exhibit 9: AIC European Smaller Companies sector peer group as at 21 June 2017*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
JESC	606.4	39.7	71.0	205.3	144.8	(9.1)	1.18	No	96	1.2
European Assets Trust	435.6	34.8	62.0	178.0	123.4	0.9	1.16	No	100	5.1
Montanaro European Smaller Companies	133.9	47.3	65.2	123.9	118.3	(11.2)	1.39	No	103	1.0
TR European Growth Trust	536.9	63.5	86.4	239.4	135.2	(6.6)	0.78	Yes	107	0.8
Weighted average		46.5	73.1	202.7	134.3	(5.9)	1.07		101	2.1
JESC's rank in sector	1	3	2	2	1	3	2		4	2

Source: Morningstar, Edison Investment Research. Note: *Performance to 20 June 2017. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There are five directors on JESC's board; all are non-executive and independent of the manager. Chairman Carolan Dobson was appointed in September 2010 and assumed her current role in 2013. The other board members and their dates of appointment are: Stephen White (April 2012), Ashok Gupta (January 2013), Nicholas Smith (May 2015) and Marc van Gelder (August 2016).

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia