

JPMorgan European Smaller Cos

A more focused approach to small-cap Europe

JPMorgan European Smaller Companies Trust (JESC) is a long-established European small- and mid-cap specialist with a stable management team. It aims to achieve capital growth by picking the winners from a broad but under-researched universe of c 1,000 stocks. Sector and country weights are mainly a result of stock selection but there is currently an overweight to technology and France compared with the index. Long-term performance has been impressive (+1,227% over 20 years), although a recent sell-off in European small caps has seen the trust's shares move to a wider discount than the average over one, three, five and 10 years.

12 months ending	Share price (%)	NAV (%)	Euromoney Smlr Eur Cos ex-UK (%)	FTSE World Europe ex-UK (%)	FTSE All-Share (%)
30/11/11	(10.3)	(8.9)	(12.3)	(5.9)	2.6
30/11/12	7.2	4.3	9.8	13.8	12.1
30/11/13	62.5	48.5	41.6	26.9	19.8
30/11/14	(10.0)	(3.1)	2.2	5.7	4.7

Source: Thomson Datastream. Note: Total return basis.

Investment strategy: Finding hidden European gems

JESC aims to achieve capital growth from a portfolio of continental European smaller companies, diversified by country and sector. Managers Jim Campbell and Francesco Conte employ a bottom-up process based on J.P. Morgan Asset Management's in-house behavioural finance-based approach, looking for attractively valued stocks whose growth potential is underappreciated by the market. In recent months the managers have moved to a slightly shorter stock list (c 60 rather than 70-90) and a lower level of turnover, reflecting a higher level of conviction but with a recognition that patience may be required. Gearing is actively managed in the range of -20% to +20% and the trust currently has a small net cash position.

Market outlook: Opportunities after recent sell-off?

After reaching a seven-year high in June 2014, the Euromoney Smaller Europe ex-UK Index sold off over the summer, rallied a little and then sold off again in September and October, before recovering somewhat to stand at -1.9% year-to-date at 12 December (total return basis). Mixed signals at the geopolitical and macroeconomic level make it difficult to call the market in the short term, although valuations for European small caps are at lower levels relative to history than the whole-market averages for Europe, the US and the UK. Earnings recovery has been coming through in the recent reporting season and the pause in the market may throw up opportunities for patient investors willing to take a selective approach.

Valuation: Discount widens following market setback

With European small caps having fallen from favour somewhat in recent months, JESC's discount to NAV has drifted wider, standing at 15.8% (cum income) at 16 December. This is a little narrower than the one-year widest point of 16.1% reached in mid-October, but is wider than the average discount over one, three, five and 10 years. There have been no share buybacks or tender offers in 2014 to date, although in the past the board has used both methods of discount management.

Investment trusts

18 December 2014

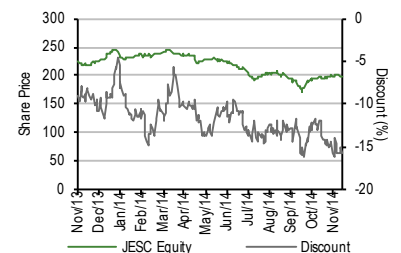
Price 193.3p
Market cap* £309.5m
AUM £402.8m

NAV* 225.9p
Discount to NAV 14.4%
NAV** 229.5p
Discount to NAV 15.8%
Yield 1.5%

*Excluding income. **Including income. Data at 16 December 2014.

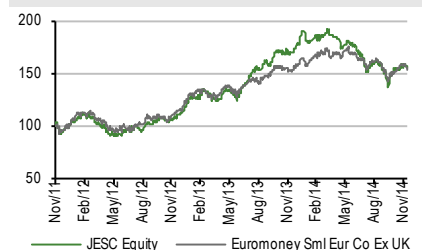
Ordinary shares in issue 160.1m
Code JESC
Primary exchange LSE
AIC sector European Smaller Companies

Share price/discount performance*



*Including income. Positive values indicate a premium; negative values indicate a discount.

Three-year cumulative perf. graph



52-week high/low* 246.0p 173.0p
NAV (cum-inc) high/low* 275.5p 204.7p

*Adjusted for five-for-one stock split on 23 July 2014.

Gearing

Gross 6.4%
Net -2.5%

Analysts

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[Edison profile page](#)

Exhibit 1: Trust at a glance

Investment objective and fund background

JPMorgan European Smaller Companies Trust (JESC) aims to achieve capital growth from a diversified portfolio of shares in smaller European companies (excluding 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 Companies (ex-UK) total return index in sterling terms.

Recent developments

- 25 November 2014: Half-year results for period to 30 September: NAV TR -16.6% over six months compared with -7.1% for the benchmark. Interim dividend declared: 1.2p.
- 21 July 2014: Review of fee arrangements. From 1 April 2015, management fee will change from 1.3% of market capitalisation to 1.0% of net asset value.

Forthcoming

AGM	July 2015
Annual results	May 2015
Year end	31 March
Dividend paid	January, July
Launch date	April 1990
Continuation vote	N/A

Capital structure

Total expense ratio	1.33%
Net gearing	-2.5%
Annual mgmt fee	1.3% of mkt cap (see p7)
Performance fee	None
Trust life	Indefinite
Loan facilities	€100m

Fund details

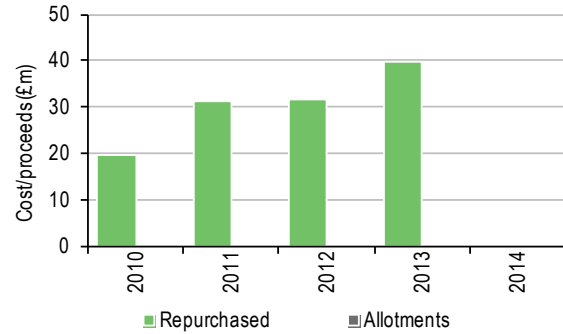
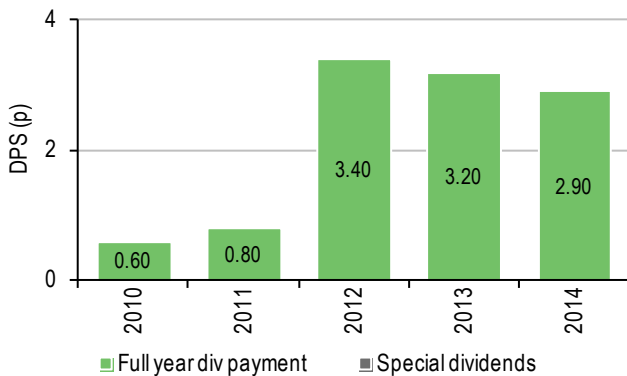
Group	JPMorgan Asset Mgmt (UK) Ltd
Manager	Jim Campbell, Francesco Conte
Address	60 Victoria Embankment, London EC4Y 0JP
Phone	+44 (0)800 731 1111
Website	www.jpmeuropeansmallercompanies.co.uk

Dividend policy and history

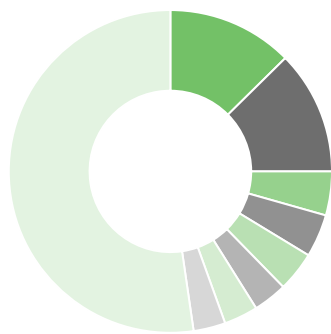
Between zero and two dividends annually. Interims, when paid, are paid in January. Finals, when paid, are paid in July. Numbers below have been adjusted for stock split.

Share buyback policy and history

Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 5% of issued share capital.

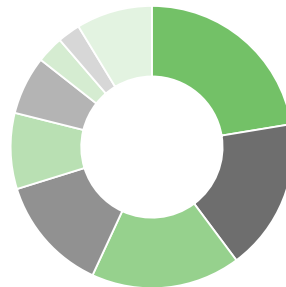


Shareholder base (as at 1 September 2014)



- JPM savings plans (12.6%)
- Lazard Asset Mgmt (12.4%)
- Quilter Cheviot (4.4%)
- Investec Wealth & Invnt (4.3%)
- J.P. Morgan funds (4.0%)
- East Riding of Yorkshire (3.4%)
- Rathbone UT Mgmt (3.4%)
- Legal & General IM (3.2%)
- Other (52.3%)

Distribution of portfolio (as at 30 November 2014)



- Industrials (22.4%)
- Financials (17.4%)
- Consumer disc. (17.1%)
- Info technology (13.3%)
- Health care (8.7%)
- Materials (6.7%)
- Telecom services (3.1%)
- Consumer staples (2.6%)
- Cash (8.7%)

Top 10 holdings (as at 30 November 2014)

Company	Country	Industry	Rationale	Portfolio weight %
Trigano	France	Camper vans	Restructuring/recovery	2.0
Geox	Italy	Footwear	Restructuring/growth	2.0
Topdanmark	Denmark	Insurance & pensions	Quality	2.0
Intrum Justitia	Sweden	Credit management	Growth	2.0
Husqvarna	Sweden	Outdoor power tools	Restructuring	1.9
GAM Holding	Switzerland	Asset management	Yield/buybacks	1.9
Kaba Group	Switzerland	Doors and access systems	Growth	1.9
Sopra	France	IT services	Restructuring	1.9
Aalberts Industries	Netherlands	Industrial pipework	Cyclical recovery	1.9
Straumann	Switzerland	Dental implants	Growth	1.8
Top 10				19.3

Source: JPMorgan European Smaller Companies Trust, Edison Investment Research

Small-cap outlook: Mixed signals but valuations fair

After a strong run, European small caps have fallen back in recent months. The Euromoney Smaller Europe ex UK Index level on 9 December was down 1.9% year-to-date and 10.2% below the peak in mid-June (total return, in sterling terms). However, since the beginning of the bull phase in June 2012, the index is still up 68% in spite of recent falls.

Exhibit 2: European Union economic sentiment indicator since inception



Source: European Commission. Note: Data to end-November 2014.

A range of factors may influence what happens next for investors. Sentiment indicators in Europe (Exhibit 2) are broadly positive, although at the underlying level, businesses are more confident than consumers, and France and Spain are more optimistic than Italy and Germany. The latter two have been more affected by Russian sanctions and trade embargoes. Volatility has been rising and the sliding oil price is causing further market jitters. Conversely, Shinzo Abe's victory in a snap election means the liquidity taps are likely to keep running in Japan for some time, while outright QE may also be seen in Europe. However, divisions are beginning to emerge at the European Central Bank.

Smaller companies are trading on more attractive valuations than the average for all companies in Europe, the UK and US (Exhibit 3, below), although in most cases forward P/E multiples are above long-term averages, suggesting value at a relative rather than an absolute level. In such conditions investors may favour a more selective approach to finding attractively valued individual stocks.

Exhibit 3: Valuation comparison

Forward P/E ratio (x)	Last	High	Low	10 year average	Last % of average	Dividend yield (%)
Europe – all cap	16.5	16.8	6.9	13.4	123%	3.1
Germany – small cap	11.9	24.0	7.3	14.5	82%	1.9
France – small cap	14.7	25.5	7.4	14.7	100%	1.8
Spain – small cap	21.9	44.9	4.3	19.3	114%	3.1
UK	16.1	16.1	6.4	12.9	125%	3.3
US	19.9	22.8	9.6	17.3	115%	1.9
World	17.1	20.0	8.6	15.4	111%	2.4

Source: Thomson Datastream. Note: Uses Datastream indices. As at 29 November 2014.

Fund profile: Stable team with impressive track record

JPMorgan European Smaller Companies was launched in 1990 and has been managed since 1995 by Jim Campbell and Francesco Conte, who take a growth-orientated approach to investing in under-researched smaller companies in continental Europe. Campbell and Conte are part of a well-resourced European equities team at JPMorgan Asset Management, which broadly follows a behavioural finance-based process, centred on the belief that attractively valued, high-quality stocks with positive momentum outperform over time. The portfolio has performed strongly over the long term, with an NAV total return of 1,227% over 20 years compared with 781% for its nearest rival.

The fund managers: Jim Campbell & Francesco Conte

The managers' view: Balance of risks is to the upside

The economic signals coming from Europe are mixed but are not nearly as bad as some commentators might suggest, according to Francesco Conte. While confidence is fragile – particularly in Germany, which is closer to Russia than other Western European economies – the latest Ifo survey was positive and PMIs (a key measure of sentiment) are turning upwards in many markets. Italy is passing important labour reforms and has joined the other peripheral nations in achieving a current account surplus. Furthermore, ECB President Mario Draghi is still indicating a willingness to adjust monetary policy further to underpin the recovery.

In all, says Conte, the balance of risks is more to the upside than the downside. Leading indicators point to an improving trend in European stocks: historically, falls in both the oil price and the euro have translated into stock market gains down the line. A lower oil price is good for manufacturing countries but bad for oil services stocks; JESC has no holdings in this sector, however. Conte says that small-cap European stocks in particular compete for investor airtime with global emerging markets, and with Europe arguably less sensitive to changes in the oil price, investors with a bias to 'risk on' might revisit the region.

With markets "very moody and volatile", however, stock selection is key. "It is all about not bailing out too soon and not being overconfident about stocks that are at all-time highs," says Conte. He identifies M&A and the continued earnings recovery as two important current themes. With companies cautious in their guidance and analysts similarly so in their outlook, there is potential for significant re-rating where stocks exceed earnings expectations.

Asset allocation

Investment process: Looking for the leaders

JESC's managers aim to construct a diversified portfolio of smaller European stocks from a universe of c 1,000 companies across 15 countries in continental Europe. The investment process is an extension of J.P. Morgan Asset Management's behavioural finance-based, multi-factor approach, incorporating fundamental analysis and frequent meetings with the management of current and potential holdings. It is a primarily bottom-up process but will take account of macro factors and leading indicators that may give an early guide to future market direction.

When assessing stocks for the portfolio, Campbell and Conte look for companies with market-leading positions, where business is improving, valuations are attractive and there is a catalyst for re-rating. With sentiment having turned against small caps as the European economy struggles to advance, the managers say they are increasingly willing to wait for catalysts to appear, and hold stocks on a two-year view, although if they achieve their price targets they may be sold earlier.

Portfolio turnover has historically been high at 200-400% a year. It is currently c 200% but Conte says this is likely to fall.

Current portfolio positioning

At 30 November JESC had 67 holdings, significantly fewer than the 83 it held at 30 April. This was a little below the weighted mean average for the peer group, although above the 55-stock median. Concentration (the proportion of the portfolio held in the top 10 stocks) was 19.3%, close to the sector average of 22.3%.

The top 10 holdings themselves have tended to change significantly from month to month; however, this is an effect of the relatively equal weightings of stocks at the top end of the portfolio, rather than

an indication of particularly active trading. Conte points out that while the largest position is c 2%, there are 37 stocks of 1.5% or above and 17 above 1.9%, so a relatively small move in the share price can propel a stock some way up or down the ranking. Conte says he and Campbell tend to hold fewer stocks when they are feeling more confident, as it enables them to take higher-conviction positions.

Exhibit 4: Sector breakdown (all data are for 30 November 2014 except where shown)

	Trust weight %	Trust weight % 30 Nov 2013	Benchmark weight %	Trust active weight (% pts)	Trust weight/benchmark weight
Info technology	13.3	7.1	7.0	6.3	1.9
Consumer disc.	17.1	21.0	15.1	2.0	1.1
Telecom services	3.1	3.9	2.3	0.8	1.3
Materials	6.7	1.6	7.3	-0.6	0.9
Industrials	22.4	41.6	23.9	-1.5	0.9
Health care	8.7	3.6	10.2	-1.5	0.9
Financials	17.4	16.5	20.6	-3.2	0.8
Utilities	0.0	0.0	3.4	-3.4	0.0
Energy	0.0	0.0	3.5	-3.5	0.0
Consumer staples	2.6	2.0	6.7	-4.1	0.4
Cash	8.7	2.7	0.0	8.7	n/a
Total	100	100	100	0.0	

Source: JPMorgan European Smaller Companies Trust, Edison Investment Research. Note: Ranked by active weight, excluding cash. Benchmark is Euromoney Smaller European Companies Index.

Sector and country weightings are largely an output of stock selection. At 30 November JESC's largest overweight sector position relative to the Euromoney Smaller Europe ex-UK Index was in information technology, and specifically software and computer services. Holdings in this category include French consulting firms Altran and Alten (both major outsourcing partners of Airbus) and bank software providers Sopra (France) and Temenos (Switzerland).

Compared with November 2013, the industrials and consumer discretionary weightings have fallen, while the IT, materials and healthcare weightings have risen. In financials, broadly unchanged since a year ago, the trust is most overweight non-bank financials, favouring asset managers like Banca Generali in Italy and Swiss multi-asset specialist GAM. Healthcare holdings include Italian orphan drug acquirer Recordati; Ipsen, a French pharmaceutical firm that is finding new applications for some of its existing drug portfolio; and Swiss dental implant specialist Straumann.

Recent purchases include Kaba, a Swiss firm that makes locks and entry systems. The managers of JESC have been monitoring the company for some time and have chosen to invest now that clear signs are emerging of success in the new CEO's strategy implementation. Sales include online travel stocks Bravofly and eDreams, both of which disappointed with post-IPO profit warnings that called the investment case into question, and holdings leaving the portfolio through acquisition, including Nutreco and Jazztel.

Exhibit 5: Geographical breakdown, as at 30 November 2014

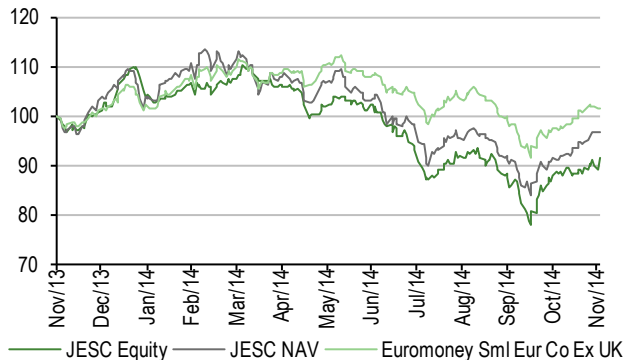
	Trust weight %	Benchmark weight %	Active weight (% pts)	Trust weight/benchmark weight
France	19.1	13.2	5.9	1.4
Sweden	15.6	12.2	3.4	1.3
Switzerland	12.3	10.8	1.5	1.1
Netherlands	5.1	4.1	1.0	1.2
Denmark	4.3	3.4	0.9	1.3
Germany	15.5	14.7	0.8	1.1
Greece	0.0	0.0	0.0	n/a
Ireland	0.7	1.5	-0.8	0.5
Italy	10.1	11.0	-0.9	0.9
Belgium	3.0	4.8	-1.8	0.6
Finland	1.6	4.4	-2.8	0.4
Norway	1.4	4.5	-3.1	0.3
Spain	2.6	7.6	-5.0	0.3
Cash	8.7	0.0	8.7	n/a
Total	100.0	100.0	0.0	

Source: JPMorgan European Smaller Companies Trust, Edison Investment Research. Note: Ranked by active weight, excluding cash.

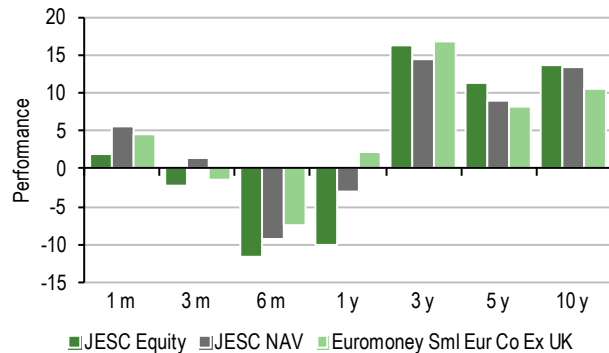
Performance: Bouncing back from recent sell-off

Exhibit 6: Investment trust performance to 30 November 2014

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



Price, NAV and benchmark total return performance (%)*



Source: Morningstar, Thomson Datastream, Edison Investment Research. Note: *Three, five and 10 years annualised.

Exhibit 7: Share price and NAV total return performance (sterling adjusted), relative to benchmarks

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to Euromoney Sml Eur Co Ex UK	(2.4)	(0.8)	(4.5)	(11.9)	(1.4)	15.3	30.6
NAV relative to Euromoney Sml Eur Co Ex UK	1.0	3.0	(2.0)	(5.1)	(5.6)	4.3	28.5
Price relative to FTSE World Europe Ex UK	(3.6)	(5.6)	(11.2)	(14.9)	2.7	18.5	54.7
NAV relative to FTSE World Europe Ex UK	(0.1)	(2.0)	(8.9)	(8.3)	(1.7)	7.2	52.2
Price relative to FTSE All Share	(0.8)	(1.6)	(11.5)	(14.1)	11.4	5.6	63.8
NAV relative to FTSE All Share	2.7	2.2	(9.2)	(7.4)	6.7	(4.4)	61.1

Source: Morningstar, Thomson Datastream, Edison Investment Research. Note: Geometric calculation.

JESC's longer-term performance record remains intact, with outperformance on a share price and NAV basis over five and 10 years to 30 November. However, after an extremely strong run of performance from mid-2012, European small caps declined sharply in summer 2014 and were hit once again in the global market sell-off during October. JESC's pro-cyclical positioning and relatively high gearing (16.7% at end-June) exacerbated the effect of the initial sell-off (there was no gearing going into the October slump), and the trust has posted negative total returns over six months and one year on both a share price and NAV basis, underperforming the benchmark (Exhibits 6 and 7).

More recently there has been an upturn, and the trust is ahead of benchmark on an NAV basis over one month, boosted by strong performance from stocks such as French campervan maker Trigano. However, share price performance is still behind the benchmark as a result of the widening discount. JESC's move from a geared to a small net cash position may slightly hold back relative performance in the short term, although a range of leading indicators studied by the managers suggest the market upturn should continue in absolute terms, and they may add back some gearing on a stock-by stock basis.

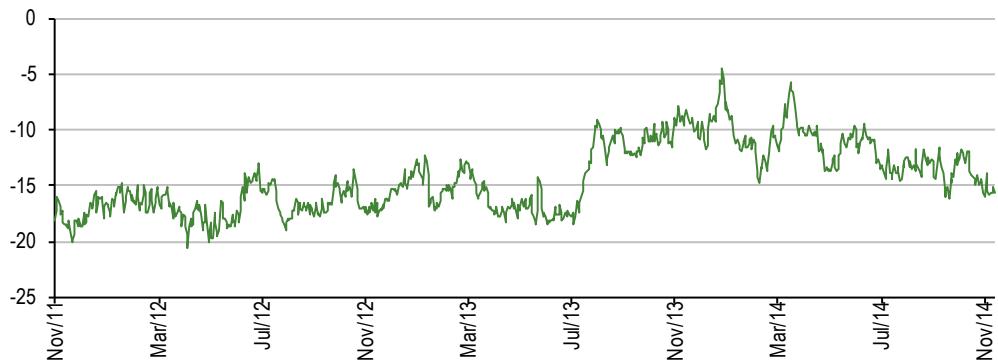
Discount: Trending wider since the summer

After trading consistently at a discount to cum-income NAV of more than 10% for the period from late 2011 to mid-2013 (Exhibit 8), JESC's discount narrowed to a five-year low point of 4.6% in January 2014. Since the summer the discount has drifted wider and at 16 December it stood at 15.8%, within touching distance of the 16.1% widest point seen during the October 2014 market sell-off. This was wider than the average discount over one, three, five and 10 years (range of 10.4% to 15.3%).

JESC has the authority to allot up to 5% and repurchase up to 15% of its shares annually. In the past 12 months it has bought back 1.4m shares (adjusted for the stock split), although the buybacks in question took place in December 2013 and no shares have been repurchased in 2014 to date. From time to time JESC undertakes tender offers allowing investors to sell back their shares at an agreed discount to NAV; the most recent of these took place in June 2013.

The trust's discount was the widest in its sector in mid-December, although excluding European Assets Trust (which was trading near par, reflecting demand for high-yielding strategies) it was closer to the peer group average.

Exhibit 8: Discount to NAV (debt at fair value, including income) – past three years



Source: Thomson Datastream. Note: Positive values indicate a discount.

Capital structure and fees

JESC is conventionally structured with one class of share. Following a five-for-one share split in July 2014 there are now 160.1m shares in issue with a nominal value of 5p. The rationale for the share split was to facilitate regular savings and dividend reinvestment, which had in some cases become problematic as the shares were consistently trading at more than £10.

The trust has a gearing facility of €100m with Scotiabank, half at a fixed rate of 1.6% and half at a floating rate of Libor +1.5%. The trust can gear in a range of 20% geared to 20% net cash. Having employed gearing of between 11% and 17% in the first nine months of the year, JESC had moved to a net cash position of 2.5% by the 30 September half-year end.

Following a review of fees, the management fee paid to J.P. Morgan Funds Ltd (appointed as Alternative Investment Fund Manager [AIFM] under the AIFM Directive in June 2014) will change from 1.3% of market capitalisation to 1.0% of net assets with effect from 1 April 2015. Based on the market capitalisation and net assets at the 30 September half-year end, this equates to a reduction from £4.1m to £3.6m. There is no performance fee and ongoing charges at HY14 were 1.33%.

Dividend policy and record

JESC aims to achieve capital growth, and any dividends paid are essentially a function of income received. For this reason they may fluctuate from year to year. No dividends were paid prior to 2010. Adjusted for the five-for-one stock split, dividends in each of the past three financial years have been c 3p per share, although there was a fall from 3.2p (pro rata) to 2.9p (pro rata) between the 2013 and 2014 financial years. At the 31 March 2014 year-end the revenue reserve of £5.4m was roughly equal to the £5.3m dividends paid for the year. Dividends are paid up to twice a year, in January and July. A first interim dividend of 1.2p has been declared for the 2015 financial year. This is equal to the first interim dividend for FY14. Historically the first interim has been smaller than the

second interim. See Exhibit 1 on page 2 for a chart of the dividend record going back to 2010. Based on the 16 December share price of 193.3p, JESC had a yield of 1.5%.

Peer group comparison

The Association of Investment Companies' European Smaller Companies sector is a small peer group of four funds with diverse investment styles. JESC is the largest in the group. Over one and three years its NAV total return ranks it third in the group, while over five years it is placed second. Risk-adjusted performance as measured by the Sharpe ratio is a little below average over both one and three years, having suffered in the recent sell-off. Gearing is largely in line with the average according to Morningstar figures. Excluding European Assets Trust, which has a high distribution policy and may pay its dividends out of capital, JESC's yield is in line with the sector average. Ongoing charges are the second lowest in the sector while the discount to NAV is currently the widest in the group.

Exhibit 9: European Smaller Companies investment trusts

% unless stated	Market cap £m	TR one year	TR three years	TR five years	Ongoing charge	Perf. fee	Discount (-) /premium	Net gearing	Yield	Sharpe NAV 1 year	Sharpe NAV 3 years
JPMorgan European Smaller Cos	315.8	-1.0	55.7	49.4	1.3	No	-14.7	112.0	1.5	-0.8	0.6
European Assets Trust	209.3	9.2	89.0	105.4	1.4	No	1.4	105.0	6.0	0.1	1.3
Montanaro European Smaller Cos	72.7	-7.1	36.0	41.9	1.5	No	-13.5	98.0	1.5	-0.9	0.5
TR European Growth	252.8	0.7	72.6	45.8	0.7	Yes	-11.5	114.0	1.3	-0.2	0.9
Sector weighted average		1.5	67.2	61.5	1.2		-9.7	109.7	2.5	-0.4	0.8
JESC rank in sector	1	3	3	2	3		4	2	3	3	3

Source: Morningstar, 15 December 2014, Edison Investment Research. Notes: TR = NAV total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is shown here as total assets less cash/cash equivalents as a percentage of shareholders' funds.

The board

JESC has five non-executive directors, all independent of the manager. Carolan Dobson has been on the board since 2010 and was appointed chairman in 2013. Anthony Davidson and Federico Marescotti were appointed in 2005. Stephen White became a director in 2010 and Ashok Gupta joined the board in 2013. The directors have backgrounds in fund management and financial services.

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