EDISON

BlackRock Greater Europe Investment Trust

Europe is undervalued and under-owned

Investment trusts
European equities

16 June 2023

BlackRock Greater Europe Investment Trust (BRGE) is managed by Stefan Gries, who seeks to invest in the best wealth-creating businesses on a minimum three- to five-year view. The process has proved successful as the trust's NAV has outperformed the Europe ex-UK market over the last one, three, five and 10 years. BRGE is one of seven funds in the AIC Europe sector, and its NAV total returns rank first over the last one, five and 10 years. It has also generated very acceptable double-digit absolute total returns over the last decade: NAV and share price are both +10.9% pa.

NAV versus the broad European market (five years to end-May 2023)

Source: Refinitiv, Edison Investment Research

Why consider BRGE?

European equities are attractively valued versus their history on both an absolute basis and compared with the world market, while continued outflows from the region indicate a lack of investor appetite for the asset class. This is despite a better macroeconomic backdrop versus a year ago, which has reduced the chance of a European recession. The economic environment has been helped by fewer concerns about energy supplies, the reopening of China's economy, moderating inflation and consumer resilience in the face of rising prices.

BRGE has a diversified portfolio of around 40 high-conviction investments, which are selected on a strict bottom-up basis, as while stock markets can experience periods of high volatility, company fundamentals drive share prices over the long term. The trust's 5.7% share price discount to cum-income NAV is slightly wider than the 2.1% to 5.6% range of average discounts over the last one, three, five and 10 years. Compared with its six peers in the AIC Europe sector, BRGE's valuation is currently the second highest (none of the funds are trading at a premium).

Gries employs a genuine long-term approach, behaving like an investor in businesses rather than a trader in shares, and is not influenced by the sector or geographic weightings of the reference index. The manager has four primary investment criteria when assessing a company as a potential addition to the fund: a quality management team with a clearly defined strategy and a strong track record of value creation; a high and predictable return on capital and strong free cash flow conversion; options to deploy cash in areas of high and sustainable returns; and a unique aspect, such as a product, brand or contract structure, which protects a business from future competition.

NOT INTENDED FOR PERSONS IN THE EEA

Price		**546.0p**
Market cap		**£552m**
Total assets		**£580m**
NAV*		578.8p
Discount to NAV		5.7%
*Including income. At 14 June 2023.		
Yield		1.2%
Ordinary shares in issue		101.0m
Code/ISIN		BRGE/GB00B01RDH75
Primary exchange		LSE
AIC sector		Europe
Financial year end		31 August
52-week high/low	563.0p	408.5p
NAV* high/low	581.5p	437.3p
*Including income		
Net gearing (at 30 April 2023)		8.8%

Fund objective

BlackRock Greater Europe Investment Trust's objective is to achieve capital growth, primarily through investment in a focused portfolio of large-, mid- and small-cap European companies, together with some investments in the developing markets of Europe. It aims to achieve a net asset value total return in excess of a broad index of European ex-UK equities (in sterling terms).

Bull points

- Proven track record, with NAV total returns ranked first in the AIC Europe sector over one, five and 10 years.
- Portfolio has well diversified revenue streams from different geographies and sectors.
- Very well-resourced team, backed up by strong risk-management oversight.

Bear points

- Performance can struggle in a market driven by macroeconomic factors rather than company fundamentals.
- Relatively concentrated portfolio.
- Modest dividend yield.

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BlackRock Greater Europe Investment Trust is a research client of Edison Investment Research

BRGE: Strong candidate for European equity exposure

Company developments

On 21 December 2022, the board announced that Stefan Gries would become BRGE's sole manager with immediate effect. Sam Vecht, the trust's former co-manager, stepped down; he had been responsible for the trust's modest emerging Europe weighting. Historically, the majority of BRGE's emerging market exposure was in Russia but following its invasion of Ukraine, this market is now uninvestable. The trust's remaining emerging Europe stocks, Bank Pekao (Poland) and National Bank of Greece, were sold, although Gries will consider investing in emerging market stocks if attractive opportunities are identified.

As flagged in BRGE's FY22 annual report, the board was in discussions with BlackRock about lowering the trust's investment management fees, as they were relatively high versus the market. The outcome is that, effective from 1 January 2023, the annual management fee changed from 0.85% per annum of NAV to 0.85% per annum of NAV on net assets up to £350m and 0.75% per annum of NAV on net assets above £350m.

The manager's insights into the investment backdrop

Interestingly, while European stocks have rallied strongly in recent months, there has not been much investor participation; it has been a case of short covering rather than long buying. While there were inflows in Europe earlier this year, generally investors remain cautious, resulting in European equities as an asset class being under-owned and undervalued.

While the outlook for the European economy remains uncertain, it appears to have improved since summer 2022. Energy supplies have increased, with gas storage at 55% full compared to an average 25% coming out of winter. Higher storage levels have been helped by corporates becoming more efficient or switching to alternative fuel sources, including coal and renewables. Liquified natural gas capacity is increasing, with projects scheduled through to 2026.

The de-risking of Europe's energy position is positive for consumers and industrial companies and is helping to bring inflation down, although some elements of core inflation are sticky. Companies appear to be less concerned about wage inflation as employment trends are working in their favour; for example, the European quit rate has declined to a two-year low as there are less jobs available in the market. While freight rates are coming down, this is deemed to be due to inventory destocking rather than reduced consumer demand.

As inflation is declining, it is likely that the bulk of the European interest rate hikes have already occurred, while the end of China's zero-COVID-19 policy is an important positive development. China is one of Europe's larger trading partners and the end of lockdowns in the country is driving demand for a range of products and services, including luxury goods and tourism.

In Europe, consumer and corporate economies have proved to be more resilient over the winter than markets expected. There had been concerns, in particular about lower-end consumer spend, due to the negative effects of higher energy and food costs. However, consumer confidence has increased, and the savings rate remains elevated. In the corporate sector, business sentiment is above average, and leverage has declined over the last decade, which is an important consideration in a higher interest rate environment.

Comparing Europe to the United States, where a few regional banks have recently failed, the European banking sector is in a stronger position, having undergone more than a decade of strict regulation. In the United States, c 10% of consumer household assets are held in cash, whereas in

Germany the cash figure is c 40%, which is held in the banking system, making bank failures in Europe less likely.

European equity valuations

Considering the valuation of European equities, the Datastream Europe Index is trading on a forward P/E multiple of 13.0x, which is an 11.1% discount to its 10-year average. In relative terms, this index is trading at a 16.0% forward P/E discount to the Datastream World Index, which is considerably wider than the 5.6% 10-year average discount.

Current portfolio positioning

At the end of April 2023, BRGE's top 10 holdings made up 52.7% of the fund, which was broadly in line with 52.1% a year before; six positions were common to both periods.

Exhibit 1: Top 10 holdings (at 30 April 2023)

Company	Country	Sector	Portfolio weight %	
			30 April 2023	30 April 2022*
Novo Nordisk	Denmark	Pharmaceuticals & biotechnology	9.0	7.7
LVMH Moët Hennessy Louis Vuitton	France	Luxury goods	8.1	7.3
ASML	Netherlands	Technology hardware & equipment	6.2	7.3
RELX	UK	Media	5.4	5.2
Lonza Group	Switzerland	Pharmaceuticals & biotechnology	4.8	5.2
Hermès International	France	Luxury goods	4.3	N/A
DSV Panalpina	Denmark	Industrial transportation	4.2	4.3
KBC Groep	Belgium	Insurance	3.9	N/A
STMicroelectronics	Switzerland	Semiconductors	3.5	N/A
Safran	France	Aerospace & defence	3.3	N/A
Top 10 (% of portfolio)			**52.7**	**52.1**

Source: BRGE, Edison Investment Research. Note: *N/A where not in end-April 2022 top 10.

The largest changes in BRGE's geographic exposure over the 12 months to end-April 2023 (Exhibit 2) were higher weightings to France (+5.7pp) and Belgium (+3.0pp) and lower allocations to Sweden (-3.7pp) and 'other' countries (-2.7pp). However, it is important to stress that the fund's geographic and sector breakdowns are purely an outcome of the manager's bottom-up stock selection.

Exhibit 2: Portfolio geographic exposure versus reference index (% unless stated)

	Portfolio end-April 2023	Portfolio end-April 2022	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
France	20.5	14.8	5.7	23.6	(3.0)	0.9
Switzerland	18.9	20.3	(1.4)	19.3	(0.4)	1.0
Netherlands	17.1	17.1	0.0	8.7	8.5	2.0
Denmark	16.4	18.0	(1.6)	5.8	10.6	2.8
UK	6.1	6.2	(0.1)	0.0	6.1	N/A
Sweden	5.1	8.8	(3.7)	6.3	(1.2)	0.8
Italy	4.8	5.5	(0.7)	5.2	(0.4)	0.9
Belgium	3.9	0.9	3.0	2.0	1.9	1.9
Ireland	3.7	2.2	1.5	0.6	3.1	6.6
Other	3.4	6.1	(2.7)	28.6	(25.2)	0.1
Total	**100.0**	**100.0**		**100.0**		

Source: BRGE, Edison Investment Research. Note: Rebased for net current assets/liabilities.

Over the 12 months to end-April 2023, the largest changes in BRGE's sector exposure (Exhibit 3) were higher weightings in technology (+3.2pp) and consumer discretionary (+2.6pp), and a lower allocation to the healthcare sector (-2.5pp). The fund remains overweight four sectors: technology (+12.5pp at end-April 2023); consumer discretionary (+6.7pp); industrials (+5.8pp); and healthcare (+2.0pp). Four sectors were not represented in the portfolio – energy, real estate, telecommunications and utilities – which together made up 13.0% of the reference index.

Exhibit 3: Portfolio sector exposure versus reference index (% unless stated)

	Portfolio end-April 2023	Portfolio end-April 2022	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Industrials	23.3	24.7	(1.4)	17.6	5.8	1.3
Technology	21.2	18.0	3.2	8.7	12.5	2.4
Consumer discretionary	20.7	18.1	2.6	14.0	6.7	1.5
Healthcare	18.2	20.7	(2.5)	16.2	2.0	1.1
Financials	9.5	9.6	(0.1)	16.6	(7.1)	0.6
Consumer staples	4.4	5.5	(1.1)	9.4	(5.0)	0.5
Basic materials	2.6	3.3	(0.7)	4.7	(2.1)	0.6
Real estate	0.0	0.0	0.0	1.0	(1.0)	0.0
Telecommunications	0.0	0.0	0.0	3.4	(3.4)	0.0
Energy	0.0	0.0	0.0	4.3	(4.3)	0.0
Utilities	0.0	0.0	0.0	4.3	(4.3)	0.0
Total	**100.0**			**100.0**		

Source: BRGE, Edison Investment Research. Note: Rebased for net current assets/liabilities.

Within BRGE's underweight financials position, the trust does not own many banks. Exposure to this subsector was increased as European interest rates started to rise and there was an expectation that the region would not experience a deep recession. Since then, the two emerging market banks, National Bank of Greece and Bank Pekao, were sold. More recently, Gries initiated a position in Irish bank AIB Group. It operates in a consolidated market, is interest rate sensitive and is generating strong returns on capital. AIB has made a series of acquisitions and now has a c 40% share in its domestic mortgage market.

The manager has increased the trust's technology exposure. There is a new position in STMicroelectronics, a semiconductor company headquartered in Switzerland. It is exposed to electric vehicles and manufactures chips for use in consumer electronic goods such as the iPhone. Gries deems STMicroelectronics to be a quality company that is benefiting from increased demand. He notes that during the technology stock derating in 2022, the company's P/E valuation declined to 10x 2024 consensus estimates. Another addition to the fund is Alten, a French engineering and IT consulting company that is founder-led, which the manager likes as the business has a long-term focus. Alten has a wide range of customers across both public and private sectors, helping them with their digital strategies.

Recently, Gries sold the remaining holding in Italian diagnostics company DiaSorin. He had been trimming the position, having lost conviction in the investment. In July 2021, DiaSorin completed the acquisition of Luminex, which had businesses outside of DiaSorin's core operations.

Performance: Commendable track record

Exhibit 4: AIC Europe peer group at 15 June 2023*

% unless stated	Market cap (£m)	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
BlackRock Greater Europe	551.5	27.0	44.6	67.9	203.5	(5.4)	1.0	No	106	1.2
Baillie Gifford European Growth	335.6	14.7	2.7	9.9	75.6	(14.7)	0.6	No	111	0.7
European Opportunities Trust	773.7	13.0	12.6	13.5	144.5	(12.2)	1.0	No	100	0.3
Fidelity European Trust	1,432.6	24.0	46.7	64.3	180.6	(5.1)	0.8	No	112	2.2
Henderson European Focus Trust	337.2	16.7	43.6	47.1	176.6	(10.8)	0.8	No	107	2.7
Henderson EuroTrust	289.2	21.5	24.3	43.7	169.9	(13.3)	0.8	No	102	2.8
JPMorgan European Growth & Inc	407.9	22.1	48.9	39.0	153.4	(10.4)	0.7	No	103	4.5
Simple average	**589.7**	**19.9**	**31.9**	**40.8**	**157.7**	**(10.3)**	**0.8**		**106**	**2.1**
BRGE rank in sector (7 funds)	**3**	**1**	**3**	**1**	**1**	**2**	**6**		**4**	**5**

Source: Morningstar, Edison Investment Research. Note: *Performance to 15 June 2023 based on ex-par NAV. TR, total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

BRGE's relative performance is improving. In our last published update in December 2022, the trust's NAV total return ranked sixth over 12 months; it now ranks first. While its three-year rank has slipped modestly from second to third during a period when value funds have outperformed, BRGE has retained its number-one position over both the last five years and the last decade (+27.1pp and +45.8pp above average respectively).

The trust currently has the second-highest valuation in a sector where none of the funds are trading at a premium to NAV. Its ongoing charge is above average, and it has an average level of gearing. Unsurprisingly, given its focus on capital growth rather than income, BRGE's dividend yield is below the mean.

Exhibit 5: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	MSCI Europe ex-UK (%)	CBOE UK All Companies (%)	MSCI World (%)
31/05/19	6.3	4.8	(3.4)	(3.4)	5.9
31/05/20	14.3	12.2	(0.0)	(12.0)	9.5
31/05/21	55.9	47.5	45.3	23.4	22.9
31/05/22	(23.1)	(15.5)	(12.4)	8.5	7.8
31/05/23	17.1	15.1	7.1	0.9	4.3

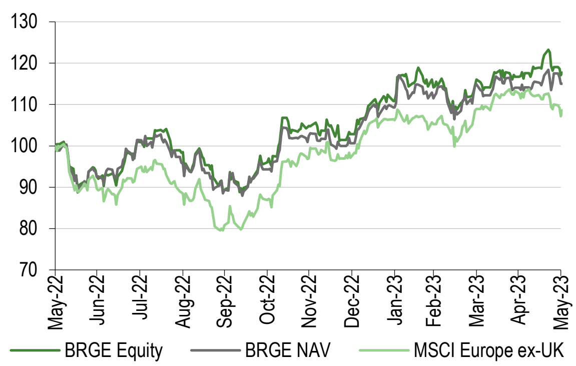
Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

Considering BRGE's performance over the last 12 months, positive contributors include Novo Nordisk (Novo), which is a global leader in diabetes care and has developed a breakthrough treatment for obesity. Its Wegovy product helps with weight loss and the company cannot keep up with the high levels of demand. The obesity market is a duopoly between Novo and Eli Lilly; Gries is impressed with the business and Novo's management team but needs to determine what is a realistic growth rate for the obesity market. The shares of luxury goods companies Hermès and LVMH have performed strongly in 2023, helped by the reopening of the Chinese economy. BE Semiconductor delivered good results in Q123 and provided a positive business outlook largely due to strong orders for its hybrid bonding technology. Technology shares are rebounding in 2023 following a sharp derating in 2022 despite no change in fundamentals; as a reminder, this is the trust's largest overweight sector exposure.

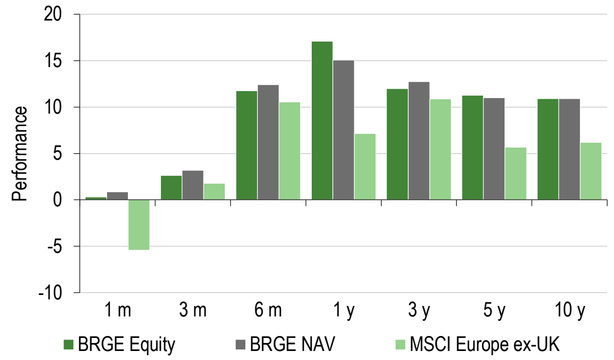
Stocks that detracted from BRGE's performance over the last 12 months include diagnostic company PolyPeptide Group. Its business is attractive given the strength of its end markets, high barriers to entry and strong growth rates. However, the company issued two profit warnings in 2022 due to technical and manufacturing process issues that required manufacturing lines to be suspended. ChemoMetec's shares came under pressure following the announced resignation of its well-regarded CEO and a decline in orders. Both the PolyPeptide and Chemometec positions have a low weighting in the portfolio. Another position that has detracted from the trust's performance is specialty chemical company Sika, which is a high-multiple stock that has derated. The company is a play on energy efficiency and has robust fundamentals. However, Sika raised its prices in 2022 and there are concerns about whether these can be maintained now commodity prices are coming down and construction activity is moderating.

Exhibit 6: Investment trust performance to 31 May 2023

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



Price, NAV and index total return performance (%)



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

As shown below in Exhibit 7, BRGE has a very strong relative performance record; the trust has outperformed the Europe ex-UK market over the last one, three, five and 10 years in both NAV and share price terms. The five- and 10-year numbers are particularly notable.

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 MSCI Europe ex-UK	6.1	0.8	1.1	9.3	3.0	29.6	54.5
NAV relative to MSCI Europe ex-UK	6.6	1.4	1.7	7.4	5.2	27.9	54.3
Price relative to CBOE UK All Companies	5.5	7.5	11.8	16.0	4.0	48.8	68.1
NAV relative to CBOE UK All Companies	6.1	8.1	12.5	14.0	6.2	46.9	68.0
Price relative to MSCI World	(0.2)	1.0	11.6	12.2	1.6	6.5	(4.1)
NAV relative to MSCI World	0.4	1.5	12.2	10.3	3.7	5.2	(4.2)

Source: Refinitiv, Edison Investment Research. Note: Data to end-May 2023. Geometric calculation.