Fidelity European Trust

Kepler GROWTH 2025

FEV has delivered consistent outperformance and strong dividend growth...

Update
17 January 2025

Overview

Fidelity European Trust (FEV) is a core European equity fund with a long and consistent track record of outperformance, with an NAV total return over the last five years of c. 54%, significantly ahead of the benchmark, c.35%, and Morningstar Europe peer group, 34%. The size of an investment trust is a hot topic for many investors, and FEV's market cap of c. £1.4bn means it is the largest European equity investment trust and a constituent of the FTSE 250 index. Cementing its status as a 'core' holding, FEV also scores well in our risk and downside protection analysis shown in the **Performance section**.

The team managing FEV focus on stock picking and their analysis shows that the bulk of returns over the long term come from this focus. Although FEV does not have a specific equity income objective, the management team look at the sustainability of dividends and dividend growth as important factors, and FEV's dividend has grown every year under manager Sam Morse's tenure, beginning in 2011. FEV's yield is 2.4%.

FEV's **Gearing** is currently c. 13% and this is approximately the level that investors should expect most of the time. The team does not try to time markets or dynamically adjust gearing, and the trust will typically be geared by this amount. Instead, gearing is held at around this level as the team's internal analysis that this offers the best risk/reward match to the investment strategy over the long term.

The **discount** is currently c. 8%, and this has held at a consistently narrower level than the Morningstar Europe peer group, currently c. 10%, over the long term. The board has historically used share buybacks when the discount has widened beyond 10%, most recently in 2022.

FEV has been awarded a Kepler 'Growth' rating for 2025..

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Analyst's View

It's not hard to make a list of negative concerns about Europe, nevertheless, Europe collectively is an important equity market home to some key global companies and FEV's status as the largest 'core' European equity trust with an impressive track record should place it high on the list for any investor seeking to build a diversified portfolio.

With that in mind, and with the caveat that FEV is not specifically designed as an equity income trust, its **dividend** growth record is also impressive, well ahead of inflation over more than a decade, and in our view FEV could make a good addition to an equity income portfolio, providing some diversification and an engine for income growth that higher yielding trusts might struggle to keep pace with.

As we enter 2025, a key area of concern for investors in European equities relates to potential trade tariffs with the US. It's no surprise that this is a live discussion within the FEV team, but their focus has always been on stock picking and like any other potential challenge for markets they are analysing this in terms of the individual stocks in the portfolio, rather than at a macro level. As a generalisation though, the portfolio is populated by companies with diverse global revenues, and the trust is naturally underweight in companies that appear particularly at risk, such as automotives and spirits. As ever, uncertainties in stock markets can create volatility and provide investors with a good opportunity to initiate or add to a position in FEV.

BULL
Consistently strong performance track record driven by a focus on stock picking
Dividend growth significantly ahead of inflation over the long term
FEV's scale may help reduce the impact of fixed and trading costs

BEAR
Generally weak sentiment toward Europe could continue into 2025
Shorter-term uncertainty over the new US administration could lead to volatility
Gearing can amplify losses as well as gains

Portfolio

Fidelity European Trust (FEV) offers a core European equity proposition, with a focussed and predominantly large-cap portfolio of 40-50 stocks, of which the top ten forms over 40%, compared to the benchmark, where the top ten is about 25%. The team managing FEV emphasise stock picking as their main source of alpha, and generally, sector exposure stays close (+/- 5%) to the benchmark. The manager's own attribution analysis shows that most of the trust's outperformance over the long term has come from stock selection and further shows that there are no sectors where the team is more or less successful selecting stocks . As we discuss in the **Gearing section**, the trust is geared using a mixture of index futures and contracts for difference (CFDs) rather than conventional gearing and as well as potential cost savings, CFDs allow the team to be specific in which companies they choose to gear.

The team take a risk-averse approach and try to look at each investment they make on a long-term basis, with the trust's annual portfolio turnover averaging c.20%. In the **Performance section**, we look at, among other impressive scores, how the trust does very well in our quantitative analysis of downside protection and this is a confirmation of the approach the team takes to each holding, with the starting point being 'what could go wrong?'.

The table below sets out some of the key portfolio characteristics compared to FEV's benchmark. As we look at the **Dividend section**, FEV has an impressive track record of dividend growth, and sometimes this can be associated in investors' minds with a 'value' strategy. The statistics below show that FEV is more aligned with a 'quality growth' strategy, with a portfolio of companies with higher returns on capital and, currently, more highly valued than the benchmark in price to earnings and price to book terms, with the team believing the higher valuations are justified. Notably the portfolio has much higher estimated dividend growth than the market, and dividend growth and sustainability is a key indicator used by the team when identifying stocks for the portfolio.

Current Portfolio Characteristics

	PORTFOLIO	INDEX
Dividend growth (2024e)	6.1%	3.1%
Volatility (ex-ante)	13.9	14.1
ROE (2024e)	18.3%	14.7%
ROIC (2024e)	16.2%	12.6%
P/E (2024e)	17.0	14.6
P/B (2024e)	3.0	2.1

Source: Fidelity as of 30/09/2024

Next, we look at how those characteristics have evolved over 2024, with the same figures from a previous note alongside the most recent. This is a relatively short period, but it's interesting to see the positive movement across all the various metrics, without any significant change in valuation.

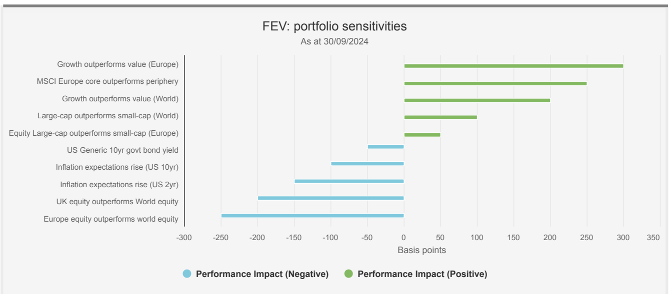
Portfolio Characteristics Evolution

	30/09/2024	31/01/2024	KEPLER COMMENT
Dividend growth (2025e)	0.1	6.1%	Forecast dividend growth has increased
Volatility (ex-ante)	12.9%	13.9%	Volatility has reduced
ROE (2025e)	18.8%	18.3%	Return on equity expected to be higher
ROIC (2025e)	17.4%	16.2%	Return on invested capital expected to be higher
P/E (2025e)	17.1	17.0	P/E ratio flat
P/B (2025e)	3.0	3.0	Price to Book flat

Source: Fidelity, Kepler

Readers may be familiar with NAV sensitivity analyses in the context of infrastructure investment trusts, and the chart below is somewhat analogous to that. In the case of infrastructure, these types of analysis are, to quite a large extent, mechanical, as many elements are contractual and feed directly into the valuations of assets. Here, we think it is better to think of the analysis as directional. The analysis is, though, quantitatively modelled by Fidelity to be as objective as possible. Notably, the analysis shows that FEV is expected to perform less well if European equities outperform world equities, perhaps indicative of the global nature of many of FEV's holdings. Certainly, European equities have not, in recent years, outperformed world equities but FEV itself has performed very well. And again, while investors sometimes associate 'dividends' with 'value' investing, the analysis also shows that FEV tends to perform better when 'growth' outperforms 'value '. That said, FEV's overall defensive bias, with a portfolio beta of less than 1, means that for example in 2022 it outperformed even though, at an index level, value outperformed growth.

Fig.1: Portfolio Sensitivities

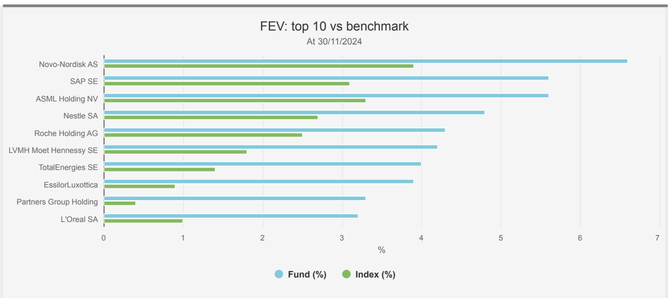


Source: Fidelity

Past performance is not a reliable indicator of future results.

FEV's top-ten holdings are shown in the chart below together with the corresponding index weighting. One of the factors co-manager Marcel notes about Europe is that many of its successful companies are lower profile than large US companies because they tend to be business-to-business rather than businesses that have a direct relationship with consumers. A couple of examples in the top ten of this are SAP, which provides its business customers with a range of software products and is expected to be a significant beneficiary of AI, and ASML, which dominates its particular niche in the semiconductor supply chain. While both these companies will probably be familiar to regular Kepler readers, their profile compared to, say, the Magnificent Seven, is very low. The chart also highlights that while FEV maintains a sector exposure fairly close to the benchmark, at a stock level, the portfolio is very active and diverges significantly from the index weights.

Fig.2: Top-Ten Holdings Relative To Benchmark

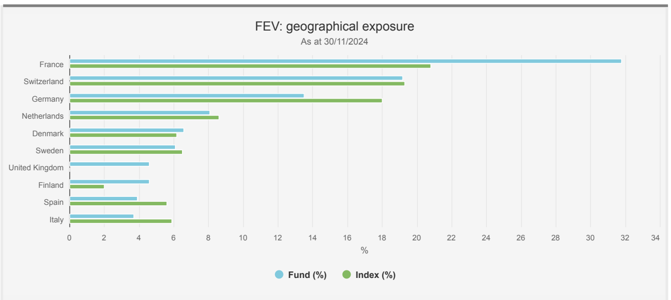


Source: Fidelity

Outside the top ten, portfolio company Epiroc is a case study of another business-to-business company that the team first encountered when it spanned out of Atlas Copco in 2018, taking a position after some initial share price weakness. Epiroc is a Swedish manufacturer specialising in mining equipment, and is a world leader in deep mines, providing mining and safety equipment that allows mines to go deeper more efficiently than they could in the past. This doesn't have to involve very complex solutions, with one example being the company's electric trucks, which operate in the mine and thereby remove the need to install complex air filtration kits that would otherwise be required with more traditional trucks.

To round things off, the geographical exposure is shown below, although this is an output from rather than input to stock picking. Neither of the two main overweight countries, France and the UK, are driven by any specific view of those countries. Clearly, the UK is not in the benchmark, and FEV's exposure comes from its holding in the private equity investment trust 3i Group (III), which has seen the value of its holding in Action Group, a European retailer, grow to be the majority of 3i's NAV, and therefore in reality FEV isn't really making an allocation to a UK stock. The French exposure is driven by active positions in a number of companies with global businesses such as LVMH, L'Oreal, Total Energie, and EssilorLuxottica, all of which may be closely associated with France, but have global revenues that aren't especially dependent on local economics.

Fig.3: Geographical Exposure



Source: Fidelity

This leads us to the final point. A key area of investor concern as we enter 2025, is the rhetoric from the incoming US administration on trade tariffs. This could be a key determinant of investor sentiment in all equity markets, and Europe is no exception. The team notes that this is an area of uncertainty and is a live topic of conversation. Their analysis is focussed on how each company they own might adapt to a different landscape for trade with the US while noting that many of the companies in the portfolio have diverse global revenues that aren't simply dependent on the US. The portfolio is also underweight in areas such as automobiles where the tariff risk seems higher, and with examples such as ASML above, occupying a crucial niche in the semiconductor supply chain, it may be challenging to put simplistic tariffs in place. Equally, it may prove difficult to put tariffs on service-based companies such as SAP.

Gearing

FEV's net gearing is currently c.13%. Since 2020 the board's policy has been to maintain a relatively fixed level of gearing, at around the current level. The policy is supported by analysis by the manager which shows that for FEV's investment strategy, this is the optimal level of balancing risk and reward. The result is that Sam and Marcel are not trying to time markets and investors should have a general expectation that gearing over the long term will fluctuate in a small range around the current level. That said, gearing is reviewed regularly between the manager and board and there could be circumstances where it is reduced.

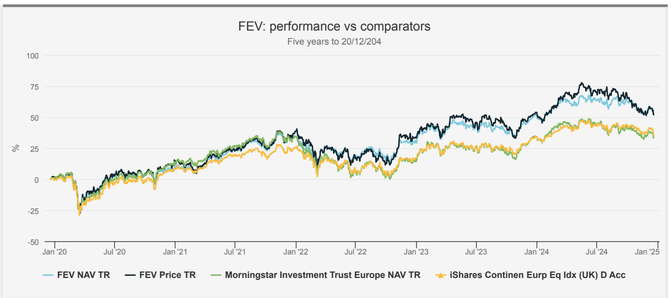
FEV is geared using derivatives, using a mixture of index futures and CFDs, which are a well-established alternative to using debt and can offer cost and flexibility advantages. This approach also allows for an element of stock picking in the gearing of the trust, as CFDs may be written over individual stocks.

Performance

FEV's five-year NAV and share price total returns of c. 54% and 53% are comfortably ahead of the benchmark, c. 35%, and the Morningstar Europe peer group, c. 34% in NAV TR terms, and 33% in share price TR terms. We note that FEV is the largest constituent of this peer group, c. 40% of the total and therefore its performance carries significant weight in the overall average. Performance since the start of Sam's tenure, beginning 01/01/2011, is equally impressive, with NAV and share price total returns of c. 285% and 332% compared to the benchmark's 156% and the peer group's NAV TR of c. 220%. As we discuss in the **Dividend section**, FEV also has a strong track record of dividend growth, comfortably ahead of inflation over the last ten years, albeit the strong capital growth means the dividend yield today, 2.4%, is relatively low.

Generally, FEV's outperformance over time is a function of stock selection. The team stays fairly close to the benchmark in terms of sector distribution, with a deviation of +/-5%. This approach is supported by an analysis that shows that the team's successful stock selection isn't limited to a particular group of sectors.

Fig.4: Five-Year Performance

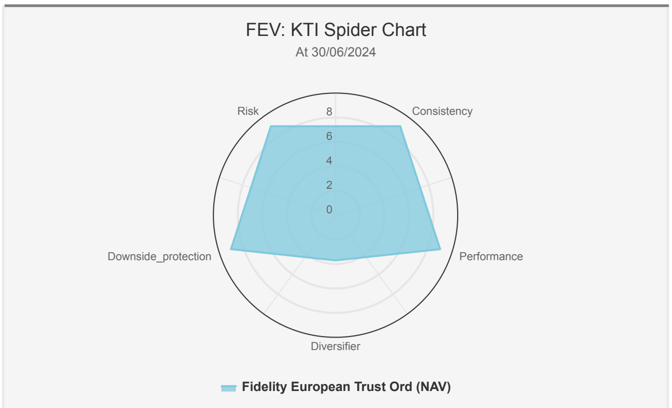


Source: Morningstar
Past performance is not a reliable indicator of future results.

In our proprietary KTI spider chart below, we show how FEV has performed versus an expanded peer group of all AIC Europe and AIC European Smaller Companies trusts over the past five years, in some key categories. Each category is scored out of ten, based on returns over this period, and scores are normalised to the peer group. As such, this data reflects the performance characteristics investors would have experienced over the last five years.

High scores across most categories are, in fact, among the highest in FEV's peer group and confirm that it has delivered a set of desirable performance characteristics for a core European equity fund beyond strong performance, namely consistency, risk, and downside protection. The last of these is notable given that FEV has an approach to **gearing** which means it is usually geared and doesn't try to time markets. The low score in the 'diversifier' category is understandable given that FEV is a core European equity fund, and one would therefore expect a strong correlation. But as we note in the **Dividend section**, FEV may also have a role to play for investors seeking to inject some growth into an income portfolio, where it could play a role in portfolio diversification.

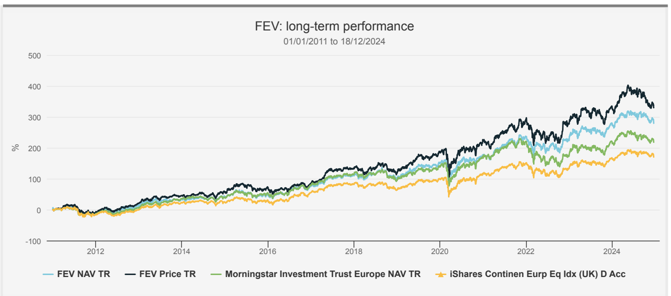
Fig.5: KTI Spider Chart



Source: Morningstar, KTI calculations
Past performance is not a reliable indicator of future results.

The next chart plots FEV's performance under Sam's tenure from the start of 2011, with the NAV and share price TRs, c. 285% and 332%, comfortably outperforming the benchmark's c. 156%, and the peer group's 220% NAV total return.

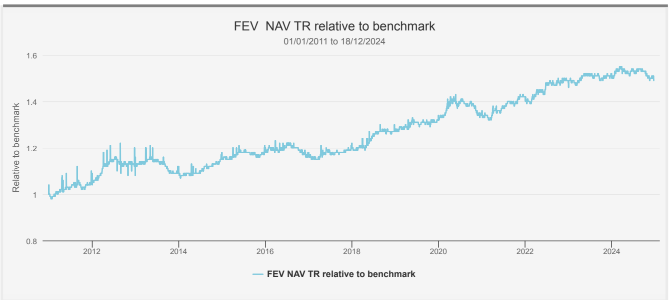
Fig.6: Long-Term Performance



Source: Morningstar
Past performance is not a reliable indicator of future results.

The above analysis can also be shown in a single line, with FEV's NAV total return divided by the benchmark total return. Thus in the chart below, a positive left-to-right slope indicates FEV is outperforming and the chart helps to highlight FEV's very consistent outperformance identified in the KTI analysis above.

Fig.7: Long-Term Performance Relative



Source: Morningstar

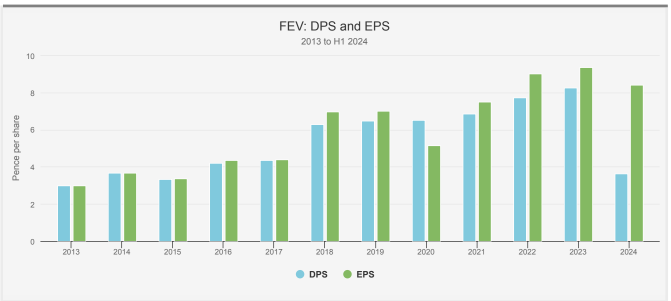
Past performance is not a reliable indicator of future results.

Dividend

FEV has a total return rather than an equity income objective but as noted in the **Portfolio section**, dividends are an important metric for the team, and the board 'have a policy whereby it seeks to pay a progressive dividend in normal circumstances' and is willing to use revenue reserves to supplement dividends where a shortfall occurs. In our view, lower-yielding trusts with a history of dividend growth have a role to play for investors seeking income, where the starting point is not the highest yield possible. Combining a trust like FEV with more explicitly income-seeking strategies can help protect against inflation and provide diversification.

FEV currently yields c. 2.4% and pays dividends twice a year. The dividend has increased for 13 consecutive years, putting it on the AIC's 'next generation' of **dividend heroes**, which is for trusts which have increased their dividend for between 10 and 20 years. At the half-year to 30/06/2024, the dividend was increased by 10.4% compared to the previous year's interim dividend. The dividend amount, 3.60p, compares to underlying earnings of 8.38p, an increase on the same period in the previous year. The chart below shows dividends and earnings from 2013 to the end of FEV's half-year to 30/06/2024 and it's worth noting that the seemingly very high earnings in the first half of 2024 are a common pattern for FEV, and European equities generally , so one should not extrapolate this figure in the expectation that it will double in the second half. In any case, the main points to take away from this chart are that the board will, from time to time, use revenue reserves, e.g. in 2020, and again while FEV's yield is not that high compared to a dedicated equity income strategy, the dividend growth rate over the period to 31/12/2023 is c. 17% annualised, which is significantly ahead of inflation, which lends credence to FEV's potential role within an investor portfolio with an overall income objective. Another way to look at dividend yield is to look at the dividend yield using the initial purchase price, or the yield on book cost. Making an investment at the end of 2013, the first year in the series below would have cost c. 150p, which on today's dividend means an investor would now have a yield of c. 5.5% on their original cost.

Fig.8: Dividends And Earnings Per Share



Source: Fidelity

Management

FEV is managed jointly by Sam Morse and Marcel Stötzel. Sam has managed FEV for over 13 years and started at Fidelity in 2004, initially in the UK equities team before moving to European equities. Sam began his career in 1986, working as an analyst before moving to a fund management role in 1992. He also manages the c. £4.2bn open-ended Fidelity European Fund, using the same investment approach.

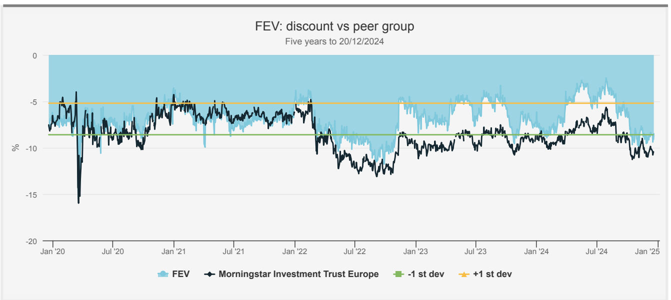
Marcel became co-manager of FEV 2020, having joined Fidelity in 2014 as a pan-European equity analyst and moving to a fund manager role in 2018, co-managing Fidelity's Sustainable European Equity fund, which he continues to manage. Marcel began his career in investment banking in 2011.

Fidelity has a team of 133 equity analysts covering the US, Europe, Pan-Asia, and Emerging Markets, of which 33 are European specialists, and the team can also call on large teams of credit, ESG, and quantitative analysts. Fidelity has long-term incentive plans in place that reward analysts for successful stock picking.

Discount

FEV's current discount is c. 8%, narrower than the peer group average of just over 10%. Over the last two years in particular FEV has traded at a narrower discount than the peer group. FEV's strong performance undoubtedly plays a significant role in this, but other factors that, in our view, contribute to this is FEV's scale. Investors place increasing importance on this as it tends to coincide with greater liquidity in the shares, and may lead to lower costs, and the dividend yield, 2.4%, which although lower than the yields on equity income trusts, is still high enough to give it a role in a broader portfolio with an income requirement, particularly when one considers the track record of dividend growth discussed in the **Dividend section**.

Fig.9: Discount Vs Peer Group



Source: Morningstar

Charges

FEV's ongoing charges figure (OCF) is 0.77% which compares to a simple average of 0.78% for the AIC Europe peer group. FEV's management fee is on a tiered basis of 0.85% on the first £400m of net assets, reducing to 0.65% of net assets over £400m. With net assets of approximately £1.55bn at the time of writing, this would equate to an average management fee of 0.70%.

FEV's most recent KID shows the OCF, above, as the expenses charged by the trust. We note that the KID and its disclosures are under regulatory review and requirements for this disclosure may change or be dropped entirely.

ESG

FEV has an ESG rating of 'average' from Morningstar. European equities conform to higher ESG standards when measured against global indices, and so an average rating for Europe is, in global terms, above average. Fidelity has its own large ESG team and its own proprietary ESG ratings, which show different scores for some companies when compared to the industry ratings from Morningstar and MSCI, and this shows the portfolio as being 'above average' when compared to the market. Fidelity has a team of 34 sustainability specialists integrated into its overall research platform and ESG factors are fully integrated into the team's overall assessment of a company.

The team's risk-averse approach means that ESG assessments can help them have a broader understanding of where a company might go wrong. Fidelity's approach to engagement with companies is flexible and may take different forms, depending on the specific circumstances, and may be led by sustainability specialists or sector analysts. Their proprietary system allows them to track engagement and to track trends in ESG performance by their investee companies. In the previous financial year, the most frequent topic of engagement with companies was remuneration, followed by governance and biodiversity.

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