JPMorgan European Discovery Trust (JEDT)

JEDT's performance is improving but smaller companies remain undervalued...

Update
28 March 2025

Overview

JPMorgan European Discovery (JEDT) targets capital growth through investing in smaller continental European equities. The trust is managed under the principles of value, quality, and momentum, with the team managing JEDT having access to large teams of traditional analysts and data scientists.

Over the last five years , JEDT's NAV total return of c. 82% is ahead of the benchmark's c. 75% total return and slightly behind the peer group's NAV total return of c. 90%. Shorter term, JEDT's NAV TR is ahead of the benchmark and peer group over one year, and over ten years, JEDT's NAV TR of c. 133% is a good reminder of the potential for high returns from small-caps, being ahead of the benchmark, c. 125%, and the large-cap equivalent index, c. 109%.

Since March 2024 JEDT has been managed by Jules Bloch, Jack Featherby and Jon Ingram. The new team continues with the same high-level investment approach as before, with some refinements to risk control and greater analysis of decision-making. Smaller companies made positive returns over the last few years, but the team's view is that European smaller companies continue to trade at historically attractive valuations that could be the source of significant returns.

JEDT's **Discount**, c. 8% at the time of writing, has narrowed significantly compared to the five-year average of c. 13%. Since 2023, JEDT's board has spent c. £167m on buybacks, including a tender offer in September 2024 returning £104m to shareholders at a 2% (plus costs) discount. In the **Discount section**, we look at some of the contributory factors in JEDT's peer group that have played a role in narrowing the discount.

JEDT primarily targets capital growth and its yield, 2.1%, can be viewed as an outcome rather than an objective of the strategy, and investors should not necessarily expect a progressive dividend.

Analysts:

Alan Ray
alan@keplerpartners.com

Analyst's View

Changes implemented at JEDT in the last year have begun to bear fruit, notably with the NAV and share price ahead of the index over the shorter time period of one year and, importantly, making positive returns after a period when it's been a tough environment for small-cap equities in Europe and elsewhere. As the team note, the valuation discount for European equities isn't new, but they have seen a strong pickup in share buybacks, which is a good sign that the CEOs of European companies agree and that their confidence in the future is rising. In the **Performance section**, we look at this trend of outperformance and also provide a reminder that, over the long-term, JEDT and small-caps generally, can generate significant outperformance of the wider market.

Shareholders have also benefitted from discount narrowing, with JEDT's board implementing both conventional share buybacks and a tender offer in 2024, bringing the discount to c. 8%. An additional backstop has been introduced in the form of a performance-related tender in 2029.

It seems likely that markets will spend some time trying to decode what the new US administration means for companies in every region and while it's hard to see smaller companies being immune from bouts of market uncertainty, they can also be a rich source of idiosyncratic returns. A key tenet of JEDT's investment strategy is based on 'momentum' derived from companies beating expectations and, in our view, JEDT's recent performance suggests it could be developing a momentum story of its own.

BULL
Positive absolute and relative performance since the new team took on management of the trust
European smaller companies are at low valuations and are buying back shares
Small-caps can provide idiosyncratic returns and strong recovery potential when interest rates fall

BEAR
Uncertainties about the implications of the new US administration for European equities
JEDT's gearing can amplify losses as well as gains
Macro outlook for Europe is uninspiring

Portfolio

JPMorgan European Discovery (JEDT) aims to generate primarily capital growth through a portfolio of continental European smaller company equities managed using JPMorgan Asset Management's value, momentum, and quality process. Rather than having a specific style bias, this process leads to a constant evolution of the portfolio in different market conditions, although factors such as return on capital—strong and visible cash flows—typically associated with 'quality' are usually favoured across the portfolio. Investors should therefore expect the portfolio to have various value attributes when compared to the benchmark.

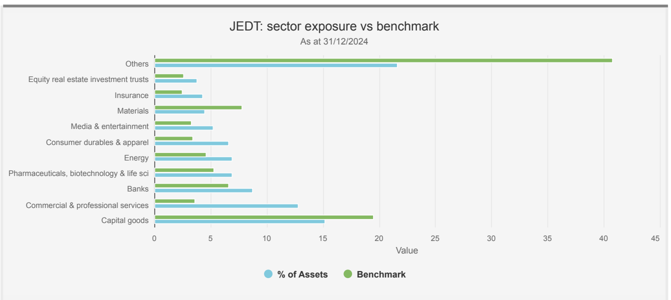
Stocks selected for their value characteristics will typically conform to themes such as a company-specific catalyst for recovery, or a wider market-related cyclical recovery, and the most important measure of value is cash generation. This is a tangible measure of a company's performance rather than a financial metric that can be manipulated. Momentum stocks on the other hand tend to have characteristics such as a fast-growing end market, an acquisition strategy, or a disruptive technology . This process means JEDT has relatively high portfolio turnover, with the team having a rigorous sell discipline and constant reassessment of whether portfolio holdings have met their objectives, or are experiencing deteriorating momentum, for example.

Looking at the big picture, the team continues to note that European equities are trading at much lower valuations than US equities but many offer similar growth potential. European equities' lower valuation than US equities is nothing new but currently is particularly extreme, and nowhere more so than in small-caps. The team notes that as a result, they see more share buybacks than ever before as European companies themselves take advantage of the low valuations of their own shares. A good measure of the value is to look at the cyclically adjusted PE (CAPE) ratio. The CAPE ratio is arguably a more useful version of the traditional PE ratio, using long-term average earnings and adjusting for inflation. This is particularly relevant given we have just been through a period of very high inflation. The team's data shows that over the last 25 years the average CAPE ratio for European smaller companies is c. 18x. However, this is currently just over 13x, a level only seen twice before in that period: in the aftermath of the 'dot com' bubble and after the GFC. Furthermore, small-caps continue to trade at a historically wide CAPE ratio discount to large-caps, even though there have been long periods when the reverse has been true due to small-caps' propensity to grow faster than large-caps. This helps explain why European companies have begun to buy their own shares back, as the valuations look compelling compared to other opportunities to use spare cash.

While the team are primarily stock pickers, they see a few linking secular growth themes as being very important for returns, identifying technology adoption, innovation in healthcare, climate change and growth in consumption in emerging markets, as drivers of long-term returns. Overarching this, the team see the opportunities arising from the adoption of artificial intelligence and further below, looking at the sector and stock selections we can see several professional service businesses likely to be particular beneficiaries of this.

The chart below shows JEDT's main sector exposures against the benchmark. The sectors are more granular than is often the case in these types of analyses. For example, the two largest sectors are often shown together under 'Industrials' and therefore this more granular analysis clearly shows JEDT is overweight Commercial and Professional service businesses and underweight capital goods. That said, the trust's main active decisions come at a stock level, and thus sector weights are less likely to be the main source of returns.

Fig.1: Sector Exposure



Source: JPMorgan Asset Management

The top-ten holdings, c. 24% of the total portfolio, listed in the table below, show this in more detail, showing the corresponding sector for each company, and

Top Ten Holdings

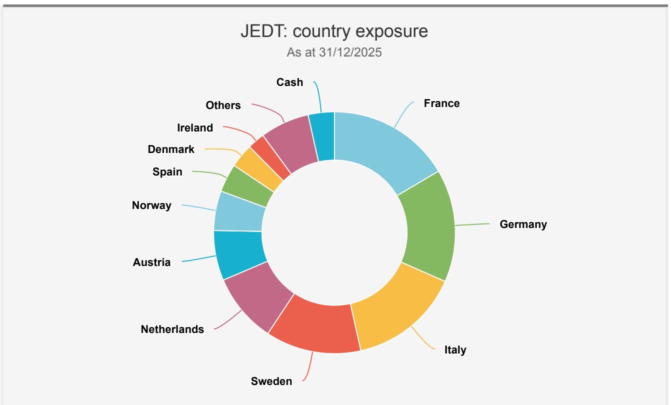
COMPANY	SECTOR	% OF ASSETS
SPIE	Commercial & Professional Services	2.8
Do & Co	Commercial & Professional Services	2.6
Bilfinger	Commercial & Professional Services	2.5
Royal Vopak	Energy	2.5
BAWAG	Banks	2.4
TAG Immobilien	Real Estate Management & Development	2.3
Elis	Commercial & Professional Services	2.3
Cairn Homes	Consumer Durables & Apparel	2.3
Storebrand	Insurance	2.3
AAK	Food, Beverage & Tobacco	2.3

Source: JPMorgan Asset Management as of 31/12/2024 highlighting several service businesses that would often just be classified under the generic 'industrials' label. DO & CO has been one of the strongest contributors to recent performance. The company is an Austrian-based international catering business serving airlines, events, and restaurants and is a good example of where the market has underestimated earnings, resulting in significant momentum and strong share price performance. The team think stocks such as BAWAG and Storebrand, both financial service businesses, are likely to be particular beneficiaries of AI efficiencies in the foreseeable future.

A further example of a recent positive contributor to performance is Cairn Homes, the Irish homebuilder. This is a stock with positive earnings momentum; Cairn's domestic market has, much like the UK, more demand for new homes than supply is currently meeting, and Cairn is benefitting from this. With investors currently fretting about international trade tariffs, this is a good example of where small-caps can offer opportunities idiosyncratic to a specific market.

JEDT's geographical exposure is shown below and this is a good reminder of the diversification potential of small-caps. The large-cap European equity index has become increasingly concentrated with France, Switzerland, and Germany making up 50% of the index, and the largest ten companies 25% of the index. While clearly, the small-cap index features the same countries in the mix, the concentration is lower and in addition, the small-cap index and JEDT provide a different sector mix as well, with higher weightings to industrials, discussed above, and real estate. JEDT has benefitted from real estate in the shorter term as interest rates have fallen, compared to the large-cap index's heavier weighting to healthcare and financials.

Fig.2: Geographical Exposure



Source: JPMorgan Asset Management

Gearing

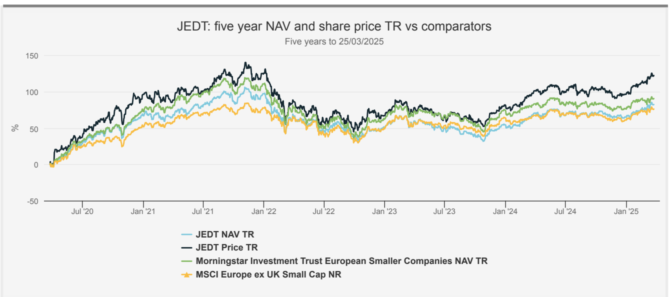
JEDT is currently geared at c. 7%, this having risen a little in the middle of 2024 when it was c. 4%, and a little higher than the long-term average of c. 6%. Decisions on gearing are led by fundamentals and the rise in gearing is a reflection of the team's current views on valuations discussed in the **Portfolio section**.

JEDT's formal policy on gearing is to allow a range of between 20% cash and 20% net geared, with the trust using a short-term multicurrency revolving credit facility, which gives the flexibility to adjust gearing dynamically, using the most appropriate currency.

Performance

Over the last five years , JEDT's NAV TR was c. 82% and the share price TR was c. 121% compared to a NAV TR of c. 90% for the Morningstar European Smaller Companies peer group and c. 75% for JEDT's benchmark. Shorter term, over one year, JEDT's NAV and share price TR of c. 8% and c. 12% respectively are ahead of the peer group NAV TR, c. 5% and benchmark, c. 6%.

Fig.3: Five-Year Performance

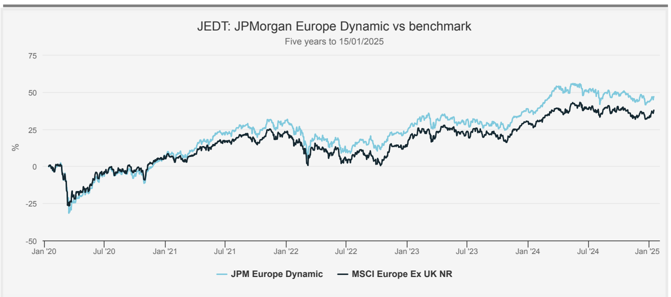


Source: Morningstar

Past performance is not a reliable indicator of future results.

With the changes to the team managing JEDT implemented a year ago, some context to performance is given by looking at the performance of the most comparable fund managed by Jon Ingram, the JPM Europe Dynamic fund, which has a five-year total return of c. 115%. This differs from JEDT in that it is an all-cap fund, and the performance

Fig.4: JPmorgan European Dynamic Fund Performance



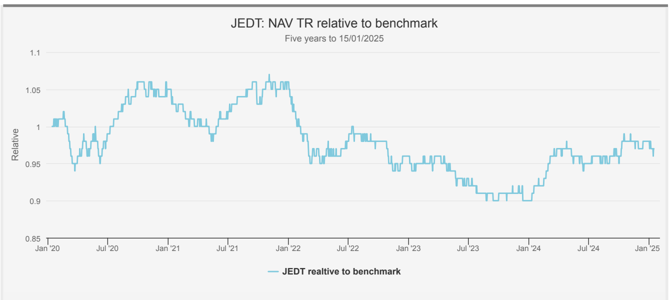
Source: Morningstar

Past performance is not a reliable indicator of future results.

is ahead of both the small- and large-cap indices over this period. The chart below shows this fund's performance against its benchmark.

The chart below shows JEDT's NAV TR performance relative to the benchmark, so a line sloping up left to right indicates outperformance and vice versa. Again, it is a relatively short space of time, but the chart shows that a period of outperformance has coincided with the changes to the management team.

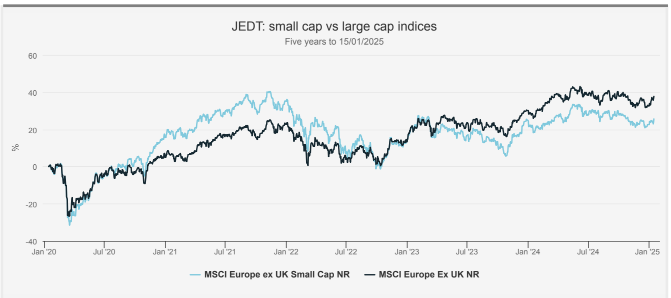
Fig.5: Relative Performance



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

In the Portfolio section, we discuss the team's view that small-caps remain undervalued compared to large-caps, and indeed European equities generally are undervalued compared to US equities. The chart below simply shows the two small- and large-cap indices over the last five years, illustrating that small-caps have, as an asset class, underperformed large-caps, exacerbating that valuation gap.

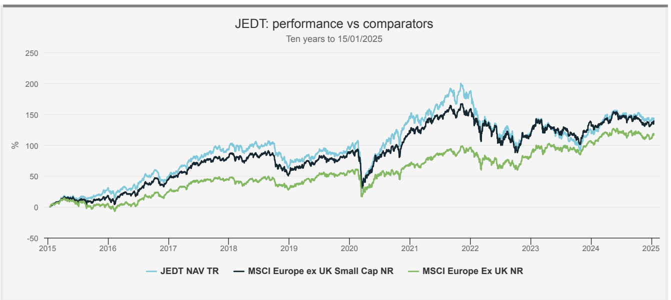
Fig.6: Small-Cap Vs Large-Cap



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

The next chart expands the time series to ten years and highlights that over the longer term, smaller companies have outperformed larger companies. The chart shows JEDT's NAV TR, c. 133%, against its benchmark, c. 125%, and the equivalent large-cap index, c. 109%. It is also a good reminder that over the long term, small-caps have the potential to deliver higher growth than large-caps. Historically, small-caps perform well at the tail end of periods of inflation, when interest rates are falling, and this may be one reason why, in the last year, JEDT's performance has been better than large-caps.

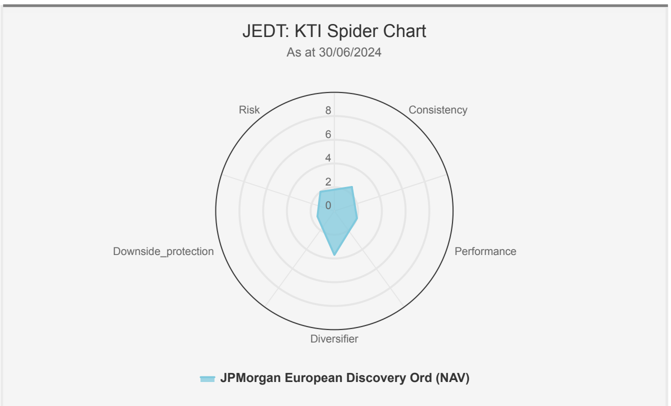
Fig.7: Ten-Year Performance Vs Comparators



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

In our proprietary spider chart below, JEDT's performance is analysed against an expanded peer group of all European and European smaller companies trusts over the past five years in some key categories. Each category is scored out of ten based on rolling 12-month returns over the last five years, 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. The underperformance of small-caps as an asset class is one of the main factors contributing to JEDT's relatively low scores, with other smaller companies trusts showing a similar pattern. In our view, quantitative analysis such as this can only be useful if read in context, which in this case is that smaller companies have, as an asset class, underperformed large-caps for well-explored macro reasons, creating the valuation anomalies discussed in the **Portfolio section**. Therefore, quantitative analysis such as this can, in our view, be just as valid for identifying turning points in performance as it can be for highlighting historic track records.

Fig.8: KTI Spider Chart



Source: Kepler Trust Intelligence, Morningstar
Past performance is not a reliable indicator of future results.

Dividend

JEDT's current yield is 2.1%. The trust pays dividends twice yearly and the board's policy is to pay out substantially all revenue received in the year. Since the goal is primarily capital growth, JEDT does not have a progressive dividend policy and dividends can be considered an output of the investment process rather than an objective of it.

Illustrating that JEDT will not necessarily pay a progressive dividend, from 2018 to 2023 JEDT paid the same 6.7p dividend. The last two years have seen increases to 9.0p and 10.5p but the board continues to guide investors not to anticipate annual dividend increases. JEDT's current buyback programme, discussed in the **Discount section** should, for the current year, help enhance earnings per share although this enhancement only persists during the financial year shares are repurchased, something we discussed in a recent article you can **read here**.

Management

Starting on 01/03/2024, JEDT is managed by Jules Bloch, Jack Featherby and Jon Ingram. This followed a review by the board and JPMorgan Asset Management.

Jules Bloch, Vice President, is a portfolio manager in JPMAM's European small-cap specialist investment team and currently manages a number of European small-cap mandates, both in fund structures and in segregated mandates, including the c. €120m Europe Dynamic Small Cap Fund. An employee since 2017, Jules was previously an investor analyst within JPMorgan Private Bank. He holds a master's in management from the EDHEC Business School and a Diploma in Accounting and Finance from the London School of Economics and Political Science. He is also a CFA charter holder.

Jack Featherby, Executive Director, is a portfolio manager in JPMAM's European small-cap specialist investment team and currently manages a number of European small-cap mandates, both in fund structures and in segregated mandates. Jack manages the c. €500m Europe Sustainable Small Cap Equity Fund, which has outperformed its benchmark since its launch in December 2019. Jack has been with JPMAM since 2018 and previously held merger and acquisitions advisory roles with Rothschild and Wells Fargo. Jack holds an M.Eng in Materials, Economics, and Management from the University of Oxford and is a CFA charter holder.

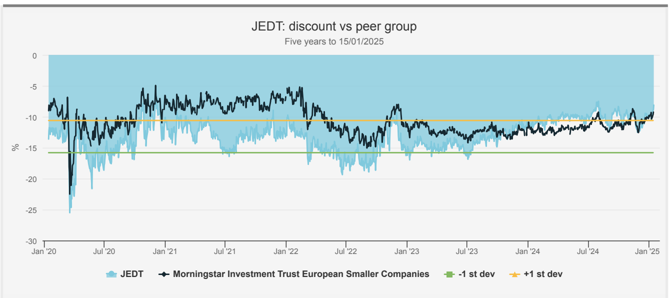
Jon Ingram has been with the firm for 24 years and has a strong record of outperformance. In the **Performance section**, we look at the performance of Jon's most relevant fund, the JPMorgan European Dynamic fund, which is an unconstrained fund that, unlike, JEDT, invests across the market cap spectrum.

The team has numerous tools and resources available to it, and JPMorgan Asset Management has a large global team of analysts covering c. 2,500 companies, together with other specialists such as data scientists and ESG specialists who can furnish them with decision-making tools and information, but the ultimate judgement on what companies to own rests with the team. The value, momentum, and quality process is well-established across a number of equity mandates at JPMAM, including some of its other investment trusts, such as JPMorgan European Growth & Income (JEGI), and there is no plan for the new team to reinvent this, but they do see this as an opportunity to reassess how portfolio decisions are made. It's not uncommon, particularly at larger firms such as JPMAM, for regular analysis and reviews to be held of investment decisions made, but the team observe that very often these reviews only involve looking at trades that were executed, either buying or selling. However, they keep formal records of all decisions made, including decisions not to buy or sell, which would not be captured in trading data, and which allows a much more holistic review to be undertaken, e.g. asking why a particular stock wasn't bought, which they can learn from. In our view, this is a nice example of how one can have access to vast arrays of data, but the application of commonsense on top of that can add a great deal of value to whatever analysis is undertaken on that data.

Discount

JEDT's current discount of c. 8% is narrower than the Morningstar European Smaller Companies peer group average of c. 9% and significantly narrower than JEDT's five-year average discount of c. 13%. Given that JEDT's peer group is made up of just four trusts, the average is the arithmetic rather than the weighted average, as the peer group's largest constituent, the European Smaller Companies Trust (ESCT), is c. 40% of the total. ESCT has seen significant recent discount narrowing, driven by as yet unresolved negotiations with corporate activist Saba Capital. Saba Capital has an announced holding of 13.98% in JEDT, reduced from 14.01%.

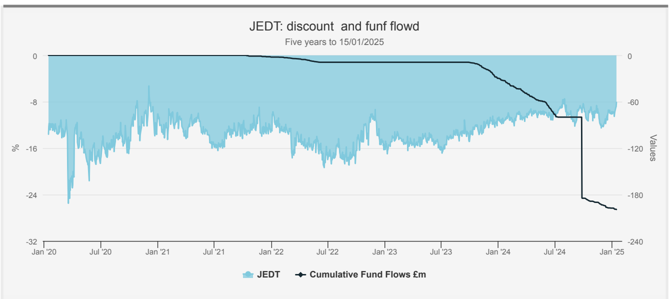
Fig.9: Discount Vs Peer Group



Source: Morningstar

The next chart shows the discount against the cumulative total of fund flows, with a descending black line indicating share buybacks (an ascending line would indicate share issuance). Over the course of calendar year 2024, the board spent c. £167m on buybacks, including implementing a tender offer for 15% of the shares in issue in September, which returned c. £104m to shareholders at a discount of 2% (less costs of the tender). The board has continued to buy shares back in the market following the tender offer.

Fig.10: Discount And Buybacks



Source: Morningstar

JEDT also has a performance-related tender offer, which would be triggered if JEDT's NAV total return was less than the benchmark total return over a five-year period, ending 31/03/2029.

Charges

JEDT's management fee is 0.75% of net assets. The ongoing charges figure (OCF) of 0.92% compares to the AIC European Smaller Companies peer group average of 0.91%, with JEDT the second lowest in the group. If JEDT were to own other JPMorgan-managed funds, there would be no double charging, although, at the time of writing, there are no funds in the portfolio (although JEDT itself is owned by stablemate JPMorgan European Growth and Income (JEGI)).

JEDT's KID shows 'n/a' for the RIY figure. The disclosure regulations around the KID RIY are currently under review and may be dropped or amended. Recording an 'n/a' is one approach being taken by investment trusts as an interim measure.

ESG

JEDT is assigned an 'above average' rating for ESG from Morningstar, using portfolio analytics to compare it to its entire database of European smaller companies equity funds. JEDT is not marketed as an ESG product .

The team conforms to JPMAM's integrated approach to ESG, treating financially material ESG factors as integral to investment decisions alongside other factors, with over 2,500 companies globally covered by the firm's checklist of 40 questions, which aims to capture consistent quantitative data on ESG factors. Co-manager Jack Featherby currently manages other ESG-specific strategies, bringing that direct experience to the JEDT team.

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