European Opportunities Trust

Consistent, resilient trust returning to form

Investment trusts
European equities

European Opportunities Trust's (EOT's) manager, Alexander Darwall, invests in globally focused companies with unique technologies, favourable industry structures and multiple growth channels, with the aim of constructing a resilient portfolio capable of generating capital growth in all economic climates. EOT's long-term performance is strong in absolute and relative terms, with average annualised returns of 11.4% on an NAV basis and 10.2% in share price terms over the 10 years to end-July 2022. This compares with a benchmark total return of 9.2%. Recent performance has improved notably after some setbacks in 2020 and 2021, providing confirmation of Darwall's stock selection skills and vindication of his consistent, high-conviction, patient investment approach.

Long-term NAV outperformance versus the benchmark, MSCI Europe

Source: Refinitiv, Edison Investment Research. Note: Total returns in sterling.

The analyst's view

- EOT's track record of long-term capital growth and outperformance is evidence of Darwall's stock selection skills. This, combined with the recent improvement in returns, may appeal to investors.
- The manager's focus on innovative, world-leading, growth-oriented companies may appeal to those keen to invest in 'tomorrow's winners'.
- The trust targets resilient businesses, which are relatively immune to high input costs, rising interest rates and weak consumer demand. This may attract investors seeking exposure to companies capable of thriving even in the current challenging economic environment.
- Darwall has proven skills in the tactical use of gearing to enhance performance over the business cycle.
- EOT's historically wide share price discount to cum-income NAV has scope to narrow if performance continues to improve and/or as investors come to appreciate the relative value EOT's shares offer at their current, historically wide levels. In the meantime, investors may see a rare opportunity to gain exposure to high-quality, growth-oriented stocks at a particularly attractive price.
- EOT's focus on capital growth means that it does not receive, or pay, significant dividends. This low-dividend policy may detract from the trust's appeal for those requiring regular and attractive income.

NOT INTENDED FOR PERSONS IN THE EEA

17 August 2022

Price		**732.0p**
Market cap		**£746m**
AUM		**£889m**
NAV*		867.2p
Discount to NAV		15.6%
*Including income. At 15 August 2022.		
Yield		0.3%
Ordinary shares in issue		101.9m
Code		EOT
Primary exchange		LSE
AIC sector		Europe
52-week high/low	891.0p	644.0p
NAV* high/low	987.1p	747.2p
*Including income		
Net gearing*		7.9%
*At 31 July 2022		

Fund objective

The objective of European Opportunities Trust (EOT) is to invest in securities of European and UK companies, in sectors or geographical areas that are considered by the investment manager to offer good prospects for capital growth, taking into account economic trends and business development.

Bull points

- A focus on 'special', high-quality growth companies capable of succeeding despite short-term economic vicissitudes.
- An experienced, high-conviction manager with a track record of outperformance over the long term and a significant personal holding in the trust's shares.
- A historically wide discount offers investors a potentially attractive entry point.

Bear points

- It may take time for the manager to rebuild investor confidence after underperformance in 2020 and 2021.
- The trust will lag the benchmark at times when cyclical and value stocks are in favour with investors.
- EOT's relatively high concentration may not appeal to some investors

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Edison profile page

European Opportunities Trust is a research client of Edison Investment Research Limited

Fund profile: High conviction investment in quality

EOT was launched by Jupiter Asset Management in November 2000 and is now managed by Devon Equity Management (see our initiation note for details). Alexander Darwall, Devon's chief investment officer, has managed the fund since its inception, first at Jupiter and subsequently at Devon, under the same investment strategy adopted at the trust's launch. The trust changed its ticker to EOT from JEO in November 2021.

EOT's objective is to invest in securities of European companies, including UK, and in sectors or geographical areas that are considered by the manager to offer good prospects for capital growth, taking into account long-term economic trends and business development. Darwall characterises these portfolio holdings as 'special', globally focused companies, that benefit from unique technologies or favourable industry structures and possess multiple growth paths. EOT's benchmark is the MSCI Europe TR GBP Index, although the manager is not tied to investing in the benchmark's constituent companies.

The trust invests primarily in equity and equity-related securities of issuers that have their registered office in Europe or conduct the predominant part of their economic activities in Europe (including the UK). Darwall employs an active, bottom-up approach to selecting investments. The portfolio is relatively concentrated, consisting of around 30 high-conviction investments. Its top 10 holdings usually represent around 70% of assets under management. The company is a member of the AIC Europe sector. It uses gearing tactically and has access to an unsecured committed £125m multi-currency revolving credit facility with Scotiabank, at 65bp above Libor.

The fund manager: Alexander Darwall

The manager's view: Future is bright despite economic gloom

EOT's recent performance has improved notably after a rare period of disappointing performance during 2020 and 2021 when the trust's high-quality and growth focused companies lagged more economically sensitive stocks. Returns were also undermined by the trust's exposure to the Wirecard fraud which came to light in June 2020 (discussed in our September 2021 initiation note and March 2022 update). Manager Alexander Darwall views the recent improvement in performance as vindication of his consistent, high-conviction, long-term investment approach. Many of the 'special' companies that comprise EOT's portfolio have been performing well, in some cases exceeding Darwall's expectations. He is particularly pleased that the improvement in the trust's performance is being driven by gains from many areas of the portfolio, including healthcare (Novo Nordisk and Bayer), energy (Neste and Gaztransport et Technigaz (GTT)), stock exchanges (Deutsche Boerse) and food (Mowi) – see details below.

Darwall is also upbeat about the future, as he believes that many of EOT's portfolio holdings have addressable markets that are set to grow strongly over the medium term. He cites as one example the trust's largest holding, Novo Nordisk, a Danish pharmaceutical company (12.6% of the portfolio, see Exhibit 1). Novo Nordisk has recently launched a revolutionary anti-obesity drug, Wegovy, whose efficacy is being acclaimed widely. Darwall says that Novo Nordisk is presently 'only in the foothills of the global obesity drug market', with many years of strong and rising demand ahead. Novo Nordisk is also one of the world's two major suppliers of treatments for diabetes, a disease that is afflicting a growing number of people in industrialised countries. In Darwall's view, it is 'very unusual to have the chance to invest in a company with such a compelling investment case. The strategy, the varied product offerings, the pipeline and the management amount to a truly exceptional opportunity.'

EOT's manager is equally confident about the medium-term growth prospects of Experian, EOT's second-largest position. This Irish company provides credit data services mainly to other businesses, but it is developing new consumer products that have become an additional driver of growth, and still have a 'long way to go', according to Darwall. Experian is also benefiting from its exposure to Brazil. This is one of the company's key markets, whose large and buoyant farming sector is supporting demand for Experian's digitalised agricultural credit services.

Neste, a Finnish producer of renewable diesel and sustainable aviation fuel, is another smaller portfolio holding where EOT's manager sees a 'realistic opportunity' for significant long-term growth. It is inevitable that demand for sustainable fuels will increase as the world transitions to a low carbon future, and Neste is well-positioned to grow accordingly. Darwall is further encouraged by Neste's efforts to boost its market penetration, including a major strategic alliance with a US partner which assures the production and distribution of its renewable diesel products on the West Coast. The severe shortage of traditional oil refining capacity in Europe is also supporting Neste's performance. Its latest results were 'extraordinarily strong', says Darwall, and better than expected, and he has added modestly to the trust's position.

EOT's manager chooses companies such as Novo Nordisk, Experian and Neste not just for their medium- to long-term growth prospects, but also for their resilience, which should allow them to flourish regardless of the prevailing economic climate. Specifically, he looks for companies with strong pricing power, healthy cashflows, low borrowings, limited reliance on consumer demand and multiple sources of growth. He believes these characteristics reduce the risks of rising costs, higher interest rates and slower growth posed by the current, challenging economic climate, and will help ensure EOT maintains its record of delivering capital growth for shareholders over the long term.

Asset allocation

Current portfolio positioning

Darwall's long-term, high-conviction approach means that EOT's portfolio turnover is usually relatively low. Several stocks – including Novo Nordisk, Dassault Systèmes, a French software company, and RELX, a UK business information and analytics company – have been held since inception and EOT has owned over half its holdings for more than six years. The portfolio has not changed materially over recent years, apart from the disposal of some travel-related stocks at the onset of the coronavirus pandemic.

Clearly, Darwall is prepared to give investments the time they need to realise their growth potential and maximise their valuations, and he is willing to ride out near-term bad news where he believes a company's long-term investment case remains robust. He cites GTT, a French company which provides containment systems for the transportation of liquified natural gas (LNG), as evidence of how his patience can pay off. Darwall purchased this company in September 2019, in part motivated by the monopolistic power it commands in the global market for gas transport. He also expected demand for LNG to increase as the world transitions to less carbon-intensive energy sources. This expectation was recently realised when the European Union formally categorised LNG as a transition fuel, as part of a plan to encourage investment in clean energy. In addition, Russia's invasion of Ukraine triggered a sharp rise in GTT's share price, as energy prices soared. GTT was the second-largest contributor to EOT's performance over the six months to end-June 2022.

In other cases, such as Genus, a UK animal genetics company which is a world leader in its field, Darwall's patience is yet to be rewarded. Genus's offerings include a treatment for one of the main porcine respiratory diseases. This treatment is undergoing trials. The manager expects the successful conclusion of these trials to be followed by government approval, first in the US, then in

Japan and China, where its commercial potential is particularly significant given the size of the Chinese market. These developments would 'massively transform the company's prospects', says Darwall, potentially doubling the size of the company and bolstering profitability accordingly.

However, none of this potential is captured in Genus's current share price. It declined by more than 60% in H221, in response to China's severe lockdowns, which weakened the domestic pork market, and the share price has stayed low this year, making Genus the portfolio's poorest performer over the six months to end-June 2022. Yet Darwall remains committed to the stock, which he views as 'significantly undervalued' at current levels. In fact, he made a small addition to the portfolio's holding in July and is biding his time until the Chinese pork market revives once lockdowns end, and government approvals for Genus's game-changing treatment are granted.

Overall, the manager is very comfortable with the portfolio as it stands. This is reflected in the fact that portfolio turnover (defined as total sales divided by average total assets over the past 12 months) was 18% during the 12 months to end-July 2022, lower than in recent years. Darwall hopes his confidence – and patience – will be matched with higher valuations in due course, as they have been in the past. Meantime, recent portfolio activity has been limited, with only small reductions in exposure to some of the trust's largest positions, including Novo Nordisk, RELX, Dassault Systèmes and Experian.

No significant new positions have been added to the portfolio in recent months. The proceeds of the sales have been used in part to make small top-ups to existing holdings where Darwall believes valuations have reached especially attractive levels. In addition to minor purchases of Neste and Genus, mentioned above, he has added to positions in Deutsche Boerse, the German exchange operator and Oxford Instruments, a UK manufacturer of machinery used in the production of semiconductors. He has also topped up exposure to Darktrace, a UK cybersecurity company that has a unique process which uses machine learning to protect commercial systems from cyber threats. Darktrace has given upbeat guidance for forthcoming results and has set up a US Federal Division with the ambition of winning US government contracts in future.

The proceeds of recent portfolio sales have also been deployed to reduce EOT's net borrowings by around £19m. Accordingly, gearing stood at 7.9% at end-July 2022, down from 10.5% the previous month. This compares with 3.9% at end-July 2021. The manager adopts a tactical approach to gearing, increasing it during periods in which he believes valuations are excessively low, as has been the case during H122, to enhance performance as valuations recover. This approach has added sustained value over the course of the trust's life. However, Darwall remains cautious about the use of debt, and as in previous cycles, he has begun to reduce portfolio gearing recently, as performance has improved.

Exhibit 1: Top 10 holdings (at 31 July 2022)

			Portfolio weighting (%)		
Company	**Country**	**Industry**	**31 July 2022 (%)**	**31 July 2021 (%)***	**Change (%)**
Novo Nordisk	Denmark	Pharmaceuticals	12.6	11.1	0.3
Experian	UK	Credit data provider	10.4	10.6	(1.1)
RELX	Netherlands	Publishing	9.9	8.6	0.4
Dassault Systemes	France	Software	9.1	9.2	(0.9)
BioMerieux	France	Pharmaceuticals	6.7	5.0	1.0
Deutsche Boerse	Germany	Stock exchanges	6.4	5.1	0.7
Genus	UK	Animal genetics	5.1	8.1	(3.4)
Bayer AG	Germany	Pharmaceuticals	4.9	N/A	N/A
Edenred	France	Credit services	4.8	N/A	N/A
Intermediate Capital Group	UK	Financials	4.2	7.8	(4.0)
Top 10 (% of holdings)			**74.1**	**74.6**	

Source: European Opportunities Trust, Edison Investment Research. Note: *N/A signifies that the company was not among EOT's top 10 holdings at end July 2021.

The manager's high-conviction approach results in a very concentrated portfolio that usually holds only around 30 stocks. Positions thus tend to be large relative to the benchmark. EOT's top 10 holdings comprise 74% of total net assets, unchanged from a year before, although these stocks are drawn from a wide range of industries, as illustrated in Exhibit 1. At the sector level, around 60% of the portfolio is held in the healthcare and tech sectors (Exhibit 2), significantly above the benchmark. The portfolio is more modestly overweight industrials and energy, while the most notable underweights are in consumer sectors, financials, utilities and materials.

Exhibit 2: Portfolio sector exposure at 31 July 2022 (% unless stated)

Sector	Portfolio weight 31 July 2022	Portfolio weight 31 July 2021	Change (pp)	MSCI Europe	Active weight vs benchmark (pp)
Healthcare	34.4	29.3	5.1	16.0	18.4
Information Technology	25.2	26.4	(1.2)	7.3	17.9
Industrials	16.7	19.7	(3.0)	14.6	2.1
Financials	7.4	13.4	(6.0)	15.3	(7.9)
Energy	6.5	3.3	3.2	6.1	0.4
Consumer Staples	4.1	2.8	1.3	13.9	(9.8)
Materials	4.0	2.5	1.5	7.1	(3.1)
Consumer Discretionary	1.7	2.0	(0.3)	10.4	(8.7)
Consumer Services	0.0	0.6	(0.6)	3.8	(3.8)
Utilities	0.0	0.0	0.0	4.3	(4.3)
Real Estate	0.0	0.0	0.0	1.1	(1.1)
Total	**100.0**	**100.0**		**100.0**	

Source: European Opportunities Trust, Edison Investment Research

The portfolio is geographically well-diversified. It is modestly overweight the UK and France, although it has a significant underweight to Switzerland. However, this breakdown by country of listing does not tell the whole story regarding the extent of the portfolio's geographical diversity beyond Europe and the UK. When the portfolio is broken down according to regional sales, sales to Europe comprise only 40% of the total. Sales to North America – mainly the United States – are the second largest, at 35% of the total sales. Sales to North America, and other non-European markets, have almost doubled over the past decade. EOT does not hold any stocks listed in Russia or Ukraine, and although a few portfolio positions, including Genus and Bayer, a German agri-chemical and pharmaceutical company, have operations in Russia and Ukraine, EOT's manager believes this exposure is not significant to these companies' prospects.

Performance: Recent uptick vindicates conviction

Exhibit 3: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	MSCI Europe (%)	MSCI Europe ex-UK (%)	CBOE UK All Cos (%)
31/07/18	19.6	17.3	6.8	6.1	9.1
31/07/19	3.8	8.6	4.3	5.0	1.1
31/07/20	(20.2)	(15.2)	(7.4)	(2.8)	(18.5)
31/07/21	19.7	22.2	25.7	26.4	26.4
31/07/22	(7.1)	(5.1)	(2.3)	(6.5)	6.1

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

EOT's one-, three- and five-year performance track record has been adversely affected by its poor performance during 2020 and 2021 (discussed above). However, its long-term absolute and relative performance has been strong. In the 10 years to end-July 2022, the trust's annualised total return has been 11.4% in net asset value (NAV) terms and 10.2% on a share price basis, compared to an annualised return of 9.2% on the trust's benchmark, the MSCI Europe Index (Exhibit 4, right-hand side). EOT has also outpaced the UK market, represented here by the CBOE All Companies Index, on both an NAV and share price basis over 10 years – an illustration for UK-based investors of the merits of diversification away from the home market (Exhibit 5).

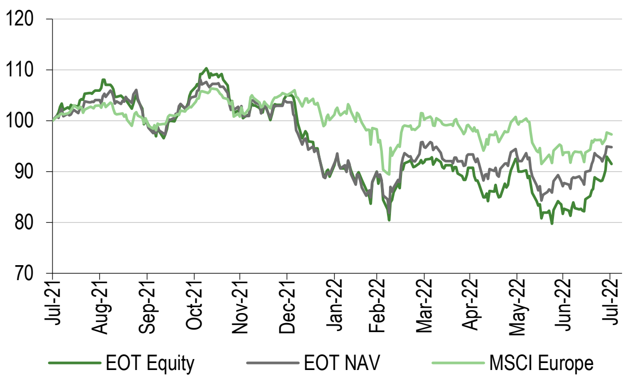
EOT's recent performance has improved. In July 2022, the trust returned an impressive 9.0% in NAV terms and 13.8% on a share price basis, compared to a return of 4.8% on the trust's benchmark. In the six months to end-July 2022, the trust's NAV increased by 3.6%, while its share price increased 1.9%. This compares to a 3.4% decline in the benchmark. The improvement in performance over the six months to end-July has been driven by gains in several of EOT's largest positions, led by Novo Nordisk. Historically, the market for its diabetes treatment has been unaffected by recession, and its new anti-obesity drug, Wegovy, is in high demand. Bayer, another company that Darwall likes due to its heavy investment in research and development, also made a notable contribution to returns over the period. Bayer, another top 10 holding, has been dogged by lawsuits that kept the share price under pressure throughout 2021. However, management maintains that it has now made full provision for any adverse rulings, and the share price rose sharply in March 2022 thanks to the jump in commodity prices, which boosted the prospects of Bayer's crop protection products.

GTT (discussed above) was another significant contributor to performance, along with Deutsche Boerse, another top 10 holding. Deutsche Boerse has benefited from recent volatility and uncertainty in energy markets, which has increased the appeal of on-exchange trading facilities offered by commodity exchanges such as Deutsche Boerse. Mowi, a Norwegian salmon farmer, also added to returns. Its share price rose in the early months of 2022 due to continued strong growth in demand for its products, combined with limited supply, which saw profits reach a record high in Q122.

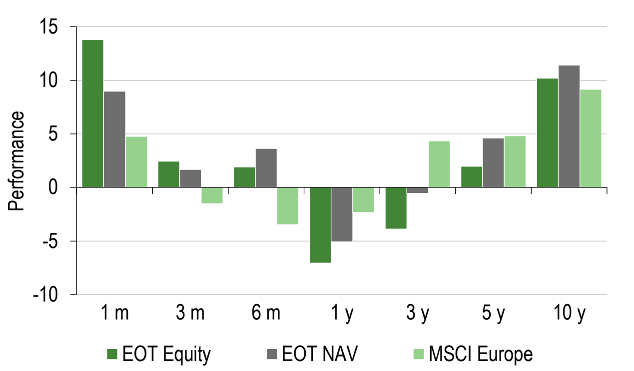
The gains from these, and several other positions, including an underweight to the Dutch semiconductor producer ASML, were only partially offset by negative contributions from several other holdings, most notably Genus and Experian. As discussed above, Genus was hit by weakness in the Chinese pork market, while investors sold Experian on the view – misguided in Darwall's opinion – that the company is heavily exposed to rising US mortgage rates, which could be impacted by waning demand. EOT's overweight to technology also hurt performance over the past six months to July, as several of its tech holdings were caught up in the sector's general sell-off. Shares in Dassault Systèmes, Infineon Technologies, a German semiconductor producer, and Soitec, a French producer of silicon-on-insulator (SOI) wafers, which are a key component in smartphones, all saw sharp falls. However, true to form, Darwall is unfazed by this short-term market volatility and has maintained his exposure to each of these names, on the basis that their underlying performance has been good and their long-term growth prospects remain attractive.

Exhibit 4: Investment fund performance to 31 July 2022

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



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



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

Exhibit 5: 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	8.6	4.0	5.5	(4.8)	(21.9)	(12.9)	9.9
NAV relative to MSCI Europe	4.0	3.2	7.3	(2.8)	(13.5)	(1.0)	22.6
Price relative to MSCI Europe ex-UK	8.2	4.4	7.8	(0.6)	(22.7)	(13.8)	(0.8)
NAV relative to MSCI Europe ex-UK	3.6	3.6	9.6	1.5	(14.4)	(2.1)	10.7
Price relative to CBOE UK All Cos	9.0	3.3	1.3	(12.4)	(18.8)	(8.7)	32.2
NAV relative to CBOE UK All Cos	4.4	2.6	3.0	(10.5)	(10.0)	3.8	47.5

Source: Refinitiv, Edison Investment Research. Note: Data to end-July 2022. Geometric calculation.

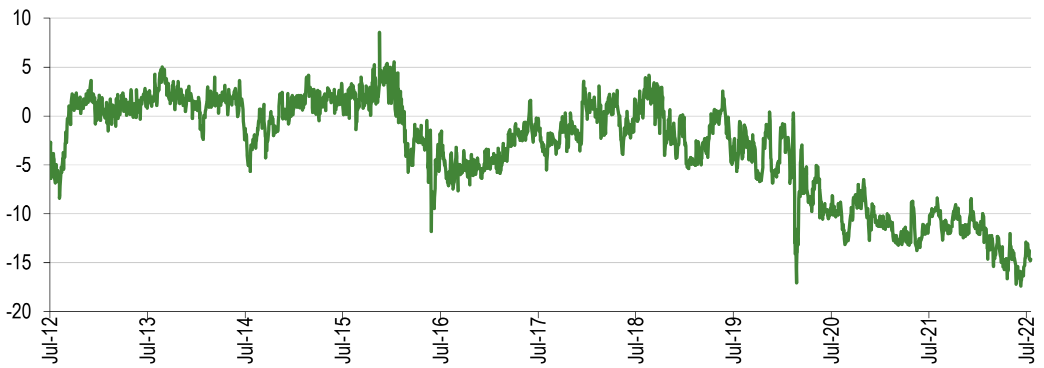
Discount: Wide discount could offer an attractive entry

EOT's shares have traded at a modest discount to its cum-income NAV over the long term, with the discount averaging 3.3% over 10 years. The onset of the pandemic in 2020 saw the discount of many investment trusts, including EOT, widen sharply for a brief period. Between March 2020 and the Russian invasion of Ukraine in February 2022, EOT's discount established a new trading range around 10%. Consistent with the experience of many investment trusts, the outbreak of war in Ukraine triggered a further widening in EOT's discount and it is currently trading at 15.6% (Exhibit 6).

EOT's board actively manages the trust's discount and is committed to maintaining it in single figures in normal market conditions. During the financial year ended May 2022, the trust repurchased a total of 4.1m shares to support the share price. Since then, it has repurchased a further 0.7m shares.

The board's consistent efforts to support the share price may narrow the discount over time, especially if performance maintains its recent improvement and/or as investors come to appreciate the relative value EOT's shares offer at their current, historically wide discount.

Exhibit 6: Premium/discount over 10 years (NAV including income)



Source: Refinitiv, Edison Investment Research

Peer group comparison

EOT is one of seven members of the AIC Europe sector (Exhibit 7). More than half of these trusts share EOT's focus on growth rather than income, but EOT is unique in several ways. As discussed above, portfolio concentration is relatively high, due to the manager's high-conviction approach. The trust usually only holds around 30 stocks, and its top 10 holdings normally comprise around 70% of portfolio value, compared to around 40% among EOT's peers. Unlike most of its peers, EOT also has a sizable exposure to UK-listed companies, as Darwall prefers to hold the best stock in its sector, even if it happens to be UK-listed. These distinguishing features mean that EOT's portfolio is markedly different to those of its peers, with few, if any, stocks in common.

Exhibit 7: Selected peer group at 17 August 2022*

% 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
European Opportunities Trust	746.0	(7.0)	1.8	21.4	184.8	(15.6)	1.0	No	108	0.3
Baillie Gifford European Growth	340.6	(33.7)	25.1	9.7	120.4	(13.4)	0.7	No	111	0.4
BlackRock Greater Europe	490.7	(23.4)	32.9	58.7	227.2	(4.9)	1.0	No	98	1.3
Fidelity European Trust	1,233.0	(4.0)	32.4	50.9	195.2	(9.3)	0.8	No	111	2.3
Henderson European Focus Trust	296.9	(8.4)	25.4	29.4	205.3	(14.1)	0.8	No	108	2.4
Henderson EuroTrust	258.5	(16.0)	19.7	29.7	198.7	(15.2)	0.8	No	103	2.0
JPMorgan European Growth & Income	353.4	(7.3)	22.3	22.9	176.6	(13.8)	1.3	No	103	4.9
Simple average	**531.3**	**(14.3)**	**22.8**	**31.8**	**186.9**	**(12.3)**	**0.9**		**106**	**1.9**
EOT rank in peer group	**2**	**2**	**7**	**6**	**5**	**7**	**3**		**3**	**7**

Source: Morningstar, Edison Investment Research. Note: *Performance at 16 August 2022 based on ex-par NAV. **Ordinary shares only. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

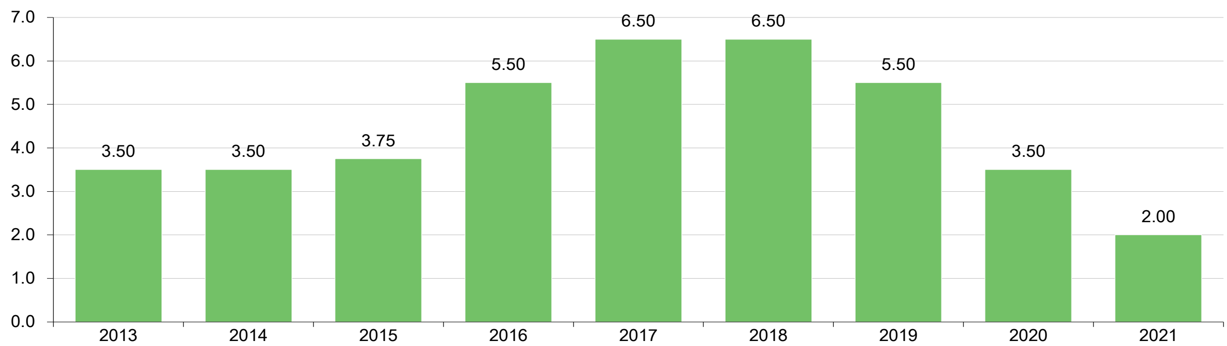
This means that comparing EOT with its so-called peers provides limited insight. However, for the sake of completeness, EOT is the second-largest fund in its sector. Its NAV total return has exceeded the sector average over one year and almost matched it over 10 years. The trust has the widest discount, while its ongoing charge is slightly higher than average. Like its peers, it does not charge a performance fee. EOT's use of gearing is higher than the sector average, but as discussed above, the manager has begun to reduce gearing and it is likely to fall further in the coming months.

Dividend

EOT's objective is to achieve capital growth, rather than income. And the trust invests in companies focused on structural growth. These investee companies tend to reinvest their earnings in further growth, rather than pay dividends to their shareholders, so the dividends EOT receives from its investments tend to be low. EOT's policy is to pay out income equal to 85% of this investment income, the minimum required by legislation to maintain its investment trust status. This means that the trust's dividend is quite low in absolute terms, and relative to its peers, and does not usually make a significant contribution to total returns. As can be seen from Exhibit 8, the dividend may fluctuate in line with its investment income.

In the financial year to end-May 2021, the company paid a final dividend of 2.0p per share, down from 3.5p per share in the previous financial year. The dividend for the year to end-May 2021 represents a yield of 0.3%, based on the current share price. EOT makes one final dividend payment per year. It is expected to announce its final dividend for the current financial year ended May 2022 at the time of publication of its annual results, in September 2022. Subject to the agreement of shareholders at the annual general meeting, the dividend will be paid in November 2022.

Exhibit 8: Dividend, pence per share (£)



Source: European Opportunities Trust

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