Jupiter UK Growth Investment Trust

Recovery potential for UK equities

Investment trusts
UK equities

13 May 2019

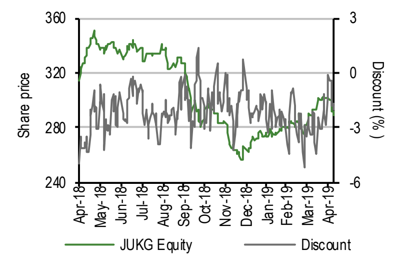
Price	**289.0p**
Market cap	**£50.4m**
AUM	**£69.8m**

NAV*	287.5p
Premium to NAV	0.5%
NAV**	294.9p
Discount to NAV	2.0%

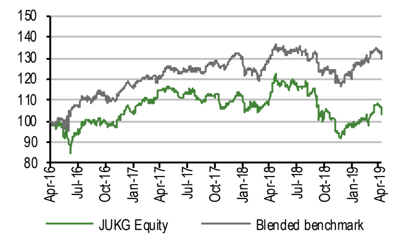
*Excluding income. **Including income. As at 2 May 2019.

Yield	2.4%
Ordinary shares in issue	17.4m
Code	JUKG
Primary exchange	LSE
AIC sector	UK All Companies
Benchmark	FTSE All-Share

Share price/discount performance



Three-year performance vs index



52-week high/low	352.0p	257.0p
NAV** high/low	355.4p	259.2p

**Including income.

Gearing

Gross*	18.2%
Net*	10.3%

*As at 30 April 2019.

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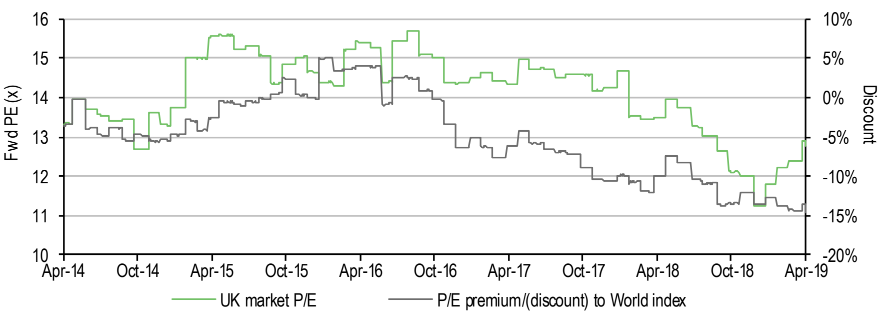
Jupiter UK Growth Investment Trust is a research client of Edison Investment Research Limited

Jupiter UK Growth Investment Trust (JUKG) aims to generate long-term capital growth, primarily through investing in UK-listed equities. The fund manager, Steve Davies, follows a detailed and fundamental approach to find companies with growth or recovery potential. Unconstrained by benchmark considerations, he is not afraid of being contrarian, and his approach is patient and highly selective. The portfolio consists of just 30–35 holdings and is very different from the FTSE All-Share index, therefore, short- and medium-term performance can diverge from the benchmark. The trust's NAV total return performance has lagged the benchmark over the past one and three years. This partly reflects JUKG's significant holdings in UK domestic stocks, which have been very out of favour with investors, but where the manager finds compelling long-term value.

UK equities' forward P/E discount to world equities



Source: Refinitiv, Edison Investment research

The market opportunity

As shown in the chart above, UK equities have de-rated significantly since early 2016 when it traded at similar forward P/E multiples to global equities. Following the UK's EU referendum in mid 2016, its equity market moved to a discount, which has continued to widen. Currently trading at a c 14% discount to global equities, UK shares may be of interest to contrarian and longer-term investors.

Why consider investing in JUKG?

- The portfolio has significant exposure to domestic UK stocks, which have been particularly out of favour in recent years.
- Well-placed for recovery potential should Brexit negotiations progress.
- Differentiated approach to corporate engagement; Davies meets with the chairmen of all portfolio companies.
- Relatively concentrated, high-conviction portfolio.

Shares trade close to NAV, nil-discount policy

JUKG currently trades at a 2.0% discount to its cum-income NAV, which is the same as its the three-year average. The shares typically trade close to its NAV, reflecting the board's nil-discount policy. The trust has a dividend yield of 2.4% and, as at end-April 2019, had net gearing of 10.3%.

Exhibit 1: Trust at a glance

Investment objective and fund background

Jupiter UK Growth Investment Trust aims to achieve capital appreciation by holding predominantly listed investments. It invests in a concentrated portfolio made up of the manager's best ideas from any sector. The trust was known as Jupiter Global Trust from November 2015 until April 2016 and was previously Jupiter Primadona Growth Trust. It adopted its new name, fund manager, investment strategy and FTSE All-Share benchmark on 18 April 2016.

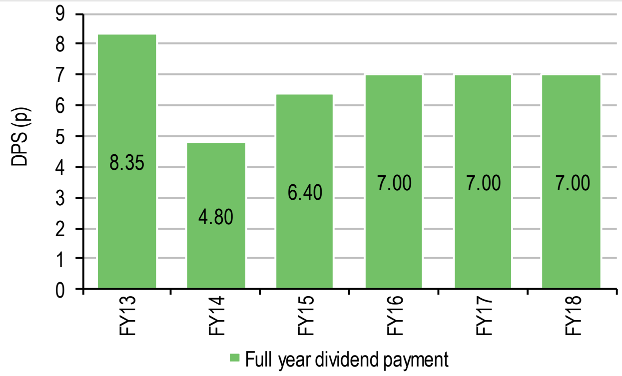
Recent developments

- 29 March 2019: Interim report for six months ending 31 December 2018. NAV TR -19.8% versus benchmark FTSE All-Share index TR -11.0%.
- 20 September 2018: Annual report for the year ending 31 December 2018. NAV TR+4.0% versus benchmark FTSE All-Share index TR +9.0%.
- 20 September 2018: Declaration of annual dividend for FY18 of 7p per share.

Forthcoming		Capital structure		Fund details	
AGM	November 2019	Ongoing charges	1.14%	Group	Jupiter Unit Trust Managers
Final results	September 2019	Net gearing	10.3%	Manager	Steve Davies
Year end	30 June	Annual mgmt fee	0.5% (see page 7)	Address	The Zig Zag Building, 70 Victoria St, London SW1E 6SQ
Dividend paid	Annually	Performance fee	Yes (see page 7)		
Launch date	June 1972 (April 2016 for new strategy)	Trust life	Indefinite	Phone	+44 (0) 20 3817 1000
Continuation vote	No	Loan facilities	£17m with Scotiabank	Website	www.jupiteram.com/JUKG

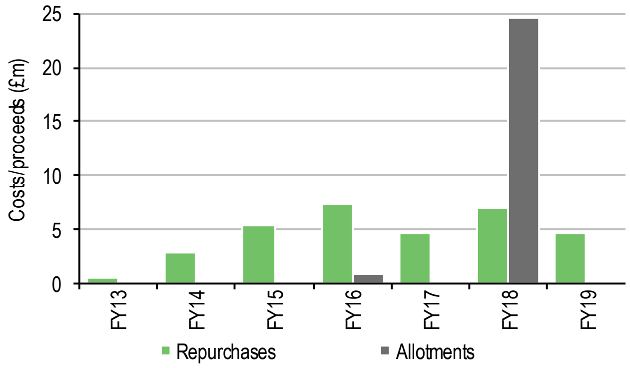
Dividend policy and history (financial years)

Dividends, historically paid quarterly, moved to a single annual dividend from FY17. Only three dividends were paid in 2014, owing to a change in dividend policy that year.

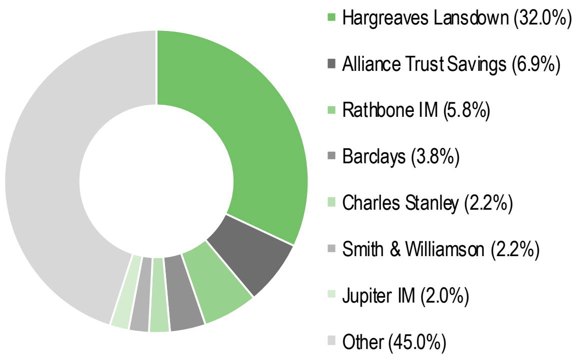


Share buyback policy and history (financial years)

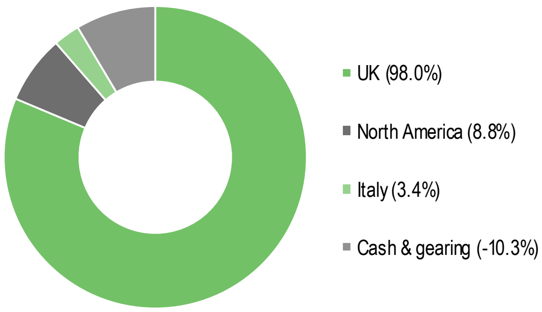
The board aims to maintain the share price close to NAV through the use of share buybacks and allotments. Allotments in FY18 include 7.8m new shares issued from the rollover of JDG into JUKG in November 2017.



Shareholder base (as at 10 April 2019)



Portfolio exposure by geography (as at 30 April 2019)



Top 10 holdings (as at 30 April 2019)

		Portfolio weight %	
Company	**Sector**	**30 April 2019**	**30 April 2018***
Experian	Industrials	5.8	4.2
Legal & General	Financials	5.5	7.5
Lloyds Banking Group	Financials	5.4	7.4
Diageo	Consumer goods	4.7	N/A
Talktalk	Telecommunications	4.5	4.1
Inmarsat	Telecommunications	4.5	N/A
Barclays	Financials	4.3	6.5
Manchester United	Consumer services	4.1	N/A
Merlin Entertainments	Consumer services	4.0	N/A
Sirius Minerals	Basic materials	3.8	7.2
Top 10 holdings		**46.6**	**54.6**

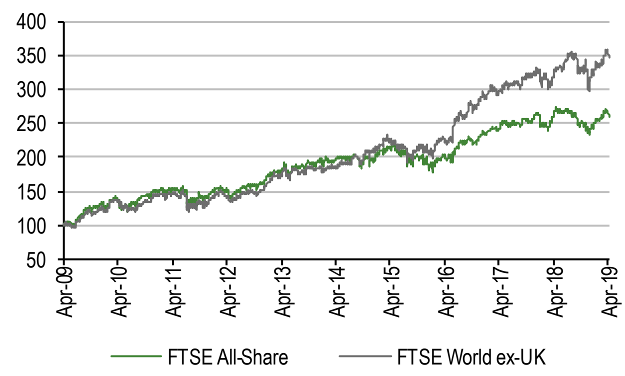
Source: JUKG, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-April 2019 top 10.

Market outlook: Influenced by geopolitical factors

The FTSE All-Share index appreciated by c 8% in Q119, following one of the weakest fourth quarters in its history in 2018, reflecting a rapidly deteriorating outlook for global growth, which was exacerbated by geopolitical factors. These included the ongoing US-China trade dispute and uncertainty over Brexit outcomes. Since the start of 2019, fears for a sharp slowdown in major economies have receded, led by the US, where the Federal Reserve signalled that interest rate rises are on hold for the time being. Meanwhile, investors are more optimistic that recently implemented Chinese government policies to help stimulate its economy are taking effect, and that talks to resolve the US-China trade dispute may succeed. However, uncertainty over Brexit outcomes remains and, as shown in the chart on page 1 and Exhibit 2 (LHS), continues to weigh on the relative performance of UK equities, which are at a significant discount to global equities. According to the Bank of America Merrill Lynch survey of global fund managers, allocations to UK equities are at a 20-year low, at levels significantly below those of 2008 and 2009 when the banking system was facing a systemic crisis. Valuations are not stretched (as shown in Exhibit 2 RHS), but there is a wide dispersion between the highest- and lowest-valued securities presenting opportunities for stock pickers. However, the direction of UK equities in the near term will likely continue to be influenced by geopolitical factors.

Exhibit 2: Market performance and valuation

UK and rest of the world equity markets over 10 years (in GBP)



Valuation metrics of Datastream UK index

	Last	High	Low	10-year average	Last as % of average
P/E 12 months forward (x)	12.4	15.7	8.5	12.6	99
Price to book (x)	1.4	2.1	1.3	1.7	86
Dividend yield (%)	4.3	4.8	2.7	3.4	123
Return on equity (%)	9.9	14.7	2.5	9.7	102

Source: Refinitiv, Edison Investment Research. Note: Index valuations at 10 May 2019.

Fund profile: Concentrated, high conviction

JUKG was launched in 1972 as Jupiter Primadona Growth Trust (JPG) and renamed the Jupiter Growth Trust in November 2015. In April 2016 the trust changed its mandate to a UK growth strategy and appointed Steve Davies as its new manager. It was renamed the Jupiter UK Growth Investment Trust; JUKG largely mirrors the strategy of the equivalent £1.1bn open-ended Jupiter UK Growth Fund, which has been managed by Davies since 2015 (he was the deputy manager between 2009 and 2015). In November 2017, the Jupiter Dividend and Growth Trust was rolled up into JUKG, which resulted in increased assets of £24.6m and the issue of 7.8m shares.

JUKG's objective is to generate capital growth, primarily from investing in UK-listed equities. Davies has an equities research background, which is reflected in his detailed and fundamental approach to selecting a relatively small number of 30–35 high-conviction stocks for the portfolio. He is supported by an analyst, James Moir, who joined Jupiter in 2017. There are no constraints against the benchmark and the manager is also permitted to invest in listed equities outside of the UK; as a result, JUKG's portfolio is typically very different from its FTSE All-Share index benchmark.

The fund manager: Steve Davies

The manager's view: UK equities are relatively attractive

Davies believes that the UK equity market has been driven by investor sentiment over the past few years, heavily influenced by Brexit developments, with seemingly little regard for fundamental factors such as valuation. He thinks that the valuations of many UK-listed companies are at "extreme" low levels, particularly for domestically oriented stocks, which have significantly underperformed those with international exposure since the results of the UK's EU referendum. Davies believes the UK economy has shown resilience; employment levels are at an all-time high, wages are rising and inflation is low, conditions that he would normally expect to support more optimistic equity valuations. However, consumer and investment sentiment are very depressed. As a result of this, merger and acquisition (M&A) activity has been extremely weak recently, even though the manager thinks many businesses are trading on very low multiples. Davies believes any clarity on Brexit could allow for a return of M&A activity to the market. In his view, UK equities are also relatively attractive on a global basis, are very under-owned by international fund managers, and have significant re-rating potential.

Asset allocation

Investment process: Bottom-up, constructive engagement

The manager undertakes detailed fundamental analysis of companies and has a long-term investment horizon. He looks for two broad categories of investments, recovery and growth. Recovery stocks are those that have been 'written off' or deemed 'un-investible' by the market but have catalysts (such as new management and a change in strategy) that could lead to a re-rating. These companies typically trade on forward P/Es of less than 10x, have free cash flow yields above 10% and have significant share price upside potential. Growth companies are those that can deliver consistently strong growth over the medium term with forecastable business models, yet are reasonably valued. At present, the portfolio is equally balanced between these two categories, reflecting the very unloved nature of UK domestically oriented stocks. In more normal market conditions, Davies would expect recovery stocks to constitute around 20–30% of the portfolio.

Management engagement is an important part of JUKG's investment process and is undertaken by Davies himself. In addition to meeting senior managements of companies, he aims to meet with chairmen at least once a year, and more frequently when necessary. The nature of the engagement is constructive rather than activist, and the scope can include assessing value in mergers and acquisitions (GKN and Zoopla), giving advice on restoring shareholder value through better communication with investors (Barclays) and day-to-day issues such as remuneration. Davies believes this engagement adds significant insight to his understanding of companies and differentiates JUKG from its peers. The active engagement approach can be accommodated due to the relatively small number of holdings in the portfolio and the additional resource of a dedicated analyst, James Moir.

Current portfolio positioning

As shown in Exhibit 3, JUKG's largest exposure as at end-April 2019 was to consumer services (40.8%) and, combined with consumer goods (11.6%), over half of the portfolio are in these two consumer-related sectors. One of the largest holdings is a new position in alcoholic beverages company Diageo. The company has a leading position in many of its market segments and a portfolio of premium brands, including Tanqueray (gin) and Johnny Walker (whisky). Davies believes its management is innovative in its approach to strengthening the value of its brands, responding to changing consumer tastes and optimising its portfolio of products. Over recent years, Diageo has invested in fast-growing beverage segments including tequila (Casamigos) and Chinese baijiu (Shui Jing Fang) and disposed of lower-growth products. The company's sales are well diversified internationally, with strong growth prospects in emerging markets, particularly in India, and it has the potential to expand margins. The manager believes the company can continue to generate organic sales growth of c 6–7% pa and strong free cash flow.

At end-April 2019, financials was the second-largest sector exposure at 26.0%. Year-on-year this exposure had fallen 5.9pp, which partially reflects the manager's tactical reduction to UK domestically oriented stocks to de-risk the portfolio in view of uncertain Brexit outcomes during the latter half of 2018. Due to the tactical nature of these sales, the manager focused on the more liquid names in the portfolio, including RBS, Legal & General, Lloyds Bank and Barclays. The sales do not reflect a change in the manager's fundamental views about these companies and Davies remains very positive on their prospects. He thinks that UK banks' valuations are unjustifiably low when considering their returns on tangible equity (ROTE), high levels of capital adequacy and increasing dividends. Although the overall exposure to financials has fallen, during H218, the manager started to purchase a new position in life insurer Prudential. The company is exposed to global equity markets and has significant businesses in emerging markets through its Hong Kong-listed subsidiary, Prudential Asia. Global equity markets suffered one of their weakest quarters in Q418 and emerging markets risk was amplified by acute currency weakness in some countries, including Argentina and Turkey. These factors contributed to a sharp fall in Prudential's share price, to levels which Davies believed reflected very bleak outcomes, and where he saw compelling long-term value.

Exhibit 3: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-April 2019	Portfolio end-April 2018	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Consumer services	40.8	39.0	1.8	11.7	29.1	3.5
Financials	26.0	31.9	(5.9)	26.4	(0.4)	1.0
Industrials	12.9	13.4	(0.5)	11.5	1.4	1.1
Consumer goods	11.6	6.4	5.2	14.3	(2.7)	0.8
Telecommunications	9.0	8.5	0.5	2.7	6.3	3.4
Healthcare	6.2	3.5	2.7	8.0	(1.8)	0.8
Basic materials	3.8	7.2	(3.4)	7.8	(4.0)	0.5
Technology	0.0	2.7	(2.7)	1.1	(1.1)	0.0
Oil & gas	0.0	0.0	0.0	14.0	(14.0)	0.0
Utilities	0.0	0.0	0.0	2.7	(2.7)	0.0
Cash & gearing	(10.3)	(12.5)	(0.2)	0.0	(12.7)	N/A
Total	**100.0**	**100.0**		**100.0**		

Source: Jupiter UK Growth Investment Trust, FTSE Russell, Edison Investment Research. Note: subject to rounding.

The portfolio's exposure to technology was reduced by 2.7pp to zero weight in the year ended 30 April 2019, largely reflecting the sale of US-listed Apple. The manager re-evaluated the company's business in China following its profit warning in January 2019 and concluded that the weakness could only be partially attributed to economic factors. Davies believes the company faces many structural impediments to its China operations, including more intense local competition than expected. Despite the sale of Apple, the portfolio's exposure to internationally listed companies has increased 2.5pp to 12.2% as Davies sought to balance the portfolio's UK risk. This reflects gradual additions to existing positions and strong share price performances from overseas holdings, including Yum China and Ferrari.

Given the short-term uncertainty surrounding Brexit that persisted at the tail end of 2018, Davies tactically de-risked the trust's exposure to UK domestic companies in the FTSE 100 (for example, householders and UK banks), reallocating that capital to the international companies that would perform well were sterling to fall sharply in the wake of a no-deal Brexit (for example, Diageo). In early 2019, as the manager judged the likelihood of a chaotic no-deal Brexit to have reduced, he has begun to increase the trust's positions in domestically exposed names. He thinks one of JUKG's advantages is its ability to be flexible and respond to changing market conditions.

Performance: Weighed down by Brexit

Exhibit 4: Five-year discrete performance data

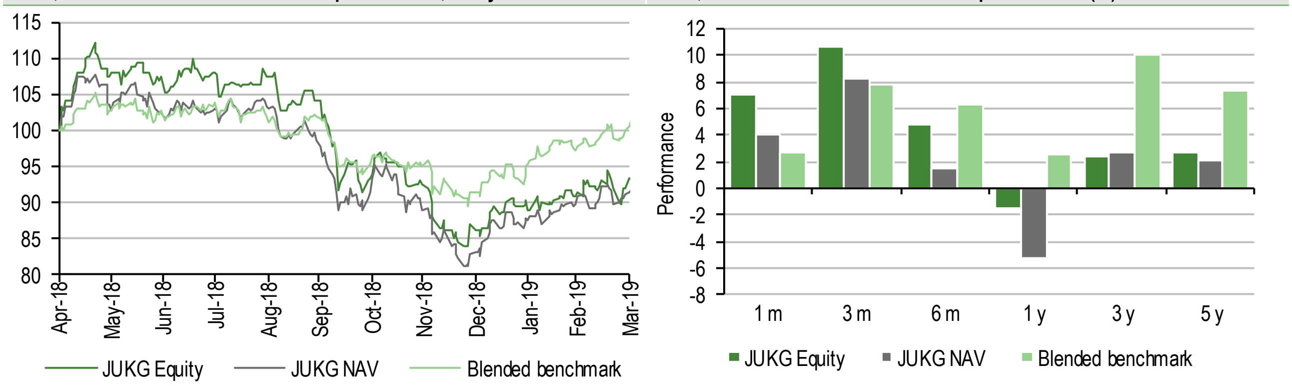
12 months ending	JUKG* share price (%)	JUKG* NAV (%)	Blended benchmark^ (%)	FTSE All-Share (%)	FTSE All-World (%)
30/04/15	10.5	10.1	10.4	7.5	18.0
30/04/16	(3.9)	(6.7)	(3.4)	(5.7)	0.5
30/04/17	14.4	16.1	20.1	20.1	31.0
30/04/18	(4.6)	(1.6)	8.2	8.2	7.5
30/04/19	(1.5)	(5.3)	2.6	2.6	11.7

Source: Refinitiv, Jupiter UK Growth Trust. Note: All % on a total return basis in pounds sterling. *JUKG track record is for Jupiter Primadona Growth (Jupiter Global Trust until 18 April 2016). ^Blended benchmark is 75% FTSE All-Share and 25% FTSE World ex-UK until 17 April 2016, and FTSE All-Share thereafter.

JUKG adopted its current mandate and appointed Davies as its manager in April 2016. Therefore, the most relevant performance periods to consider are one and three years. As shown in Exhibits 5 and 6, the trust's NAV total return has underperformed the FTSE All-Share index over one and three years (and also over five years). The manager is focused on capital growth over the long term and has a contrarian bias to invest in companies that are very out of favour or have strong growth prospects which are not being appreciated by the market. As a result, the portfolio is meaningfully different from the FTSE All-Share index, and the performance divergence can be expected, especially over short- and medium-term periods. Over one year, the fund's performance suffered a setback, attributable to a narrow number of stocks, including Apple (now sold), Sirius Minerals and Thomas Cook. Davies has engaged with the managements and chairmen of both Sirius Minerals and Thomas Cook and believes the investment cases remain intact. The three-year underperformance largely reflects the portfolio's positioning for a Remain vote in the UK's EU referendum in June 2016. JUKG had significant exposure to UK domestically oriented stocks and small- and mid-caps, which have suffered disproportionately in the subsequent years, as investors have favoured large-caps and stocks with multinational exposure.

Exhibit 5: Investment trust performance to 30 April 2019

Price, NAV and benchmark total return performance, one-year rebased | **Price, NAV and benchmark total return performance (%)**



Source: Refinitiv, Edison Investment Research. Note: Three- and five-year performance figures annualised. Blended benchmark is 75% FTSE All-Share and 25% FTSE World ex-UK until 17 April 2016 and FTSE All-Share thereafter.

Exhibit 6: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years
Price relative to FTSE All-Share	4.3	2.6	(1.4)	(4.0)	(19.3)	(15.5)
NAV relative to FTSE All-Share	1.3	0.4	(4.5)	(7.7)	(18.8)	(17.8)

Source: Refinitiv, Edison Investment Research. Note: Data to end-April 2019. Geometric calculation.

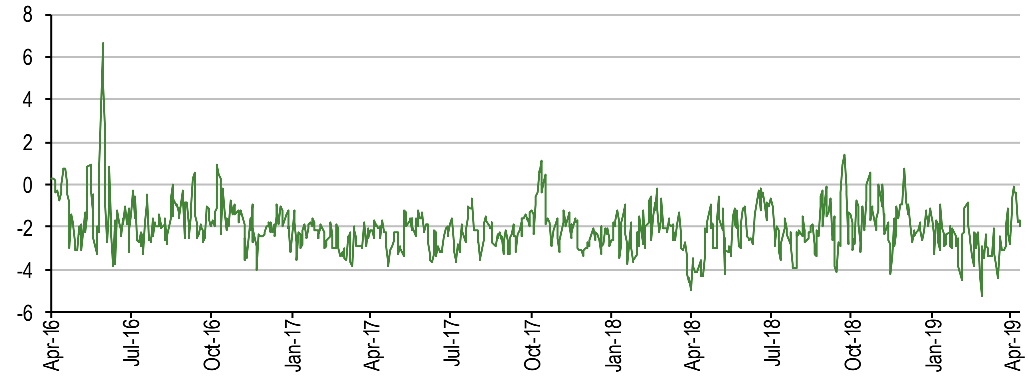
Exhibit 7: NAV total return performance relative to benchmark over three years

Source: Refinitiv, Edison Investment Research

Discount: Trades close to NAV, nil-discount policy

JUKG currently trades on a 2.0% discount to cum-income NAV, which is the same as the three-year average. The board adopted a nil-discount policy in 2014 and (as shown in Exhibit 8) the trust has traded close to its NAV over the past few years. JUKG is the only trust in the UK All Companies sector to have this zero-discount commitment.

Exhibit 8: Share price premium/discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

Capital structure and fees

JUKG is a conventional investment trust with one class of share. The reconstruction of Jupiter Dividend and Growth Trust on 30 November 2017 resulted in the issue of 7.8m new shares at 315p per share, increasing assets by £24.6m. During FY19 to date, the board has repurchased 4.5m shares at a cost of £1.5m; there are currently 29.7m shares in issue, of which 12.3m are held in treasury. In FY18, 2.2m shares were repurchased (1% of the shareholder base).

Jupiter Asset Management is paid an annual management fee of 0.50% on net assets up to £150m, reducing to 0.45% between £150m and £250m, and 0.40% above £250m. JUKG is entitled to a performance fee of 15% of the outperformance above 2% of the FTSE All-Share index total return, with a high watermark of the NAV as at the end of the prior year. The combined total fee is capped at 2% of the year-end adjusted net assets. As at end FY18, the ongoing charge was 1.14%. This is down from 1.20% in FY17 reflecting an enlarged asset base. The trust has a loan facility with Scotia Bank and as at end-April 2019, had net gearing of 10.3%.

Dividend policy and record

JUKG's primary objective is to concentrate on capital growth. It pays an annual dividend and the board aims to at least maintain the dividend at the prior year's level, while growing it over time. For FY18, the board paid a dividend of 7p per share, the same as the previous year, representing an historic yield of 2.4%.

Peer group comparison

Exhibit 9 shows the members of the AIC UK All Companies sector, comprising 14 trusts. JUKG is one of the smallest, ranking 13th. To capture the current manager's tenure (since 18 April 2016), the most relevant performance periods are one and three years, over which JUKG's NAV total returns rank 13th and 12th respectively. The dividend yield ranks eighth and is above the peer group average. The trust's ongoing charge is also above average, ranking third, reflecting the relatively smaller size of the fund. The discount to cum-fair NAV is one of the narrowest in the group, ranking third, and JUKG is the only fund with a no-discount policy.

Exhibit 9: AIC UK All Companies investment trusts as at 10 May 2019

% unless stated	Market cap/ fund size £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 (%)
Jupiter UK Investment Trust	50.4	(13.2)	5.8	6.1	106.5	(2.0)	1.1	Yes	110	2.4
Artemis Alpha Trust	120.5	(12.2)	21.6	10.7	99.4	(15.7)	0.9	No	100	1.7
Aurora	123.9	(4.9)	30.9	17.6	79.9	3.6	0.4	Yes	100	1.3
Baillie Gifford UK Growth	284.1	(3.7)	27.7	22.3	178.8	(5.4)	0.6	No	100	2.4
Crystal Amber	208.8	4.3	56.5	63.3	121.4	(7.5)	2.0	Yes	100	2.3
Fidelity Special Values	712.7	(6.0)	33.4	42.4	209.7	2.0	1.0	No	102	2.3
Henderson Opportunities	81.4	(3.2)	34.2	39.1	320.9	(14.8)	0.8	Yes	114	2.0
Invesco Perp Select UK Equity	57.6	(5.1)	19.7	36.8	238.3	(1.2)	0.8	Yes	114	3.8
JPMorgan Mid Cap	256.2	(7.7)	29.0	55.5	292.4	(9.5)	0.8	No	104	2.6
Keystone	219.7	(5.1)	12.5	20.9	174.6	(13.2)	0.5	Yes	106	3.4
Mercantile	1,656.3	(2.9)	32.6	54.1	248.0	(8.5)	0.5	No	103	3.0
Sanditon Investment Trust	40.6	(6.2)	(11.9)			(8.4)	1.3	Yes	100	0.6
Schroder UK Mid Cap	190.4	(5.1)	29.9	36.5	283.5	(13.6)	0.9	No	105	3.0
Woodford Patient Capital Trust	726.9	11.2	0.8			(12.9)	0.2	Yes	117	0.3
Sector weighted average	337.8	(4.3)	23.1	33.8	196.1	(7.7)	0.9		105	2.2
JUKG rank in sector	**13**	**13**	**12**	**12**	**10**	**3**	**3**		**4**	**8**

Source: Morningstar, Edison Investment Research. Note: *Performance to 9 May 2019. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

The board has five independent non-executive directors. Chairman Tom Bartlam was appointed in July 2013 and assumed his current role in November of that year. The other board members and their years of appointment are Lorna Tilbian (2001), Jonathan Davis (2011), Graham Fuller (2013) and most recently, Keith Bray (2018).

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