EDISON

JPMorgan European Discovery Trust

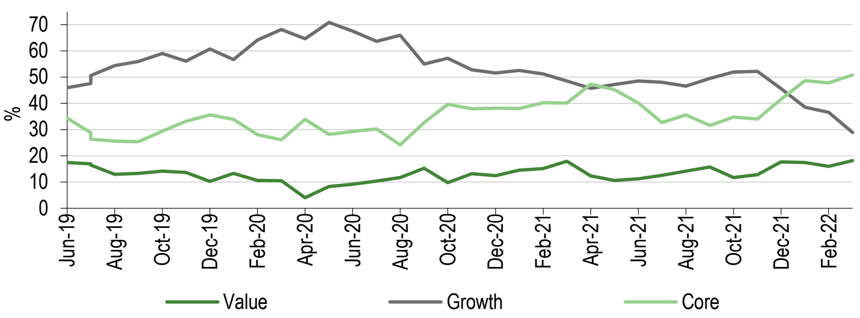
Becoming more stylistically balanced

Investment trusts
European smaller companies

21 July 2022

JPMorgan European Discovery Trust (JEDT) specialises in continental European small and mid-caps. The strength of the strategy is that while it is actively managed, it is also stylistically more balanced than many funds in the sector and of late there has been a nuanced move to more 'core' and 'value' holdings and a reduction in 'growth' stocks. Performance over the year to the end of June 2022 was weaker than the index, but slightly ahead of the AIC European smaller companies peer group. This was due to a combination of good stock selection and a rapid reduction in gearing, although sector and stylistic positioning detracted from performance relative to the benchmark.

Stylistically balanced, although reducing the number of growth names



Source: Morningstar, Edison Investment Research. Note: In pounds sterling.

Why invest in JEDT now?

European smaller companies are a niche but historically strongly performing asset class. Short-term share prices can be driven by investor sentiment, which often ignores the long-term fundamental attractiveness of higher earnings growth and valuation support that European smaller companies have over larger companies.

The analyst's view

JEDT has a good long-term record and an established, well-resourced and experienced management team. The rotation away from growth stocks lends the strategy a more balanced approach, which should allow the managers the ability to add value more incrementally via good stock selection rather than be whipsawed by stylistic turbulence.

Value on offer

JEDT arguably trades on an overly wide discount, which is likely the result of the recent underperformance and adverse investor sentiment towards European smaller companies. With improved investor sentiment towards the sector and the potential for performance to improve, this discount has every chance to narrow, which makes the current share price an opportunity to initiate or add to positions.

Price		**392.0p**
Market cap		**£617m**
Total assets		**£821m**
NAV*		472.3p
Discount to NAV		17.0%
*Including income. At 30 June 2022		
Yield		1.7%
Ordinary shares in issue		157.5m
Code/ISIN		JEDT/GB00BMTS0Z37
Primary exchange		LSE
AIC sector		European Smaller Companies
52-week high/low	582.0p	366.5p
NAV* high/low	654.0p	448.3p
*Including income		
Net gearing*		0.0%
*At 20 July 2022		

Fund objective

JPMorgan European Discovery Trust (JEDT) aims to provide capital growth from a diversified portfolio of smaller European companies (ex-UK). With JEDT's focus on capital growth, shareholders should expect the dividend to vary from year to year. The company can borrow to gear the portfolio within a range of 20% net cash to 20% geared in normal market conditions.

Bull points

- Current discount opportunity.
- Balanced stylistically.
- Exposure to global earnings.

Bear points

- Performance has lagged of late.
- European small caps are out of favour.
- Fees were reduced in April 2020 but, arguably, could be lower.

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Market outlook: Growing headwinds

Investors are preoccupied by the major themes of the war in Ukraine, rising inflation, the associated potential path for higher interest rates and the Chinese government's COVID-19 policies, which are all contributing to slowing global economic growth. So far in 2022 (to the end of June), these concerns have seen global markets sell off by around 10%. European markets have fared a little worse, with the MSCI Europe ex UK Index down 15% and the MSCI Europe ex UK Small Cap index down 20%. As in other global markets, value has outperformed growth with the small cap growth index returning -27% year to date and the value index returning -13% (all returns data in GBP).

Global growth will likely slow with the current headwinds and the drivers of this trend are not short lived or easily overcome. Higher food, energy and input prices are a substantial tax on consumers and corporates alike, so it will become even more crucial to be able to identify those companies with defendable barriers to entry, strong reoccurring cash flows, solid balance sheets and talented company management able to navigate this landscape.

The fund manager's view: Edward Greaves

While there is plenty of negative investor sentiment surrounding global macro events and the seemingly inexorable rise in prices, Edward Greaves has a more positive view in that he believes the European consumer is in reasonable shape, household balance sheets and savings rates are relatively healthy and there is still pent up consumer demand (post lockdown) that should help support GDP growth. He argues that historically the effects of energy shocks or geopolitical events have been quite short lived, albeit they can lead to spikes in market volatility, with investors looking through what they perceive to be short-term woes. Greaves also expects government and corporate capex spending to be a positive factor in supporting eurozone small caps' earnings growth.

Within a volatile and ever-changing economic and geopolitical environment, niche and nimble smaller businesses are often better placed to navigate changes in demand and the economic environment. As a group they are also less indebted than larger companies and in aggregate are trading on a marginally lower price to book value of 1.4x relative to their 20-year average valuation of 1.6x.

Positioned for higher for longer inflation

Through Q122 the team's view on inflation altered from being in the transient camp to expecting it to be higher for longer. This has resulted in a change to portfolio positioning: previously higher growth, more expensively rated (growth) stocks that were facing declining operational momentum, such as Vitrolife and Tecan Group in medtech and software stocks Cint Group and Esker, were sold.

The proceeds were reinvested into those industries and companies with some element of pricing power, inflation linked earnings or the beneficiaries of rising bond yields such as insurers, real estate and renewables. Within insurance the portfolio has around 12.7% invested and holds four names, with Baloise Holding the newest addition alongside ASR Nederland, Unipol Gruppo and Helvetia Holding. Greaves points out that life insurers, with their long-dated liabilities, are often positively correlated with rising bond yields so should perform well in a rising interest rate environment. Greaves is confident in the level of capitalisation and the quality of the assets held by these businesses to match their liabilities. They should also be relatively immune from weakening economic growth or recession that could hurt other financials such as banks, which ordinarily may benefit from an upward sloping yield curve, allowing them to borrow short and lend long.

Real estate is another area of interest within an inflationary environment. Rent reviews are often linked to rising prices and the portfolio has around 9% invested here. The portfolio has a position in high-quality office owner PSP. Swiss Property should benefit from the return to work trend seen since lockdowns were reversed. There have been four other additions to the portfolio in this area through 2022, including Spanish special situation Merlin Properties, pan-European industrials and logistics business VGP, and logistic warehousing specialists Catena and Warehouses De Pauw.

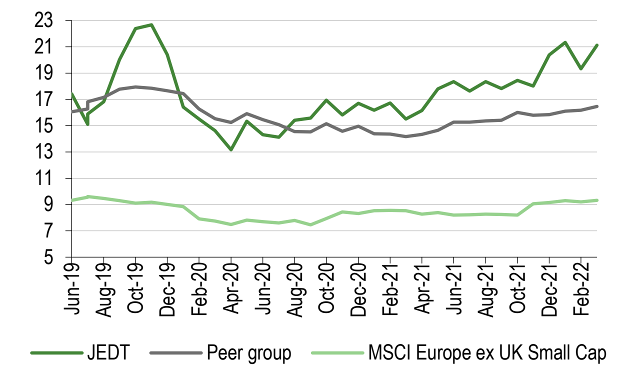
Exhibit 1: Sector weightings (% unless stated)

	Portfolio end-May 2022	Portfolio end-May 2021	Change (pp)	Index weight	Active weight vs index (pp)
Industrials	40.5	31.0	9.5	27.8	12.7
Consumer discretionary	15.3	16.2	(0.9)	11.7	3.6
Financials	12.6	5.0	7.6	14.8	(2.2)
Real estate	10.2	1.6	8.6	9.6	0.6
Technology	8.7	15.7	(7.0)	8.9	(0.2)
Energy	5.3	0.0	5.3	5.7	(0.4)
Healthcare	3.3	7.8	(4.5)	7.1	(3.8)
Consumer staples	0.9	6.8	(5.9)	5.7	(4.8)
Basic materials	0.0	1.8	(1.8)	6.2	(6.2)
Utilities	0.0	4.5	(4.5)	0.0	0.0
Telecommunications	0.0	6.7	(6.7)	2.2	(2.2)
Cash	3.3	2.9			

Source: JPMorgan. Note: May not add up to 100 due to rounding.

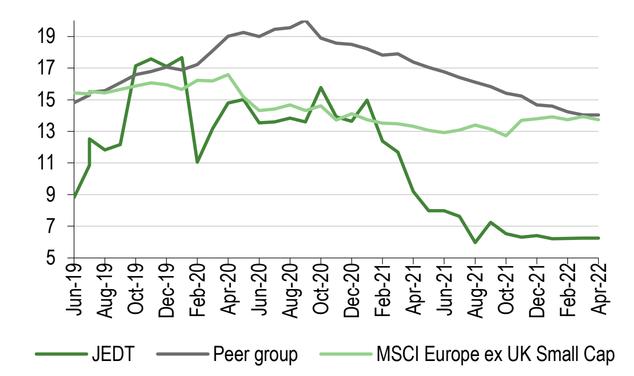
Renewables have been an area where the fund has been invested previously but reduced its exposure on valuation concerns. Since Q421 it has been revisiting this area and rebuilding exposure to the current level of 6.3% via four companies, with the most recent additions being French integrated renewable energy developer, storer and generator Neoen, Spanish solar energy generator Solaria Energia y Medio Ambiente and Encavis, a German developer and operator of solar and wind farm parks.

Exhibit 2: Continued bias to French equities (%)



Source: Morningstar. Note: Peer group = Morningstar open and closed ended Europe ex UK small and mid-cap category.

Exhibit 3: Still underweight German equities (%)



Source: Morningstar. Note: Peer group = Morningstar open and closed ended Europe ex UK small and mid-cap category.

The portfolio is predominantly built from the bottom up, but there are some enduring biases within the portfolio. The portfolio remains overweight French stocks (Exhibits 2 and 4) when compared with the index.

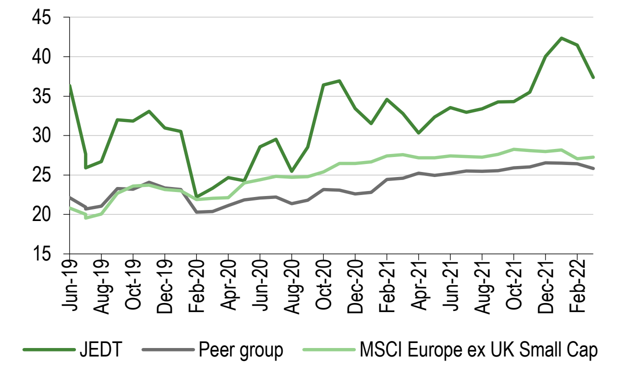
Exhibit 4: Regional weightings (% unless stated)

	Portfolio end-May 2022	Portfolio end-May 2021	Change (pp)	Index weight	Active weight vs index (pp)
France	19.2	14.7	4.5	9.5	9.7
Italy	15.0	14.6	0.4	7.9	7.1
Sweden	11.6	25.6	(14.0)	17.4	(5.8)
Switzerland	11.5	9.2	2.3	13.3	(1.8)
Netherlands	10.4	9.6	0.8	6.4	4.0
Belgium	8.5	6.5	2.0	4.8	3.7
Germany	5.7	8.4	(2.7)	14.2	(8.5)
Spain	2.9	0.0	2.9	5.5	(2.6)
Denmark	2.4	2.4	0.0	4.7	(2.3)
Czech Republic	1.9	0.0	1.9	0.2	1.7
Other	0.2	0.0	0.2	16.1	(15.9)
Cash	10.7	2.9	7.8		

Source: JPMorgan. Note: May not add up to 100 due to rounding.

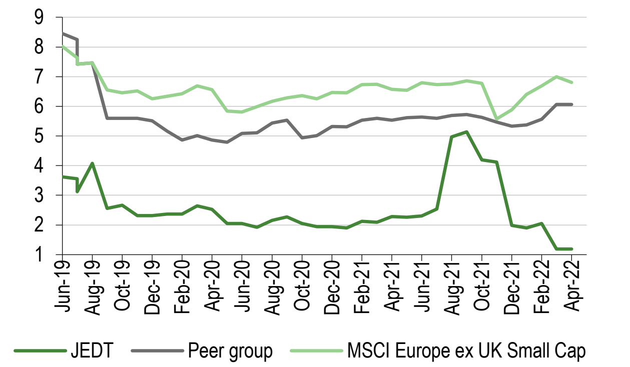
The largest French-listed holdings here vary from the long-standing position in IT services Alten through to the April 2019 initiation in market researcher Ipsos. The newest additions to the weighting come in the form of Virbac, Neoen and Rexel. We have discussed Neoen above, while Virbac is a domestic and livestock drug and treatment specialist and Rexel an electrical engineer. The underweight to Germany continues (Exhibit 3 and 4) and is purely accounted for via the opportunities in the stocks listed in Germany. The three stocks owned make up a diverse list of Bechtle, which offers IT services, CTS Eventim, which is in leisure and entertainment, and the previously mentioned Encavis. The investment process is essentially looking for good top-line growth, valuation support or momentum, Greaves opines that the industrial 'metal bashing' type of industries that are prevalent in the German small-cap index face headwinds from slowing growth and higher energy input costs, which make them a challenging proposition. In addition, Hella (auto electric components) was acquired by Faurecia and Eckert & Ziegler was sold from the portfolio.

Exhibit 5: Bias to industrials (%)



Source: Morningstar. Note Peer group = Morningstar open and closed ended Europe ex UK small and mid-cap category.

Exhibit 6: Still underweight basic materials (%)



Source: Morningstar. Note: Peer group = Morningstar open and closed ended Europe ex UK small and mid-cap category.

From a sector position, the portfolio is still overweight the diverse industrials sector (Exhibits 1 and 5), with exposure added to companies enabling energy efficiency and electrification infrastructure. The largest industrials positions are all French-listed including the market researcher Ipsos, high-voltage cable provider Nexans and Spie, which specialises in energy and communication networks. Basic materials continue to be an underweight (Exhibits 1 and 6) with the prospects for the sector primarily driven by spot prices, added to which the sector is also seeing cost price input inflation. The sole holding in this area is Azelis, which is a Belgian specialist chemicals producer.

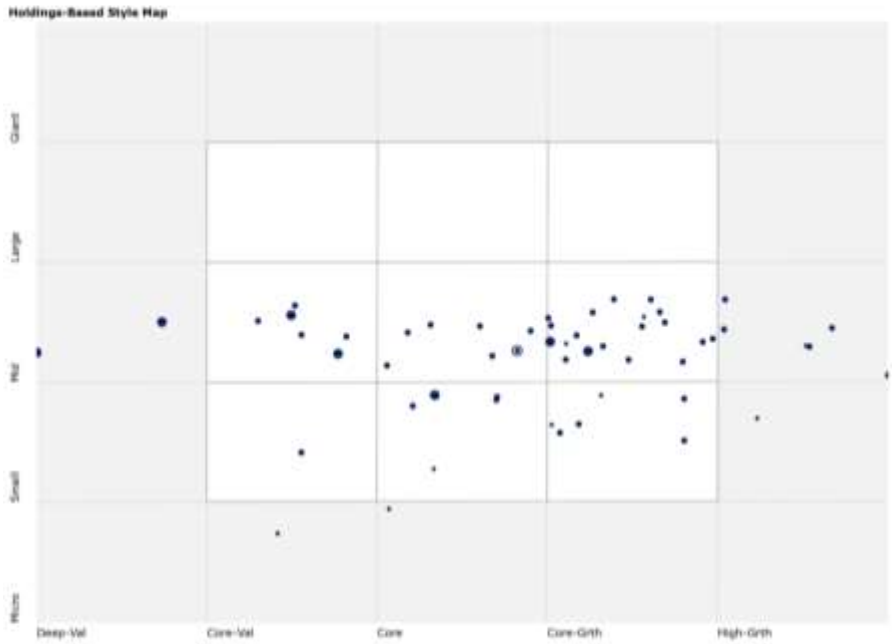
Exhibit 7: Top 10 holdings (at 31 May 2022)

Company	Country	Sector	Portfolio weight % 31 May 2022	31 May 2021*	Benchmark weight	Active weight vs benchmark
Helvetia	Switzerland	Financials	3.7	N/A	0.5	3.2
Alten	France	Technology	3.6	2.3	0.4	3.2
IPSOS	France	Industrials	3.3	N/A	0.2	3.1
Nexans	France	Industrials	3.3	2.6	0.2	3.1
SPIE	France	Industrials	3.3	N/A	0.3	3.0
Sanlorenzo	Italy	Consumer discretionary	2.9	N/A	0.0	2.9
Unipol	Italy	Financials	3.0	N/A	0.2	2.8
Baloise Holding	Switzerland	Financials	2.7	N/A	0.0	2.7
ASR Nederland	Netherlands	Financials	3.3	N/A	0.6	2.6
Bravida Holding	Sweden	Industrials	2.7	3.0	0.2	2.5
Top 10 (% of holdings)			31.8	7.9		

Source: JPMorgan, Edison Investment Research. Note: *N/A where not in May 2021 top 10.

The tilt away from growth stocks resulted in sales, in addition to those noted above, of some of the portfolio's other noted growth names such as isotope provider Eckert & Ziegler, speciality chemical business IMCD and cloud-based accountant Fortnox. In aggregate these changes resulted in the portfolio tilting incrementally away from growth stocks towards more value/core stocks. In addition to the exhibit on the front page, Exhibits 1, 12 and 13 illustrate that the portfolio has, over the year to the end of May 2022, become more exposed to classically more value-orientated sectors such as financials and away from higher growth areas such as technology. Overall (Exhibit 8) the portfolio remains fairly diversified at the stock level from deeper value names, via core to higher growth companies.

Exhibit 8: Stylistically diverse underlying holdings within JEDT



Source: Morningstar. Note: At April 2022.

Performance: Lagging over 12 months

Exhibit 9: Five-year discrete performance data

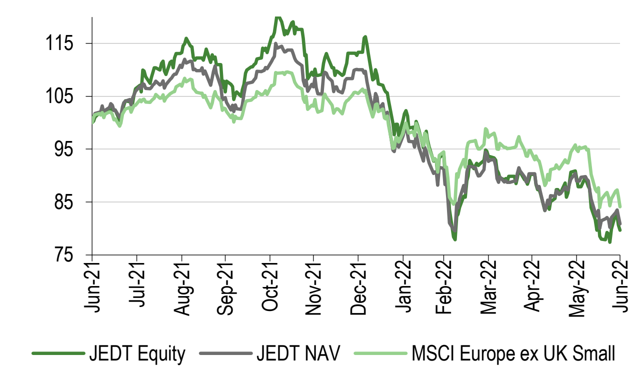
12 months ending	Total share price return (%)	Total NAV return (%)	MSCI Europe ex UK Small (%)	MSCI Eur ex-UK (%)	CBOE UK All Cos (%)
30/06/18	10.7	12.9	9.2	2.7	9.5
30/06/19	(7.9)	(4.4)	(1.4)	8.2	0.3
30/06/20	(6.6)	(0.8)	1.8	0.6	(13.6)
30/06/21	45.0	38.9	36.0	22.6	21.1
30/06/22	(20.3)	(19.1)	(15.9)	(9.8)	2.2

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

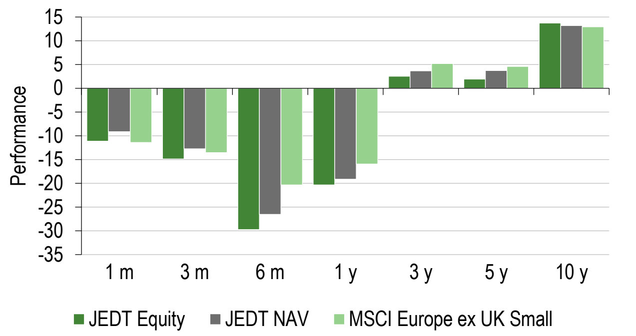
The fund performance in the 12 months to the end of June 2022 was -19.1% in terms of NAV, with the MSCI Europe ex UK Small Cap index returning -15.9% over that period, while the Morningstar category of open and closed ended peers returned -17.7% and the Association of Investment Companies (AIC) European smaller companies peer group returned -21.1% (all returns in pounds sterling). The fund manager's reduction in the use of gearing and utilisation of cash (Exhibits 20, 21) helped relative performance versus its AIC peers. From a stylistic perspective, the fund's, albeit decreased, allocation to growth stocks detracted from performance as growth as a style was out of favour through the period. In addition the funds exposure to economically sensitive sectors such as leisure, banks and autos was also a drag on performance, with only non-life insurance a positive counter balance at the sector level. More importantly for the strategy, stock selection was positive (although not sufficiently so to offset the style/sector detractors) with Sanlorenzo (luxury yacht builder), Helvetia Holding (insurance), Nexans (electrification infrastructure) and Ipsos (market research) all being accretive to relative performance. The largest detractors were a diverse group from a variety of industries and end users, including Aramis Group (online used car sales), SoftwareONE Holding (software/cloud computing), Technogym (health and fitness equipment), AFRY (packaged goods) and Eckert & Ziegler Strahlen (medical and industrial isotopes).

Exhibit 10: Investment trust performance to 30 June 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 11: Share price and NAV total return performance, relative to indices (%)

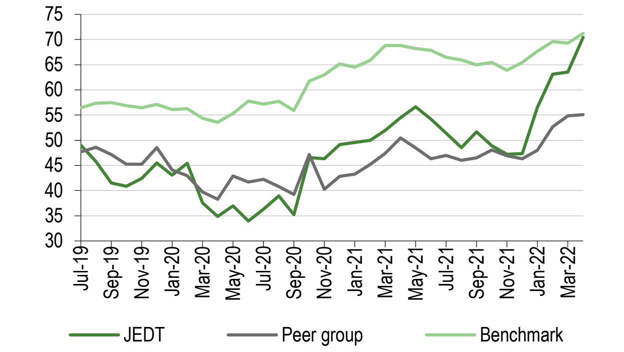
	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI Europe ex UK Small	0.3	(1.6)	(11.8)	(5.3)	(7.3)	(12.3)	7.1
NAV relative to MSCI Europe ex UK Small	2.5	0.9	(7.8)	(3.9)	(4.2)	(4.1)	2.2
Price relative to MSCI Eur ex-UK	(4.4)	(7.3)	(17.5)	(11.7)	(3.1)	(11.0)	41.2
NAV relative to MSCI Eur ex-UK	(2.3)	(4.9)	(13.7)	(10.4)	0.2	(2.7)	34.8

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

Peer group comparison: Rotation away from growth

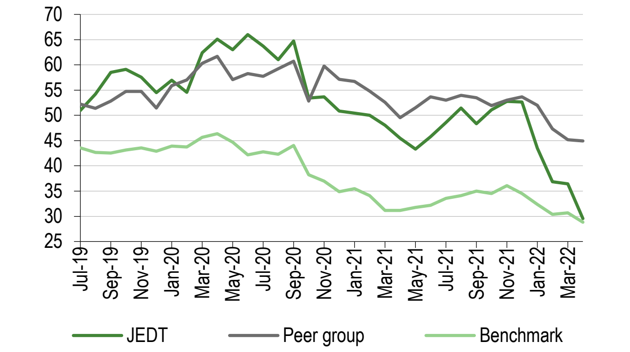
As discussed earlier in this note, JEDT has rotated some of its holdings in growth stocks into core and value holdings. In Exhibit 12 we can see that exposure here is higher than for European smaller companies peers and nearer the MSCI Europe ex UK Small Cap Index weighting. Conversely the weighting to growth stocks has reduced and is now less than the peer group average and again is nearer the index in weighting.

Exhibit 12: Weighting to core and value increasing



Source: Morningstar. Peer group= Morningstar open and closed ended Europe ex UK small and mid-cap category. Benchmark: MSCI Europe ex UK Small Cap Index.

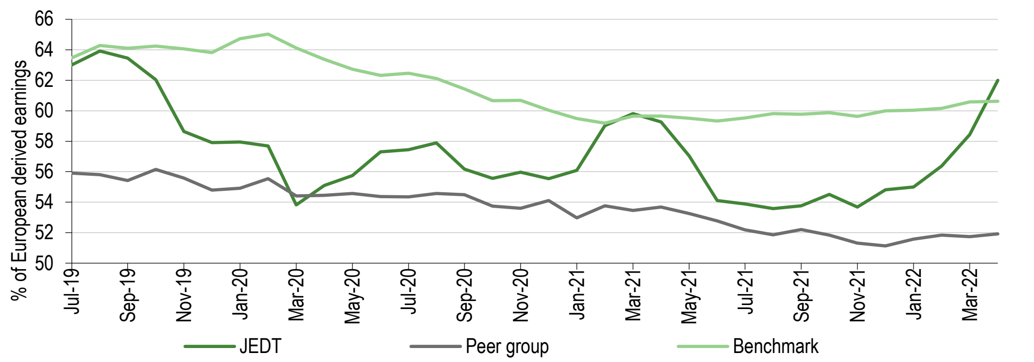
Exhibit 13: Weighting to growth decreasing



Source: Morningstar. Peer group= Morningstar open and closed ended Europe ex UK small and mid-cap category. Benchmark: MSCI Europe ex UK Small Cap Index.

Regional smaller companies funds tend to have more domestic earnings than larger companies. Larger companies are often global conglomerates with geographically diversified businesses and earnings. While JEDT has a bias to European domestic earnings (according to work done by Morningstar), this has been increasing of late, which may be explained by the reduction in technology, healthcare and consumer staples and increase in industrials, financials and real estate. This still leaves over 30% of earnings derived from outside of Europe, principally in the United States and Asia. This makes JEDT arguably a purer play on European earnings than some competitors, albeit with some exposure to higher-growth overseas markets.

Exhibit 14: Increasingly European derived earnings within the portfolio



Source: Morningstar. Peer group= Morningstar open and closed ended Europe ex UK small and mid-cap category. Benchmark: MSCI Europe ex UK Small Cap Index.

Looking at the AIC peer group, which is a compact group of four funds, all of the constituents have struggled over the last 12 months, posting negative returns and underperforming the benchmark. This is largely due to the higher weighting to growth stocks than in the index, which has been a detractor to performance. Arguably the fees that investors in JEDT pay could be lower given the economies of scale delivered by its size, but perhaps in a high-returning asset class such as European smaller companies, the opportunity to outperform strongly can mitigate the effects of slightly higher fees. In addition, unlike in some sectors such as large cap or thematic, passive investment solutions are also less prevalent in this part of the market, potentially reducing downward fee pressures on active managers.

Exhibit 15: AIC European Smaller Companies at 19 July 2022*

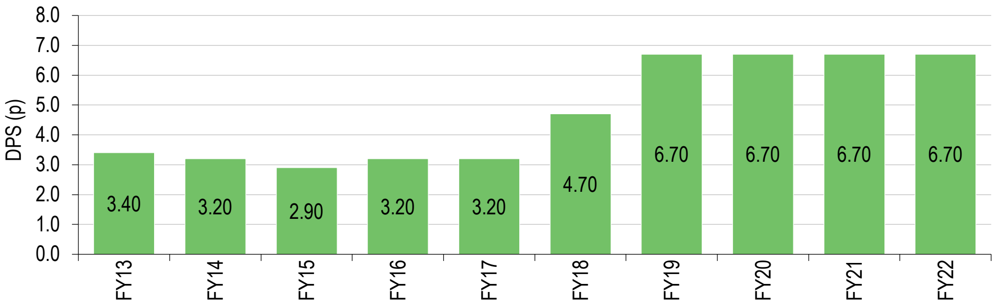
% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (cum-fair)	Net gearing	Dividend yield
JPMorgan European Discovery	617	-17.3	15.3	20.5	263.5	0.93	No	-17.0	97	1.7
European Assets	324	-26.4	7.2	8.4	197.8	0.89	No	-9.0	98	9.8
Montanaro European Smaller	250	-20.7	31.8	65.3	263.4	1.09	No	-10.4	103	0.7
The European Smaller Companies Trust	553	-15.8	37.0	23.2	331.3	0.71	Yes	-17.8	111	1.8
Average	436	-17.4	20.1	25.2	242.5	0.90		-13.6	102	3.5
JEDT rank in peer group	1	2	3	3	2	3		3	4	3

Source: Morningstar, Edison Investment Research. Note: *Performance at 19 July 2022 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

Dividends: A contributing factor to investor returns

The portfolio is managed for capital growth rather than dividends, which can be expected to vary from year to year. That said, they have historically been a feature here (Exhibit 18) and are paid in January and July. The focus on quality, cash-generative companies naturally provide some income. For FY22 dividends of 6.7p per share (FY21: 6.7p) were paid on revenues of 7.00p (FY21: 4.42p). Dividend income increased to £11.1m through the year from £7.1m in FY21. JEDT currently yields 1.7%, which compares to the index yield at the end of May 2022 of 2.7% and is third in the AIC peer group. JEDT and ESCT yield similar levels (and are both more core stylistically), while the far more growth orientated Montanaro is the lowest yielding. EAT with its enhanced dividend policy is by far the standout within the AIC category with a 9.8% yield (Exhibit 15).

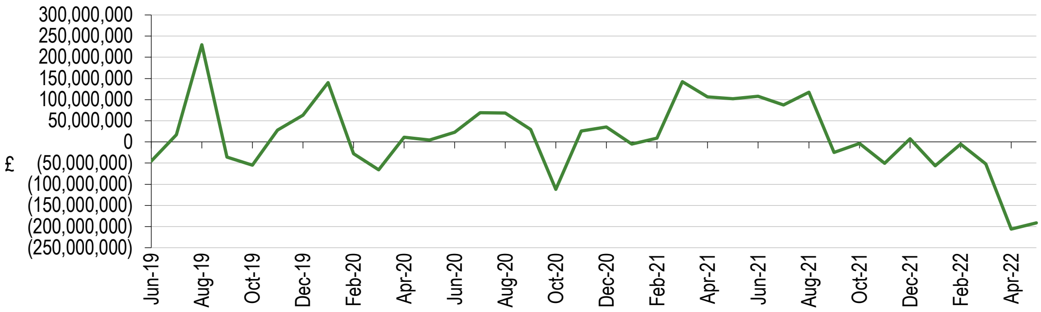
Exhibit 16: Dividend history since FY13



Source: JPMorgan, Edison Investment Research

Discount: A sector out of favour with investors

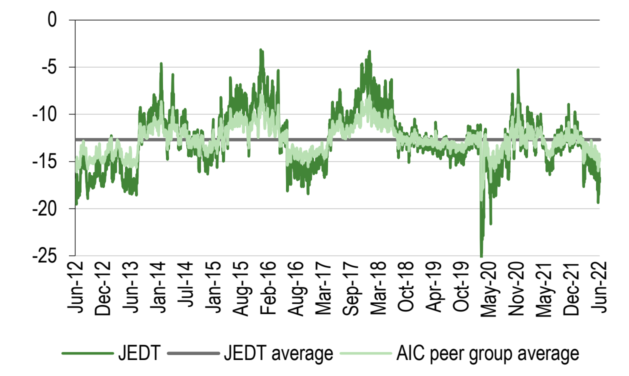
Exhibit 17: Fund flows into European ex UK small-cap open-ended strategies



Source: Morningstar

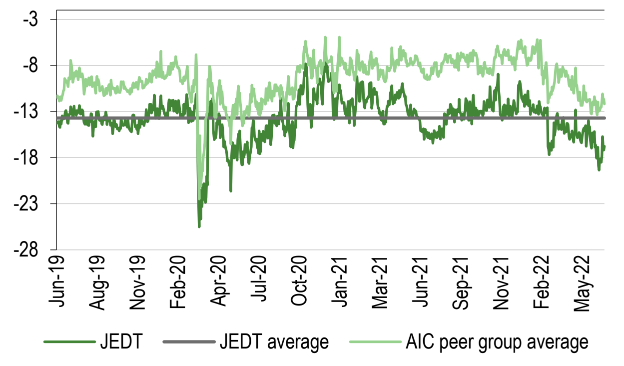
JEDT's board monitors the discount closely and has authorisation to buy back up to 14.99% of the issued share capital to minimise short-term volatility. During FY22 the board repurchased 992,954 shares with a further 995,000 subsequent to year end for cancelation. The current discount is 17%, which is wider than the longer-term average (12.7% over 10 years). This is most likely a factor of recent underperformance but is arguably excessively wide given the quality of the proposition here.

Exhibit 18: Discount over 10 years



Source: Morningstar. Edison Investment Research

Exhibit 19: Discount over three years



Source: Morningstar, Edison Investment Research

Fund profile: Diversified European small-/mid-cap exposure

In June 2021 the fund changed its name from JPMorgan European Smaller Companies Trust to JPMorgan European Discovery Trust. This was to reflect that it invests across the gamut of opportunities in European smaller companies of up to €7bn (£6bn) market cap at the time of investment. It was also to convey to UK investors that many European smaller companies are actually far larger in size than their UK smaller company brethren. With an average market cap of some €4bn (£3.4bn), there is a range of company sizes within the portfolio. Thus, the investable opportunity set is potentially broader than purely smaller companies and the change of name reflects this. There has been no change in the investment process, which has been in place over many years.

The trust was launched in April 1990. It aims to generate long-term capital growth from a diversified portfolio of European ex-UK small-cap equities. The trust is managed by Francesco Conte (since 1998) and Edward Greaves (since 2016), who are able to draw on the broad resources of J.P. Morgan Asset Management's European equity team. The trust is benchmarked against the MSCI Europe (ex UK) Small Cap Net Total Return Index (until 31 March 2020 EMIX Smaller European Companies (ex UK) net total return index (in sterling terms)). The MSCI Europe (ex UK) Small Cap Index contains c 780 companies with market caps from £45m up to £7.1bn spread across 14 developed markets. At the time of investment, a maximum 5% of the portfolio is permitted in a single stock and no more than 15% may be invested outside of the benchmark. Currency exposure is not hedged. JEDT may gear up to 20% or run up to a 20% net cash position.

One area of interest is comparing the open- and closed-ended versions of this strategy. The closed-ended iteration has outperformed, but there is relatively little difference between the two portfolios currently. In fact, at the end of April 2022, only two stocks are held in JEDT and not the open-ended version of the strategy (Lotus Bakeries and Nordnet), with common holdings equating to a virtually identical 98.8%.

Investment process recap: Focus on quality

The managers aim to generate long-term capital growth from a diversified portfolio (50–75 holdings) of small-cap European ex-UK equities. Initially they use a proprietary multi-factor model to screen the universe, which is made up of c 780 small-cap European stocks. Companies passing the screen undergo thorough fundamental analysis.

There are three characteristics that the team is looking for and the portfolio will have a positive bias to these factors through time, which should help the trust to have an all-weather ability to perform consistently in varying market environments.

The team looks for attractively **valued** opportunities and puts a lot of emphasis on free cash flow yield as it sees it as the highest-quality valuation metric. These are generally robust, cash-generative companies that may be out of favour with investors, but importantly where the team can identify a catalyst for a re-rating. These companies may operate in cyclical end-markets or where investor sentiment is weak.

Another characteristic that it looks for is '**quality**'. These companies are likely to be market leaders in niches, with robust balance sheets, high and sustainable return on equity, disciplined and proven management ability to allocate capital effectively, and high barriers to entry.

Lastly there is allocation to **momentum** as a factor. These companies are typically in structurally growing markets, and often have disruptive technology allowing market share gains and continued beating of market expectations.

Each prospective company is also assessed against three additional criteria:

1. economics: does the company generate value, ie is the return on capital above the cost of capital?
2. duration: will the company continue to generate added value in the future, ie does the company have a strong economic moat?
3. governance: will minority shareholders be able to benefit from this added value or might it be wasted by management, for instance through poorly conceived acquisitions?

Position size is determined by the managers' level of conviction and a company's share liquidity. New positions are typically c 1% of the portfolio and are generally trimmed when they reach above c 3%. Reasons for selling a holding will be due to a fundamental deterioration in business conditions; if the company has grown too large; on valuation grounds; or if there is a better investment opportunity available. Portfolio turnover is currently running at c 70% a year, which is broadly in line with historical averages.

ESG considerations are factored into the process, as companies that put their clients, the environment and their employees at the front and centre are likely to have long-term sustainable earnings. The team uses a range of proprietary tools such as the AI unstructured data model, which is able to sift through vast amounts of published information to unearth potential nuanced messaging from company management and wider market sentiment. There is also an Equity Failure Model that optimises 170 different inputs (such as short interest and balance sheet anomalies) that can highlight potential issues in a stock and is run on over 10,000 stocks globally.

The team: Well resourced

The team of five is led by the experienced Francesco Conte, who has been with J.P. Morgan since 1998 and was previously a lead analyst within Italian equities at Schroders. Co-manager Edward Greaves has worked alongside Conte since 2011, having previously been at Rothschild. Jack Featherby has been in the team since January 2018, with previous experience at Rothschild and Wells Fargo. Jules Bloch has been within the team since 2017 having previously worked within J.P. Morgan's private bank. Wioletta Krejner is the most recent addition, having joined J.P. Morgan in 2017 as a graduate trainee.

The team are all generalists and have a certain latitude to follow opportunities where they present themselves, regardless of sector or country. The portfolio is built from the bottom up, but at times Conte and Greaves may direct the resource within the team towards areas with potential rich veins of opportunities. This team does not operate within a vacuum and there is regular discussion with other teams, most notably the six-strong UK small- and mid-cap team headed by Guy Anderson, lead portfolio manager of The Mercantile Investment Trust. As one would expect with the extensive resources of J.P. Morgan, the team is also free to utilise external research where appropriate, but this tends to be limited to sector or thematic research. The board has a clause that it can terminate its contract with J.P. Morgan on three months' notice (ordinarily six months' notice) should Conte not be a named manager on the trust. This highlights the element of key person risk that exists currently with the management arrangement, although with Greeves's long association with JEDT this risk is mitigated to an extent.

ESG: Integrated within the investment process

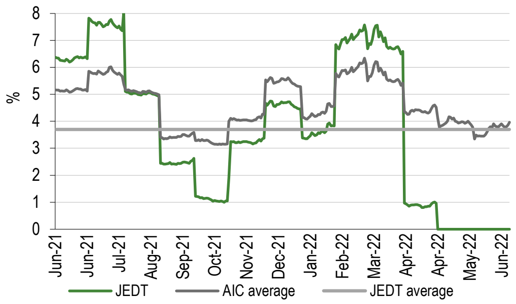
J.P. Morgan fully integrates ESG considerations into its investment process, which is executed by 500 portfolio managers and 300 research analysts, and it is an important element in their stock analysis. The firm's heritage in this space is well established, from the 1970s and values-based investment mandates to the launch of the global socially responsible strategy in 2000 and becoming a signatory of the Principles for Responsible Investment (PRI) in 2007. In 2019 ESG was formally embedded in the investment process across the board. The company uses third-party data providers, albeit on a diminishing basis as it fully builds out its own internal proprietary scoring system. ESG is integrated across 450 strategies and around $2.3tn of assets and the firm manages around $7bn in dedicated sustainable mandates. The global sustainable investing team at J.P. Morgan numbers 35 and is organised by region, addressing client solutions, data and research and investment stewardship. Jennifer Wu leads this team and reports directly into the J.P. Morgan committee.

It is good to see that Sustainalytics scores the portfolio four out of five globes on ESG considerations. The trust also scores particularly well on emitting less carbon than the market average and has a Morningstar Low Carbon designation.

Gearing: Increasingly cautious of late

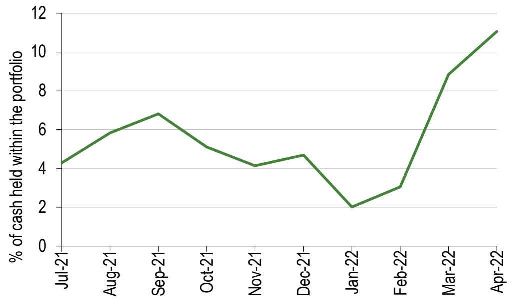
The company can be geared up to 20% or hold 20% in cash. Gearing is an investment decision made at the discretion of the portfolio managers rather than in concert with or directed by the board. Gearing is arranged via a revolving credit facility of €125m with Scotiabank, which expires on 17 January 2023. JEDT is currently ungeared versus an average level of 3.7% over the past 12 months. The judicious use of gearing has been a long-term driver of returns as markets have appreciated over time. Through the market volatility seen in CY22 to date the managers have pared back its use (Exhibit 20) and held more assets in cash (Exhibit 21).

Exhibit 20: 12-month gearing – JEDT has become increasingly cautious



Source: Morningstar, Edison Investment Research

Exhibit 21: Increased use of cash within the portfolio as market volatility has picked up



Source: Morningstar, Edison Investment Research

Fees and charges: Arguably scope for lower fees

From 1 April 2020, the annual management fee has been a flat fee of 0.85% applied to net assets, with no performance fee. The ongoing charge (which includes management and other expenses but excludes finance costs) is 0.93% for FY22 (FY21: 0.91%) and has generally been steadily falling over the past 10 years (FY11: 1.21%). The management fee and finance costs are levied 30% against income with 70% apportioned to capital. Other more modest administrative costs are charged to income. Given the scale of the assets relative some of its AIC competitors (JEDT is the largest fund within the AIC category) arguably the fund could be a little more competitive in terms of fees, with 0.93% exceeding the average (ex-performance fee) ongoing charge within the AIC category cohort of 0.90%.

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