EDISON

European Assets Trust

Sticking to the investment process

Investment companies

European Assets Trust (EAT) aims to generate long-term capital growth from investment in European small- and mid-cap companies. It also has a high distribution policy; 6% of its euro-denominated NAV is paid out each year. Given the 9.4% discount to NAV, the current dividend yield is 7.8%. While EAT's near-term performance has trailed the benchmark Euromoney Smaller Europe ex-UK index, exacerbated by the result of the UK's European referendum, manager Sam Cosh states that his investment philosophy and process have not changed. He suggests that the process is robust and has been successful over the long term; areas of the portfolio that have been weak in the near term are expected to recover. EAT is currently running a net cash position of c 4%.

12 months ending	Share price (%)	NAV (%)	Euromoney Smaller Europe ex-UK (%)	FTSE AW Europe ex-UK (%)	FTSE All-Share (%)
31/12/12	36.1	28.4	16.9	17.4	12.3
31/12/13	47.8	38.1	37.5	24.0	20.8
31/12/14	8.9	7.7	(1.9)	(1.4)	1.2
31/12/15	20.4	23.0	17.2	5.5	1.0
31/12/16	(2.7)	7.3	23.3	21.2	16.8

Source: Thomson Datastream. Note: All % on a total return basis in GBP.

Investment strategy: Searching for value

The manager selects a relatively concentrated portfolio of c 40 stocks from a universe of c 2,000 companies. He and his team employ detailed fundamental analysis, investing in companies with strong balance sheets, healthy cash flows and high returns that are trading at a discount to their estimated intrinsic value. Meeting company management is an important part of the investment process. Stocks where the manager likes the fundamentals and the company management, but not the valuation, are put on to a 'patient fisherman' list awaiting a more favourable valuation entry point.

Market outlook: Signs of economic improvement

While the European economy has been slower to recover following the global financial crisis versus other developed regions, the International Monetary Fund has modestly increased its growth estimates for 2016 and 2017. Valuations of European equities are more favourable than for world equities and consensus growth estimates for European smaller companies exceed those of large companies. For investors looking for exposure to smaller companies in Europe, a fund with a rigorous investment process and a positive long-term performance track record may hold appeal.

Valuation: Scope for discount to narrow

Having traded at a modest premium for a good part of the last three years, EAT's share price is currently trading at a 9.4% discount to cum-income NAV. This is wider than the average discounts of the last one, three, five and 10 years (range of 0.5% to 6.1%). There is scope for the discount to narrow if EAT's near-term investment performance versus the benchmark improves. EAT's current dividend yield is 7.8%.

3 January 2017

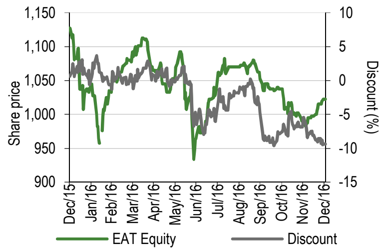
Price	**1,022.5p**
Market cap	**£339m**
AUM	**£375m**

NAV*	1,128.1p
Discount to NAV	9.4%

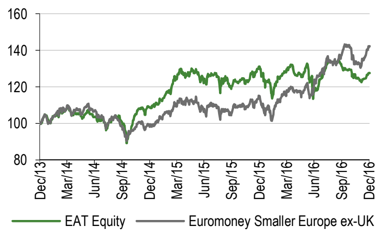
*Including income. As at 29 December 2016.

Yield	7.8%
Ordinary shares in issue	33.2m
Code	EAT
Primary exchange	LSE
AIC sector	European Smaller Companies
Benchmark	Euromoney Smaller Europe ex-UK

Share price/discount performance



Three-year performance vs index



52-week high/low	1,117.5p	934.0p
NAV** high/low	1,147.0p	941.5p

**Including income.

Gearing

Gross*	0.0%
Net cash*	4.1%

*As at 30 November 2016.

Analysts

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

Exhibit 1: Fund at a glance

Investment objective and fund background

European Assets Trust is an investment company incorporated in the Netherlands and listed on the LSE and Euronext Amsterdam. It targets capital growth through investment in quoted small and medium-sized companies in Europe (ex-UK), taking the Euromoney Smaller Europe ex-UK index as a benchmark. It has adopted a high distribution policy; dividends have been paid from a combination of income and capital.

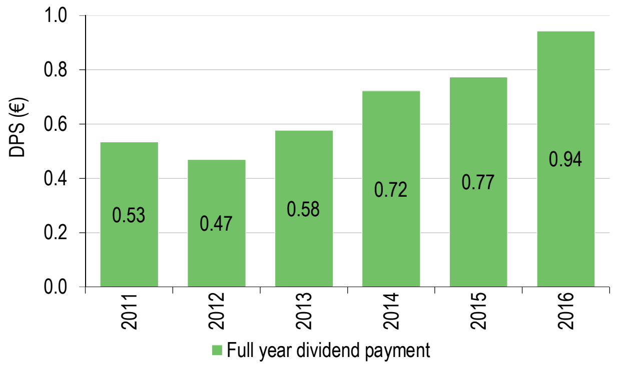
Recent developments

- 26 October 2016: Interim management statement for three months ended 30 September 2016. Sterling NAV TR +10.4% vs +13.3% for benchmark. Sterling share price TR +12.4%
- 8 August 2016: Six-month report ended 30 June 2016. Sterling NAV TR -4.0% vs +5.5% for benchmark. Sterling share price TR -10.9%.
- 1 August 2016: Gross dividend of €0.3349 per share announced (net €0.304).

Forthcoming		Capital structure		Fund details	
AGM	May 2017	Ongoing charges	1.1%	Group	BMO Global Asset Mgt (formerly F&C)
Final results	March 2017	Net cash	4.1%	Manager	Sam Cosh
Year end	31 December	Annual mgmt fee	0.8% of gross assets	Address	Exchange House, Primrose Street, London, EC2A 2NY
Dividend paid	January, May, August	Performance fee	None		
Launch date	1972	Trust life	Indefinite	Phone	+44 (0)800 136420
Continuation vote	None	Loan facilities	€45m with Kas Bank	Website	www.europeanassets.eu

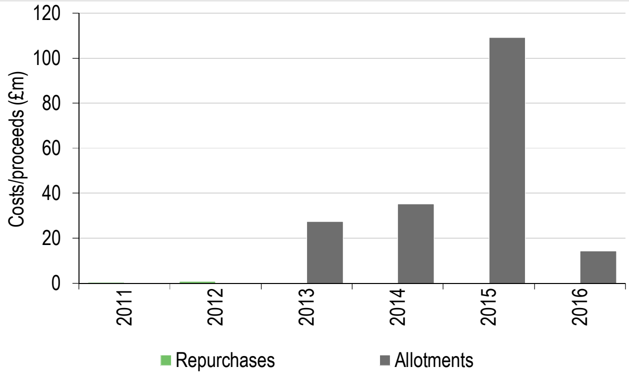
Dividend policy and history

Three dividends are paid annually (January, May and August) totalling 6% of the opening NAV (in euros) at the start of the financial year.

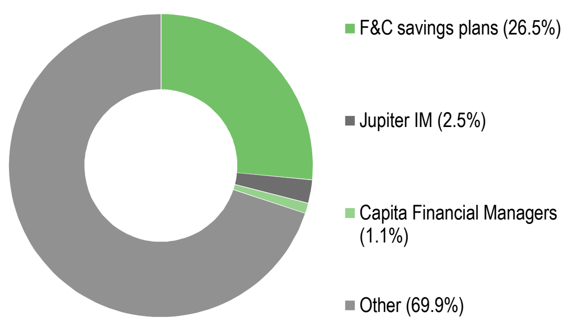


Share buyback policy and history

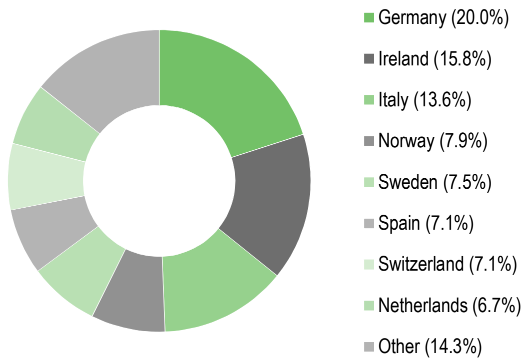
EAT is authorised to both repurchase and allot its ordinary shares. The chart of buybacks and issuance excludes shares issued as scrip dividends.



Shareholder base (at 30 November 2016)



Portfolio exposure by geography (at 30 November 2016)



Top 10 holdings (at 30 November 2016)

			Portfolio weight %	
Company	**Country**	**Main area of business**	**30 November 2016**	**30 November 2015***
Forbo Holding	Switzerland	Flooring, adhesives and conveyor belts	4.8	3.0
Gerresheimer	Germany	Glass and plastic containers	4.5	3.7
Cerved Information Solutions	Italy	Solutions credit information provider	4.4	3.2
Origin Enterprises	Ireland	Agricultural nutrition	3.9	3.6
Amer Sports	Finland	Sporting goods	3.9	3.5
Interpump Group	Italy	Pumps and power take-offs	3.7	N/A
Glanbia	Ireland	Agricultural nutrition	3.5	3.0
ASM International	Netherlands	Semiconductor equipment	3.4	N/A
IMCD Group	Netherlands	Specialty chemicals	3.3	N/A
CTS Eventim	Germany	Concert and ticketing	3.2	N/A
Top 10			**38.6**	**33.5**

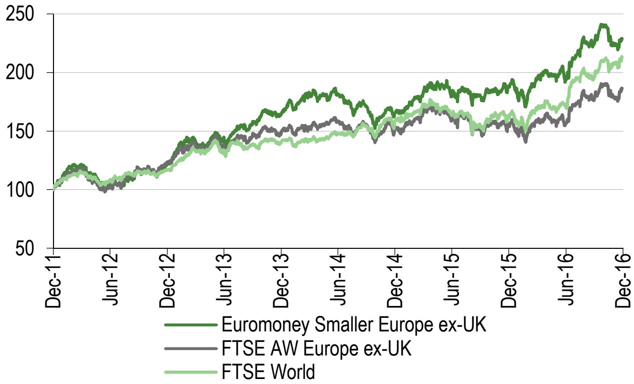
Source: European Assets Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in November 2015 top 10.

Market outlook: More favourable within Europe

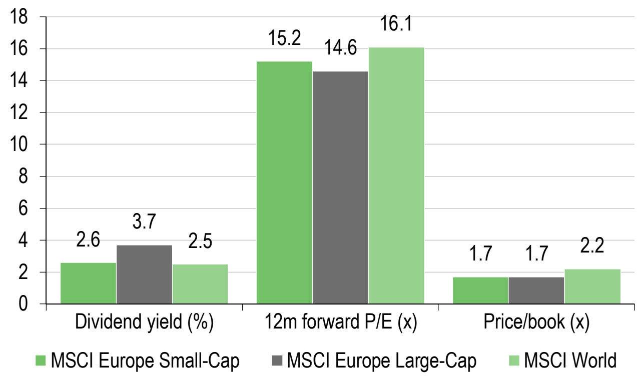
Exhibit 2 (left-hand side) shows the performance of European and world equities over the last five years. After a strong run up in 2016 in an environment of firmer commodity prices and weak sterling, European stocks have pulled back modestly following the result of the US presidential election, as investors are unsure about the impact of changes in US policy, and the European political environment remains uncertain. However, while slower to recover than other developed regions following the global financial crisis, the European economy is showing signs of improvement and in its October World Economic outlook; the International Monetary Fund modestly revised upwards its European growth forecasts for both 2016 and 2017 to 1.7% and 1.5% respectively. As shown in Exhibit 2 (right-hand side), European stocks are more attractively valued than global equities and although European small-cap companies are modestly more expensive than large-cap companies, consensus growth forecasts favour small-caps. For investors seeking exposure to European small caps, a fund with a rigorous investment process and a long-term record of relative outperformance may be of interest.

Exhibit 2: Market performance and valuation

European and world index total returns over five years (£)



Valuation metrics for European small cap, large cap and world equities



Source: Thomson Datastream, Edison Investment Research

Fund profile: High distribution policy

EAT was launched as a Dutch company in 1972 and is listed on the London and Amsterdam stock exchanges. It aims to generate long-term capital growth from investment in European small- and mid-cap companies; it is benchmarked against the Euromoney Smaller Europe ex-UK index. At the time of investment, a company should have a market cap below the largest company in the benchmark or €2.5bn, whichever is greater. No more than 20% of total assets may be invested in a single company. The portfolio must be appropriately diversified by geography and sector, although there are no specific exposure limits. Gearing of up to 20% of gross assets is permitted. Sam Cosh has been lead manager since 2011. In 2001, EAT adopted a high distribution policy, with dividends paid out of current-year profits and other reserves. Each year during January, a 6% distribution is declared based on the euro-denominated NAV at 31 December (financial year end).

The fund manager: Sam Cosh

The manager's view: Rotation in the stock market

The manager comments that in spite of the political turmoil, in stock market terms not much has changed – valuations do not look cheap but they are based off earnings that have still not recovered from the depths of the financial crisis. US earnings have risen because the US economy has grown and corporate debt has reduced, but Europe is still dealing with its issues; there needs to be a recovery in earnings to justify current equity valuations. There are signs of economic recovery in Europe overall; however, Brexit makes the recovery more challenging, although economic data since the vote have been better than expected.

Europe is a heterogeneous region and as a result there has been bifurcation in the stock market; German stocks have risen on the back of very good earnings growth; unlike other European equities in general. There has been a wide spread between the stock price performance of high and low return on equity (ROE) companies – companies with a high ROE, which are seen as better quality, have seen a consistent rerating since mid-2011. The manager suggests that the extent of quality outperformance has been astronomical and is represented in valuation levels. Stocks seen as bond proxies have outperformed because of low returns available from fixed income; stable cash generators have rallied to unsustainable levels on low discount rates.

Cosh says that the market dispersion has affected portfolio construction. He likes to invest in quality companies, with good management teams, on attractive valuations. The fact that quality stocks are expensive has resulted in a shift to a higher exposure in value parts of the portfolio; this has not been the right position over the last 18 months, but the manager suggests there are signs of a turnaround. Quality momentum remained the biggest driver of the European stock market until about September, when there was more of a move into value. More recently, value sectors have moved higher following the result of the US presidential election. There is an expectation of higher inflation and growth and as a result, bond yields have risen; financials and cyclicals have outperformed.

Cosh comments that while Q316 earnings have been a real mix, in aggregate there has been reasonable earnings momentum. EAT has been hit by some disappointments, such as window manufacturer Inwido, which has been hurt by the weather and the withdrawal of incentives to refurbishment. Company share prices have reacted badly if forecast earnings have not been met.

Asset allocation

Investment process: Four broad categories of investment

The European small- and mid-cap universe is large with around 2,000 quoted companies; from this the manager creates a relatively concentrated portfolio of c 40 stocks. Sam Cosh works within the BMO Global Asset Management European equity team, where all managers and analysts undertake fundamental research – meeting company management is an important part of the investment process. Company research leads to detailed standardised reports for prospective or current investments that are debated by the team at twice-weekly meetings; each company is given a qualitative score. Preferred investments are companies with strong balance sheets, healthy cash flows and high and sustainable returns on capital. The manager suggests that the challenge is to find companies with a margin of safety in the valuation. There are some where he likes the business and the management, but not the valuation. These names are put on a 'patient fisherman' list, awaiting a more attractive valuation entry point. This list is currently longer than normal and EAT has c 4% cash in the portfolio; the manager would rather wait and get the investment decision right.

Portfolio holdings are assigned to one of four broad categories:

- Durable franchise – this is the core of the portfolio; companies with at least modest growth potential, disciplined management teams and robust business models. Typically 40-50% of the portfolio, currently c 45%.

- Wide moat growth – higher growth companies with a strong brand, unique product or high market share in a competitive industry. Typically 25-30% of the portfolio, currently c 28%.
- Transformation/recovery – undervalued stocks with a catalyst for change. Typically 15-20% of the portfolio, currently c 15%.
- Deep value – out-of-favour companies, where the recovery or growth potential is underappreciated in the market. Typically 10-15% of the portfolio, currently c 13%.

The first two categories are considered 'obvious quality' stocks, while the last two are considered 'unrecognised future quality'. Portfolio holdings are constantly monitored and are reviewed when they hit the team's forecast price targets, if their share prices rise or fall by more than 25% relative to the benchmark, or if the original buy thesis no longer holds true.

Current portfolio positioning

At end-November 2016, EAT's top 10 positions accounted for 38.6% of the portfolio; this is 5.1pp higher than a year earlier. On a geographic basis, EAT is overweight Germany, where the manager suggests there are some good quality companies at a reasonable price, such as pan-European property lender Aareal Bank, which is trading at a discount to book value, and glass and plastic container company Gerresheimer, which is viewed as a quality growth company without an outrageous earnings multiple.

As shown in Exhibit 3, on a sector basis over the last 12 months to end-November 2016, the largest increase in exposure was to industrials, while the largest decrease was to financials; a function of sector underperformance versus the broader market as well as some asset sales. The manager considers that there are some businesses in the financial sector trading at attractive valuations; he is overweight banks and life insurers but holds no real estate companies.

The manager continues to have zero exposure to three sectors:

- Telecoms – the manager made money investing in cable companies in the past. Cable is viewed as a good business, unlike regular telecom operations.
- Oil & gas – although the sector has done well in recent months, the manager considers the industry is hostage to commodity prices.
- Utilities – there are very few small-cap utility companies and earnings can be affected by government intervention and allowed rates of return.

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

	Portfolio end-November 2016	Portfolio end- November 2015	Change (pp)
Industrials	33.4	25.0	8.4
Consumer goods	25.0	22.0	3.0
Financials	15.2	27.6	-12.4
Consumer services	10.8	15.7	-4.9
Healthcare	6.4	6.1	0.3
Basic materials	4.7	1.2	3.5
Technology	4.5	2.4	2.1
	100.0	**100.0**	

Source: European Assets Trust, Edison Investment Research

New positions that have recently been added to the portfolio are lower down the market cap scale, where the manager is finding better value because the companies are not as well known.

Lectra is a French software and machinery business, selling to fashion houses and auto companies. Lectra's software analyses materials and ensures they are cut efficiently. It is a high-quality business, with strong market share and a high percentage of recurring revenues. It is a family business, where management has been reinvesting in its operations. The manager envisages continued growth at the company; there is potential for more cost leverage and the company is attractively priced relative to other high-quality stocks.

Metall Zug is a very small Swiss family-owned company, with 40% of its market cap in cash. It is attractively valued and has three divisions:

- high-end appliances for kitchens and bathrooms, it has a franchise with luxury apartment builders;
- the number two global player in wire processing, which supplies the auto industry and is benefiting from higher electric content in vehicles and the move to increased automation; and
- infection control; this is currently loss making, but if the business can be turned around, it would be an added bonus.

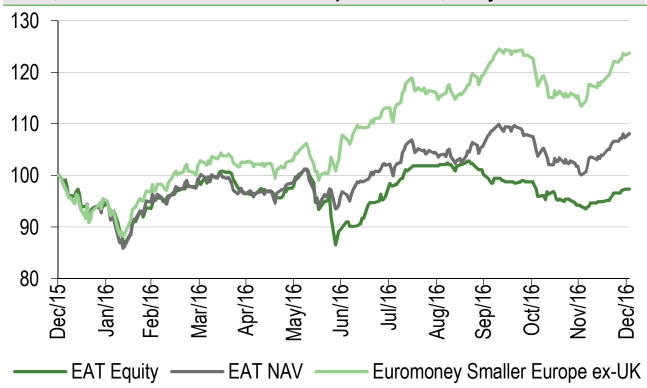
Komax is another Swiss company; it is Metall Zug's main competitor in wire processing, holding the number one global position. The company is undergoing a transformation, selling non-core operations and has a significant amount of cash on its balance sheet.

Recent sales in the portfolio include Danish non-life insurance company Topdanmark. The company's underwriting business is very profitable and its share price has performed well over the long term. Historically the company has repurchased 10% of its shares each year, which has been a very powerful driver for its share price. However, Finnish insurance company Sampo had accumulated a large enough position to launch a takeover bid at Topdanmark's prevailing share price. The manager suggests they are more likely to pay dividends than repurchase shares, and the dividend yield is unlikely to be as high as 10%.

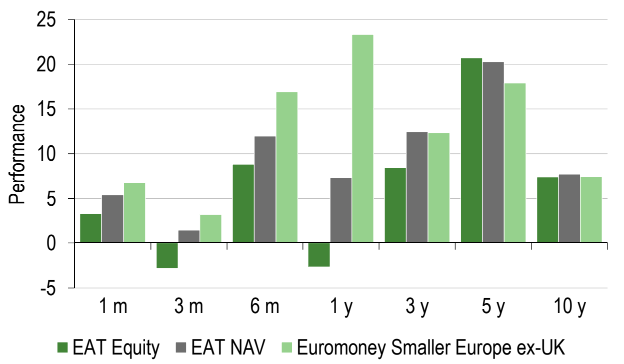
Performance: Tough near-term performance

Exhibit 4: Investment company performance to 31 December 2016

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



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, 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 Euromoney Smaller Europe ex-UK	(3.3)	(5.9)	(6.9)	(21.1)	(10.1)	12.6	(0.4)
NAV relative to Euromoney Smaller Europe ex-UK	(1.3)	(1.7)	(4.3)	(13.0)	0.2	10.5	2.7
Price relative to FTSE AW Europe ex-UK	(3.6)	(7.8)	(5.3)	(19.7)	1.2	39.8	16.8
NAV relative to FTSE AW Europe ex-UK	(1.7)	(3.7)	(2.6)	(11.4)	12.8	37.3	20.4
Price relative to FTSE All-Share	(1.6)	(6.5)	(2.8)	(16.6)	6.9	58.6	18.7
NAV relative to FTSE All-Share	0.4	(2.4)	(0.0)	(8.1)	19.2	55.7	22.3

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-December 2016. Geometric calculation.

EAT's performance record has been affected by weakness versus the benchmark over the past year; its NAV total return has trailed the benchmark by 13pp. The manager explains that this is a result of both portfolio strategy, as deep value has not been favoured by investors, and some poor individual stock performances such as Swiss financial services company Leonteq. The poor performance has been exacerbated by Brexit; EAT had an overweight exposure to the UK via its Irish holdings, which have hurt performance in recent months. The Irish positions have been reviewed and the manager is confident that they will outperform in the longer term. However, given the stock market is currently momentum driven, he is wary about adding exposure on current share price weakness. EAT's long-term record of outperformance versus the benchmark remains in place; its NAV relative total return is higher than the index over three, five and 10 years.

Exhibit 6: NAV total return performance relative to benchmark over five years

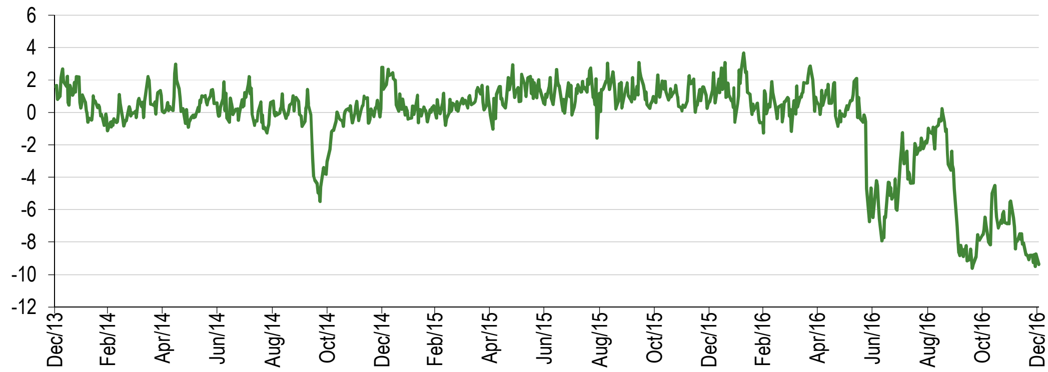
Source: Thomson Datastream, Edison Investment Research

Discount: Wider than historical averages

Having traded at a premium for most of the last three years, following the result of the UK's European referendum EAT's shares moved to a discount to cum-income NAV. The manager has recently seen buying interest (above the regular demand from F&C savings plan investors) as the discount has widened, which he views as comforting.

EAT's current 9.4% share price discount to cum-income NAV is meaningfully wider than the 2.5% average discount of the last 12 months (range of a 3.7% premium to 9.6% discount). It is also wider than the averages of the last three, five and 10 years of 0.5%, 2.9% and 6.1% respectively.

Exhibit 7: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

EAT has one class of shares; there are currently 33.2m ordinary shares in issue. It has a €45m loan facility with Kas Bank, but at end-November 2016, EAT was running a net cash position of 4.1% (in FY15 the range was 2.2% net cash to 2.9% net gearing). The Dutch management board, FCA Management BV is paid an annual fee (€103,975 in FY15) and the investment manager BMO

Global Asset Management is paid an annual management fee of 0.8% of gross assets, which is payable quarterly.

Dividend policy and record

EAT adopted a high distribution policy in 2001; it pays a distribution equal to 6% of euro-denominated NAV on 1 January and is paid in three instalments in January, May and August. The dividend is funded from a combination of current year net profits and other reserves. For UK shareholders the exact amount payable will depend on the sterling/euro exchange rate at the time. Shareholders may also receive their dividend as a scrip (in EAT shares rather than cash).

Peer group comparison

EAT is part of the small AIC European Smaller Companies sector. Its NAV total returns are broadly in line with the sector weighted average over five years, but behind over one, three and 10 years. EAT's risk-adjusted returns, measured by the Sharpe ratio, are below average over one and three years, while its ongoing charge is in line. EAT's 6% distribution policy means that it has the highest dividend yield in the group by a significant margin, which may explain why its discount is by far the lowest in the peer group.

Exhibit 8: European Smaller Companies peer group as at 2 January 2017

% unless stated	Market cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
European Assets Trust	339.4	8.3	40.5	146.2	111.6	(0.6)	0.1	(9.5)	1.1	No	100	7.8
JPMorgan European Smaller Cos	468.8	15.8	44.1	137.6	134.9	(0.3)	0.2	(16.1)	1.2	No	100	1.1
Montanaro European Smaller	102.4	19.7	37.5	99.2	113.1	(0.1)	0.1	(18.6)	1.4	No	111	1.2
TR European Growth	385.0	30.3	58.9	180.2	120.2	0.4	0.4	(15.6)	0.8	Yes	113	1.2
Sector weighted average		**18.4**	**47.0**	**149.5**	**122.7**	**(0.1)**	**0.2**	**(14.4)**	**1.1**		**105**	**2.9**
EAT rank in sector	**3**	**4**	**3**	**2**	**4**	**4**	**3**	**1**	**3**		**3**	**1**

Source: Morningstar, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

EAT is incorporated in the Netherlands and has a two-tier board structure. The management board has a single director, FCA Management BV, which is represented by Wilbert van Twuijver and Tim Koster. The supervisory board is similar to the board of directors of a UK investment trust. It currently has five members: chairman Jack Perry, deputy chairman and chair of audit Professor Robert van der Meer, senior independent director Julia Bond, Laurence Jacquot and Martin Breuer (the newest member of the supervisory board, elected at the May 2016 AGM).