

TR European Growth Trust

Finding value in European small-caps

TR European Growth Trust (TRG) holds a diversified portfolio of European (ex-UK) small and mid-cap companies, with the aim of achieving long-term capital appreciation. Set up in 1990, the trust has been managed by Ollie Beckett (assisted by Rory Stokes) at Henderson Global Investors since July 2011, over which time it has comfortably beaten the benchmark Euromoney Smaller Europe ex-UK index in share price and NAV total return terms, as well as outperforming larger-cap European stocks and the FTSE All-Share index. The portfolio is biased towards value situations and companies at the smaller end of the market cap spectrum. While focused on capital growth, the trust has also grown its ordinary dividend by a compound 15.5% a year over the past five years.

12 months ending	Share price (%)	NAV (%)	Euromoney Smaller Europe ex-UK (%)	FTSE World Europe ex-UK (%)	FTSE All-Share (%)
31/05/12	(36.1)	(30.8)	(29.4)	(24.2)	(8.0)
31/05/13	50.4	41.1	42.7	43.3	30.1
31/05/14	38.8	32.0	24.9	13.4	8.9
31/05/15	15.9	8.3	2.7	4.7	7.5
31/05/16	2.3	6.7	6.3	(3.7)	(6.3)

Source: Thomson Datastream. Note: Total returns in sterling.

Investment strategy: Value-focused, research-driven

TRG holds a diversified portfolio of European small and mid-cap stocks, chosen by managers Ollie Beckett and Rory Stokes for their growth or recovery potential. The managers have a value bias and seek to invest in companies whose worth is underappreciated by the market. The large universe of stocks (c 1,300) is filtered using quantitative screens, and the managers meet or speak with hundreds of companies each year in their search for compelling investment ideas. The portfolio is biased towards the smaller end of the market (c 70% is in sub-£1bn companies), with diversification across a large number of names (c 145) to mitigate risk.

Market outlook: Opportunity from earnings growth?

A combination of geopolitical and macroeconomic worries has led to volatile world stockmarkets so far in 2016 and this may continue in the near term, with the quieter summer months usually subject to lower trading volumes. However, more favourable expectations of earnings growth in Europe – particularly for smaller companies – could drive better returns for investors in the medium term.

Valuation: Wider discount in recent months

At 15 June, TRG's shares traded at a 13.0% discount to cum-income NAV, above the medium-term averages (10.6% and 11.7% respectively over one and three years), but below the 12-month widest point of 16.2% reached at the start of April. The board has not chosen to buy back any shares in the past four financial years, and sees good performance and increased investor interest in Europe, which may have been dampened by Brexit fears recently, as the key factors in sustainably narrowing the discount.

Investment trusts

20 June 2016

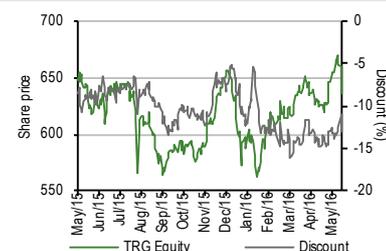
Price 636.0p
Market cap £317.9m
AUM £408.5m

NAV* 717.7p
Discount to NAV 11.4%
NAV** 731.2p
Discount to NAV 13.0%

*Excluding income. **Including income. Data at 15 June 2016

Yield 1.5%
Ordinary shares in issue 50.0m
Code TRG
Primary exchange LSE
AIC sector European Smaller Cos

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low 670.0p 563.0p
NAV** high/low 769.5p 617.7p

**Including income.

Gearing

Gross* 12.0%
Net* 12.0%

*As at 30 April 2016.

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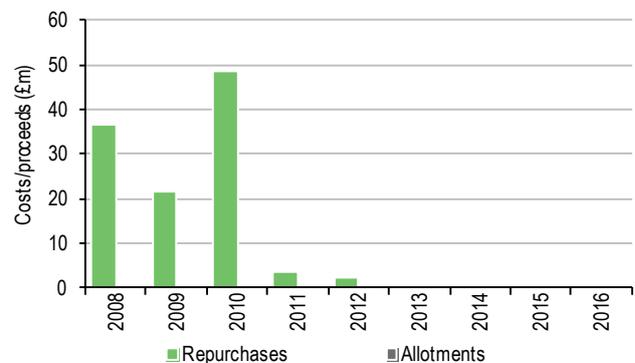
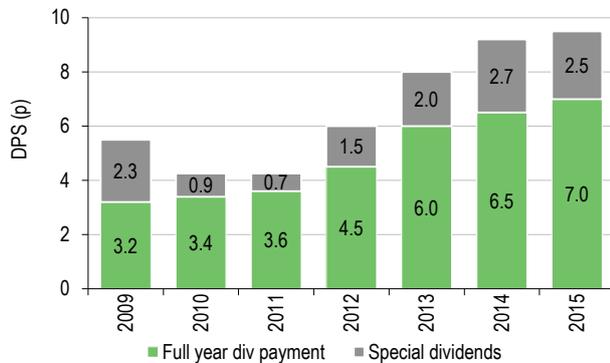
TR European Growth Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

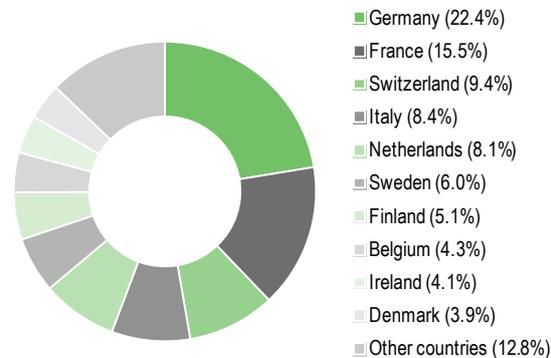
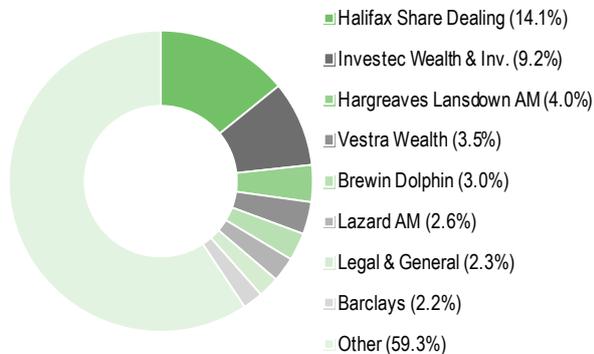
Investment objective and fund background	Recent developments
TR European Growth Trust's objective is to achieve capital growth by investing in smaller and medium-sized companies in Europe (ex-UK). It aims to achieve a net asset value total return in excess of the benchmark Euromoney Smaller Europe ex-UK index (in sterling terms).	<ul style="list-style-type: none"> 22 February 2016: Results for the six months to 31 December 2015. NAV TR +6.7% compared with +8.2% for benchmark Euromoney Smaller Europe ex-UK index. Share price TR +7.0%. 9 November 2015: All AGM resolutions passed.

Forthcoming		Capital structure		Fund details	
AGM	November 2016	Ongoing charges	0.78% (as at 30 June 2015)	Group	Henderson Global Investors
Annual results	September 2016	Gearing	12.0% net	Managers	Ollie Beckett, Rory Stokes
Year end	30 June	Annual mgmt fee	0.6%	Address	201 Bishopsgate, London, EC2M 3AE
Dividend paid	November	Performance fee	Yes (see page 7)		
Launch date	1990	Trust life	Indefinite	Phone	+44 (0) 20 7818 6825
Continuation vote	Three-yearly, next 2016	Loan facilities	£50m overdraft	Website	www.treuropeangrowth.com

Dividend policy and history	Share buyback policy and history
Dividends paid annually in November. While TRG's primary objective is to achieve capital growth, the board also hopes to maintain and grow the ordinary dividend.	TRG has the authority, renewed annually, to buy back up to 14.99% of shares. Buybacks are at the board's discretion following the removal in 2010 of an obligation to repurchase shares if the discount exceeded 10%. The chart below is for financial years to 30 June.



Shareholder base (as at 18 May 2016)	Portfolio exposure by geography (as at 30 April 2016)
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Top 10 holdings (as at 30 April 2016)			Portfolio weight %	
Company	Country of listing	Sector	30 April 2016	30 April 2015*

Brainlab**	Germany	Healthcare equipment & services	2.9	2.4
Aareal Bank	Germany	Financial services	1.7	N/A
OC Oerlikon	Switzerland	Construction & materials	1.6	2.2
DFDS	Denmark	Industrial transportation	1.4	N/A
Verkkokauppa	Finland	General retailers	1.4	1.4
ASM International	Netherlands	Industrial metals & mining	1.3	N/A
Carl Zeiss Meditec	Germany	Healthcare equipment & services	1.2	N/A
Origin Enterprises	Ireland	Support services	1.2	N/A
Van Lanschot	Netherlands	Financial services	1.2	N/A
EVS Broadcast Equipment	Belgium	Technology hardware & equipment	1.2	N/A
Top 10 (% of portfolio)			15.1	16.4

Source: TR European Growth Trust, Edison Investment Research, Morningstar, Bloomberg. Note: *N/A where not in April 2015 top 10. **Unquoted investment.

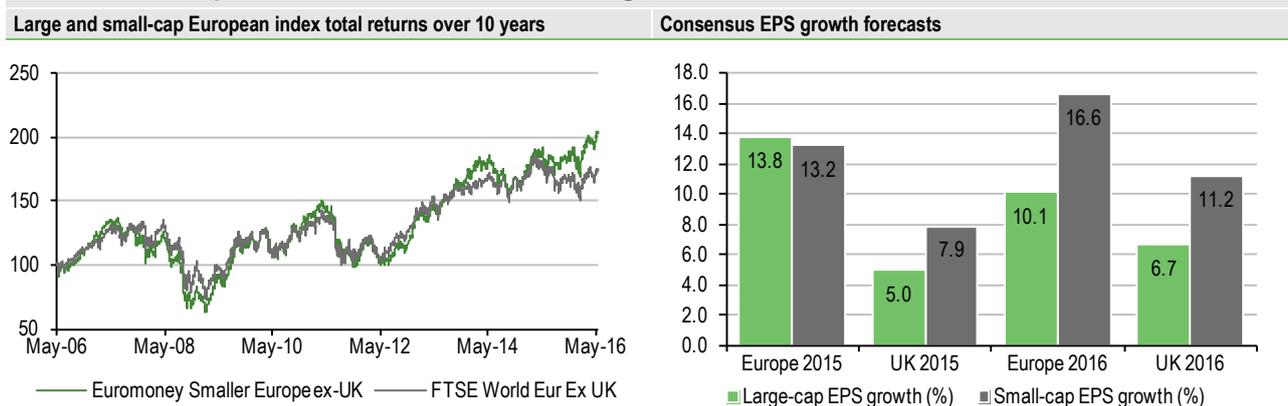
Market outlook: Opportunity from volatility?

As we reach the mid-point of 2016, it seems clear that the volatility which has characterised the year to date may remain for some time longer. Geopolitical worries such as the UK's EU referendum and the US presidential election stand alongside concerns over global economic growth and monetary policy. Added to this, the lower level of market activity during the summer can mean share prices are volatile on thin trading volumes. However, investors should bear in mind that volatility can be a source of opportunity as well as risk.

Looking at the performance of European stockmarkets over the past 10 years (Exhibit 2, left-hand chart), larger and smaller companies experienced similar returns from 2006 until early 2014, since when smaller companies have outperformed. It is important to note, however, that the Euromoney index is a mid- and small-cap index, and as in the UK it is the mid-caps that have been the engine of much of this performance.

Consensus earnings growth forecasts (right-hand chart) suggest a decline in European large-cap EPS growth from 2015; small-cap EPS growth, by contrast, is forecast to accelerate by a similar margin. (In both cases European companies are forecast to enjoy higher EPS growth than their UK peers.) While investors should bear in mind that earnings forecasts may be over-optimistic and are often downgraded later, this differential may nevertheless point to a continuance of smaller company outperformance, particularly in Europe.

Exhibit 2: Market performance and consensus earnings estimates



Source: Thomson Datastream, Edison Investment Research, TR European Growth Trust

Fund profile: Growth from Europe's growing small-caps

TR European Growth Trust (TRG) was launched in 1990 by Touche Remnant (TR), which was acquired by Henderson Global Investors in 1992. The board has continued to subcontract management to Henderson, and since July 2011 the portfolio has been managed by Ollie Beckett, assisted by Rory Stokes since 2013.

TRG aims to achieve long-term capital appreciation by investing in a diversified portfolio of European (excluding UK) small and mid-cap companies. There is a bias towards the smaller, less liquid end of the market, leading to the trust having a longer stock list (c 145 companies) than its peers, in order to mitigate risk. While focused primarily on capital growth, the trust also has a long record of year-on-year dividend increases. Performance is measured against the Euromoney Smaller Europe ex-UK index.

The fund managers: Ollie Beckett and Rory Stokes

The managers' view: Time for a value renaissance?

Lead manager Ollie Beckett notes that in an environment of low growth, low inflation and negative interest rates, market participants have been willing to pay a premium for 'reliable growth' from equities. However, with a market driven by earnings momentum having morphed into one driven by price momentum – where those stocks that have gone up continue to do so and vice versa, almost regardless of fundamentals – Beckett argues that investors are now overpaying for growth, and especially for low growth, as in the case of consumer staples stocks.

While investors with an earnings momentum style have produced good performance in the era of extraordinary monetary policy, Beckett argues that value investing may be on the verge of a comeback. After a period of significant underperformance for stocks with the lowest price/book valuations relative to the broad market, so far in 2016 the decline has stalled, with signs of relative outperformance beginning to emerge. Part of this may have been due to a bounce in oil and banking stocks during March, but a weaker US dollar versus the euro may prove to be the catalyst for a value renaissance.

At the portfolio level, however, what matters more is individual stock catalysts. Beckett says examples would be where he perceives a change in earnings momentum, or if there is a change in management. He gives the example of cable manufacturer Nexans – one of the top contributors to performance so far in 2016 – where operational improvements driven by the new management have led to a reassessment of the company by the market.

Beckett says he and Stokes are prepared to cast their net widely in the search for value, with holdings including Spanish security company Prosegur, which has operations in Brazil and Argentina and is benefiting from the lifting of capital controls under the new Argentinean government. However, the managers still believe in having a core of stocks with structural growth and high returns on capital, such as 3D printer specialist SLM Solutions and high-end online clothing retailer Yoox, which recently merged with Net-a-Porter.

Macro considerations include the British referendum on EU membership, which has affected sentiment towards companies that are exposed to the UK, such as Nobia (a fitted kitchen maker whose brands include Magnet) and Danish ferry operator DFDS. Beckett says that fund managers outside the UK have been selling these types of stock well in advance of the vote, and that fund flows may remain on the sidelines for a while longer, given the quieter summer months and the likely lack of any further supportive action from the ECB while politicians are in recess.

Asset allocation

Investment process: Contrarian focus on small-cap value

Ollie Beckett and assistant Rory Stokes sit within the well-resourced European equities team at Henderson Global Investors, which manages £8-9bn of assets across the market cap spectrum. The managers' aim with TRG is to build a portfolio of stocks that are undervalued because of market misperceptions. They use quant screens to narrow down the universe of more than 1,300 small- and mid-cap companies, and HOLT discounted cash flow analysis to help generate ideas. Beckett and Stokes prefer in-house idea generation to the use of sell-side research, and meeting with company management is a key part of the investment process; the managers see or speak to more than 600 companies each year.

The managers build simplified valuation models for candidate stocks, using a range of metrics such as P/E ratios, free cash flow, dividend yield and EV/EBITDA. Company meetings help the

managers to gauge the quality of management, the robustness of the business model and the drivers of growth. Given the focus on undervalued stocks, interactions with management are also important in helping Beckett and Stokes to understand likely catalysts for a re-rating.

TRG has a longer stock list than peers, as a result of its greater focus on the smaller, less liquid end of the market, where diversification is key to controlling risk. While the portfolio is built from the bottom up, the managers do take account of the macro environment, and also work with Henderson's risk team to eliminate unintended biases from the portfolio.

Stocks may be sold when they reach valuation targets, if there is a deterioration in the fundamentals underlying the original investment thesis, or if the managers see better ideas elsewhere. Turnover is moderate at c 40% a year.

Current portfolio positioning

At 30 April, TRG had 145 holdings, a far longer stock list than its peers, which tend to hold 40-60 companies. As a result, it is also less concentrated, with only 15.1% of assets invested in its top 10 holdings, versus a peer group average of 27.7%. The diverse portfolio is a direct result of TRG's greater focus on smaller and micro-cap companies; Beckett says 70% of the portfolio is in sub-£1bn companies, as that is where he sees the best value opportunities.

TRG's largest holding, Brainlab (bought by a previous manager), is an unquoted German medical technology company; Beckett says further unquoted investments are unlikely, and the position will be exited when an appropriate buyer is found. Germany is also the largest country weighting, at 22.4% (see Exhibit 1); the top four country weightings (including France, Switzerland and Italy) make up 55.7% of assets, underlining the manager's focus on mature Western European markets.

Industrial companies are the largest sector weighting (Exhibit 3) and are also the largest overweight versus the benchmark; the manager also favours technology stocks, but is most underweight financials. Recent purchases include gym equipment maker Technogym and valve manufacturer VAT, both bought at IPO, and clothing firm Hugo Boss. Sales include Swiss asset manager GAM and Aegean Airlines, as well as the exit of several acquired companies (generally sold after a bid is agreed rather than waiting for the deal to complete), including travel consultancy Kuoni, electrical retailer Darty, railway equipment maker Faiveley Transport and video game developer Gameloft.

Beckett reports that the 12-month forward P/E ratio of the portfolio is 15.5x and the underlying portfolio yield is 2.5%. Gearing stood at 12% at 30 April.

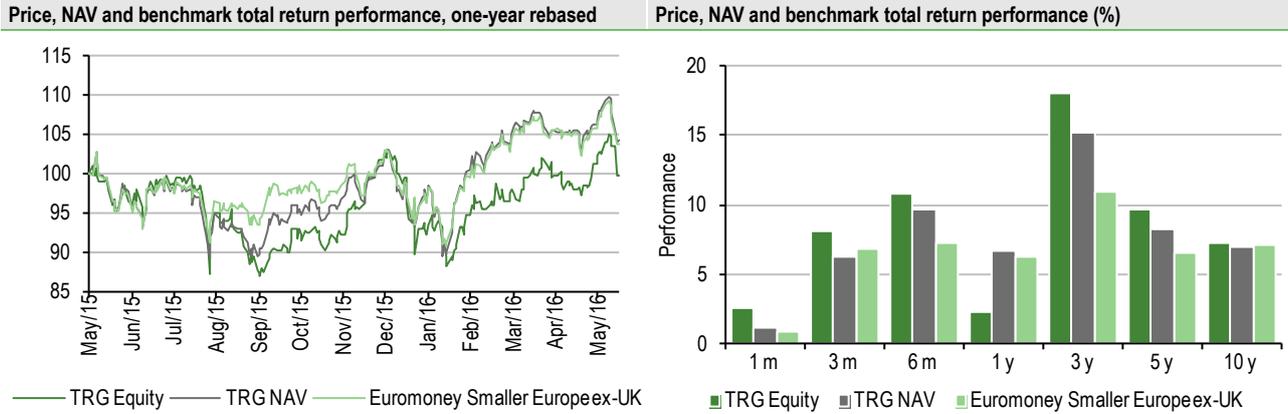
Exhibit 3: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-April 2016	Portfolio end-April 2015	Change (% pts)	Benchmark* weight	Active weight vs index (% pts)	Trust weight/index weight (x)
Industrial goods	22.0	26.7	-4.7	14.7	7.3	1.5
Business providers	14.9	13.6	1.2	20.6	-5.8	0.7
Technology	14.4	14.5	-0.2	8.3	6.1	1.7
Financial	14.2	14.3	-0.2	22.3	-8.2	0.6
Consumer goods	13.0	10.6	2.4	15.6	-2.6	0.8
Basic materials	12.3	12.9	-0.6	10.4	1.9	1.2
Retail providers	7.8	6.1	1.7	6.6	1.2	1.2
Natural resources	1.5	1.2	0.3	1.4	0.1	1.1
	100.0	100.0		100.0		

Source: TR European Growth Trust, Edison Investment Research. Note: *Benchmark is Euromoney Smaller Europe ex-UK index.

Performance: Strong record versus indices

Exhibit 4: Investment trust performance to 31 May 2016



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 Sml Co Eur ex-UK	1.8	1.2	3.3	(3.8)	20.7	15.3	1.6
NAV relative to Euromoney Sml Co Eur ex-UK	0.4	(0.5)	2.2	0.4	11.9	8.5	(1.0)
Price relative to FTSE World Eur ex-UK	2.6	3.5	9.6	6.2	43.8	27.3	17.7
NAV relative to FTSE World Eur ex-UK	1.1	1.8	8.4	10.8	33.3	19.8	14.7
Price relative to FTSE All-Share	1.9	4.1	10.6	9.1	50.1	20.6	20.3
NAV relative to FTSE All-Share	0.5	2.3	9.5	13.9	39.1	13.5	17.3

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

Under manager Ollie Beckett (since July 2011), TRG has outperformed the Euromoney Smaller Europe ex-UK in both share price and NAV total return terms over most periods to 31 May 2016 (Exhibits 4, 5 and 6). Share price performance was weak over 12 months, but has rebounded since the turn of the year. The strategy has also outperformed the larger company European index and the FTSE All-Share over one, three and six months and one, three, five and 10 years (Exhibit 5).

In 2016 to date, strong performance has come from takeover targets Kuoni and Darty, as well as specialist component manufacturers Valmet (Finland), BE Semiconductor (Netherlands), Nexans (France) and SLM Solutions (Germany), which together added 2.2% to TRG's NAV from 1 January to 30 April. The top 10 positive contributors produced a combined gain of 3.5%. The top 10 detractors, which included Elmos Semiconductor (Germany), Belgian engineering and construction firm CFE, agricultural consultancy Origin Enterprises (Ireland) and Italian glasses-maker Safilo together produced a 1.4% reduction in NAV.

Exhibit 6: NAV performance relative to benchmark under Ollie Beckett



Source: Thomson Datastream, Edison Investment Research

Discount: Wider than average in volatile climate

At 15 June 2016, TRG's shares traded at a 13.0% discount to cum-income NAV. This is wider than the averages over one and three years (10.6% and 11.7% respectively), but narrower than the 16.2% reached in April (a 12-month high). In the recent past (Exhibit 7), TRG's shares have tended to trade in a discount range of 5-15%. Larger discounts have been widespread across the investment trust sector during 2016's volatile market climate. TRG may buy back shares to manage a discount, but in practice has not done so since mid-2012; the board sees increased investor appetite for European equities and good performance as key to narrowing the discount.

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



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

TRG is a conventional investment trust with one class of share; at 15 June 2016 there were 50m ordinary shares in issue. The board may buy back up to 14.99% of shares annually to manage a discount, but has not done so in any significant volume since the removal of a hard discount control mechanism (obliging buybacks if the discount exceeded 10%) in 2010. There is a continuation vote every three years, with the next due at the November 2016 AGM. The trust has a £50m borrowing facility with HSBC, indicating a maximum gearing level of 13.7% based on 15 June net assets. The board has set a working limit of 15% gearing and at 30 April actual net gearing stood at 12%.

Henderson Investment Funds acts as TRG's alternative investment fund manager (AIFM) under the AIFM Directive and delegates investment management to Henderson Global Investors. TRG pays Henderson an annual management fee of 0.6% of net assets. A performance fee may also be paid subject to certain conditions: on a three-year basis, the average NAV total return of the trust must outperform the return on the Euromoney Smaller Europe ex-UK index by at least 1%, in which case a fee of 15% of outperformance is due. Total fees are capped at 2%; for FY15 a performance fee of £1.76m was paid and ongoing charges (which exclude the performance fee) were 0.78%.

Dividend policy and record

Although it is primarily focused on achieving capital growth, TRG also has a 14-year track record of consecutive annual dividend increases (based on ordinary dividends). As an investment trust, TRG must pay out at least 85% of net income each year. In recognition of the fact that smaller companies can be volatile and revenue returns may vary significantly from year to year, the board has declared a special dividend in 10 of the last 12 years to safeguard its stable record of ordinary dividend growth. Dividends are paid annually in November. For FY15 a total dividend of 9.5p was

paid, made up of an ordinary dividend of 7.0p and a special dividend of 2.5p. Based on the 15 June share price of 636p and the FY15 total dividend, TRG currently yields 1.5%.

Peer group comparison

There are four investment companies in the AIC's European Smaller Companies peer group (Exhibit 8), with three of them being relatively large (c £318m to £430m) and long-established (one in 1972 and two in 1990). TRG is, by a narrow margin, the smallest and youngest of these three. NAV total return performance is behind the weighted average for the group over one and five years, but ahead over three years. Risk-adjusted performance as measured by the Sharpe ratio is broadly in line with averages over one and three years. TRG has the lowest ongoing charges, but is the only member of the peer group to charge a performance fee. Its discount to NAV is currently wider than the sector average, while its level of gearing is the highest of the group. TRG has the second-highest dividend yield in the peer group; the weighted average is skewed by the high distribution policy of European Assets Trust, which pays dividends partly out of capital.

Exhibit 8: European Smaller Companies peer group as at 14 June 2016

% unless stated	Market cap £m	TR 1 Year	TR 3 Year	TR 5 Year	Ongoing charge	Perf. fee	Discount (ex-par)	Net gearing	Dividend yield (%)	Sharpe 1y (NAV)	Sharpe 3y (NAV)
TR European Growth	318.3	6.0	54.1	50.4	0.8	Yes	(11.2)	113.0	1.5	0.2	1.1
European Assets Trust	339.2	0.5	43.1	78.5	1.3	No	(0.5)	100.0	5.5	(0.2)	0.9
JPMorgan European Smaller Cos	431.2	14.5	58.7	54.8	1.3	No	(12.3)	99.0	1.2	0.6	1.0
Montanaro European Smaller	91.1	10.2	21.0	25.8	1.5	No	(13.2)	112.0	1.4	0.5	0.4
Sector weighted average		7.9	50.1	58.2	1.2		(8.7)	104.0	2.5	0.3	1.0
TRG rank in sector	3	3	2	3	4		2	1	2	3	1

Source: Morningstar, Edison Investment Research. Note: TR = NAV 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 (100 = ungeared).

The board

TRG has five non-executive directors. Chairman Audley Twiston-Davies has served on the board since 2000 and has been in his current role since May 2002. Andrew Martin Smith became a director in 2008, while Christopher Casey was appointed in 2010. Alexander Mettenheimer, a resident of Germany, joined the board in 2011 and the newest director, Simona Heidempergher, who lives in Italy and works in Belgium, was appointed in September 2014. The directors have backgrounds in banking, accountancy and investment management (including private equity).

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