EDISON

BlackRock Greater Europe Investment Trust

Sticking to successful long-term strategy

Investment trusts
European equities

BlackRock Greater Europe Investment Trust's (BRGE) manager Stefan Gries (developed markets, c 95% of the fund) is continuing with his successful long-term approach of being 'an investor in businesses rather a trader in shares'. He believes that stock market volatility will persist as the extended period of low interest rates has come to an end, with central banks tightening monetary policy in response to higher inflation. The manager is confident about the earnings prospects for the fund's investee companies, which he suggests are underestimated by the market. While BRGE's performance in 2022 has been negatively affected by the focus on macroeconomic events rather than company fundamentals, the trust has a commendable medium- and longer-term record. Its NAV total return ranks first in the AIC Europe sector over the last five and 10 years, and second over the last three years.

NAV versus the broad European market (last five years to end-Nov 2022)

Source: Refinitiv, Edison Investment Research

The analyst's view

BRGE offers investors a high-conviction diversified exposure to European equities. Despite a tricky 2022, the trust has meaningfully outperformed its reference index over the last three, five and 10 years. BRGE's portfolio includes some businesses that are benefiting from powerful structural growth trends such as the move to renewable energy, the shift to electric vehicles and advances in healthcare and life sciences. Despite a slowing European economy, corporate balance sheets are in better shape compared with previous downturns, following a decade of deleveraging. A higher-than-average savings rate provides a partial cushion as household incomes are squeezed.

Discount wider than historical averages

In Q122, BRGE moved from trading at a premium to a discount. This is not unsurprising as in general, investment trust valuations have declined this year during a period of above-average investor risk aversion. Given its medium- and longer-term outperformance, over time BRGE could return to a premium valuation. Its 5.2% share price discount to cum-income NAV is wider than the 2.0% to 3.5% range of average discounts over the last one, three, five and 10 years.

13 December 2022

Price		**475p**
Market cap		**£480m**
Total assets		**£505m**
NAV*		501.3p
Discount to NAV		5.2%
*Including income. At 9 December 2022.		
Yield		1.4%
Ordinary shares in issue		101.0m
Code/ISIN		BRGE/GB00B01RDH75
Primary exchange		LSE
AIC sector		Europe
Financial year end		31 August
52-week high/low	704.0p	408.5p
NAV* high/low	685.4p	437.3p
*Including income		
Net gearing*		0.0%
*At 31 October 2022.		

Fund objective

BlackRock Greater Europe Investment Trust's objective is to achieve capital growth, primarily through investment in a focused portfolio of large-, mid- and small-cap European companies, together with some investments in the developing markets of Europe. It aims to achieve a net asset value total return in excess of a broad index of European ex-UK equities (in sterling terms).

Bull points

- Proven longer-term track record, with NAV total returns ranked first in the AIC Europe sector over five and 10 years.
- Portfolio has well diversified revenue streams from different geographies and sectors.
- Very well-resourced team, backed up by strong risk-management oversight.

Bear points

- Performance over the last year has been disappointing.
- Relatively concentrated portfolio.
- Modest dividend yield.

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The fund managers: Stefan Gries and Sam Vecht

The manager's view: Relatively upbeat on economic outlook

Gries says that 2022 has been a challenging year in many respects. His philosophy is to run a high-conviction portfolio investing for the long term; the expectation is that the fund will deliver medium- to long-term outperformance with shorter periods of underperformance. Gries anticipated that inflation would normalise in 2022, but it has been rising and is proving persistent, which has caused central banks to hike interest rates; they are willing to risk recession in order to bring inflation under control.

At the beginning of this year there was a rotation in market leadership from growth to value stocks in anticipation of higher interest rates. Current levels of inflation have not been seen in Europe since the 1970s and stock markets have derated; inflation is being exacerbated by the war in Ukraine, which is adding to commodity price pressures, and supply chain issues. As a result, there has been a flight to quality within the market leading to a dislocation of returns. There are 19 subsectors in the European Stoxx 600 Index and in 2022 to the end of October, there was only one in positive territory (Energy +20%) with the remaining subsectors having declined by at least 8%.

The manager says that the stock market is attractively valued, and investor sentiment is depressed. He notes that market rotations are normally short and sharp and emphasises that earnings, cash flow and company fundamentals drive share prices over the long term. Gries believes that multiple compression is largely complete and company valuations are already pricing in higher interest rates. He suggests that there could be a negative surprise if the European Central Bank overshoots in term of interest rate hikes, but this is not the consensus view. The manager says that investors are focusing on inflation, when interest rates may peak and the potential depth of an economic slowdown. However, he highlights that corporate and consumer balance sheets are in better shape now than they were heading into the last recession and there has been a decade of deleveraging, so debt levels look manageable and interest coverage is considerably higher now than at the time of the global financial crisis in 2008. Gries says that capex is being spent on transformational projects such as better energy efficiency or advancing the digital age, while a labour shortage is supportive for jobs and wages and savings levels are healthy.

Commenting on the Q322 corporate earnings season, the manager says there is a big difference between the demand from high- and low-end consumers, with a lack of a slowdown at the high end and weakness at the low end. As examples, recently, Ferrari upgraded its earnings guidance and LVMH Moët Hennessy Louis Vuitton has been trading strongly.

Gries comments that the US labour market has not started to deteriorate so he does not anticipate a pivot in the Federal Reserve's monetary policy, although he says that the situation in Europe is more nuanced as the labour market has not been as tight as in the United States. The manager reports that the message from companies is that wage gains are manageable. He notes that consumer goods demand in general is declining, port congestion is easing, freight rates are coming down indicating lower volumes and semiconductor prices are moderating. Hence, Gries believes that these factors should filter through to lower inflation. He comments that gas futures prices are declining, energy storage is full and demand in Europe is lower. There is an urgency to lower the dependence on energy imports and to increase energy efficiency, which will require long-term spending on projects.

The manager highlights that BRGE's opportunity set is more than 2k companies and its portfolio is made up of what he and his team consider to be the 35–45 most compelling ideas. He says that Europe is home to some companies that are global leaders in their fields and investors do not need to be positive on the outlook for the European economy to invest in the region; stocks can do well regardless of the domestic economy. Gries comments that important considerations when considering potential investments are a company's corporate culture, its cash flow generation and what opportunities there are to deploy that cash flow into projects that generate a high return on capital. He suggests that the last two years have provided the ultimate test for any management team as they have had to deal with so many issues. During this time, it has been important for companies to be able to cut costs and raise prices.

Current portfolio positioning

At end-October 2022, BRGE's top 10 holdings, in a diversified range of businesses, made up 52.5% of the fund, which was a higher concentration compared with 44.6% a year before. There is a notable increase in the size of the largest three holdings, which collectively made up 22.2% of the fund at end-October 2022 compared with just 13.5% at end-October 2021.

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

Company	Country	Sector	Portfolio weight %	
			31 Oct 2022	31 Oct 2021*
Novo Nordisk	Denmark	Pharmaceuticals & biotechnology	8.8	4.8
LVMH Moët Hennessy Louis Vuitton	France	Luxury goods	7.1	4.7
RELX	UK	Media	6.3	4.0
ASML	Netherlands	Technology hardware & equipment	6.2	7.4
Lonza Group	Switzerland	Pharmaceuticals & biotechnology	5.7	5.5
DSV Panalpina	Denmark	Industrial transportation	4.4	4.1
Sika	Switzerland	Construction & materials	3.7	4.7
Hermès International	France	Luxury goods	3.7	N/A
Safran	France	Aerospace & defence	3.4	N/A
IMCD	Netherlands	Speciality chemicals	3.2	3.1
Top 10 (% of portfolio)			**52.5**	**44.6**

Source: BRGE, Edison Investment Research. Note: *N/A where not in end-October 2021 top 10.

Over the 12 months to end-September 2022, the largest changes in BRGE's sector exposure were lower weightings in technology (-9.4pp) and energy (-3.8pp), and higher allocations to the healthcare (+4.7pp), consumer discretionary (+4.3pp) and financials (+4.1pp) sectors. There were no significant changes to the structure of the fund, which remains overweight consumer discretionary, technology, industrials and healthcare stocks. Four sectors are not represented in the portfolio, energy, real estate, telecommunications and utilities, which together make up 13.8% of the reference index. The lack of energy exposure follows the sale of specialist refiner Neste Oil due to increased competition.

Exhibit 2: Portfolio sector exposure versus reference index (% unless stated)

	Portfolio end-Sept 2022	Portfolio end-Sept 2021	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Industrials	21.5	22.0	(0.5)	16.7	4.8	1.3
Healthcare	21.2	16.4	4.7	17.2	4.0	1.2
Cons Discretionary	20.3	15.9	4.3	12.5	7.7	1.6
Technology	14.5	23.9	(9.4)	8.2	6.3	1.8
Financials	13.0	8.9	4.1	16.3	(3.3)	0.8
Consumer staples	6.4	5.0	1.4	10.4	(4.0)	0.6
Basic materials	3.2	4.1	(0.8)	4.8	(1.6)	0.7
Energy	0.0	3.8	(3.8)	4.7	(4.7)	0.0
Real estate	0.0	0.0	0.0	1.2	(1.2)	0.0
Telecommunications	0.0	0.0	0.0	3.6	(3.6)	0.0
Utilities	0.0	0.0	0.0	4.3	(4.3)	0.0
Total	**100.0**			**100.0**		

Source: BRGE, Edison Investment Research. Note: Rebased for net current assets/liabilities.

The largest changes in BRGE's geographic exposure over the 12 months to end-September 2022 were higher weightings to Belgium and France (both +2.8pp) and a lower allocation to 'other countries' (-6.3pp), the largest component of which was the write down to zero of the fund's Russian holdings in Q122, which made up 4.2% of the fund at end-September 2021.

Exhibit 3: Portfolio geographic exposure versus reference index (% unless stated)

	Portfolio end-Sept 2022	Portfolio end-Sept 2021	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Denmark	19.3	16.7	2.5	5.3	13.9	3.6
Switzerland	17.9	21.8	(3.9)	21.6	(3.6)	0.8
Netherlands	15.5	17.7	(2.2)	8.8	6.7	1.8
France	15.2	12.4	2.8	22.2	(7.0)	0.7
UK	7.4	5.7	1.7	0.0	7.4	N/A
Italy	7.2	4.6	2.6	4.9	2.3	1.5
Sweden	6.7	7.3	(0.6)	6.6	0.0	1.0
Belgium	2.8	0.0	2.8	2.1	0.8	1.4
Spain	2.4	2.0	0.4	4.9	(2.5)	0.5
Other	5.6	11.9	(6.3)	23.6	(18.0)	0.2
Total	**100.0**	**100.0**		**100.0**		

Source: BRGE, Edison Investment Research. Note: Rebased for net current assets/liabilities.

Within the portfolio Gries has reduced some of BRGE's cyclical exposure, but, as highlighted above, the fund's composition is little changed given his long-term investment approach. Activity is relatively muted with annualised portfolio turnover running at 12.5%. The manager highlights a series of themes represented within the fund: pricing power – including ASML, Ferrari and Hermès; medtech – including Lonza and Straumann; a defensive element – including Novo Nordisk and RELX; and structural growth opportunities – including ASML, Hexagon and Sika.

Gries is now more optimistic on the outlook for European banks having had a long-term cautious view. Over the last decade banks have strengthened their balance sheets, their credit quality is satisfactory and they made provisions during the COVID-19 pandemic that were not required. Also, net interest margins are expanding in a rising interest rate environment as loans reprice faster than deposits. Gries believes that there is potential for positive estimate revisions at European banks.

Performance: Moving on from a tough FY22

In FY22 (ending 31 August), BRGE's NAV and share price total returns of -29.2% and -33.4%, respectively, lagged the reference index's -11.5% total return. There were three main drivers of the trust's underperformance:

- BRGE's Russian exposure made up 6.1% of the fund at 31 January 2022. These securities were written down to zero following Russia's invasion of Ukraine.
- Companies with long-duration income and positive fundamentals whose share prices were punished in a rising interest rate environment, such as Lonza (contract manufacturer for the pharmaceutical, biotechnology and nutrition sectors) and Adyen (online payment platform).
- Holdings where the assessment of business conditions was incorrect, such as Netcompany. This IT services company made an acquisition that is likely to increase its business complexity and prove difficult to integrate; also, the firm's operating environment deteriorated.

Positive contributors to BRGE's performance in FY22 included Novo Nordisk (pharmaceuticals) and Hermès and LVMH (both high-end consumer goods).

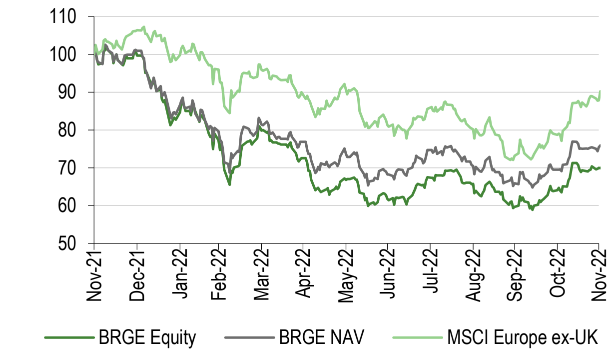
Exhibit 4: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	MSCI Europe ex-UK (%)	CBOE UK All Companies (%)	MSCI World (%)
30/11/18	(1.9)	2.0	(9.8)	(1.8)	6.8
30/11/19	23.6	22.5	15.7	11.3	13.6
30/11/20	27.7	24.3	10.6	(11.2)	11.5
30/11/21	41.1	35.1	14.4	17.1	23.4
30/11/22	(30.0)	(24.5)	(12.1)	7.9	(0.5)

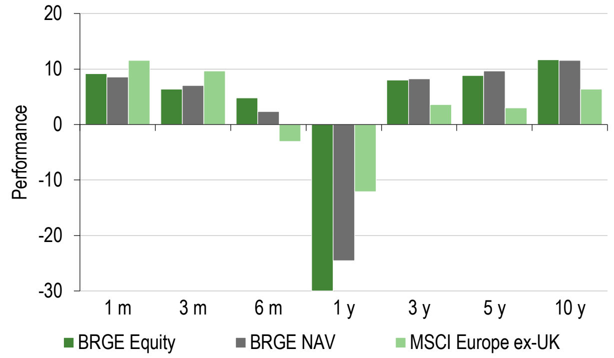
Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

Exhibit 5: Investment trust performance to 30 November 2022

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



Price, NAV and index total return performance (%)



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

While BRGE has outperformed its reference index over the last three, five and 10 years, the last 12 months have proved more challenging. As shown below in Exhibit 6 there has been an improvement over the last six months. Gries is unhappy with the trust's performance so far in 2022, but he and his team remain very focused on seeking longer-term opportunities. The manager believes that the earnings power of BRGE's portfolio companies is underestimated by the market.

Exhibit 6: 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	(2.2)	(3.0)	8.1	(20.3)	13.4	31.7	62.5
NAV relative to MSCI Europe ex-UK	(2.7)	(2.4)	5.6	(14.1)	14.0	36.6	61.1
Price relative to CBOE UK All Companies	1.7	1.9	3.8	(35.2)	12.3	24.5	55.9
NAV relative to CBOE UK All Companies	1.2	2.5	1.4	(30.1)	13.0	29.1	54.6
Price relative to MSCI World	5.5	4.6	0.6	(29.7)	(8.0)	(8.1)	(14.4)
NAV relative to MSCI World	4.9	5.3	(1.7)	(24.2)	(7.5)	(4.7)	(15.2)

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

Peer group comparison

Exhibit 7: AIC Europe peer group at 12 December 2022*

% unless stated	Market cap (£m)	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
BlackRock Greater Europe	479.8	(25.9)	27.1	54.8	194.1	(5.1)	1.0	No	100	1.4
Baillie Gifford European Growth	314.2	(37.4)	9.1	2.4	88.1	(14.2)	0.7	No	114	0.8
European Opportunities Trust	736.4	(11.4)	2.6	17.6	155.9	(13.2)	1.0	No	108	0.3
Fidelity European Trust	1,305.9	(3.6)	33.8	53.3	181.0	(5.4)	0.8	No	112	2.1
Henderson European Focus Trust	306.4	(7.6)	22.4	33.2	176.8	(12.5)	0.8	No	107	3.0
Henderson EuroTrust	260.6	(12.2)	18.1	31.4	180.4	(13.5)	0.8	No	102	3.1
JPMorgan European Growth & Inc	366.6	(5.3)	26.0	26.6	160.0	(12.6)	1.3	No	105	3.6
Simple average	**538.6**	**(14.8)**	**19.9**	**31.3**	**162.3**	**(10.9)**	**0.9**		**107**	**2.0**
BRGE rank in sector (7 funds)	**3**	**6**	**2**	**1**	**1**	**1**	**5**		**7**	**5**

Source: Morningstar, Edison Investment Research. Note: *Performance to 12 December 2022 based on ex-par NAV. TR: total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

BRGE's performance over the last year has been disappointing, with its NAV total return ranking sixth out of seven funds in the ASC Europe sector over the last 12 months. However, its longer-term performance remains very commendable. Over the last three years, the trust's NAV total return ranks second (+7.2pp above average) and it ranks first over the last five and 10 years (+23.5pp and +31.8pp higher than average respectively).

BRGE has the highest valuation in the peer group, it is the only fund that is ungeared and unsurprisingly, given its focus on capital growth rather than income, the trust's dividend yield is below average. Currently, BRGE has the third-highest ongoing charge in the sector. However, its board considers that the trust's investment management fees are high relative to the market and discussions with BlackRock are ongoing.

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