



# Henderson European Trust

HET picks up where its predecessors left off...



Update

23 October 2024

## Overview

Henderson European Trust (HET) is the product of the July 2024 merger of Henderson European Focus Trust (HEFT) and Henderson EuroTrust (HNE), and is co-managed by Tom O’Hara and Jamie Ross, the respective managers of the two trusts. In the **Portfolio section** we discuss how HET looks compared to its predecessors, but essentially it continues with the concentrated forty or so stock portfolio approach of both, homing in on companies the team see as global leaders. While there is currently a quality growth tilt to the portfolio, the team take a pragmatic approach to investing, and aren’t bound by a particular investment style.

Tom and Jamie both have a track record of outperforming HET’s benchmark and have worked together for several years within the 11-strong European equities team at Janus Henderson. The two predecessor trusts had a c. 50% overlap in portfolio immediately before the merger and since then they have made various changes, for example reassessing and reducing exposure to the luxury goods sector and more recently taking positions in some interest rate sensitive stocks in the utilities, telecommunications and REIT sectors.

HET trades at a c. 12% discount, in line with its five-year average, and a little wider than the peer group average of c. 9%. In July HET was promoted to the FTSE 250 Index, which could create additional demand for the shares in due course.

HET is primarily aimed at producing capital growth but nonetheless has an attractive 2.4% **Dividend** yield. The merger created changes to the timing of dividends in 2024, but the expectation is to return to a similar pattern established by predecessor HEFT. HET is currently geared just under 4%, with most of its long-term, low-cost **Gearing** deployed. Any additional gearing will be funded by short-term borrowings.

## Analyst’s View

We’ve discussed the rationale for the merger to create HET in a previous note, but in summary, a larger trust has cost efficiencies, a broader investor audience and is more liquid. In HET’s case, the merger was executed at no cost to shareholders of either trust and it also brings together two managers whose approaches had already converged, so while there are a few corporate refinements to HET, which we look at in the **Charges** and **Discount sections**, changes to the portfolio following the merger are mostly related to investment decisions by the team rather than for technical reasons.

Merger aside, the business of fund management never stops and the pair have been busy reassessing their position in the luxury goods sector, now reduced, and looking for ways to ‘lean in’ to the interest rate cutting cycle, taking a new position in the real estate sector. This is an interesting time for European equities, with large stocks in particular performing well over the last year despite very muted investor sentiment, which we look at in the **Performance section**.

In a **recent article** we discussed some reasons why macro-factors for Europe don’t necessarily map across to European equities, and HET is a very good example of this, with a portfolio of companies expected to grow due to global trends in healthcare, IT spending, energy security and deglobalisation and thus not especially tied to their country of listing.

For readability, we will simply refer to HET when we are referring to historical factors relating to Henderson European Focus Trust (HEFT), unless otherwise specified.

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### BULL

A merger of two successful strategies into one, with greater liquidity and economies of scale

Remains at an attractive discount, with new ‘backstop’ measures in place

European equities trade at a historically large discount to the US

### BEAR

Investor sentiment to Europe remains weak, likely due to macro concerns

Gearing can amplify losses as well as gains

European equity funds continue to see outflows, albeit a reversal could be very positive for markets



## Portfolio

Henderson European Trust (HET) is a focussed portfolio of forty or so European large- and mid-cap companies. The team look for companies that are global leaders in their field and they believe that large-cap companies can offer stronger balance sheets, efficiencies of scale and can be more robust than smaller competitors when economic conditions are difficult. They also believe that there are a few important megatrends that will be significant drivers of returns over many years. These include an IT capex supercycle, energy security and infrastructure spending. Statistics further below suggest the team favour quality growth companies at present, but as some of the examples below will illustrate, the team also make straightforward pragmatic investment decisions, such as their recent increase in exposure to real estate in anticipation of a positive tailwind from falling interest rates.

Although the headline is that HET offers a very similar experience to its predecessors, it's worth briefly looking at some comparisons to illustrate this. The table below shows some comparative portfolio characteristics. The first thing to say is that HEFT in particular had a very style-agnostic approach and the statistics below are very much a moment in time, and at various points has had a more value-orientated portfolio when the opportunities led the team in that direction. With that caveat, we would summarise by saying that both the two predecessors were relatively close in their bias to large- and mega-caps, and to quality growth companies immediately prior to the merger, noting the relatively high return on equity figures for all three portfolios. As the table shows, the various standard financial metrics line up quite closely,

and HET meets in the middle with a slightly lower portfolio P/E ratio, for example than HEFT. Like HEFT though, HET could move across different styles as opportunities arise. Overall, the shifts are quite subtle, and we would further note that the HET portfolio has evolved since the merger as various investment decisions have been taken, which will have shifted the metrics a little bit. HET marries its current quality growth preference with a longer-term style agnosticism and the recent purchase of a position in the REIT sector, below, is an illustration of that pragmatism.

While Tom and Jamie's central case for investing is much more to do with the global leadership of the companies they have selected, it is worth briefly touching on the valuation discount of European equities to the US. On a one-year-forward P/E basis European equities are at nearly a 40% discount to the US and while it is true that Europe does typically trade at a discount to the US, the current level is the widest it has been this century. And, as Tom has previously discussed, the European equity index is more biased to technology, albeit some of this comes classified as 'industrials', and much lighter in sectors such as Oil and Financials than it was 10 or 20 years ago, so the composition of the index is more skewed to sectors that, in our view, naturally trade at higher ratings. So one might argue the discount is even more acute than the headline suggests. Tom and Jamie don't base their case for the trust and the portfolio on our observation, but we think from a big picture perspective this is interesting.

Coming to the portfolio, Jamie and Tom have been carefully reassessing exposure to the luxury goods sector, which readers may know has been a long-standing position for the trust, as well as being one of the distinctive

## Comparison Of Portfolio Characteristics

	HENDERSON EUROPEAN TRUST	HENDERSON EUROPEAN FOCUS TRUST	HENDERSON EUROTRUST
Value			
Price to earnings (1yr forward)	16.4x	17.8x	17.0x
Dividend yield (1yr forward)	2.8%	2.3%	2.5%
Price to book	3.0x	3.0x	3.0x
Growth			
Earnings growth (1yr forward)	14.7%	22.2%	13.0%
Sales growth (1yr forward)	9.6%	6.8%	9.3%
Quality			
Return on equity (1yr trailing)	24.3%	24.4%	27.8%
Risk			
Tracking error	2.9%	3.7%	2.7%
Beta	0.96	1.04	1.00
Number of stocks	40	41	44

Source: Janus Henderson, as at 29 February 2024. Data shown for Henderson European Trust is hypothetical and based on holdings as at 31/12/2023

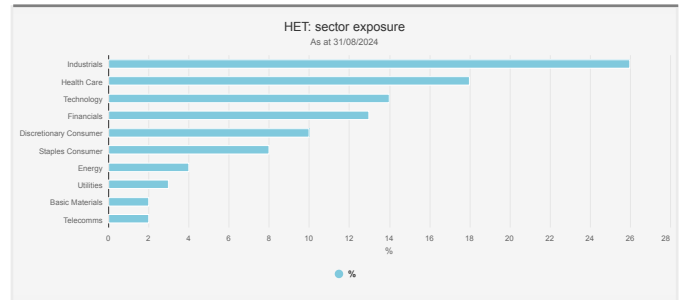


characteristics of European equities, with notable listings in France often being the explanation for why some European equity funds appear to be ‘overweight’ that country. Luxury goods companies such as LVMH have long been seen as an indirect way to capture some of the growth of the middle classes, with more disposable income, across the globe, with China for example accounting for about 30% of LVMH’s revenues. On top of slowing revenues that are more rooted in slowing consumer spending, the team are very conscious that the megatrend of a growing middle class is subject to some very powerful demographic trends in China, where although the one-child policy was removed in 2016, the general pattern for families remains the same, and the birth rate is only just over one. China’s population is therefore expected to age rapidly over the coming decades, with little sign that immigration will balance this out in the same way it does in the US. Therefore, the megatrend that has powered the performance of the luxury goods sector is now being carefully reassessed by the team.

They have also been asking themselves how to lean in to falling interest rates, and for example have taken a position in British Land, the UK-listed REIT. After having considered other European REITs, they feel that this gives them the best broad exposure to commercial real estate, which is generally expected to do well as interest rates fall. While HET is primarily aimed at continental European stocks, it can take up to 20% in positions in other markets, and British Land, together with National Grid, below, are two examples of opportunities where the UK stock has the greatest appeal. They note as a rule that the UK is notably undervalued and took a position in National Grid immediately following its rights issue. Their view is that the rights issue was very necessary to fund the investment that National Grid needs to make to bring grid infrastructure in the UK and US up to a standard that can facilitate the continuing electrification of the economy, but following the rights issue, which was at discount to the share price, the team felt that the price had fallen too far, given the long-term potential for the company to benefit from that investment programme.

The chart below shows HET’s sector weightings, confirming the point above that European equities today are more heavily skewed to industrials, healthcare and technology and less so to financials and oil majors than was the case a decade or two ago. HET is overweight in the industrials sector, which often means companies with a high degree of technology, for example Schneider Electric, which among many other things makes control systems that help data centres use energy efficiently. Similarly HET continues to be overweight technology, for example ASML, the dominant global player in equipment used to etch transistors onto semiconductors, counting all the major manufacturers as customers.

**Fig.1: Sector Exposure**



Source: Janus Henderson

Overall, this remains a focussed portfolio of large-cap stocks where many of the long-term drivers aren’t especially tied to the specifics of macroeconomics at a particular point in time. Even then, the team demonstrate flexible thinking: with the rise of the middle class allied to the luxury goods sector having been a trend for many years now seemingly waning, the team are able to reassess this and not hold on to ideas dogmatically.

## Gearing

HET is currently net geared just under 4%. The trust has €35m of long-term debt in two tranches:

- €25m 1.53% unsecured loan notes redeemable at par on 31/01/2047.
- €10m 1.66% unsecured loan notes redeemable at par on 31/01/2052.

The blended interest cost is 1.57%, and as we look at in the **Portfolio section**, HET’s portfolio yield is c. 2.8%, so even though gearing is primarily aimed at increasing capital returns, it has a positive impact on the income of the trust, given the cost of borrowing is so much lower than the dividend income received when investing that gearing. At time of writing the long-term debt is almost fully deployed so any further increase in gearing would be funded by short-term borrowings. The combination of the two gives the managers cost benefits from the above debt, together with greater flexibility to adjust the level of gearing from time to time as conditions change. The team don’t, though, try to time markets with gearing.

Formally, the policy is to limit gearing at the time of borrowing to 20%.

## Performance

As we discuss in the **Portfolio section**, HET is the marrying of two similar strategies with continuity of management, so the prior track record remains relevant. Since Henderson

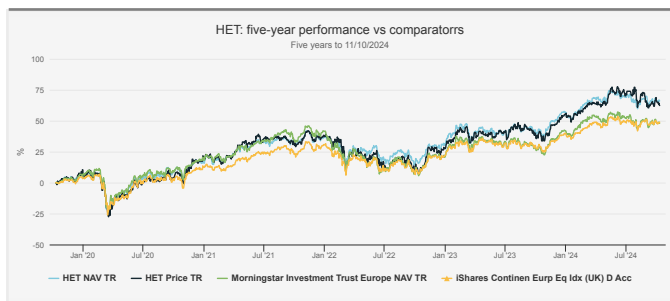


European Focus Trust (HEFT) is the vehicle that absorbed the assets of its stablemate, this is the track record that will appear in all industry data sources and is the one we chart below as HET's record.

Over the last five years to 11/10/2024, HET's NAV and share price TR were c. 66% and c. 63%, which compares favourably to the Morningstar Europe peer group's c. 48% NAV total return, and HET's benchmark, the FTSE World Europe ex. UK's c. 46% total return.

For the record, over the five years to 28/06/2024, HNE's NAV and share price total returns were 54.56% and 58.12%, compared to the benchmark's 50.71%.

**Fig.2: Five-Year Performance**

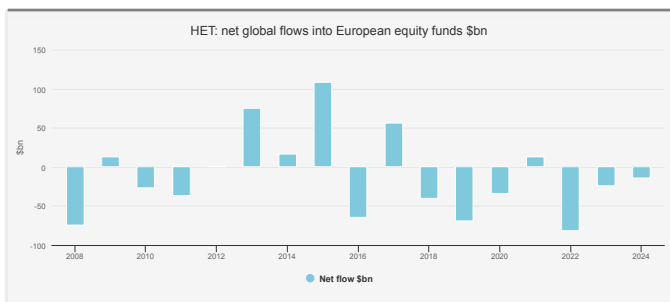


Source: Morningstar, as at 11/10/2024

**Past performance is not a reliable indicator of future results.**

While we would always be cautious about reading very much into short-term numbers such as one year, HET's performance, and indeed the benchmark's, is an interesting contrast to subdued investor sentiment. Given some of the commentary, it would be easy to think that European equities were flat, whereas HET's NAV and share price TR are both c. 14%, and the benchmark's total return is c. 12% (with the peer group about the same). Figures below are an updated version of a chart we have shown before, showing fund flows into and out of European equity funds globally, essentially every European equity fund under Morningstar's coverage, a sample size of several hundred billion US dollars. While the big outflows seen in 2022 have abated, there isn't much sign yet that investors are returning to European equities. And yet,

**Fig.3: European Equity Fund Flows**



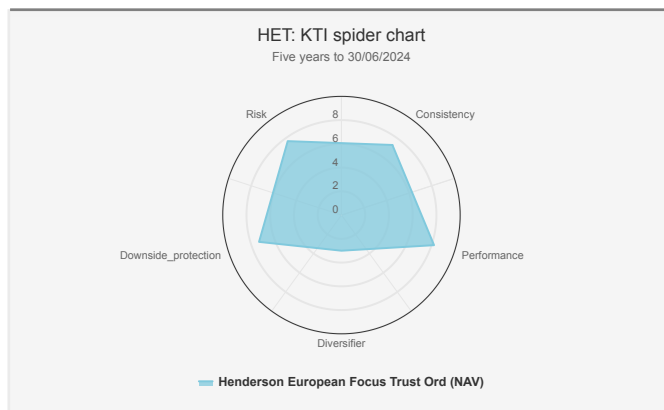
Source: Morningstar

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they have performed well. This is a barometer of investor sentiment that might be equally well be placed in the **Discount section**, as in our view investor sentiment is one of the factors that influence discounts, and thus a change in sentiment would very likely act as a catalyst for HET's discount to narrow, as well as potentially providing impetus to European equities.

In our proprietary KTI Spider Chart below, we show how HET has performed versus an expanded peer group of all European and European smaller companies trusts over the past five years in some key categories. Each category is scored out of ten based on rolling 12-month returns over the last five years, and scores are normalised to the peer group. As such, this data reflects the performance characteristics investors would have experienced over the last five years. This is a strong set of scores in the performance and consistency categories, but also in downside protection, which is an area where trusts with very focussed active portfolios can fall down. Here it is a good illustration of the team's pragmatic approach to changing market conditions, having taken defensive action in 2022 that reduced the impact of market falls, and as a by-product increased underlying income.

**Fig.4: KTI Spider Chart**



Source: Morningstar, KTI calculations

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## Dividend

HET is designed primarily to generate capital returns, but in that context, the trust has an attractive yield of c. 2.4%, and a good track record of paying a progressive dividend. That said, underlying revenues can vary, and from time to time the board has held the dividend, such as in 2020, but in general prefers a progressive dividend if possible.

Just prior to the merger with HNE, HET paid an interim dividend to its existing shareholders to ensure that for the year ending 30/09/2024 they received at least the same dividend as the prior year, and therefore the final dividend, which at time of writing is pending announcement, is likely





to be lower than in previous years. The board has stated that it expects to resume the normal pattern of dividend payments in the year ending 30/09/2025.

## Management

HET is co-managed by Tom O'Hara and Jamie Ross. Given that Tom and Jamie are part of the same European equities team, their working relationship predates their appointment as co-managers on HET so they describe the transition as seamless, and all the focus has been on making investment decisions, including rationalising the portfolio.

Tom O'Hara was a co-manager of HEFT from 2020 until the formation of HET. He is a portfolio manager in the pan-European equities team and co-manages a number of large-cap European equity strategies. Tom joined Janus Henderson as an analyst in 2018, moving from the sell-side, where he was an analyst specialising in metals and mining. Tom received his BA (Hons) degree in Economics from Newcastle University and has 18 years of financial industry experience.

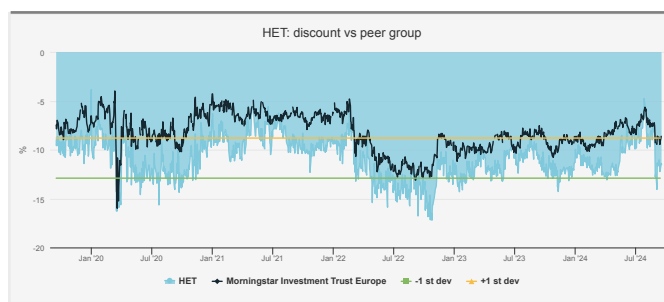
Jamie Ross was appointed co-manager of HET in July 2024, having previously been fund manager of Henderson EuroTrust (HNE) since 2018. Jamie has been a portfolio manager in the European equities team since 2016. Prior to this, he was a portfolio manager on the UK equities team, where he co-managed a UK equities pooled fund. Before that, he was an assistant portfolio manager on the pan-European equities team. He started his career with Henderson in 2007. Jamie graduated with a BA (Hons) degree in Economics from Durham University. He holds the Chartered Financial Analyst designation and has 17 years of financial industry experience.

Tom and Jamie are part of an 11-strong European equity investment team with c. €14bn of AUM.

## Discount

HET currently trades at a c. 12% discount compared to the average for the Morningstar Europe peer group of just under 9%. This is in line with the five-year average, as can be seen in the chart below. In the very short term, in late summer 2024, European and US markets became very volatile and retraced some of the positive performance built up over the first half of the year, and one can see on the chart that HET and the peer group as a whole saw some discount volatility as a result. In July 2024 HET was promoted to the FTSE 250 index, and in due course one could expect additional demand for the shares to be generated by various passive funds and ETFs, with the associated potential for the discount to narrow.

Fig.5: Five-Year Discount



Source: Morningstar as of 17/09/2024

Post-merger, from September 2024, the board has spent c. £4.7m on share buybacks, using normal buyback powers. In the **Performance section** we look at global fund flows in and out of European equity funds, which act as a barometer of investor sentiment, and discuss how a change in sentiment could be both an influence on the performance of European equities and equally on HET's discount.

As well as standard share buyback powers, HET also has the following mechanisms designed to address the discount:

- A performance-related conditional tender offer. If HET has underperformed its benchmark in the five years to 30/09/2029, the board will propose a 25% tender offer, to be priced at a 2% discount to NAV, less the costs of implementing the tender. Should the conditions for the tender be met, it will be subject to shareholder approval.
- No earlier than three years following the merger, the board will consider, at its discretion, whether to offer shareholders an opportunity to realise some of their holding. In doing so the board will take into account, among other factors, the absolute and relative discount compared to the peer group. The merger was completed in July 2024, meaning the decision around this will likely be considered in the second half of 2027.

## Charges

HET has a reduced management fee compared to its two predecessors, which, combined with a larger asset base over which to spread fixed costs, should mean lower overall costs, with an anticipated OCF of c. 0.70%. The average for the AIC Europe peer group is 0.8%.

The new management fee is a tiered fee structure charged at 0.60% on net assets up to £500m, 0.475% on net assets between £500m and £1bn and then 0.45% on net asset above £1bn. HET's current net assets of £680m mean



that it has crossed into the second tier and this gives an average management fee of c. 0.57%, although this figure will rise and fall inversely to the net assets.

HET's KID reduction in yield (RIY) figure is 1.08%. We note that the situation regarding KID RIY figures is evolving rapidly and it appears likely they will be phased out.

## **ESG**

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HEFT is not marketed or presented as an ESG-specific product and, as such, does not have any specific exclusions for sectors or stocks, although Janus Henderson has a firm-wide policy of excluding manufacturers of cluster munitions, anti-personnel mines, and chemical and biological weapons.

ESG is integrated into the investment process. Historically the team has worked to identify opportunities in companies that they believe have not been properly rewarded for their improvements in ESG factors, such as energy efficiency in heavy industry. HET is assigned an average ESG score by Morningstar, moving up from a below average rating in 2023.



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