

# Jupiter US Smaller Companies

## Benefiting from enhanced investment process

Jupiter US Smaller Companies (JUS) is managed by Robert Siddles, who aims to generate long-term capital growth, while preserving capital in periods of stock market weakness, from a diversified portfolio of mid- and small-cap US equities. Since October 2017, the manager has employed a tighter investment process, increasing JUS's portfolio concentration and enhancing the sell discipline. This has proved effective; since then, the trust has outperformed its US small-cap equity benchmark by more than 15pp. Relative performance has remained robust during recent months, which have been characterised by high levels of stock market volatility.

12 months ending	Share price (%)	NAV (%)	US small-cap equities (%)	FTSE All-Share (%)	S&P 500 (%)
31/10/14	(2.2)	6.4	7.1	1.0	17.8
31/10/15	(6.2)	(3.4)	2.6	3.0	9.0
31/10/16	26.2	30.2	29.7	12.2	32.2
31/10/17	10.8	6.4	16.0	13.4	13.7
31/10/18	17.1	18.2	4.5	(1.5)	11.6

Source: Thomson Datastream. Note: all % in pounds sterling.

## Investment strategy: Very disciplined approach

The manager undertakes stock selection in a very disciplined manner, which involves quantitative screening; a qualitative risk assessment, aiming to avoid 'value traps'; and a 'good company test' (a strong franchise, meaningful free cash flow, a high level of insider ownership, potential pricing flexibility and at least 50% potential upside from its current share price). Very few companies pass this three-stage process and are deemed worthy of in-depth fundamental analysis, which includes the construction of a detailed financial model.

## Market outlook: A pick-up in volatility

Last year was a particularly benign period in terms of share price volatility. However, 2018 has seen a return to more normal conditions, and the US stock market has suffered two corrections since end-December 2017. Investor concerns include tensions between the US and its trading partners, and the pace and magnitude of US interest rate hikes. Given this backdrop, investors may benefit from being selective and adopting a more valuation-aware approach.

## Valuation: Scope for a narrower discount

JUS is currently trading at an 11.0% discount to cum-income NAV, which is wider than the 6.6% to 10.0% range of averages over the past one, three, five and 10 years. The board actively manages the discount by repurchasing shares, aiming for a maximum 8% discount in normal market conditions. The significant improvement in the trust's performance since the investment process was tightened in October 2017 suggests there is scope for the discount to narrow. US smaller companies is a low-yielding asset class; hence, JUS does not pay a dividend.

## Investment trusts

29 November 2018

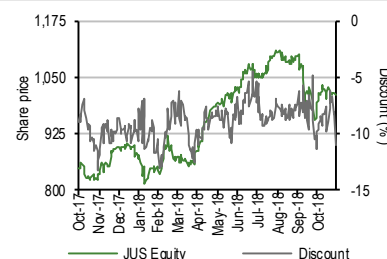
**Price** 1,010.0p  
**Market cap** £147m  
**AUM** £167m

NAV\* 1,134.5p  
Discount to NAV 11.0%

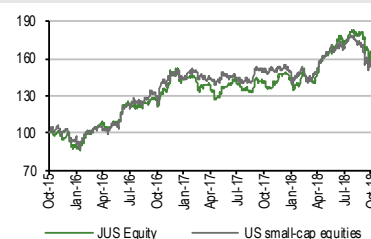
\*Including income. As at 28 November 2018.

Yield 0.0%  
Ordinary shares in issue 14.6m  
Code JUS  
Primary exchange LSE  
AIC sector North America Smaller Companies

## Share price/discount performance



## Three-year performance vs index



52-week high/low 1,112.5p 812.0p  
NAV\*\* high/low 1,206.0p 900.3p

\*\*Including income.

## Gearing

Net\* 1.2%

\*As at 31 October 2018.

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**Jupiter US Smaller Companies is a research client of Edison Investment Research Limited**

### Exhibit 1: Trust at a glance

#### Investment objective and fund background

Jupiter US Smaller Companies' objective is to achieve long-term capital growth by investing in a diversified portfolio primarily of quoted US smaller and mid-sized companies. It uses a [2,000-stock US small and mid-cap index](#) (capital returns, sterling adjusted) as its benchmark.

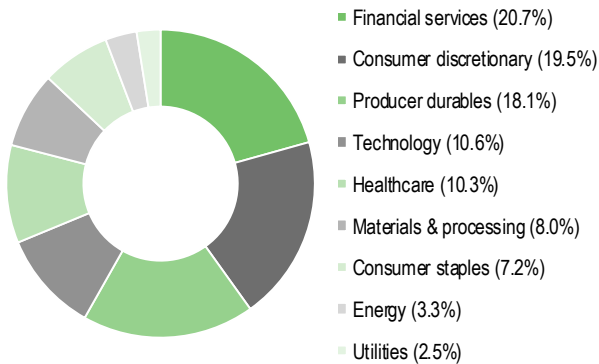
#### Recent developments

- 27 September 2018: annual results for the year ended 30 June 2018. NAV +21.1% and share price +23.8% versus +14.2% capital return for the benchmark (all in sterling terms).
- 9 May 2018: special resolution passed at general meeting to renew JUS's share buyback authority.
- 7 March 2018: half-year report for the period ended 31 December 2017. NAV +7.4% and share price +7.5% versus +4.2% capital return for benchmark (all in sterling terms).

Forthcoming		Capital structure		Fund details	
AGM	November 2019	Ongoing charges	1.02% (30 June 2018)	Group	Jupiter Unit Trust Managers
Interim results	March 2019	Net gearing	1.2%	Manager	Robert Siddles
Year end	30 June	Annual mgmt fee	Tiered (see page 7)	Address	The Zig Zag Building, 70 Victoria Street, London SW1E 6SQ
Dividend paid	N/A	Performance fee	No	Phone	+44 (0)20 3817 1000
Launch date	10 March 1993	Trust life	Indefinite, subject to vote	Website	<a href="http://www.jupiteram.com/JUS">www.jupiteram.com/JUS</a>
Continuation vote	Three-yearly, next 2020	Loan facilities	£20m with Scotiabank		

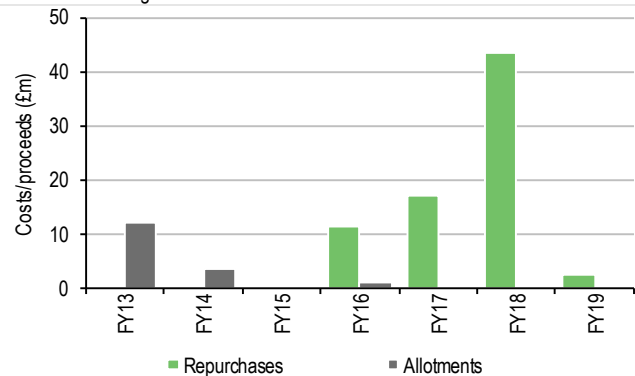
#### Portfolio exposure by sector (as at 31 October 2018)

Weightings are adjusted for net debt (1.2% at end-October).

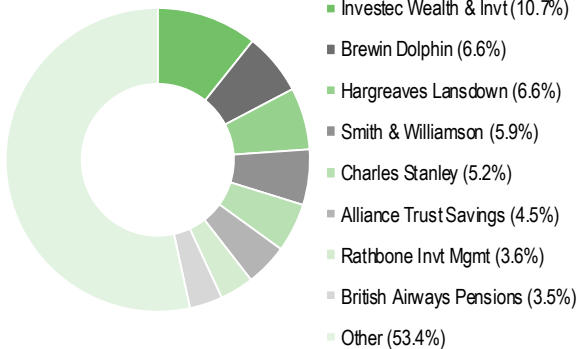


#### Share buyback policy and history (financial years)

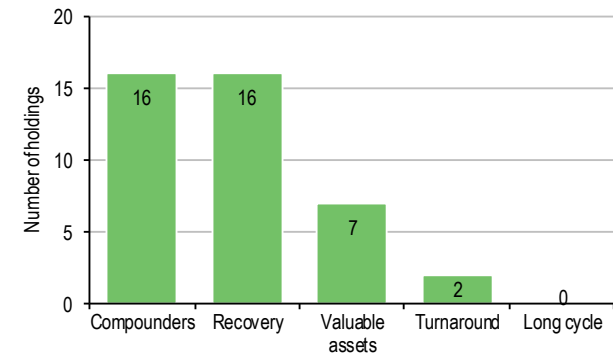
JUS has the authority to allot up to 10% and buy back up to 14.99% of shares annually, to manage a premium or a discount. Buybacks are employed with the aim of maintaining the discount at a maximum of c 8%.



#### Shareholder base (as at 31 October 2018)



#### Portfolio exposure by theme (as at 31 October 2018)



#### Top 10 holdings (as at 31 October 2018)

Company	Exchange	Industry	Portfolio weight %	
			31 October 2018	31 October 2017*
Ollie's Bargain Outlet	NASDAQ	Retailing	7.0	3.1
Chef's Warehouse	NASDAQ	Food products wholesaler	5.3	N/A
America's Car-Mart	NASDAQ	Auto retailing	4.0	2.1
Genesee & Wyoming	NYSE	Rail freight	3.9	2.5
MSC Industrial Direct	NYSE	Industrial tool distributor	3.5	N/A
Ensign Group	NASDAQ	Healthcare facilities	3.5	N/A
Alleghany	NYSE	Reinsurance	3.5	N/A
LiveRamp Holdings	NASDAQ	Application software	3.3	N/A
Bottomline Technologies	NASDAQ	Application software	3.2	N/A
Covanta	NYSE	Waste management	3.1	N/A
<b>Top 10 (% of holdings)</b>			<b>40.3</b>	<b>23.1</b>

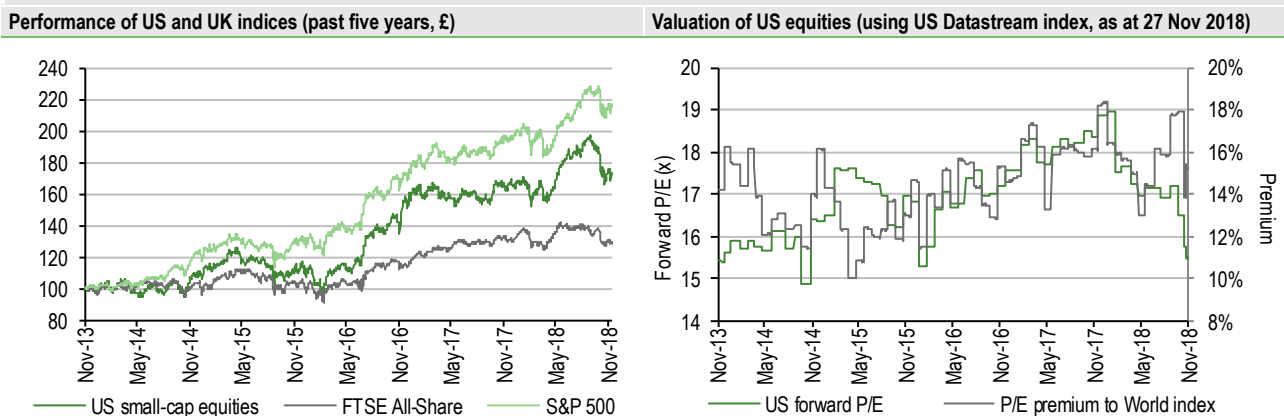
Source: Jupiter US Smaller Companies, Edison Investment Research, Bloomberg, Morningstar. Note: \*N/A where not in end-October 2017 top 10.

## Market outlook: Increased share price volatility

Exhibit 2 (LHS) shows the performance of both US and UK shares, in sterling terms, over the past five years. US equities have performed better, particularly larger-cap stocks (unlike over the longer term, when smaller US stocks have outperformed significantly). So far in 2018, global stock markets have experienced a higher level of volatility compared to a very benign period in 2017; investor concerns include US/China trade tensions and higher US interest rates.

In terms of valuation, US shares (measured by the US Datastream index) are currently trading on a forward P/E multiple of 15.6x. While lower than the high of 19.0x over the past five years, US equities are now at a 15.2% premium to world equities, which is 0.8pp higher than the five-year average. In an environment of higher stock market volatility and above-average relative valuations, investors may be well served by focusing on a fund with a disciplined approach to stock selection that seeks significantly undervalued companies and has a strong performance track record.

**Exhibit 2: Market performance and valuation**



Source: Thomson Datastream, Edison Investment Research

## Fund profile: Focused US smaller-cap investment

JUS was launched in March 1993 as F&C US Smaller Companies. In 2014, the trust moved from F&C Asset Management to Jupiter Asset Management, along with manager Robert Siddles. He aims to generate long-term capital growth from a diversified portfolio of smaller and medium-sized US companies, while also preserving capital in periods of stock-market weakness. The board believes that the US smaller companies sector is an attractive asset class, which is often under-researched, offering areas of undiscovered value. Siddles typically invests in companies with a market cap between \$100m and \$10bn, seeking firms that are trading at a significant discount to their intrinsic value. Data supplied by Jupiter shows that from 1927 to 2014, US value stock returns have compounded at an average 12.8% pa, compared to 10.3% for growth stocks. In 2017, the board announced changes to the investment process and a reduced cost structure (see pages 4 and 7). Gearing of up to 20% is permitted; at end-October 2018, net gearing was 1.2%.

## The fund manager: Robert Siddles

### The manager's view: Support for smaller US companies' shares

Siddles provides an interesting perspective, suggesting support, in terms of reduced supply for, US mid- and small-cap company shares. He cites data showing that from 1996 to 2014, the number of US publicly quoted small-cap companies declined by 53%, while the number of mid-cap companies

fell by 30%. These percentages were much larger than the 11% decline in the number of large quoted US companies. Reasons for the reduction in the number of quoted companies include low interest rates, which have driven a high level of private equity deals, including management buyouts and an increased regulatory burden for publicly listed firms.

Considering the macro background, the manager says that wage inflation in the US was low for a long time and is gradually rising, now up to 3.1%. He says the Federal Reserve begins to get uncomfortable when wages are rising above 3%; hence there is potential for another interest rate hike this December. Siddles believes that, in aggregate, the economy is doing 'fine' as higher wages are limited to selected geographies and industries, such as energy, nursing and trucking. The manager expects a lower number of interest rate rises in 2019 compared with 2018, as he says the longer the Federal Reserve can hold off slowing the economy, the better for the average American. He believes that continued economic expansion can move the 'discouraged' back into employment and increase real wages for the average US worker, following 18 years of little or no above-inflation wage gains, a factor that contributed to the election of President Trump.

In terms of the stock market, after years of easy liquidity, Siddles says that investors are now experiencing more normal conditions, and he expects more frequent corrections, unlike the benign conditions in recent years. However, the manager is not pessimistic, as he is continuing to find companies that fit his strict stock selection criteria, and he remains positive on the prospects of the firms within JUS's more concentrated portfolio. He notes that the higher level of stock-market volatility in 2018 means there have been periods when value rather than growth stocks have led.

## **Asset allocation**

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### **Investment process: Capital growth and preservation**

Siddles invests for the long term, focusing on high-quality companies, whose reasonable valuations should limit downside risk. The investment process leads the manager to focus on areas of the market that are out of favour, or on companies with lower-risk businesses. There is a three-stage process to stock selection: a quantitative screen of the investible universe of more than 3,000 companies with a market cap between \$100m and \$10bn; a qualitative risk assessment aiming to avoid stocks that appear inexpensive, but are unlikely to appreciate (value traps); and a 'good company test' – companies passing this hurdle are subject to thorough fundamental research, including a detailed financial model. Very few companies are able to meet the strict criteria in the 'good company test', which are: a strong franchise, meaningful free cash flow, a high level of insider ownership, potential pricing flexibility and at least 50% potential upside from its current share price. The manager's investment style means there are sectors towards which he naturally gravitates, such as staples of American life (including food and automobiles), specialist non-life insurers and distributors, while avoiding other areas, such as biotech, fashion, restaurants or technology.

JUS's portfolio companies tend to fall into one of two main 'buckets': compounders (undervalued companies with reliable long-term earnings growth) or recovery (companies with very depressed valuations), along with valuable assets (which can be exploited to generate long-term shareholder value) and turnarounds (companies requiring new management teams or strategies). Stocks may be sold if a company's growth prospects deteriorate; it makes a large non-core acquisition; there is a loss of key management or heavy insider selling; there are detrimental changes to an industry cycle; the company becomes too large; further share price appreciation is unlikely; or the manager identifies a more attractive investment opportunity. Positions may be trimmed if a stock exceeds 10% or an industry represents more than 15% of the portfolio. In October 2017, the investment process was tightened up; there is now greater exposure in Siddles' highest-conviction holdings and the sell discipline has been improved; winning positions are allowed to run and the manager is quicker to exit holdings that are underperforming.

## Current portfolio positioning

As a result of the changes in the investment process adopted in October 2017, the concentration in JUS's top 10 positions has increased – 40.3% at end-October 2018, compared with 23.1% a year earlier. The number of holdings has also reduced (from 58 to 42 during the course of FY18, now 41). In terms of sector exposure (Exhibit 3), over the past year JUS has increased exposure to materials and processing (+5.1pp) and producer durables (+4.4pp), with lower exposure in healthcare (-6.6pp).

<b>Exhibit 3: Portfolio sector exposure (% unless stated)</b>			
	<b>Portfolio end-October 2018</b>	<b>Portfolio end-October 2017</b>	<b>Change (pp)</b>
Financial services	20.9	18.4	2.5
Consumer discretionary	19.7	21.3	(1.6)
Producer durables	18.3	13.9	4.4
Technology	10.7	11.4	(0.7)
Healthcare	10.4	17.0	(6.6)
Materials & processing	8.1	3.0	5.1
Consumer staples	7.3	6.2	1.1
Energy	3.3	5.2	(1.9)
Utilities	2.5	2.1	0.4
Cash & (gearing)	(1.2)	1.5	(2.7)
	<b>100.0</b>	<b>100.0</b>	

Source: Jupiter US Smaller Companies, Edison Investment Research. Note: numbers subject to rounding.

The manager highlights two contrasting industries in which he is invested that he believes have temporary oversupply issues – chicken production and assisted living. Chicken is seen as a healthy option compared with red meat and is cheaper, driving underlying demand. Sanderson Farms is a niche player among the chicken producers, providing larger chickens for supermarkets, rather than smaller birds for fast-food restaurants. The company generates a high return on equity, but the industry has periodic overcapacity, leading to weakness in chicken pricing. Siddles says that chicken production is a short-cycle business, so chicken price weakness leads to a reduction in supply. The position in Sanderson was initiated when the company was trading on a historically low price-to-book multiple, reflecting tough industry conditions, and the manager is also attracted by the company's free cash flow generation and high insider ownership. He says that he held previously held a position in Sanderson within the past two years, but sold it when its valuation became unattractive.

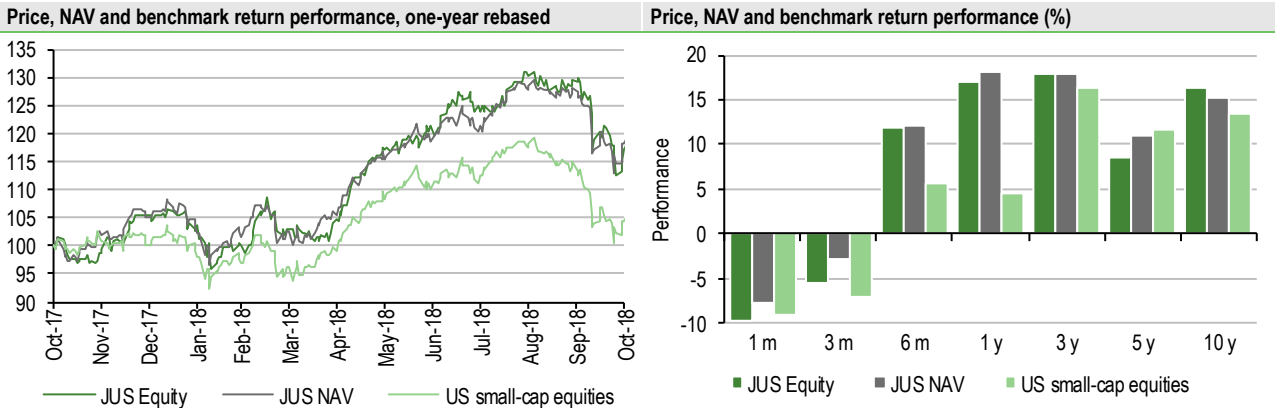
Siddles explains that assisted living is a growth industry because baby boomers are reaching an age when they require these services. However, there has been too much supply added during the past few years and developers are now cutting back on their growth plans, due to lower utilisation and difficulty in achieving fee increases to cover higher labour costs. JUS has a position in Brookdale Senior Living; the manager explains that the company compounded its problems by embarking on a significant merger four years ago, which proved to be problematic. Brookdale is now turning itself around under a new management team, which has improved the balance sheet and the company has a clear plan to fix its issues, including the disposal of unprofitable facilities and focusing more on generating sales. Siddles also expects the company to benefit from improving industry conditions in 2019 as supply growth wanes.

## Performance: Tightened process delivering results

In FY18, JUS's NAV and share price returns of +21.1% and +23.8% were significantly ahead of the benchmark's +14.2% return. The outperformance was primarily driven by the smaller companies in the portfolio, with the largest contributions to performance coming from oil service company DMC Global (+238%), food distributor to up-market restaurants Chef's Warehouse (+116%) and deep discount retailer Ollie's Bargain Outlet (+67%). Performance was also enhanced by three takeovers during FY18: Amplify Snack Brands, which was bought for a significant premium, along with State

Bank Financial and CoBiz Financial, whose bid prices were at more modest premiums to their prevailing stock prices.

**Exhibit 4: Investment trust performance to 31 October 2018**



Source: Thomson Datastream, Edison Investment Research. Note: three, five and 10-year performance figures annualised.

JUS's relative returns are shown in Exhibit 5. The trust has generated very strong results over the past 12 months in both NAV and share price terms; performance has been helped by tightening up the investment process (see below), and the manager has navigated the heightened level of stock market volatility in the past couple of months. Looking over longer periods, JUS has outperformed its benchmark over three and 10 years, while lagging over five years.

**Exhibit 5: Share price and NAV performance, relative to indices (%)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to US small-cap equities	(0.7)	1.8	5.8	12.0	4.2	(13.0)	27.5
NAV relative to US small-cap equities	1.4	4.7	6.0	13.1	4.2	(2.6)	16.2
Price relative to FTSE All-Share	(4.8)	1.9	15.9	18.8	30.7	15.2	76.7
NAV relative to FTSE All-Share	(2.7)	4.8	16.1	19.9	30.6	29.0	60.9
Price relative to S&P 500	(5.1)	(4.8)	0.3	5.0	(2.3)	(30.2)	3.4
NAV relative to S&P 500	(3.0)	(2.1)	0.5	5.9	(2.3)	(21.8)	(5.8)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-October 2018. Geometric calculation.

The success of JUS's refined investment process, with a greater concentration in Siddles' highest-conviction positions and an enhanced selling discipline, is evident in Exhibit 6. Since October 2017, the trust has outperformed the benchmark by more than 15pp, which the manager considers very gratifying. He says that several top 10 positions have performed well, such as Ollie's Bargain Outlet, which is continuing to deliver strong same-store sales growth; nursing home operator Ensign, which has worked through the tough integration of an acquisition and is benefiting from improving industry fundamentals; and America's Car-Mart, which is benefiting from a loyal customer base and a positive mix shift to higher-margin sports utility vehicles.

**Exhibit 6: NAV performance relative to benchmark over three years**

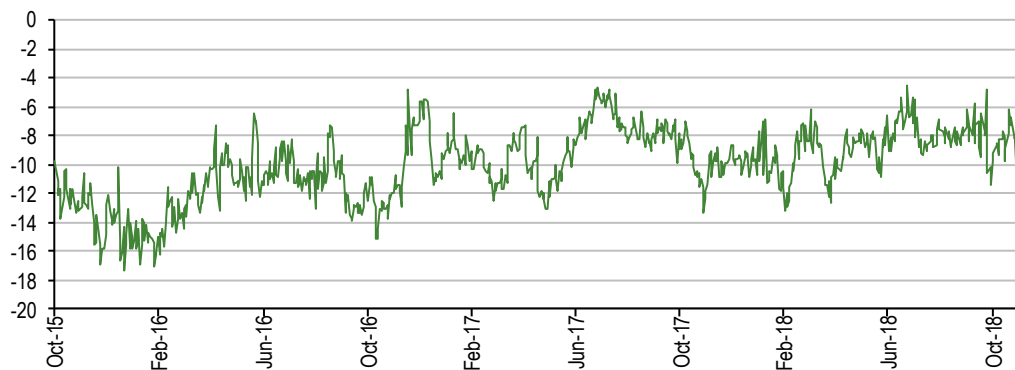


Source: Thomson Datastream, Edison Investment Research

## Discount: Aiming for a maximum discount of 8%

The board targets a maximum discount of 8% in normal market conditions and regularly repurchases shares. So far in FY19, 0.2m shares (1.5% of the end-FY18 share base) have been bought back at a cost of £2.3m. This is a much slower pace of buybacks than in FY18, when 26.0% of the share base was repurchased at a cost of £43.2m. On 9 May, the board received shareholder approval to renew the authority to repurchase up to 14.99% of its shares ahead of the 20 November 2018 AGM. JUS is currently trading at an 11.0% discount to cum-income NAV. This compares to a range of 4.5% to 13.3% over the past 12 months, and the average discounts of 8.9%, 10.0%, 8.6% and 6.6% over the past one, three, five and 10 years, respectively. There is scope for JUS's discount to narrow, given the manager's improved investment performance.

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



Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

JUS is a conventional investment trust with one class of share; there are 14.6m ordinary shares in issue. The trust historically did not employ gearing, but since 29 September 2017 has had a £20m flexible loan facility with Scotiabank (Ireland), with an option of a further £10m if required. At end-October 2018, JUS had net gearing of 1.2%. Prior to 1 October 2017, Jupiter Unit Trust Managers was paid a flat management fee of 0.80% of NAV. There is now a sliding fee of 0.75% of net assets up to £150m, 0.65% between £150m and £250m, and 0.55% above £250m. The performance fee has been removed (last paid in FY14). In FY18, JUS's ongoing charges were 1.02%, which was broadly in line with 1.01% in FY17.

## Dividend policy and record

Reflecting the trust's focus on capital growth rather than income (US smaller companies are not a high-yielding asset class), JUS does not pay a dividend. In FY18, the trust generated revenue income of £1.4m, which was more than offset by management fees and other expenses.

## Peer group comparison

JUS is one of three trusts in the AIC North American Smaller Companies sector. They are not directly comparable, as JPMorgan US Smaller Companies has a growth bias, JUS follows a value investment style, and North Atlantic Smaller Companies invests in smaller US and UK companies, both public and private. To enable a broader comparison, in Exhibit 8 we also show the sterling

share classes of open-ended US smaller company funds. JUS's NAV total return is considerably ahead of both the closed- and open-ended peer group averages over the past 12 months. It is also above the averages over three years, while lagging over five and 10 years, which is not surprising given the outperformance of growth stocks over the last decade. JUS has the lowest ongoing charge in the closed-end peer group, the second-lowest discount and an average level of gearing. The trust does not pay a dividend.

**Exhibit 8: Selected peer group as at 27 November 2018 (all in sterling)\***

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (cum-fair)	Net gearing	Dividend yield
Jupiter US Smaller Companies	148.4	18.4	58.4	68.6	352.6	1.0	No	(8.6)	101	0.0
JPMorgan US Smaller Companies	178.0	5.9	64.4	96.7	513.4	1.3	No	(0.1)	107	0.8
North Atlantic Smaller Companies	392.5	8.7	35.7	95.7	273.2	1.0	Yes	(24.4)	94	0.8
<b>Peer group average</b>	<b>239.6</b>	<b>11.0</b>	<b>52.8</b>	<b>87.0</b>	<b>379.7</b>	<b>1.1</b>		<b>(11.1)</b>	<b>101</b>	<b>0.5</b>
<b>JUS rank in sector</b>	<b>3</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>2</b>	<b>3</b>		<b>2</b>	<b>2</b>	<b>3</b>
<b>Open-ended funds</b>										
Allianz US Small Cap Equity	3.0	1.6	34.8			2.1	No			0.0
Artemis US Smaller Companies	486.8	15.3	77.1			0.9	No			0.0
BMO US Smaller Companies	86.8	9.3	48.4	80.7	395.0	0.8	No			0.0
GS US Sm Companies CORE Eq	216.5	6.8	55.5	85.4	390.5	0.9	No			0.2
Hermes US Smid Equity	783.5	4.1	46.8	80.9		0.9	No			0.0
JPM US Smaller Companies	193.5	7.9	69.5	90.0	453.4	0.8	No			0.0
Legg Mason IF Royce US SmI Cos	195.3	(0.1)	44.9	51.2	268.1	1.0	No			0.3
Legg Mason RY US SmCp Opp	778.5	(4.9)	54.9	55.1	383.5	2.0	No			0.0
Neuberger Berman US Sm Cap	290.0	7.4	50.8	70.7		1.9	No			0.0
Schroder US Smaller Comp	802.4	3.8	51.5	87.5	337.6	0.9	No			0.0
T. Rowe Price US SmI Cos Eq	1,213.9	7.7	58.0	95.5	431.4	1.1	No			0.0
Threadneedle AmerSmI Cos	623.2	2.2	43.1	82.0	408.8	0.9	No			0.2
<b>Peer group average</b>	<b>472.8</b>	<b>5.1</b>	<b>53.0</b>	<b>77.9</b>	<b>383.5</b>	<b>1.2</b>				<b>0.1</b>

Source: Morningstar, Edison Investment Research. Note: \*performance data to 26 November 2018. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

## The board

JUS's board is made up of five historically independent, non-executive directors, but they are aware that recent corporate governance changes mean that directors who have served more than nine years are considered non-independent. The chairman, Gordon Grender, was appointed as a director at the trust's inception in 1993 and assumed his current role in October 1998. The other four directors and their dates of appointment are: Norman Bachop (senior independent director since June 2007 and a board member since February 1999), Peter Barton (February 1998), Clive Parritt (January 2007) and Lisa Booth (September 2015). The directors have experience in a range of financial services including investment management, corporate finance, private equity and investment banking, along with accountancy and law.



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