Results analysis: Henderson European Focus Trust

HEFT outperforms ahead of its forthcoming merger...

Update
29 May 2024

- Over the six months to 31/03/2024, Henderson European Focus Trust (HEFT) produced an NAV total return of 17.9% and a share price total return of 17.0%. This is an outperformance of three percentage points compared to the FTSE Europe ex UK benchmark index's total return of 14.7% and the AIC Europe peer group's NAV total return of 17.8%. The corresponding IA OEIC Europe peer group average NAV total return was 15.0%.

- Longer-term, over five years to 31/03/2024, the trust's NAV and share price returns of c. 85% and c. 82% compared to the benchmark's c. 57% return and the Morningstar Europe peer group's NAV total return of c. 63%.

- The managers note that the largest 10 constituents of the benchmark make up about a quarter of the market cap of the index, of which five saw share price rises of over 30%, of which HEFT owned all five, and three names declined, of which none were owned.

- The largest positive contributions to performance were Nestle (not owned), aircraft engine maker Safran, BE Semiconductor, Roche (not owned), long-term holding Holcim, a construction materials manufacturer, and Airbus, a customer of Safran. Negative contributions came from pulp and paper manufacturer UPM Kymmene, oil company Aker BP, healthcare company Grifols (sold) and food retailer Ahold Delhaize (sold). The managers note that many of the detractors exhibit more cyclical characteristics, in contrast to the 'global winners' that contributed most to performance.

- During the period HEFT announced a proposed combination with Henderson Eurotrust (HNE), also managed by Janus Henderson, with HEFT's manager Tom O'Hara to be joined by HNE's manager Jamie Ross as co-manager. Under the proposals HEFT will be the continuing trust, renamed as Henderson European Trust, and the transaction is, subject to shareholder approval, expected to be completed in July 2024.

- HEFT maintained modest gearing of c. 2%. HEFT's long-term borrowings are fixed at 1.57% and therefore cash held on deposit to reduce gearing earns a higher interest rate than the cost of borrowing.

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- A higher-than-normal interim dividend of 3.05p will be paid on 28/06/2024, ahead of the proposed combination with HNE, to ensure that current HEFT shareholders receive a dividend in line with the previous year's total of 4.35p. Given the significant number of new shares in issue, upon completion of the transaction the board anticipates paying a smaller final dividend later in the year before the dividend pattern normalises the following year.

- At 31/03/2024 HEFT's discount stood at 12.7%, compared to the average discount for the Morningstar Europe peer group of 9.9%. The most recent discount, for 14/05/2023 stood at c. 10%, compared to the peer group's c. 8%. The board anticipates that the creation of a larger, more liquid trust should have a positive impact on the discount.

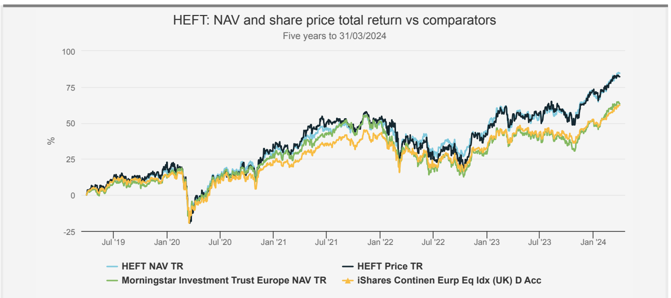
- Vicky Hastings, chair, said "European equities have now increased by over 30% over a 3-year period, despite moribund economic growth in Europe. Our fund managers have always been at

pains to point out that investing in Europe, via HEFT, is really an investment in global trends through a subset of European-listed companies. The unique nature of European equity market performance… …means that 2023 may be the moment when the investment community realised, finally, that European equities are in fact, truly global."

Kepler View

We've covered **Henderson European Focus Trust's (HEFT)** forthcoming combination with stablemate Henderson Eurotrust (HNE) **here** and all the relevant shareholder documentation can be found **here**. This is obviously an important development for the trust, but should not distract us from the strong absolute and relative performance that HEFT turned in during this period. As the managers allude, it is only a short period of time to measure performance but does mark the continuation of an upward trajectory for HEFT and European equities more generally that investors have perhaps been slow to notice. The five-year chart below shows that in the phase following the beginning of interest rate hikes, European equities reached their nadir in October 2022, but for much of 2023 the subsequent rises appeared to go unnoticed by investors, with HEFT and its peer group's discount not responding significantly to the rise in net asset value.

Fig.1: Five-Year Performance



Source: Morningstar, as at 31/03/2024
Past performance is not a reliable indicator of future results.

HEFT's manager's report is a well-thought-out discussion of the job of self-described pragmatists Tom O'Hara and John Bennett to balance their enthusiasm for stock picking with managing risk against a benchmark where, as the summary above notes, ten companies make up a quarter of the index. The team notes that European equity markets' positive performance was driven by a small number of heavyweight stocks, which will have a familiar ring to anyone invested in US equities recently. The point they are making is that when the largest names in the index are doing much of the work, it's not always so easy to outperform.

While the team has used some proceeds from trimming positions in some of their larger winners to selectively add to some more cyclical names which they expect to do well as performance across European equities broadens, it's clear that this is a pragmatic approach to managing a portfolio, and over the long-term they remain confident in their chosen long-term themes, investing in what they call their 'Global Champions' in semiconductor equipment, construction materials, aerospace, and industrials. The report also contains a thought-provoking essay that successfully separates the short-term noise around AI from the longer-term potential that comes from human ingenuity, which we recommend is read in full, as any summary we attempt will only short-change the reader.

HEFT's discount has narrowed a little since the year end, but remains wider than the peer group average, which in our view undervalues its track record of outperformance. HEFT's pending combination with Henderson Eurotrust will create a vehicle with net assets of c. £680m based on figures to the end of April 2024 and it is notable that the two trusts in the peer group with assets over £700m both trade at much narrower single-digit discounts than the rest of the peer group. One can't of course expect any re-rating to come automatically, but the 'size matters' argument of professional investors only gets louder every year, and this transaction removes a barrier that could in our view prove decisive for HEFT's discount, especially if this is combined with continued positive progress for European equities.

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