

20<sup>th</sup> April 2009

**Non-  
independent  
research**

## Update report: **Charter European Trust PLC**

Sector:	Europe	Price @ 17/04/09:	174.5p
Ticker:	CPE.L; CPE LN	NAV @ 17/04/09:	195.7p
Mkt Cap:	£40m	Discount @ 17/04/09:	-10.9%
		Discount (1 yr ave.):	-8.6%

### Summary

Charter European continues to deliver strong returns for shareholders relative to the peer group. In November, the team's efforts were recognised when they won the 2008 Investment Week "European Investment Trust of the Year" award. Following Mark's portfolio repositioning earlier in 2009, recent performance (to 17th April) has been very impressive.

- Mark Lovett of RCM took responsibility for the trust in November 2002 and has been amongst the best performers since then in what is a highly competitive investment trust sector.
- Since our last research piece, Mark has undertaken a decisive repositioning of the portfolio, selling fully priced defensives and increasing risk in the portfolio at very attractive valuations. Whilst he is by no means of the opinion that we are out of the woods yet, the recent very strong performance shows the advantage of having a nimble fund with a contrarian manager and a far from "institutional" mandate. Mark is currently fully invested, but not geared.
- Charter's portfolio is relatively highly focused and currently comprises 36 of Mark's highest conviction ideas in Europe. Mark manages the trust in a disciplined, low turnover manner according to key thematic (often contrarian) ideas. The benchmark is the FTSE World Europe ex UK, but Mark is allowed to invest up to 20% of the assets of the trust in European markets outside of the benchmark.
- As one would hope from a focussed stock picker, Mark's stock picking strategy has delivered the highest alpha scores in the European investment trust sector since November 2004 (when he first adopted the focussed strategy). He has also managed to achieve a consistently high Sharpe ratio relative to peers.

Contrarian repositioning  
at end 2008 paying off  
with strong performance

High conviction, focused  
portfolio with flexible  
mandate

Consistently high alpha  
relative to peers

Charter European represents an interesting vehicle for those wanting an exposure to Europe, but more specifically for those who want a focused and intelligently chosen selection of stocks actively managed by a true stock picker in a risk controlled manner. Mark has a long track record of investing on the continent and since November 2004 he has demonstrated the best alpha generation in the sector through his stock selection. The trust has, as a result, been consistently amongst the best performers in the European sector on both an absolute and risk adjusted basis over this period. The discount of 10.9% as at 16<sup>th</sup> April continues to represent an opportunity to buy the shares below the long term average discount.

## Background

Charter European Trust is a focused stock-picking vehicle in the continental European sector. Mark Lovett (CIO of RCM (UK)) has been the manager since November 2002, and has followed the current focused investment style since November 2004.

## Performance

Charter European has been a very impressive performer over every time period to 31 March 09 since Mark adopted the focused style in November 2004.

**FIG 1: PERFORMANCE RECORD RELATIVE TO PEERS AS AT 31<sup>ST</sup> MARCH 2009**

	1mth	Rank / 11	6mth	Rank/11	1yr	Rank / 11	3yr	Rank / 10	5yr	Rank / 9
BlackRock Greater Europe	4.9	7	-16.4	5	-27.9	5	-23.3	6		
<b>Charter European Trust</b>	<b>9.6</b>	<b>1</b>	<b>-16.3</b>	<b>4</b>	<b>-26.2</b>	<b>3</b>	<b>-14.5</b>	<b>3</b>	<b>38.7</b>	<b>5</b>
F&C Eurotrust	2.6	10	-19.0	7	-26.2	3	-18.7	4	51.4	2
Fidelity European Values	7.0	3	-23.8	9	-42.4	11	-36.9	9	1.3	8
Gartmore European	5.7	4	-11.6	3	-22.4	2	-11.7	2	49.5	3
Henderson EuroTrust	5.2	6	-7.5	1	-19.0	1	-7.1	1	58.8	1
INVESCO Perp Euro Abs	-0.6	11	-31.1	11	-39.8	10	-39.8	10	-15.2	9
JPMorgan European Gwth	7.7	2	-25.4	10	-39.6	9	-29.5	8	11.5	7
JPMorgan European Inc	3.8	9	-22.2	8	-32.8	7				
Jupiter European Opps	5.6	5	-18.7	6	-39.3	8	-23.5	7	30.6	6
SR Europe	4.0	8	-9.2	2	-29.2	6	-23.2	5	47.0	4

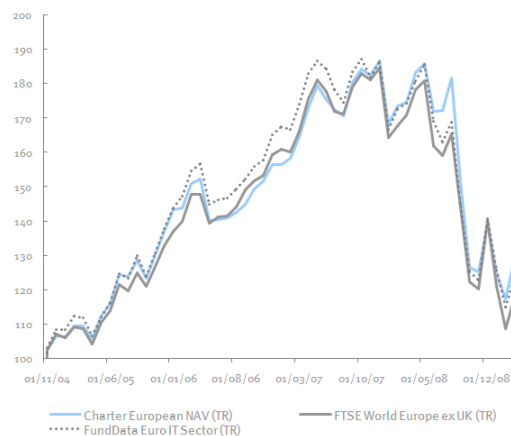
Source: Fundamental Data / Kepler Partners

Consistently strong performance

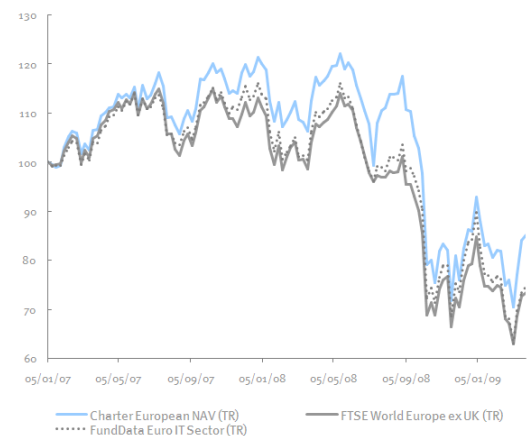
The graphs below illustrate his consistently strong performance, but Fig 3 shows how Mark has continued to perform strongly relative to peers even during more difficult times.

**FIG 2: RELATIVE PERFORMANCE (SINCE NOV. 2004)**

**FIG 3: RELATIVE PERFORMANCE (SINCE JAN. 07)**



Source: Fundamental Data



## Risk and return

Highest Alpha generator in the sector over 2 and 3 years

As one would hope from a focussed stock picker, Mark has consistently generated some of the highest alpha scores in the sector. Mark has also consistently achieved good risk adjusted returns relative to the sector.

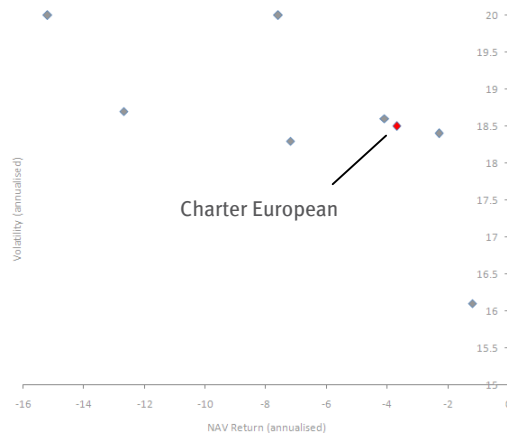
**FIG 4: RISK ADJUSTED RETURNS / ALPHA RELATIVE TO PEER GROUP**

	NAV Vol	rank	NAV TR	rank	Sharpe (ann.)	rank	Beta	rank	Alpha	rank
1 year	36.2	4	-26.2	3	-0.88	4	1.06	2	0.73	2
2 years	29.3	5	-18	2	-0.53	2	1.04	10	0.56	1
3 years	25.9	3	-14.5	3	-0.36	4	1.04	9	0.31	1

Source: Fundamental Data / Kepler Partners Rank 1 = highest out of 11

The graph below illustrates the strong position Charter European occupies in terms of risk and return when compared to the peer group.

**FIG 5: RISK / RETURN OVER 3 YEARS – EUROPEAN INVESTMENT TRUSTS**



Source: Fundamental Data

## Portfolio

### Mandate

“Benchmark unaware”

There are very few top-down constraints on portfolio construction aside from the risk controls set out below. Mark’s investment universe is the companies in the FTSE World Europe (ex UK) index, but can invest up to 20% of the portfolio in stocks in European countries that are not in the benchmark index. Mark pays no attention to benchmark weightings when making day to day decisions.

### Risk controls

Stock position sizes are restricted to 500bps greater than the benchmark. This serves as a useful tool to avoid too much concentration in any one stock (there is no minimum weighting). The board also insist that the portfolio must have stocks in at least 5 different sectors, and as we note above, no more than 20% in stocks that are not in countries in the benchmark index. In all other respects the board give Mark his head to generate alpha from his highest conviction stocks.

### Manager / Style

True stock picker

Mark Lovett is the co-CIO of European equities at RCM but has full accountability for delivering performance for Charter. Mark manages around £750m of capital invested in UK and European equities, of which Charter arguably represents his highest profile account as well as the one with the highest conviction mandate. Mark manages the portfolio in a disciplined, low turnover manner. He invests according to key thematic ideas and picks stocks which in his view are most likely to benefit from these themes. As a result, Mark believes that this is a portfolio that truly represents the views of a pure stock picker. Not surprisingly, the country in which a stock is listed makes no difference to stock selection.

Focused portfolio with around 30 high conviction stocks

### Portfolio / recent activity

Currently the portfolio consists of 36 stocks (30 as at 30 September), with the top ten holdings representing 42% of the total (down from 45%). Since our last research piece, Mark has undertaken a decisive repositioning of the portfolio. At the end of 2008, Mark saw the chance to sell fully priced defensives and increase risk in the portfolio at very attractive valuations. He has reduced his exposure to healthcare and utilities (in the process, selling Novartis which was the largest holding in the portfolio at the time) and increased the exposure to early cyclicals such as chemicals and insurance. He prefers industrial consumables rather than stocks exposed to cap-ex led industrial demand. He retains an exposure to oil and mining believing that demand from Asian economies will not moderate as much as many people fear.

**FIG 6: PORTFOLIO BREAKDOWN AS AT 31 MARCH 2009**

Top ten holdings	% of portfolio	Sector breakdown	% of portfolio
Total	6.0	Financials	27.8%
Tandberg	5.7	Basic Materials	14.8%
BNP Paribas	4.3	Oil & Gas	13.5%
Xstrata	4.3	Technology	12.6%
SAP	4.2	Consumer Services	9.2%
Unilever	3.9	Consumer Goods	8.8%
Groupe Danone	3.4	Utilities	7.9%
Koninklijke	3.4	Health care	3.1%
Solvay	3.3	Industrials	2.1%
Saipem	3.3	Other net assets	0.1%
Total	41.7		

Source: RCM

Currently fully invested but un-geared

Mark is currently fully invested (with 0% cash), but following the bounce in markets does not yet have conviction to draw down the gearing facility. Mark has the flexibility to be up to 20% geared but feels that until volatility has reduced, the risks are too high. Mark is able to invest up to 20% of the portfolio in stocks in European countries that are not in the benchmark index. The point of this is to allow him to buy better quality or higher growth companies within the themes he is positive about. Currently around 11% of the portfolio is invested in London listed financials, oil, and mining stocks.

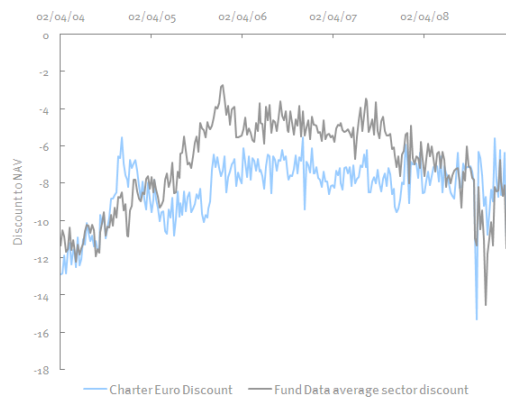
### Outlook

Mark's portfolio positioning tells it all (not always the case with less nimble funds with more institutional mandates). Whilst he is by no means of the opinion that we are out of the woods yet, the consensus "abyss" view at the end of 2008 offered a good opportunity to rebalance the portfolio to benefit from any green shoots of a recovery and improvements in sentiment. Mark was perhaps a couple of months early, but his performance since then has been stellar and illustrates the power of having a contrarian stock-picking manager with a flexible mandate.

### Structural features

#### Discount / Buybacks / Liquidity etc

The company's discount has broadly tracked that of the rest of the sector. Whilst there is no specific discount target, the board believe in being opportunistic in buying shares back when they see them at attractive levels. The board have a policy of only issuing shares from treasury at a discount narrower than 5%. Having a facility to use treasury shares to issue stock aids liquidity but enables the board to balance this with the need to retain a reasonably sized fund.

**FIG 7: 5 YEAR DISCOUNT HISTORY RELATIVE TO SECTOR**

Source: Fundamental Data

### Management fees

RCM is entitled to a basic management fee of 0.5% of net assets. In addition, the manager is entitled to a graduated performance fee of up to 0.75% of net assets depending on the outperformance of the benchmark on a rolling 3 year basis. The total fee payable in any one year is limited to 1.25% of net assets. Over the past six years, the trust has had an average TER of 1.16%, which compares favourably with the average TER for the sector over the same period of 1.36% (source: fund Data).

### Conclusion

Charter European represents an interesting vehicle for those wanting an exposure to Europe, but more specifically for those who want a focused and intelligently chosen selection of stocks actively managed by a true stock picker in a risk controlled manner. Mark has a long track record of investing on the continent and since November 2004 he has consistently demonstrated the best alpha generation in the sector through his stock selection. The trust has, as a result, been consistently amongst the best performers in the European sector on both an absolute and risk adjusted basis over this period. The discount of 11.5% as at 16th April, continues to represent an opportunity to buy the shares below the long term average discount.

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