# Jupiter Green

**Macro events have boosted JGC's story, but pulled down valuations leaving a potential opportunity...**

Update
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## Overview

Jupiter Green (JGC) has a relatively flexible mandate to invest in companies of all sizes which are providing solutions to environmental challenges, such as climate change. This is expected to be an area with strong structural growth trends and JGC aims to capture them through six environmental themes designed to identify the key opportunities. These companies will be at various stages of development, which lead manager, Jon Wallace, defines as innovators, accelerators and established leaders.

Jon assumed full control in January 2021, having worked on the trust since 2014. He is able to invest meaningful positions in smaller companies due to the relatively small size of the trust, being just c. £55m in net assets. This gives him the flexibility to invest globally and across the market cap spectrum, enabling the trust to hold smaller, fast-growing companies which larger or more generalist investors often overlook (see **Portfolio**).

Market volatility has had an impact on performance in 2022 and JGC has slipped to a wide **Discount** as investors have rotated away from the growth style of companies in which the trust invests. However, Jon believes that the macroeconomic backdrop has reinforced the drivers for his companies, for example as the world continues to seek better energy efficiency and security. Jon is remaining watchful, though, and has toned down the more nascent names in the portfolio by reducing the so-called 'innovators' bucket, and has established a net cash position (see **Gearing**). This positioning, as well as the nimbleness afforded by the trust's size, may allow Jon to take advantage should there be a turnaround in market sentiment.

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## Analyst's View

Energy security has been one of the hot topics of 2022 for politicians and we believe this trust is set to benefit from it, especially through the manager's 'Clean energy' and 'Green Buildings & Industry' themes, the latter focussing on energy efficiency (see **Portfolio**). And yet the trust has marginally underperformed both its closest peer and the wider market in the year, as investors have focussed on the impact of rising interest rates on the growth type of companies held by JGC. To us, there seems to be a disconnect between the market's short-term reaction to rising interest rates and the underlying long-term drivers of these businesses. This disconnect may offer an attractive entry point for long-term investors.

The opportunity is also reinforced by the wide **Discount** which JGC is currently trading at, especially compared to its closest peer. Much of this discount came about in a short period in early 2022, showing how quickly sentiment can impact the trust. We believe that this could reverse just as quickly, should macro fears subside and investors start to recognise the benefits to the structural growth story.

JGC has undoubtedly a growth bias which has impacted performance this year. However, we believe that the trust offers a very pure exposure to the long-term growth runways that environmental themes offer. The nimble size of the trust means that it offers investors a very authentic investment vehicle for those looking to benefit from climate change solutions.

| BULL |
| --- |
| Trust is trading at a very wide discount |
| Underlying themes have been strengthened by geopolitical issues |
| Net cash position enables manager to take advantage of weakened valuations |

| BEAR |
| --- |
| Growth bias could lead to further weak performance if interest rate rises continue |
| Smaller company focus which may mean more economic sensitivity |
| Relatively short track record under new approach |

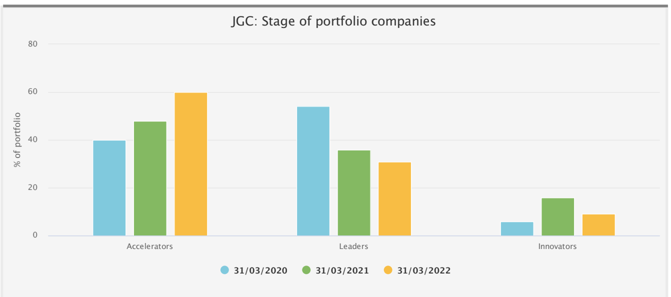
# Portfolio

Manager Jon Wallace looks for companies which provide a product or service that offers a solution to environmental problems, such as climate change. In order to find these companies, Jon typically looks for small and medium-sized companies in which environmental solutions are prominent parts of their businesses. Therefore, these will be key long-term drivers of growth. The size of the trust, with net assets of c. £55m, offers Jon the flexibility to invest in the best opportunities in the smaller-cap space from across the globe. These are firms which competitors may often have to overlook, but the nimbleness of JGC means that Jon can take meaningful positions and benefit from their potential growth as the positive impact a business makes in the real-world is reflected subsequently in share price performance. Being a global strategy, the trust can diversify away the risks of regional policy and can, instead, identify businesses set to benefit from global environmental megatrends.

In order to capture these trends, Jon looks at companies across three different stages: innovators, accelerators and established leaders. Typically, innovators are younger companies which have the potential to deliver high rates of return from disruptive new products or solutions. Accelerators are those which have proven and scalable solutions and are gaining market share from incumbents. Established leaders are larger companies which have a commanding position in their industry. As a result of relatively small changes made to the strategy in 2020, the approach was tweaked to emphasise more fully the growth offered by smaller companies. As such, we understand the trust will continue to move towards focussing on innovators and accelerators, the split of which will depend on the opportunities that Jon finds in the market.

As the graph below illustrates, over the last year Jon has moved the portfolio slightly more defensively. This has resulted in a reduction in exposure to some ‘innovator’ companies that are in the early stages of their growth runway, in particular those companies at the more nascent end of the growth spectrum. These have more limited revenue visibility due to economic uncertainty, but high expectations have meant relatively lofty valuations. Jon has reduced JGC’s weight in these names to reduce some of the

## Fig.1: Stages Of Portfolio Companies



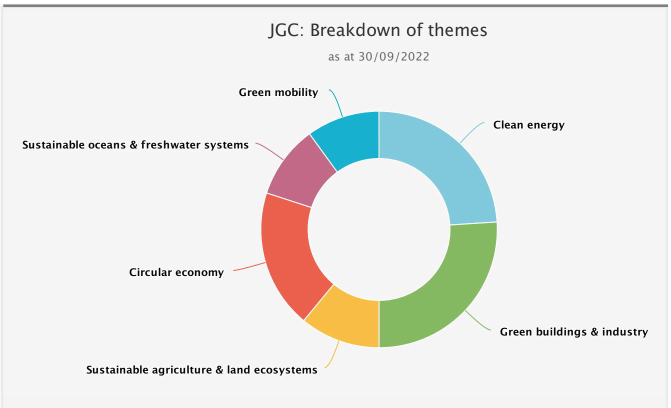

Source: Jupiter Asset Management

valuation risk of the portfolio, although he has not ejected them altogether. We understand that Jon remains confident in the operational performance of those that he does own, although he remains cognisant of the economic backdrop on their outcomes.

Aside from the stage of the company, Jon has six themes to help identify those companies with an environmental solution at the heart of their operations. We show the most recent exposure to each theme in the graph further below.

- Clean energy – including generation, storage and distribution
- Green buildings and industry – that enable a low-carbon transition, such as insulation
- Sustainable agriculture and land ecosystems – protection of natural resources
- Circular economy – sustainable materials and efficient use of resources
- Sustainable oceans and freshwater systems – including conservation and management
- Green mobility – technologies and sustainable movement

## Fig.2: Portfolio Themes




Source: JupiterAsset Management

The weights of these themes show that about half of the portfolio at present has a tilt towards firms involved in the energy transition from fossil fuels to renewable generation. The industries involved in this change have come under the spotlight as a result of a spike in energy prices following the Russian invasion of Ukraine. This has had an impact on a number of the trust’s themes, with energy efficiency being particularly well-supported. With energy prices being so high, the real-world need for efficiency has been emphasised not just for the short term, but for the medium and longer term too. Jon has taken advantage of this increased support by increasing the weight of the green buildings and industry theme, where companies are offering energy-efficient solutions to homes and businesses. One example in this theme is Daikin

Industries, a manufacturer of air conditioning equipment and heat-pumps, which will provide customers with renewable energy heating systems and energy-efficient cooling products.

The sharp increase in energy prices this year has also led to a number of other portfolio changes. Jon has reduced exposure to some of his European companies which have large energy footprints that the firms are unable to reduce in the short term. European companies have taken the brunt of the energy price spikes due to their reliance on Russian gas. This has also affected the spending power of the European consumer meaning that European companies have, generally, struggled to pass on their increased costs, which is having an impact on margins.

Jon has made more specific changes to the portfolio as a result of macro and performance issues. The clean energy theme has performed well as a result of the increase in energy prices, as well as a boost that came from the passing of the Inflation Reduction Act (IRA) in the US. This act brought in the most significant piece of US environmental policy in decades and has a number of supporting policies for renewable energy, which has boosted areas such as solar power. Jon trimmed gains from some of these winners and recycled them into the aforementioned energy efficiency theme, as well as some individual stocks which have sold off. The passing of the IRA and the energy price spike have reinforced both the short and medium-term drivers behind the portfolio but, as discussed in **Performance**, Jon does not believe that this has been reflected in valuations. These changes are no doubt helpful, but aren't the basis of an investment case. The change will be driven by consumers and businesses as a result of decisions around costs and energy availability, along with security and environmental considerations. One outcome of the falls across multiple markets has been that a number of companies are now prospective purchases. Jon is remaining cautious before adding, but we understand that there may be opportunities to take advantage of the market volatility with some new positions.

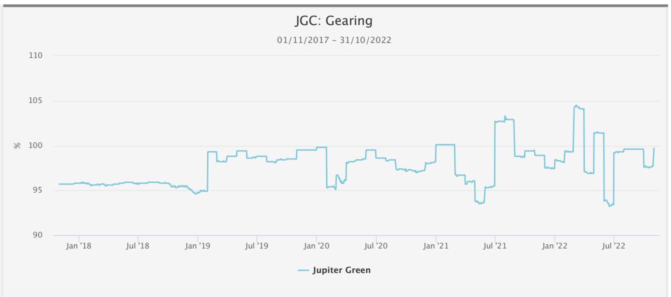
Jon believes that the secular growth drivers behind his companies have not fallen away as a result of a change in market sentiment, but have, in fact, even been reinforced. He believes though that share prices have detached from reality in some cases. He is looking for those where little has changed with the business, but the share price has changed significantly. It is here where he has been adding selectively to companies during volatility. This remains in those companies which have long-term structural growth stories, offer leading technology, have competitive market positions and are led by good management teams.

# Gearing

Jon has access to £5m of gearing through a revolving credit facility which operates on a two-year rolling basis. This equates to approximately 10% of NAV at present, although the policy allows for a maximum of 25%.

As discussed in **Performance**, Jon is taking a patient approach as he considers the current market volatility. As a result, he has not deployed any of the available gearing and JGC is still in a net cash position. Jon last deployed gearing at the end of 2021 but, subsequently, reduced it into the market weakness this year. We understand that Jon is waiting for some of the more obvious external risks to fade before redeploying the gearing, a strategy which he believes is prudent when investing in smaller companies. Once he has more confidence in the market outlook, we understand that he may look to redeploy. One thing Jon intends to focus on at a corporate level is the upcoming corporate earnings' season, which in his view will help him gain an understanding as to how companies are coping with macro issues.

### Fig.2: Net Cash Position

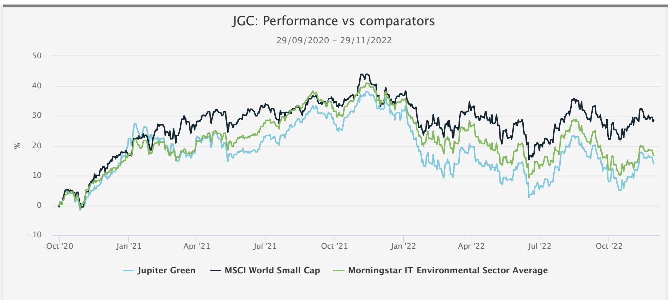



Source: Morningstar

# Performance

As a result of a series of changes to the overall mandate that we discussed in our **previous note**, JGC has increased its weight in smaller companies at an early stage in their development, i.e. 'innovators' and 'accelerators', which has led to an increase in the growth bias of the trust. Whilst this aided NAV performance initially, it has become a headwind through 2022 as the market has rotated away from growth companies as a result of rising inflation. This has led to an increase in interest rates which has shifted market preference to nearer-term returns and has led to investors becoming more fearful about future revenues due to the heightened level of uncertainty. With an increased focus on innovative companies, JGC has been exposed to this and has, as a result, gone through a difficult period which is illustrated in the graph below.

### Fig.3: Performance Since Change Of Mandate




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

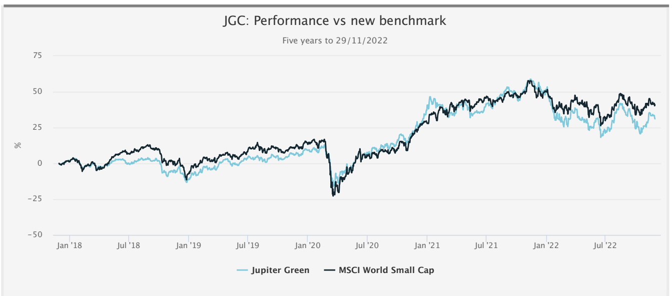
Despite a challenging period over the short term, Jon believes the market has overlooked the underlying drivers for the companies in which he invests, and that the long-term structural growth themes aren't going away just because of market sentiment. The fortunes of companies that he holds are not beholden to good or bad macroeconomic outlooks, given that they have secular growth themes which are likely to run for many years. As such, Jon believes that the fundamentals remain strong, even when the market indicates they are out of favour. In his view, many of the drivers underpinning future prospects have been reinforced recently by the war in Ukraine, which has caused energy prices to spike, in turn boosting the investment case for many of Jon's themes (see Portfolio). However, the uncertainty of the war means that share prices have fallen and this has led to underperformance. We believe that this may offer an opportunity for long-term investors to benefit from a short-term potential disconnect between sentiment and reality.

Observable in the graph above is the underperformance relative to the MSCI World Small Cap Index, JGC's formal benchmark, adopted in September 2020. This benchmark reflects the shift of emphasis towards smaller, more innovative companies. However, it is worth remembering that the index is much broader than those companies with an environmental focus that JGC invests in, meaning there has been, and will likely be, notable differences in the performances of the trust and the benchmark.

JGC is categorised in the AIC's Environmental sector, although this only consists of three trusts currently, including JGC. Impax Environmental Markets (IEM) is the most direct competitor as it also invests in smaller companies. Menhaden Resource Efficiency completes the sector but focusses primarily on the energy and resource-efficiency industries, as well as investing in larger companies than its peers. IEM dominates the sector in terms of size, with a market cap of c. £1.4b compared to c. £55m for JGC. Jon argues that JGC's size enables him to be nimbler in his approach and consider meaningful investments of a much smaller market capitalisation.

Whilst performance has been disappointing over a one-year period, JGC's NAV has shown resilience more recently, having rebounded strongly since the market nadir in the middle of June. This period of better performance, albeit very short-term, has come most notably during market rallies, reflecting the optimism in the portfolio as well as adding support to the potential for a recovery should the economic headwinds ease. We understand that Jon is taking a watching brief on markets for the time being, looking for signs of market fears subsiding before adding more risk to the portfolio (see **Portfolio**). Should the market become more settled and focussed on fundamentals once again, we would hope to see a return to better performance for the trust. The five-year performance graph is shown below, illustrating the longer-term picture, but encompassing earlier years in which the trust had a slightly different mandate, under a different lead manager.

### Fig.4: Five-Year Performance




Source: Morningstar
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## Dividend

The primary focus of JGC's investment objective is to generate total returns. As such, any dividends generated are as a by-product of the process, rather than a specific objective.

Dividends rose for five years prior to 2022, however, there was no dividend declared for the year ending 31/03/2022. This is the first full year of the new investment policy taking place and is indicative of how the approach of investing in faster-growing companies will affect the income generation from the trust. The historic dividend yield was very modest, so in our view this hasn't affected the investment case.

## Management

Jon Wallace is the lead manager of JGC, having been appointed by the board in January 2021 when the previous manager, Charlie Thomas, announced that he was leaving Jupiter for a new role. Jon had worked with Charlie for over a decade and, since 2014, specifically on JGC, meaning this was a smooth transition of management. Jon started his investment career at Jupiter when he joined in 2009. Prior to this, he worked at a non-profit organisation which partnered with businesses and governments to help with sustainability issues. He has a BA in Economics and History and an MSc in Environmental Technology.

JGC was launched in 2006 and is managed by the team that runs the much larger Jupiter Ecology Fund (c. £700m assets). This open-ended fund was launched in 1988 and was a forerunner in the UK within sustainability-themed funds. Jon also co-manages the Global Ecology Diversified Fund at Jupiter.

## Discount

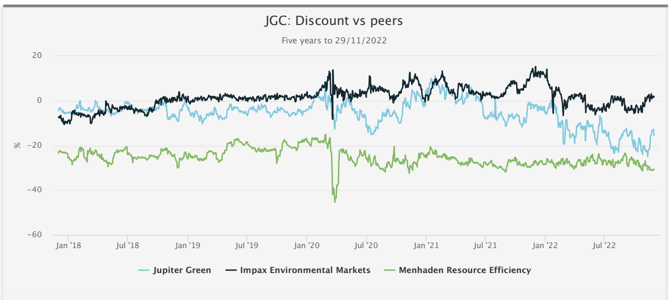
JGC has fallen to a wide discount in 2022 as the trust's bias towards growth companies has moved out of favour with the wider market. This effect has been particularly notable compared to IEM, JGC's most comparable peer. As the graph below shows, both trusts had traded close to NAV for much of the past five years and even traded on reasonable premiums at times.

Historically, the board has taken an active approach to the management of both the trust's discount and premium, which had led to a stable discount. Whilst there is no formal stated policy, the board will use their discretion to buy back and issue shares as they see fit in order to keep the share price reasonably close to NAV. In the period covered by the latest annual report, for the year ending 31/03/2022, the board both issued shares when the trust was at a premium, and bought back shares when trading at a discount. In our view, this demonstrates their desire to maintain a stable discount or premium when possible, a continuation of the approach from before the mandate change.

This approach has been challenged in 2022 following a sharp sell-off in the share price, particularly so in the first quarter of the year. This has led to the discount to NAV at which JGC's shares trade moving to a very wide level versus its own history and against peers. As discussed in **Performance**, the sector that defines the peer group only consists of three trusts, including JGC, and is dominated by IEM which has not seen its discount widen significantly.

JGC's discount has, unarguably, strayed from its longer-term range and so for valuation-focussed investors with long-term investment horizons, this might be considered a potential entry opportunity. As discussed in **Performance**, Jon believes the drivers for his stocks have been reinforced by macro trends, which we understand could lead to a narrowing of the discount should the market start to recognise this and performance improves.

### Fig.5: Discount Vs Peers




Source: Morningstar
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## Charges

JGC has a tiered approach to charges in order to pass on the economies of scale to investors, should the trust grow. The management fee for net assets up to £150m is 0.7%, which reduces to 0.6% for net assets over £150m and up to £250m, and then reduces further to 0.5% for net assets in excess of £250m. The net assets of the trust are currently c. £55m, meaning that JGC has some way to go before the tiered fee has an impact on the overall charges.

The trust's ongoing charges figure (OCF), which includes the management fee and other costs associated with running the trust, stood at 1.57% on 05/12/2022, which reflects the relatively small size of the trust. The OCF compares to the sector average of 1.41%. However, this sector only has three holdings, including the closest competitor, Impax Environmental Markets, which has an OCF of 0.73%. This reflects IEMs large size and the benefits of economies of scale. As at 30/11/2022, JGC has a KID RIY charge of 1.65% which compares to 1.48% and 2.30% for Impax Environmental and Menhaden Capital, respectively.

## ESG

JGC was launched in 2006 to invest in companies developing and implementing solutions for the world's environmental challenges. The trust is managed by the same team who run the Jupiter Ecology Fund. This open-ended fund was launched in 1988 and was a forerunner in the UK within sustainability-themed funds. As such, JGC's investment process inherently has the concept of ESG-investing at its core and, therefore, should appeal to ESG-conscious investors.

Jon is conscious of the nuances within ESG though and, therefore, defines his approach as focussing on companies which have a specific product or service that will provide solutions to the world's environmental challenges. As these companies are creating a positive impact through their business practices, they will become more prominent and attract market share which will allow investors to benefit, as well as tackling these environmental issues.

In order to cover the social and governance aspects, Jon and the team look beyond not just what a company does, but how it goes about doing this. For this, they observe governance factors such as board effectiveness, composition and independence, corporate culture, leadership and succession, and management incentives.

If ESG issues are identified in the process, this doesn't preclude Jon from investing in a company. Instead, he believes that engagement is a better approach, with the aim to enhance long-term outcomes for investors. Evidence of this positive change can also lead to share price appreciation.

Whilst the trust itself might be small, having c. £55m of net assets, it has the resources behind it enabled by a much larger pool of assets in the aforementioned Jupiter Ecology Fund, which has c. £700m of assets, of which Jon is also the manager. As a frontrunner in the ESG space, Jupiter's governance and sustainability team have strong relationships with organisations such as the UN, with their Principles for Responsible Investment (UN PRI), the Investor Forum and the Institutional Investors Group on Climate Change (IIGCC). We understand that the team engage regularly with these and other industry bodies to ensure that the company remains at the forefront of ESG integration. Lessons learned from this team's activities are disseminated across the wider investment team via its stewardship committee.

Morningstar rate JGC as 'above average' for ESG and have given it their Low Carbon Designation ™ label, with the trust scoring highly on all elements. For these reasons, we believe it would suit an ESG-conscious investor.

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