

# UBAM - SNAM Japan Equity sustainable

Quarterly Comment | Q3 2020

For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties as defined by the relevant laws.

## Market Comment

- TOPIX (TR) growth for the period from July to September was 5.2%. The domestic equity market showed a strong performance during the period as a bottom-out in corporate earnings was seen in Apr–Jun and more investors came to the opinion that new prime minister Yoshihide Suga will see through a continuation of Abenomics. That said, we did see periods of temporary decline on growth in new Covid-19 infections and uncertainty caused by former prime minister Shinzo Abe's resignation announcement.
- While valuations are increasing on the support unprecedented monetary easing has provided for the market, strong doubts remain over an economic recovery in Europe and the US as new Covid-19 case numbers have started to grow again.
- Growth stocks were preferred to value stocks. Value factors like low PER and low PBR gave way as quality names with high ROE and low credit risk were favored by investors. By sector, Machinery, Appliances, Info & Comm, and Services drove growth. Machinery and Appliances rebounded from their fall in Jan–Mar, while Info & Comm and Services have earnings that are relatively unaffected by Covid-19. Defensive sectors, such as Elec Power & Gas and Transportation lagged and underperformed.
- Growth stocks continue to dominate as liquidity injections from central banks continue to be concentrated into a limited number of names. In the US, these names are GAFA. However, in Japan we have seen signs that value stocks have hit a bottom, stopping their decline on a bottom-out in 10-year US treasuries in early August. We believe long-term interest rates have room for growth on improvements to business sentiment, and major central banks will remain hesitant to raise policy rates. As such, we believe it is highly likely headwinds against value stocks will stop as term spreads continue to expand.
- Shinzo Abe stepped down as prime minister, because of a relapse of the ulcerative colitis that forced him to abandon his first time as prime minister 13 years ago. There will not be another general election for the lower house until September 2021. Since the election of Suga the ruling Liberal Democratic Party (LDP) will remain in power, Abenomics will continue on its current trajectory. We believe it is highly likely the LDP will remain in power in 2021 as approval ratings for other parties are low in comparison. Japan will remain politically stable in comparison to the US, which will have a presidential election in November.

Sources: *UBP, Bloomberg Finance LP.*



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## Performance Review

- The portfolio underperformed TOPIX (TR). Both asset allocation and stock selection were negative.
- In sector allocation, main contributors were our overweight in Information Technology and underweight in Consumer Discretionary.
- In stock selection, our overweight in Nippon Yusen, Nomura Research Institute, and Sysmex, and overweight in Taiyo Nippon Sanso, Sumitomo Mitsui Trust Holdings, and NTT detracted from performance. Overall, stock selection detracted from performance.

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## Portfolio Activity

- The portfolio manager constructs the portfolio according to SNAM's expected alpha ranking (expected alpha = intrinsic value / market price), a reflection of the team's fundamental analysis, forecasting, and valuation methodology.
- We reduced our position in NSK and Dai-ichi Life Holdings and increased the portfolio weights of Ajinomoto and TDK. The portfolio was constructed in such a way to be neutrally weighted against our ESG classified sectors (Manufacturing, Consumer/Service, Finance, Public/Infrastructure). The sectors (GICS 11) the portfolio was overweight in at the end of the month were Health Care and Consumer Staples. Underweight sectors were Communication Services and Industrials.

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## Outlook

- In September, the US market underwent a correction, mainly in IT names, while Japanese equities stood firm. One reason for this difference is that the Japanese market does not contain many IT-related growth names. In comparison to other countries, it was favoured because of low valuations and halts to downward revisions. While not unexpected, Suga taking over from Abe as prime minister made clear that Abenomics would continue and was a sense of relief mainly for overseas investors.
- Our focus going forward will be on results season, which will get into full swing in the second half of October. Many companies will likely see earnings exceed initial guidance, which was set at a conservative level because of Covid-19. The equity market has already rebounded somewhat, and we will soon likely see a strong recovery in earnings. That said, this will not succeed in lifting share prices further.
- We believe Suga will pursue monetary and fiscal policies in line with Abenomics. In addition, we believe he will reinvigorate the reform efforts that had lost momentum during the last few years of Abe's tenure. We see a continued shift of power from ministry bureaucrats to the politicians as a positive. A key initiative of Suga's is to break down the silos between ministries and to increase transparency and information sharing through the digitization of government functions. He is a fervent supporter of deregulation, market reform and increased competition. As Suga will face both an LDP leadership election and a general election within the next 12 months, we expect him to move quickly with his reform agenda in order to have early wins before the next elections.

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