

UBAM – angel japan small cap equity

Quarterly Comment | Q3 2021

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

Market Comment

- TOPIX (TR) growth for July to September was 5.3%. Increasing Covid-19 infections both in Japan and overseas as well as reports of reduced automobile production weighed on the market initially but entering into September growth was restored on the back of reassurance of domestic political stability and increased expectations of new economic stimulus.
- The market seesawed in July and August with catalysts coming in the form of strong corporate earnings announcements and better-than-expected macro data releases and negative catalysts coming in the form of increasing Covid-19 infections, the reinstatement of a state of emergency within Japan, news of Toyota global production units for September being 40% lower than planned, and stricter regulations on the education industry in China.
- The market rose on the reassurance of stable domestic politics and growing expectations for new economic stimulus as well as a drop in new Covid-19 infections. That said, concerns of a default at a large Chinese real estate developer and troubles in US budget discussions weighed on the market.
- The market showed strength at the beginning of September as Prime Minister Yoshihide Suga's announcement he would not be running in the LDP leadership contest led to an improved approval rating for the party and hopes of new economic stimulus.
- The market then faced upside resistance during the middle of the month as concerns arising of default at a large Chinese real estate developer tempered positive sentiment surrounding the clear peak-out and continued drop in Covid-19 infections.
- The market then fell towards the end of the month following a drop in the US market caused by rising long-term rates that resulted from signals from the FOMC that the Fed would begin hiking rates earlier than the market expected.

Sources: UBP, Bloomberg Finance L.P.

Performance Review

- The portfolio underperformed the MSCI Japan Small Cap index by -1.18% net of fees (Institutional share class in JPY, LU0306285197). Stock selection was the main driver of underperformance while sector allocation was also in negative territory. Stock picking was hurt in Information Technology and Consumer Staples while Consumer Discretionary was one of the most important stock specific contributor over the third quarter. Portfolio's overweight position in Health Care did also bring positive sector effect as this was one of the best performing during the quarter.
- For individual stock picks, overweighting in Snow Peak, Shift, Lasertec, Valence and Asahi Intecc contributed positively while overweighting in Rorze, Transaction, Raccoon, Enigmo and Aval Data contributed negatively.
- The team has not drastically changed its medium-term forecast. Even if some companies' short-term results will be affected by the pandemic, the team believes that those firms can catch up by the next fiscal year if their company's strengths do not alter. In this case, the upside potential for those stocks given the market sell-off could be huge. The team anticipates the consequence of deep undervaluation will lead to a significant price recovery in the next 12–18 months.

Portfolio Activity

- No specific activity throughout the quarter. We added ADWAYS, a major Internet affiliate advertising (performance-based advertising) company. The company has cultivated the fully automatic marketing platform "UNICORN" as a new pillar of growth, but it took them time to start up. The results have finally begun to come out now, and the number of large contracts has increased. It is expected to enter a new growth phase, which is the main reason for us to add it in the portfolio.
- We sold out MENICON, a major contact lens company, with a strong business foundation centred on the monthly "Mels Plan". The company is accelerating its growth with the acquisition of a long-established contact lens store in addition to strengthening its product line-up. We decided to sell it because the stock market also recognized the growth potential.
- We added LITALICO INC, a company which operates a support facility for persons with disabilities and an educational facility for children with developmental disabilities. The company built an efficient and organized system and is continuously expanding the number of facilities. In addition, its platform business is growing and supports the sending of customers to other companies' facilities through information service sites. It does also sell tools for facility management to other companies. The company is expected to accelerate growth, hence we newly added to it.

Outlook

- The Japanese equity market underwent a significant increase in the middle of September, with TOPIX even hitting a new high. However, it has recently undergone a big dip. We still believe that the Japanese market will rise through the end of the year on expectations for an economic reopening, growth in US long-term rates (which are highly correlated with Japanese equity), and expectations for upward revisions to corporate earnings guidance.
- The primary driver of the mid-month rise was a positive outlook on a new administration as Suga and his cabinet took their leave. With Fumio Kishida, also from the LDP, taking over as prime minister there has been no significant change to government policy. We expect the LDP will maintain its dominant position in government through the October general election and that it will push for further economic stimulus.
- Key drivers behind the recent drop in equity prices have been China, which has been subject to fears surrounding real estate prices and power outages, and the US, which is facing a debt ceiling problem. We do not believe the real estate or power problems in China will have a significant impact on the economy because the government can control both of them. The debt ceiling problem in the US is something we have seen time and again and we expect a political resolution soon enough.
- The risks present in both China and the US are controllable. Further vaccinations and news of Covid-19 treatments will likely give confidence to an economic reopening. We maintain our bullish stance on the Japanese equity market as we expect US long-term rates to go on a gentle uptrend and believe companies will revise corporate earnings guidance upwards from their initial conservative estimates during Jul–Sep earnings season.

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