



Q2 2020

UBAM - SNAM Japan Equity Value

Quarterly Comment | Q2 2020

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

Market Comment

- The domestic equity market rebounded in Q2 on the back of growing expectations for the restart of economic activity caused by bold monetary easing and fiscal stimulus in a number of countries around the world as well as reductions to new Covid-19 cases. TOPIX (TR) growth for Apr–Jun was came to 11.3%, with further upside potential being squashed by signs of new Covid-19 cases picking up again around the world from mid-June.
- The equity market was strong in April despite fears of stagnant economic activity following the Japanese government's announcement of a state of emergency because of large expected support in the form of monetary and fiscal policy. The market remained on an uptrend from May as although the real economy worsened, it did not decline as much as initially expected. The market continued to rise as expectations grew for the reopening of the economy given the slowdown in growth in new Covid-19 cases in Europe and the US. However, prices then hit upside resistance as signs emerged of new Covid-19 case numbers picking up again around the world.
- 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.

Sources: UBP, Bloomberg Finance LP.

Performance Review

- The portfolio underperformed TOPIX (TR). Both asset allocation and stock selection detracted from performance. Portfolio underweighting of IT and Healthcare and overweighting of Financials detracted from performance. For individual stock picks, overweighting of Yamato Holdings, Persol Holdings, and Fanuc contributed to performance, while overweighting of East Japan Railway and Sumitomo Mitsui Trust and underweighting of SoftBank Group were detractors.
- Yamato Holdings, Temp Hodings, JGC Corp and Fanuc were among the key contributors. All belonging to the industrial sector
- On the Consumer Discretionary side, our positions in K's Holdings and Yamada Denki helped on the back of improving sentiment.
- We suffered mainly from our Financials exposure, namely Sumitomo Mitsui, Nomura Holdings, Credit Saison and Dai-Ichi Mut Ins. Co.

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 substituted stocks based on the degree of undervaluation calculated using our proprietary model. Some names we reduced our portfolio weighting in include Yamato Holdings, Mazda Motor, and K's Holdings. Examples of names we increased our weighting in include Japan Tobacco, Tokyo Gas, Komatsu, and Fanuc.
- As of the end of the quarter, the sectors (GICS 11) the portfolio was overweight in were Financials, Consumer Discretionary, Industrials, and Real Estate. Underweight sectors were Information Technology, Healthcare, and Consumer Staples.
- Our incorporation strategy will continue to focus on undervalued names, as determined by our alpha rank measure, and we will continue to construct a portfolio with an effective risk/return balance achieved through diversified alpha sources.



Outlook

- After a sharp recession in H1-20, economic activity is expected to rebound in Q3 and to recover progressively in H2-20 and 2021. Renewed COVID cases in some US states and across Latin America refuel uncertainties about the pace of the rebound after the global lockdown, but recovery progress should continue. Economic policy should continue to support labour while central banks stand ready to extend assets purchases in H2-20 if necessary.
- Business activity is recovering at a faster-than-expected pace, in China and the US. We believe the significant jump in the equity markets signals that prices now factor in this short-term rebound in business activity. The equity market will likely struggle to move in any direction over the near term given increased fears over a second wave of Covid-19 and Apr–Jun results announcements being just around the corner.
- We note the importance of keeping in mind the risk that a second wave of Covid-19 represents but believe that if we begin to see an end to the pandemic, equity market movements will be dependent on the scale of recovery in the real economy. A large part of the recent economic recovery was down to pent-up demand and economic stimulus from the government. As such, going forward the recovery, which we believe will continue, will likely be at a subdued pace. Many countries are adopting fiscal and monetary policy at a speed and scale beyond what the US adopted in the aftermath of the global financial crisis. The current drop in economic activity is different from any regular cyclical recession. There was no prior excessive investment. It is expected that following a recovery in consumption, production and investment will both recover too.
- We believe that short-term movements to either the upside or downside lack apparent catalysts but that there is little risk of TOPIX falling given our expected support level of 1,500, equivalent to a PBR of 1x. We expect a gentle recovery to the equity market as the economy picks back up through the end of the year.

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