

# UBAM – ANGEL JAPAN SMALL CAP EQUITY

Quarterly Comment | Q4 2022

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

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## Market Comment

- TOPIX (TR) rose 3.3% in Q4. The Japanese equity market was lifted by investor opinion that US monetary tightening would slow but then fell on heightened concerns the European and US economies could fall into a recession. Japanese equity prices then continued to fall as alterations to the BoJ's yield curve control strategy were seen as a de-facto rate hike.
- The Japanese market rose at the beginning of the quarter as investors came to expect a slowdown in US rate hikes and fears abated over US monetary tightening. Then entering into November, the Japanese market was pulled upwards by large-cap names on the back of US equity strength as US CPI undershot expectations and FOMC minutes suggested there would be a slowdown in rate hikes.
- The Japanese equity market then saw a downturn as we entered into December. Investors feared recessions in Europe and the US as more market participants started to believe monetary tightening would be here for the long run and US retail data came in weak. The BoJ then announced at a monetary policy meeting that it would tweak yield curve control, allowing for greater fluctuations around its long-term target rate. This betrayed market expectations for continued easy monetary policy. The market fell as investors saw the policy tweak as a de-facto rate hike. The overall market was then weighed down in particular by exporters as the yen strengthened against the US dollar.
- Global equities traded near the long-term average forward PE ratio at 15.0 at the end of December, with 2022 earnings growth expectations steady at +10.1%, up from +7% at the start of the year, while 2023 expectations were further reduced to +2.8%, down from +9% at the start of the year. In fact, significant margin pressure is expected for companies which do not have enough pricing power to offset the likely weakening consumer demand in 2023.

Sources: *UBP, Bloomberg Finance L.P.*

*Past performance is not indicative of future performance*

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## Performance Review

- The portfolio underperformed the MSCI Japan Small Cap index by -3.64% net of fees (Institutional share class in JPY, LU0306285197). Stock selection was the main driver of underperformance while sector allocation was slightly positive. Stock picking was very challenging in Communication Services and Consumer Discretionary. Stock selection was strong in Information Technology.
- 73% companies have reported inline or above our expectations. Therefore, the current portfolio is trading at extreme undervalued levels. Therefore, we are confident about the accuracy of our corporate analysis, which is the source of our mid- to long-term performance.
- One of the best performing stock during Q4 was again SHIFT. The firm is a software testing company that verifies the proper execution of computer programs. On the top of that SHIFT provides consulting services and training for software testing intelligence. The trend about outsourcing demand for software testing operation has been growing steadily, and the company is expanding business area through active recruitment and aggressive M&A.
- Another good performing stock is AMVIS. Amvis operates facilities for terminal care, providing safe place for ill elderly people, in cooperation with local medical institutions. The company has built a network with medical institutions and is strengthening its operational structure. We think the company is entering an accelerating growth phase.

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## Portfolio Activity

- We added SANWA Ltd. The firm is an online catalog retailer for kitchens and other houseware equipment. The company has strengthened its management base as an e-commerce company through structural reforms, such as recruiting and investing in systems. The company has strengthened its sales channel by combining e-commerce and showrooms and promoting integrated sales of "materials and installation" through M&A and business alliances. According to our view, the company is now entering new growth phase.
- We sold out ADWAYS Inc, the company is a major player in the affiliate (performance-based) advertising business in Japan. While there has been no change in our view about its strength in this industry, the company has been significantly affected by one of its leading clients, a major manga/magazine application provider, which has reduced its advertising spending. We exited the position as profitability will take time to recover.

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## Outlook

- December saw the Japanese equity market fall on policy changes made by the BoJ but equity prices have remained in the boxed range seen since the beginning of the year. While the BoJ's policy shift was unexpected, the market outlook is still that the equity market will continue to lack direction given concerns of a global recession.
- US long-term rates will remain an important metric to watch in 2023. We expect they will fall from their current 3.5%-4.0% range to 3.0%-3.5% given our expectations for a recession in the latter half of the year. We expect the fall in US long-term rates to boost the equity market by helping to raise valuations. We expect corporate earnings to fall at an increased pace but bottom out in 1H FY2023. We will keep watch of the level of deterioration of corporate earnings over the short term but expect all negatives to have played out after that. We believe the market factored in further negatives for monetary tightening by the BoJ given the drop in equities and bounce in the yen in December. While there are many obstacles to overcome in implementing further tightening, we will be keeping watch of movement by the BoJ as Haruhiko Kuroda approaches his term limit as governor in April.
- The pressure on the Bank of Japan (BoJ) to exit its extremely loose monetary policy continued to build. In a surprise move on 20th December, the BoJ eased its Yield Curve Control (YCC) policy by loosening the cap on 10-year government bond yield from 25bp to 50bp. The Japanese Yen had already been recovering steadily from its lows and in December rose sharply from 141 to 133 per dollar.
- We believe that the Japanese equity market will remain in its current trading range in the first half of 2023 and start to break out in the second half of the year. We believe there is room for a 10-20% increase in TOPIX versus its 2022 finish of 1,891.

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