UBAM - SNAM JAPAN EQUITY RESPONSIBLE

Quarterly Comment | Q1 2023

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

The classification of the fund(s) as per the Sustainable Finance Disclosure Regulation (SFDR) is available on ubp.com or in the latest prospectus.

Market Comment

- TOPIX (TR) rose 7.2% in January–March period. In the first half of the quarter, the Japanese equity market went up. This is because concern over excessive monetary tightening by central banks abated as inflation rates had peaked, and expectation of an economic boost rose given the lifting of China’s zero-covid policy. In the middle of March, the equity market and interest rates plummeted as the BoJ left its monetary policy unchanged and risk-off sentiment, driven by bankruptcies of US banks, worsened. However, the market then rebounded as fears over a financial crisis faded due to swift actions by the Fed and central banks in Europe. These same central banks continued to hike rates despite financial system turmoil.

- Outperforming sectors were Iron & Steel and Wholesale, benefiting from expectations of favorable earnings, and the cyclical sectors of Electric Appliances and Machinery. Underperforming sectors were Banks and Insurance, suffering because of concern over financial system turmoil and the sharp drop in interest rates following the collapse of some US banks. Value names underperformed against growth names given the fall in financials. However, small-cap value names outperformed as those with low PBRs attracted investor attention after an announcement that TSE will request sub-1x PBR companies to disclose their improvement measures.

- The Japanese market was strong at the beginning of March, benefiting from Chinese PMI overshooting expectations and yen depreciating. However, share prices, especially for financials, then fell in the middle of the month because of bankruptcies at Silicon Valley Bank and Signature Bank and heightened concerns over the financial system in Europe and the US after Credit Suisse acknowledged “material weakness” in its internal controls over financial reporting. Stocks then rebounded because excessive fears over the financial system were alleviated as the US Treasury announced protections for deposits at smaller banks, the FRB demonstrated support for the banking system by making available additional funding through a new Bank Term Funding Program, and UBS announced an acquisition bid for Credit Suisse.

- Despite the volatility brought by the banking sector fallouts over the month of March, major equity markets still delivered positive performances over the first quarter of 2023. Driven by a strong start of the year with receding recession fears and overall easing inflation prints, the MSCI AC World ended Q1 up +7.3%, with European equities gaining +8.6%, US equities +7.5% and Emerging Market equities +3.9%.

Sources: UBP, Bloomberg Finance LP.

Past performance is not indicative of future performance

Performance Review

- The portfolio underperformed the TOPIX (TR).
- Sector allocation contributed to performance while stock selection detracted.
- In sector allocation, overweighting of Information Technology and underweighting of Communication Services contributed to performance.
- In stock selection, overweighting of Citizen Watch, Fujitsu General, and Eizo contributed to performance, while overweighting of Dai-ichi Life Holdings, Sawai Group Holdings, and Mitsubishi Estate detracted. Overall, stock selection was negative.
- In March and regarding stock selection, our underweight in Mitsubishi UFJ Financial Group and overweight in Murata Manufacturing, and Eizo contributed to performance, while our overweight in Dai-ichi Life Holdings, Sumitomo Mitsui Trust Holdings, and Mitsubishi Estate detracted. Overall, stock selection was negative.

Portfolio Activity

- The portfolio manager constructs the portfolio according to Sompo AM's expected alpha ranking (expected alpha = intrinsic value / market price), a reflection of the team's fundamental analysis, forecasting, and valuation methodology, as well as ESG scores. Names we reduced our portfolio weighting in include Nippon Express, Ushio, and Fujitsu General. Names we increased our weighting in include Panasonic, Denso, and Resona Holdings.
- The portfolio was constructed in such a way to be neutrally weighted against our ESG classified sectors (Manufacturing, Consumer/Service, Finance, Public/Infrastructure). As of the end of quarter, the sectors (GICS 11) the portfolio was overweight in were Information Technology and Consumer Staples. Underweight sectors were Communication Services and Health Care.
- Our strategy will continue to focus on ESG scores and undervalued names, as determined by our alpha rank measure. We will continue to construct a portfolio with ESG sector neutral weightings and an effective risk/return balance.

Outlook

- Equity markets will be quite turbulent for the course of 2023, as the side effects of low interest rates continue to come to the surface. As far as earnings estimates are concerned – notwithstanding downgrades in recent months, the team still feels like there is limited downside to earnings estimates in 2023. Investors shall arguably be attracted to companies with attractive valuation, strong balance sheets and pricing power, while shunning those with vulnerable balance sheets. The team suspects 2023 will see ‘Quality Value’ mean revert and quite possibly outperform for a prolonged period.

- We believe the market will benefit from an increase in the number of companies working to improve capital efficiency on the back of the TSE urging those with sub-1x PBRs to disclose how they intend to improve. However we also believe that weak corporate earnings will drag on share performance. While the recovery in automobile production and Chinese economic recovery will no doubt act as a positive, we do not expect to see growth in market participants’ earnings expectations given strong worries over how continued monetary tightening at central banks around the world will impact the economy.

- It is difficult to envision a large correction to the Japanese market given valuations are not at expensive levels and record levels of share buybacks are creating a lot of demand for stocks. However, it will likely take some time before we see serious growth driven by earnings improvements.

- As active managers, such an environment should very much play to the team’s strengths, as quality companies are increasingly sought after, and the valuation sensitivity is rewarded by way of outperformance. The investment team remains very optimistic that their investment approach will be rewarded in the current environment.

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