



UBAM - SNAM Japan Equity Value

Quarterly Comment | Q3 2019

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

Market Comment

- ◆ In Q3 positive sentiment over anticipation for monetary easing from US and European central banks tussled with fears of a stronger yen and deteriorating corporate earnings, limiting upside for equities. August saw broad risk-off activity as a shock Trump tariff comment reignited trade war concerns. Japanese equities sold off as US 10 year yields slid from above 2% to 1.5% levels and the yen strengthened against the dollar. Stocks then rebounded in September, as trade talks looked likely to resume and central banks demonstrated a proactive dovish stance. Equities paused in their ascent towards the end of the quarter amid attacks in Saudi Arabia and dearth of catalysts after a second rate cut by the Fed. This saw TOPIX (TR) closing the Jul – Sep quarter up 3.39%.
- ◆ The JPY was rather flat against the USD, seeing it move from the high 108's to the low 108's. The JPY strengthened against the EUR moving from the high 122's to the high 117's.
- ◆ By style and size, growth outperformed. On the factor side, low beta stocks were firm, while those with earnings expectation cuts lagged. By sector, precision inst, retail, and real estate outperformed, while underperformers were iron & steel, oil & coal, and pulp & paper. By investor type, foreign investors were net sellers by a narrower margin to bring net selling of Japanese equities to below 1tn JPY.
- ◆ In the beginning of September, the Japanese market lacked thrust as US-China tit-for-tat tariffs persisted and various economic data soured. However, a turnaround was seen for equities as negotiations looked set to resume and the ECB announced it would reinstate quantitative easing. During the second part of the month, attacks in Saudi Arabia saw a brief spike in oil prices, but this had little impact on either Japanese stocks or the yen. Equities were largely flat for the remainder of the month amid a lack of further upside catalysts after the Fed and BOJ monetary policy announcements came in as the market expected.



Performance Review

- ◆ The portfolio underperformed the TOPIX (TR). While sector allocation contributed positively, stock selection was negative to performance. Portfolio overweighting of consumer discretionary and underweighting of industrials was positive, while overweighting of materials was negative. For individual stock picks, Nomura Holdings, K's Holdings, and Softbank Group (underweight) contributed, while Nippon Steel, JFE, and Mazda were detractors.
- ◆ The strategy outperformed TOPIX (TR) in September. Both sector allocation and stock selection contributed to performance. In sector allocation, OW of financials and UW of consumer staples contributed, while UW of industrials detracted. In stock selection, OW of Credit Saison and Sumitomo Mitsui Trust, and UW of Softbank Group contributed, while OW of Nippon Steel, Nippon Television, and KDDI detracted. In total, stock selection contributed to performance.

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. Some of the stocks sold included Mazda, Nissan, and JFE, while the portfolio manager bought AGC, Kajima Construction, and Mitsubishi Estate. As a result of this bottom-up stock selection, as of the end of the quarter the sectors (GICS 11) that the portfolio was overweight in were financials, consumer discretionary, and materials. Conversely, it was underweight in industrials, consumer staples, and healthcare. We will continue to construct the portfolio based on our alpha rank measure of undervaluation. Going forward, we intend to maintain our overweighting of undervalued financial and transport equipment stocks, with a focus on diversifying the alpha source to drive returns.



Outlook

- ◆ September has seen a powerful rebound for equities after August's trade war fuelled sell-offs. However, with ISM data having worsened more than expected, economic sentiment suggests that it may not be a straight upward trajectory from current levels.
- ◆ We cannot rule out the possibility of a recession entirely, but believe that deteriorating economic data like the ISM is now near the cyclical bottom. As Jul – Sept earnings season unfolds over the next few weeks we expect to see some downward revisions from manufacturers, although this is not a major cause for concern as it both appears to already be discounted from stock valuations and likely to mark the bottom in negative earnings growth on a YoY basis. Going forward we expect to see the market bottom out and begin to resume its upward trend towards the end of the year. This is likely to be aided by the fact that recent sagging economic data increases the likelihood of an October Fed rate cut being on the cards and as it seems resolution could be close for the trade war situation.
- ◆ Japanese equities have been lagging peers so far in 2019, primarily because of their strong correlation to the global economy. Going forward we believe that attractive current valuations mean that market retains more potential upside than other markets around the world, making it an excellent opportunity to build a position in the asset class.

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