UBAM – angel japan small cap equity

Quarterly Comment | Q2 2021

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Market Comment

- TOPIX (TR) growth for Apr-Jun was 0.3%. The domestic equity market ended the quarter largely unchanged from the beginning. Positive catalysts, which included heightened expectations for a global economic recovery and strong domestic corporate earnings announcements, were offset by negative catalysts, which included inflation fears and alarm over potential changes in monetary policy.

- The Japanese equity market fell in April because of the announcement of more states of emergency following increased new Covid-19 infections and a vaccine rollout that was slower than in other developed countries. Entering May, the market began to rise on the back of expectations for a global economic recovery and strong domestic corporate earnings announcements, but then experienced a rapid drop on inflation fears following the increase in US CPI. However, the market then rose again as investors regained their nerve following a break in US long-term rate growth. The market then showed weakness on heightened concern over monetary policy. This was a result of news the FOMC had entered discussions about an earlier increase to rates and the implementation of tapering.

- Equity markets continued their rally over the second quarter of 2021, with the MSCI AC World Index adding 7.4% in performance to reach close to 12.5% since the beginning of the year. This rally was supported by the accelerated global roll-out of COVID-19 vaccines and central banks maintaining their accommodative stance. US equities gained 8.2% over the period, while European equities were up close to 6.5% and Emerging Markets 5.0%.

- At the end of June, all sectors of the MSCI AC World Index were in positive territory except for the Utilities sector. The IT and Health Care sectors were the top contributors over Q2. All sectors are also showing strong earnings growth rate expectations.

Sources: UBP, Bloomberg Finance L.P.

Performance Review

- The portfolio outperformed the MSCI Japan Small Cap index by 4% net of fees (Institutional share class in JPY, LU0306285197). Stock selection was the main driver of outperformance while sector allocation was in positive territory. Stock picking was particularly strong Information Technology and Materials while Consumer Discretionary was one of the most important stock specific detractor over the second quarter. Portfolio's overweight position in Information Technology did also bring positive sector effect as this was one of the best performing during the quarter.
- For individual stock picks, overweighting in Lasertec, Members RG , Rorze and MEC contributed positively while overweighting in Media Do, S-Pool, Maruwa Unyu, Asahi Intecc, TKP and Digital Arts 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 ATRAE, the firm operates a performance-based recruitment site with around 90% of its sales related to IT/Web companies. In addition to the recovery of the its main business (IT companies) which were influenced by the pandemic, new business opportunities, in which upfront investment were made, entered a phase of accelerating growth.
- We sold out PHARMA FOODS, a health foods and cosmetics provider focusing on proprietary ingredients. Since its efficacy became clear due to the elaboration of a system to display functionality, the company started to supply various manufacturers. In addition, new products have been developed and are becoming the firm's second pillar. There is no change to our view about the company's strength, but we sold it out as current share price has risen to what we consider being a fair value level.
- We sold out FURAYA METAL KI-STAR REAL ESTATE, a manufacturer of industrial-use minor metal products in the platinum segment (including platinum, iridium and ruthenium). The strength of this company lies in its processing technology and stable supply system further enhanced by a high global market share for products such as iridium and ruthenium. There is no change our view about the company's strength, but the market has already recognized their medium-term growth potential.

Outlook

- Strong economic data and the momentum of the recovery have been a key driver of equity markets this quarter and with no doubt shall provide continued support. This was evident in the exceptionally strong March quarter reporting period, which saw the average earnings result beat expectations by over 20%. The stellar performance of the market since the drawdown in March 2020 has seen the MSCI World Index rally 93% and the MSCI SMID Cap Index rally 113% (all in USD).
- At this juncture, the investment team believes the June quarter earnings period should also be very strong; however, they balance their constructive outlook by recognizing the potential risks from higher valuations and cost related headwinds, which may dampen medium term expectations.
- The Japanese equity market continues to lag its European and US counterparts. This is likely a result of the slow vaccine rollout in Japan and the fall in US long-term rates, which are highly correlated with the relative performance of Japanese equity. That said, we expect to see a pickup in economic re-opening expectations given that the vaccination rollout is picking up pace. US long-term rates dropped following the previous FOMC but we believe this drop was an overreaction and that they will recover somewhat.
- We believe the Japanese equity market still has upside potential. This potential, however, is limited because of the shift to tighter monetary policy in the US and the likelihood of slowing corporate earnings growth. We expect the market to experience gentle growth through year-end as investors anticipate an escape from the pandemic.

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