

UBAM - SNAM Japan Equity sustainable

Quarterly Comment | Q4 2021

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

Market Comment

- TOPIX (TR) growth during Q4 was -1.7% (JPY). The market decline was a result of inflation concerns caused by rising energy prices and supply chain problems, tapering forecasts for the US, and alarm over the spread of the omicron Covid variant. That said, we did see a rebound towards the end of the quarter as data came out suggesting lesser severity of illness caused by omicron and support from US equity market strength. This meant the overall quarterly fall only came to 1.7%.
- The market fell at the beginning of October given inflation concerns caused by rising energy prices and supply chain problems as well as US interest rate growth. Through the end of October, the market then grew as oil prices and US interest rates stopped rising, excessive inflation fears abated, and political risk faded as the ruling LDP party's victory in the end-October general election meant an increased likelihood of continued domestic political stability. Moving into late-November, the market then fell again as the discovery of omicron led to increased risk avoidance. Equity prices then rebounded as it became clear omicron presents a lower risk of severe illness, and strength in the US market propped up the Japanese market through the end of December.
- In December, equity prices rose at the beginning of the month, rebounding from the end-November decline caused by the hit to the economy as omicron made the rounds. The rebound came despite increasing infection numbers across the globe as more market participants came to see a lower risk of severe illness from omicron.
- The market fell during the middle of the December despite increased visibility for monetary policy following the FOMC's announcement of an accelerated tapering process, just as the market expected. The drop was caused by concerns over the Chinese economy following the decision by the People's Bank of China to lower rates.

Sources: UBP, Bloomberg Finance LP.

Performance Review

- The portfolio underperformed the TOPIX (TR).
- Sector allocation contributed to performance while stock selection detracted.
- Portfolio underweighting of Communication Services and OW of Information Technology contributed to performance.
- For individual stock picks, overweighting of Fuji Electric, Nomura Research Institute, and Toyoda Gosei contributed to performance, while overweighting of Sawai Group Holdings and Mitsubishi Estate and underweighting of Tokyo Electron detracted.
- More specifically, in December, our overweight in J Front Retailing, Toyoda Gosei, and Seiko Epson contributed positively to performance, while our overweight in Ushio, Citizen Watch, and Isuzu Motors detracted. Overall, stock selection was positive.

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 NGK Spark Plug, Fujifilm Holdings, and Sony Group. Names we increased our weighting in include Fujitsu General, NEC, and Murata Manufacturing.
- 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 the quarter, the sectors (GICS 11) the portfolio was overweight in were Information Technology and Materials. Underweight sectors were Industrials and Communication Services.
- In December, we reduced our position in Sony Group and Nomura Research Institute and increased our position in Murata Manufacturing and Fujitsu General.

Outlook

- We expect market movements to remain unstable over the near term given fears over omicron. However, any impact on the global economy will be transitory and limited in scope. We expect the global economy to see continued growth through 2022. That said, we note that 2022 will also be the year we see full-on monetary tightening. While inflationary pressure and rising interest rates will no doubt drag on the global economy, we note that recent inflation has largely been the result of supply chain problems. We believe the supply chain will gradually resolve this problem and that interest rate growth and global economic expansion will continue while inflationary pressures come under control.
- The primary driver of the mid-month rise was a positive outlook on a new administration as Suga and his cabinet took their leave. With Fumio Kishida, also from the LDP, taking over as prime minister there has been no significant change to government policy. We expect the LDP will maintain its dominant position in government through the October general election and that it will push for further economic stimulus.
- The Japanese equity market underperformed other developed countries in 2021 because of the slow domestic economic reopening and the country's high degree of economic reliance on China, where economic growth slowed. In 2022 we expect the Japanese economy to get back into full swing, albeit at a slower pace than overseas, and the Chinese economy to recover. We expect Japanese GDP growth to be above 3% in 2022, higher than the above 2%-level achieved in 2021, while worldwide growth will slow YoY.
- We note that Japanese equities have historically tended to outperform during periods of rising rates. With the Japanese market currently recording a relatively low average PER of around 14x, we believe it can be expected to outperform its developed peers in 2022.

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