

U Access - Long/short Japan corporate governance

Quarterly Comment | Q4 2020

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

Market Comment

- TOPIX (TR) growth for the period from October to December was 11.2%. After a good third quarter, the fourth quarter of 2020 saw a slow start in October followed by rapid appreciation for Japanese equities particularly in November. The domestic equity market was strong as investors were hopeful for an economic recovery following the successful development of a Covid-19 vaccine. That said, the global increase in case numbers and the new Covid variant weighed on prices in late December.
- In October, the market was pulled up and down by news flow concerning the US presidential election and potential additional stimulus in the US. A risk-off mood then took over because of increasing Covid-19 case numbers in both Europe and the US, leading the market to finish the month down slightly. Successful development of a Covid vaccine was announced in November, pushing up hopes for the economy to return to normal and boosting share prices significantly from mid-month. While December market movements were weighed on by increasing Covid-19 cases in Japan and the discovery of a new strain of the virus in Europe, the market finished the month up on the rollout of vaccinations, agreement in the US on additional stimulus, and the signing of a trade agreement between the UK and the EU.
- In December, the market rose at the beginning of the month because of expectations for a quick rollout of vaccines and better-than-expected machinery orders data. That said, there were moments of weakness because of concern over the global increase in Covid-19 case numbers and short-term overheating in prices.
- Prices largely moved sideways as continued fears of damage to the economy on increasing Covid-19 cases were offset by increased hopes for a recovery on vaccine rollouts in Europe and the US and a sense of relief in the market following the FRB's announcement that it will continue with monetary easing over the long term.

Sources: UBP, Bloomberg Finance LP.

Performance Review

- During the quarter, the fund performed well, gaining 1.4% in October and 4% in November, before giving up -1.5% in December.
- The long-side of the portfolio outperformed the market in October-November, producing positive alpha. During this period the short side significantly underperformed the rising market, making an even larger positive contribution to alpha. In December the long-side did not keep up with the continuing rise in the market, while the short-side rose in line with the market. This resulted in the -1.5% return in December.
- In terms of sectors, 8 sectors contributed positively to alpha, 2 were neutral and three were negative. Staples, Tech & Media and Chemicals were the biggest positive contributors, with both the longs and shorts contributing significantly to alpha. The detractors were the Transport, Healthcare and Electronics sectors, where the longs did not rise in line with the market.

Portfolio Activity

- During the quarter we took profit on 7 long positions, replacing them with other good governance companies with better remaining upside potential. We similarly took profit on 4 short positions where the stocks fell despite the sharply rising market. We replaced these with bad governance companies that had bounced sharply with the rising market. We also did 3 stop-losses and replaced 2 other stocks as there were better alternatives in those sectors after the market moves. The total turnover during the quarter was approximately 25% on the long side and 15% on the short side.
- After the market rose 15% in November-December, we did a thorough review of the portfolio at the end of December. This resulted in 10 trades, 4 longs and 6 shorts. On the long side, 3 of the trades were to take profit on large outperformers. Similarly, 4 of the trades on the short side were to take profit on large underperformers. One of the short trades was a stop loss. The remaining two trades, 1 long and 1 short were to switch to more attractive companies after large relative stock price moves. We also made 3 small rebalancing adjustments to maintain both market and sector neutrality.
- The profit taking with exit was in three long positions in the following sectors: chemicals (stock up +36%), machinery (+27%) and automotive (+26%). On the short side we took profit on four short positions in the following sectors: materials (stock down -18%), chemicals (-10% and -6%) and machinery (-3%). Each of the names was replaced by another company in the same sector, with appropriate governance and risk/reward characteristics.
- We replaced a long position in the healthcare sector with a different good governance company with greater upside potential. This was driven both by a downward reassessment of the upside potential of our existing holding and the significant recent underperformance of the replacement stock. We replaced a short position in the materials sector with a different bad governance company with greater downside potential. Our trade was similarly driven by a reassessment of the downside potential of the existing holding combined with the large recent outperformance of the replacement stock.
- We did a stop loss in the automotive sector. Since September, the sell-side had started to raise earnings estimates for this company. The company had also recently adopted a performance-based stock compensation plan. Based on improving fundamentals and governance we decided to close the short position. We replaced this with a poor-governance automotive stock that jumped over 40% in the recent stock market rally.



Outlook

- The Japanese equity market continued to grow in December. The market has been desensitized to increasing Covid-19 case numbers and has aggressively factored in a return to normal around the globe on the back of the development of a vaccine.
- The current economic recession is unlike those of the past caused by financial crises and popped asset bubbles. This time, it is highly likely the economy will see a rapid rebound, largely pushed by the release of pent-up demand once the vaccine is able to lift restrictions on movement.
- Suga needs to face 2 elections in 2021. The LDP leadership election must be held by the end of Sept. The second is a general election, which must be held by 21 October. Either or both elections could be held early, however the probability of them being held early is not very high. There are several reasons for this. The first is to avoid holding the election early if Covid-19 is not under control. The second is the Olympics. Despite a challenging start in 2021 for many countries affected by the pandemic we do not see other major headwinds for the LDP in the coming months.
- We expect the market to fluctuate around its current level over the short term as stocks no longer look undervalued and macroeconomic indicators are expected to be weak, given increasing Covid-19 case numbers. Over the longer term, we expect market movements to remain strong as global monetary easing leaves ample cash to enter the equity market and investors are basing forecasts on profit levels for FY22, when the Covid-19 situation is expected to be behind us.
- Despite growing concerns surrounding Covid-19 and the market sector rotation towards value and large dispersion in stock returns, our performance has proved steady. This shows how effective our process is in a context of improving corporate governance in Japan.

Disclaimer

This is a marketing document and is intended for informational and/or marketing purposes only. It is confidential and is intended to be used only by the person(s) to whom it was delivered. It may not be reproduced (in whole or in part) or delivered, given, sent or in any other way made accessible, to any other person without the prior written approval of Union Bancaire Privée, UBP SA or any entity of the UBP Group (UBP). This document reflects the opinion of UBP as of the date of issue. This document is for distribution only to persons who are Professional clients in Switzerland or Professional Clients or an equivalent category of investor as defined by the relevant laws (all such persons together being referred to as "Relevant Persons"). This document is directed only at Relevant Persons and must not be acted on or relied on by persons who are not Relevant Persons. It is not intended for distribution, publication, or use, in whole or in part, in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it directed at any person or entity at which it would be unlawful to direct such a document. In particular, this document may not be distributed in the United States of America and/or to US persons (including US citizens residing outside the United States of America). This document has not been produced by UBP's financial analysts and is not to be considered financial research. It is not subject to any guidelines on financial research and independence of financial analysis. Reasonable efforts have been made to ensure that the content of this document is based on information and data obtained from reliable sources. However, UBP has not verified the information from third sources in this document and does not guarantee its accuracy or completeness. UBP makes no representations, provides no warranty and gives no undertaking, express or implied, regarding any of the information, projections or opinions contained herein, nor does it accept any liability whatsoever for any errors, omissions or misstatements. The information contained herein is subject to change without prior notice. UBP gives no undertaking to update this document or to correct any inaccuracies in it which may become apparent. This document may refer to the past performance of investment interests. Past performance is not a guide to current or future results. The value of investment interests can fall as well as rise. Any capital invested may be at risk and investors may not get back some or all of their original capital. Any performance data included in this document does not take into account fees, commissions, and expenses charged on issuance and redemption of securities, nor any taxes that may be levied. Changes in exchange rates may cause increases or decreases in investors' returns. All statements other than statements of historical fact in this document are "forward-looking statements". Forward-looking statements do not guarantee future performances. The financial projections included in this document do not constitute forecasts or budgets; they are purely illustrative examples based on a series of current expectations and assumptions which may not eventuate. The actual performance, results, financial condition and prospects of an investment interest may differ materially from those expressed or implied by the forward-looking statements in this document as the projected or targeted returns are inherently subject to significant economic, market and other uncertainties that may adversely affect performance. UBP also disclaims any obligation to update forward-looking statements, as a result of new information, future events or otherwise. The contents of this document should not be construed as any form of advice or recommendation to purchase or sell any security or funds. It does not replace a prospectus or any other legal documents, which can be obtained free of charge from the registered office of a fund or from UBP. The opinions herein do not take into account individual investors' circumstances, objectives, or needs. Each investor must make their own independent decision regarding any securities or financial instruments mentioned herein and should independently determine the merits or suitability of any investment. In addition, the tax treatment of any investment in the fund(s) mentioned herein depends on each individual investor's circumstances. Investors are invited to carefully read the risk warnings and the regulations set out in the prospectus or other legal documents and are advised to seek professional counsel from their financial, legal and tax advisors. The tax treatment of any investment in the Fund depends on the investor's individual circumstances and may be subject to change in the future. This document should not be deemed an offer nor a solicitation to buy, subscribe to, or sell any currency, funds, products, or financial instruments, to make any investment, or to participate in any particular trading strategy in any jurisdiction where such an offer or solicitation would not be authorised, or to any person to whom it would be unlawful to make such an offer or solicitation. Telephone calls to the telephone number stated in this presentation may be recorded. UBP will assume that, by calling this number, you consent to this recording.

Any subscriptions not based on the funds' latest prospectuses, KIIDs, annual or semi-annual reports or other relevant legal documents (the "Funds' Legal Documents") shall not be acceptable. The Funds' Legal Documents may be obtained free of charge from Union Bancaire Privée, UBP SA, 96-98 rue du Rhône, P.O. Box 1320, 1211 Geneva 1, Switzerland (UBP), from UBP Asset Management (Europe) S.A., 287-289 route d'Arlon, 1150 Luxembourg, Grand Duchy of Luxembourg, and from Union Bancaire Gestion Institutionnelle (France) SAS, 116 avenue des Champs-Élysées, 75008 Paris, France. The Swiss representative and paying agent of the foreign funds mentioned herein is UBP. The Funds' Legal Documents may be obtained free of charge from UBP, as indicated above. This content is being made available in the following countries:

Switzerland: UBP is authorised and regulated in Switzerland by the Swiss Financial Market Supervisory Authority (FINMA). The head office is Union Bancaire Privée, UBP SA, 96-98 rue du Rhône, P.O. Box 1320, 1211 Geneva 1, Switzerland. ubp@ubp.com | www.ubp.com

United Kingdom: UBP is authorised in the United Kingdom by the Prudential Regulation Authority (PRA) and is subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the PRA.

France: Sales and distribution are carried out by Union Bancaire Gestion Institutionnelle (France) SAS, a management company licensed with the French Autorité des Marchés Financiers, - licence n° AMF GP98041 ; 116, av. des Champs Elysées I 75008 Paris, France T +33 1 75 77 80 80 Fax +33 1 44 50 16 19 www.ubpamfrance.com.

Hong Kong: UBP Asset Management Asia Limited (CE No.: AOB278) is licensed with the Securities and Futures Commission to carry on Type 1 – Dealing in Securities, Type 4 – Advising on Securities and Type 9 – Asset Management regulated activities. The document is intended only for Institutional or Corporate Professional Investor and not for public distribution. The contents of this document have not been reviewed by the Securities and Futures Commission in Hong Kong. Investment involves risks. Past performance is not indicative of future performance. Investors should refer to the fund prospectus for further details, including the product features and risk factors. The document is intended only for Institutional Professional Investor and not for public distribution. The contents of this document and any attachments/links contained in this document are for general information only and are not advice. The information does not take into account your specific investment objectives, financial situation and investment needs and is not designed as a substitute for professional advice. You should seek independent professional advice regarding the suitability of an investment product, taking into account your specific investment objectives, financial situation and investment needs before making an investment. The contents of this document and any attachments/links contained in this document have been prepared in good faith. UBP Asset Management Asia Limited (UBP AM Asia) and all of its affiliates accept no liability for any errors or omissions. Please note that the information may also have become outdated since its publication. UBP AM Asia makes no representation that such information is accurate, reliable or complete. In particular, any information sourced from third parties is not necessarily endorsed by UBP AM Asia, and UBP AM Asia has not checked the accuracy or completeness of such third party information.

Singapore: This document is intended only for accredited investors and institutional investors as defined under the Securities and Futures Act (Cap. 289 of Singapore) ("SFA"). Persons other than accredited investors or institutional investors (as defined in the SFA) are not the intended recipients of this document and must not act upon or rely upon any of the information in this document. The financial products or services to which this material relates will only be made available to clients who are accredited investors or institutional investors under the SFA. This document has not been registered as a prospectus with the MAS. Accordingly, this document and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of this product may not be circulated or distributed, nor may the product be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to institutional investors under Section 274 or 304 of the Securities and Futures Act (Cap. 289) of Singapore ("SFA"), (ii) to relevant persons pursuant to Section 275(1) or 305(1), or any person pursuant to Section 275(1A) or 305(2) of the SFA, and in accordance with the conditions specified in Section 275 or 305 of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This advertisement has not been reviewed by the Monetary Authority of Singapore.

MSCI : Although Union Bancaire Privée, UBP SA information providers, including without limitation, MSCI ESG Research LLC and its affiliates (the "ESG Parties"), obtain information from sources they consider reliable, none of the ESG Parties warrants or guarantees the originality, accuracy and/or completeness of any data herein. None of the ESG Parties makes any express or implied warranties of any kind, and the ESG Parties hereby expressly disclaim all warranties of merchantability and fitness for a particular purpose, with respect to any data herein. None of the ESG Parties shall have any liability for any errors or omissions in connection with any data herein. Further, without limiting any of the foregoing, in no event shall any of the ESG Parties have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.