UBAM – ANGEL JAPAN SMALL CAP EQUITY

Quarterly Comment | Q4 2023

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

Market Comment

- TOPIX (TR) was up 2.0% during the October-December period. The market rose for the fifth consecutive quarter, albeit at a low rate. Domestic and overseas long-term rates rose in October on concerns over prolonged monetary tightening in the US and the BoJ's adoption of a more flexible approach to the 10-year JGB yield ceiling. The market sagged as investors became more risk-averse following the escalation of geopolitical risk in Israel. However, Japanese equities then showed strength as US equities rose following a significant drop in US long-term rates stemming from expectations for the Fed to cut rates soon, which was in turn driven by weaker-than-expected jobs data and CPI.
- In Q4, Japanese large-cap growth stocks were bought up as the US equity market grew sharply on the back of slowed inflation and the consequent abated concerns of excessive monetary tightening. Names in sectors with high valuations, such as Electric Appliances, Precision Instruments, and Services rose given lower interest rates. Stocks in Marine Transportation also outperformed due to expectations for freight charges to soar given rising geopolitical tensions in the Middle East. However, banking stocks were sluggish because of diminished expectations for normalisation in monetary policy and names in Transportation Equipment underperformed given the yen's appreciation versus the US dollar, which stemmed from narrower interest rate differentials between Japan and the US, driven by the drop in US long-term rates.
- The drop at the beginning of December was largely focused on export-related names because of the rapid appreciation of JPY versus USD. This appreciation was the result of the interest rate gap between the US and Japan shrinking following hints from BoJ governor Kazuo Ueda that changes could be made to monetary policy and heightened expectations for the Fed to cut rates soon because of the continued slow in inflation. From the middle of the month onward the market seesawed. The drop in long-term rates in the US (November employment data while strong was not enough to warrant a rate hike) and Japan (maintained easy monetary policy) was positive for the market but growth was tempered by the rapid appreciation of JPY versus USD. Across the whole month, the market was down slightly.

Sources: UBP, Bloomberg Finance L.P.

Past performance is not indicative of future performance

Performance Review

- The portfolio outperformed the MSCI Japan Small Cap index by 4.20% net of fees (Institutional share class in JPY, LU0306285197). Stock selection was the main driver of underperformance while sector allocation was also positive. Stock picking was very strong in Information Technology and Materials. Consumer Discretionary and Industrials. Stock selection was strong in Information Technology.
- Portfolio characteristic haven't change during the third quarter, average EPS growth remains higher than benchmark. We continue to monitor companies' earnings growth trajectory.
- One of the best performing stocks during Q4 and also one of our largest position and conviction is **Rorze**, an Information Technology name. The company is a global provider of highly reliable clean conveyor systems. They are indispensable for semiconductor and FPD manufacturing processes, as well as in the life science industry. Our case was that semiconductor-related equipment could bottoming out at some point and that RORZE could digest its backlog of orders and return to a healthy delivery schedule.
- Another good performing stock is **Tri Chemical**. The firm supplies ultrapure chemical reagents for semiconductors, optic fiber and photovoltaic cells. The ability to produce high-purity chemicals in a wide variety of small lots is the source of competitiveness.

Portfolio Activity

- We added **Zixgen**. The company is operating aggregation sites that allow users to search various information sites such as recruitment or real estate at once. They acquired companies specializing in the human resources market, and are improving them by PMI (Post Merger Integration) utilizing their strength and matching technology. Since the company transitioned its business model from referral sites, we believe that the company could enter a high growth phase.
- We sold out **Benefit One**. Benefit One is a leading welfare and healthcare business agency for companies and public offices. On November 14 2023, M3 announced the tender offer bid for BENEFT ONE. This resulted in a more than 50% price premium to the past one-month average.

Outlook

- At the end of July, the Bank of Japan announced a tweak to its yield curve control policy, allowing interest rates to rise a bit more freely. This resulted in rising Japanese government bond yields since July in expectation of further policy changes by the BoJ. A healthy job market and slightly higher than expected headline inflation in the US since July has resulted in the market expecting US interest rates remaining higher for longer. In November, expectations of the Fed cutting rates sometime in 2024 picked up. This resulted in US and Japanese government bond yields falling slowly, but steadily. Since October, US and Japanese 10-year yields fell by 100bp and 35bp respectively. The Japanese Yen recovered significantly from 151 to 141 to the dollar over these two months. Global stock markets, which had risen nearly 20% year-to-date by the end of November, continued rising in December. They ended the year up nearly 25%. The upward trajectory of the Japanese market, which had risen nearly +30% year-to-date by mid-November, could not maintain the upward momentum in December, falling -2.5% in the first two weeks, before recovering slightly to end the month down -0.84%.

- Value beat growth in 2023 due to continual expectations for capital efficiency improvements at low-efficiency companies on the back of TSE pressure. Outperforming sectors included Iron & Steel, Marine Transportation, and Wholesale Trade given expectations for shareholder returns on strong short-term earnings. Underperforming sectors included Pharmaceutical, which was overvalued, and Land Transportation, Services, and Retail Trade, which saw weak domestic demand and costs increases.

- Corporate profits and sales will likely increase this fiscal year thanks to the strong US economy, normalization of domestic economic activity, and yen depreciation. We predict profits will continue to grow next fiscal year on rising expectations for a soft landing for the US economy, outlooks for inventories bottoming out, and a recovery in domestic real wages. However, the earnings growth momentum will highly likely decelerate because of the negative impact monetary tightening in the US and Europe will have on the global economy. We believe market expectations will unlikely improve given the slowing economic recovery in China and heightened geopolitical risks.

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