



UBAM – angel japan small cap Equity

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

- ◆ 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.
- ◆ The portfolio outperformed small cap indices (TR), with both sector allocation and stock picking having a positive impact on performance. Stock selection was by far the main driver.
- ◆ Selection among Health Care names was very strong with M3, Japan MDM and Asahi Intecc being the key drivers of the relative contributors. Stock picking in the Materials sector did also participate in the strong quarterly performance thanks to our holding in Mec which stand out. This strong selection was further reinforced by Information Technology, namely Lasertec and Tri Chemical.

Portfolio Activity

- ◆ We increased Charm Care, the company operates high quality nursing homes mainly in the Kinki area. Aiming for further growth, the company entered and strengthened its presence in the Tokyo metropolitan area, focusing on the high-priced properties in wealthy residential areas with little competition. As per our expectation, the firm is expected to enter a new growth phase, based on those assumptions, we increased the position in the portfolio.
- ◆ We also added Furuya Metal Co. It's a manufacturer of industrial-use minor metal products in the platinum group (including platinum, iridium and ruthenium). The strength of this company is its processing technology and stable supply system. Furuya has a high global market share for products such as iridium and ruthenium. Since the results were released current R&D have been increased, and the expectation of new products launching in multiple fields has increased, we decided to add the stock in the portfolio.
- ◆ We reduced Pola Orbis Holdings. Pola Orbis is one of the largest cosmetic manufacturers operating multiple brands in Japan. "Pola" is the high-end cosmetic home-visit sales brand, and "Orbis" is the brand offering medium prices products via mail order. One of the strengths of both brands is based on the fact that they always face customers directly and recommend products that meet their needs. The company's strengths have not changed, but we reduced the weight since the growth potential is expected to stall temporarily since new product sales could be less strong.



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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