

UBAM - SNAM JAPAN EQUITY RESPONSIBLE

Quarterly Comment | Q4 2023

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

The classification of the fund(s) as per the Sustainable Finance Disclosure Regulation (SFDR) is available on ubp.com or in the latest prospectus.

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 LP.

Past performance is not indicative of future performance



Q4 2023

Performance Review

- The portfolio underperformed the TOPIX (TR).
- Sector allocation contributed to performance while stock selection detracted.
- In sector allocation, overweighting of Information Technology and underweighting of Consumer Discretionary contributed to performance.
- In stock selection, overweighting of Fujitsu, Sawai Group Holdings, and TDK contributed to performance, while overweighting of Nidec and Zeon and underweighting of Shin-Etsu Chemical detracted. Overall, stock selection was negative.
- In December, sector allocation contributed to performance while stock selection detracted. The strategy underperformed TOPIX (TR). In sector allocation, contributors were our underweight in Consumer Discretionary and overweight in Information Technology. In stock selection, our underweight in Toyota Motor and overweight in Sawai Holdings and Murata Manufacturing contributed to performance, while our underweight in Shin-Etsu Chemical and overweight in Fujitsu General and Denso detracted. Overall, stock selection was negative.

Portfolio Activity

- The portfolio manager constructs the portfolio according to Sampo 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 TDK, Wacoal Holdings, and Panasonic. Names we increased our weighting in include Omron, Murata Manufacturing, and Fujitsu General.
- 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 quarter, the sectors (GICS 11) the portfolio was overweight in were Information Technology and Financials. Underweight sectors were Consumer Discretionary and Communication Services.
- Our strategy will continue to focus on ESG scores and undervalued names, as determined by our alpha rank measure. We will continue to construct a portfolio with ESG sector neutral weightings and an effective risk/return balance.



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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