

# UBAM - SNAM JAPAN EQUITY RESPONSIBLE

Quarterly Comment | Q1 2024

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](http://ubp.com) or in the latest prospectus.

## Market Comment

- TOPIX (TR) was up 18.14% during the January-March period. The rise in large-cap equities was particularly striking as capital flowed into Japanese stocks from foreign investors against a backdrop of US equity market record-highs following robust US corporate earnings and expectations for early rate cuts by the Fed. Expectations for Japanese corporate earnings also grew as JPY depreciated versus USD. The BoJ lifted negative interest rate policy and ended yield curve control (YCC) at its March monetary policy meeting following salary increases seen at the annual spring union salary negotiations. The Japanese equity market rose substantially on heightened expectations for deflation to end.
- In Q1, Japanese large-cap stocks led the market on foreign inflows driven by expectations for the end of deflation, while small- and mid-cap stocks underperformed. Overvalued names were avoided because of the slight rise in long-term rates in and out of the country. The Transportation Equipment sector was popular because the market was bullish on JPY depreciation versus USD. Names in the Financials and Real Estate sectors also outperformed on the BoJ's normalization of monetary policy and expectations for deflation to end. Domestic-focused sectors, for which the market was concerned because of prolonged high inflation, and sectors with high valuations, such as Services and Precision Instruments, underperformed.
- The Japanese market was weighted down at the beginning of March as expectations for the BoJ to put an end to negative interest rate policy at its March monetary policy meeting led to JPY appreciation versus USD. That said, sectors that rose were led by financials. The market then rallied as despite the BoJ putting an end to negative rates and abandoning yield curve control on prospects of the country having escaped deflation and seeing spring union wage negotiations lead to high raises, investors still believed monetary policy will remain accommodative for the time being. The market then gained support through the end of the month as JPY depreciated versus USD and on comments from Fed chair Jerome Powell after leaving monetary policy unchanged (much in line with market expectations) that there is a high chance the Fed will begin cutting rates before the end of 2024.

Sources: *UBP, Bloomberg Finance LP.*

*Past performance is not indicative of future performance*



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## Performance Review

- The portfolio underperformed the TOPIX (TR).
- Sector allocation contributed to performance, while stock selection detracted.
- In sector allocation, overweighting of Financials and Real Estate contributed to performance.
- In stock selection, overweighting of Obayashi Corporation and Mitsubishi Estate and underweighting of Sony Group contributed to performance, while overweighting of Yamato Holdings and Murata Manufacturing and underweighting of Toyota Motor detracted. Overall, stock selection was negative.
- In March, sector allocation and stock selection contributed to performance. The strategy outperformed TOPIX (TR). In sector allocation, contributors were our overweight in Real Estate and underweight in Health Care. In stock selection, our overweight in Obayashi, Mitsubishi Estate, and Dai-ichi Life Holdings contributed to performance, while our overweight in Murata Manufacturing, Yamato Holdings, and NTT detracted. Overall, stock selection as positive., while our underweight in Shin-Etsu Chemical and overweight in Fujitsu General and Denso detracted. Overall, stock selection was negative.

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## 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 Nippon Shokubai, Sawai Group Holdings, and Fujitsu. Names we increased our weighting in include Daikin Industries, Sumco, and Jtekt.
- 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.



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## Outlook

- We expect corporate profits could likely increase in FY24 given expectations for inventories at manufacturers to bottom out and domestic real wages to grow and capital efficiency improvement policies to be enacted on the back of pressure from the Tokyo Stock Exchange (TSE). However, it is also highly likely that profit growth momentum will slow given little room for further domestic economic normalization and JPY depreciation.
- Valuations are not at expensive levels despite having risen at a fast pace since the beginning of the year on capital flows from foreign investors. While we believe that the market could readily respond to a new negative catalyst given that earnings improvements expectations are already baked into prices, it is difficult to envision a large correction to the Japanese market given expectations for capital efficiency improvements on TSE pressure and support for equity demand from the high level of large scale share buybacks seen recently.
- The probability of a 10 bp rate hike in October increased. We can't exclude the possibility of this taking place sooner in July, although the data remains inconclusive. Investors should examine BOJ's statement for cues on when that could be. A weaker yen and higher oil prices may also exert upside pressures on BOJ's inflation forecast. We are watching for signs that a virtuous wage-price cycle has started to take hold.

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