

Q2 2020

UBAM – angel japan small cap equity

Quarterly Comment | Q2 2020

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

Market Comment

- The domestic equity market rebounded in 2Q on the back of growing expectations for the restart of economic activity caused by bold monetary easing and fiscal stimulus in a number of countries around the world as well as reductions to new Covid-19 cases. TOPIX (TR) growth for Apr–Jun was came to 11.3%, with further upside potential being squashed by signs of new Covid-19 cases picking up again around the world from mid-June.
- The equity market was strong in April despite fears of stagnant economic activity following the Japanese government’s announcement of a state of emergency because of large expected support in the form of monetary and fiscal policy. The market remained on an uptrend from May as although the real economy worsened, it did not decline as much as initially expected. The market continued to rise as expectations grew for the reopening of the economy given the slowdown in growth in new Covid-19 cases in Europe and the US. However, prices then hit upside resistance as signs emerged of new Covid-19 case numbers picking up again around the world.
- Growth stocks were preferred to value stocks. Value factors like low PER and low PBR gave way as quality names with high ROE and low credit risk were favored by investors. By sector, Machinery, Appliances, Info & Comm, and Services drove growth. Machinery and Appliances rebounded from their fall in Jan–Mar, while Info & Comm and Services have earnings that are relatively unaffected by Covid-19. Defensive sectors, such as Elec Power & Gas and Transportation lagged and underperformed.

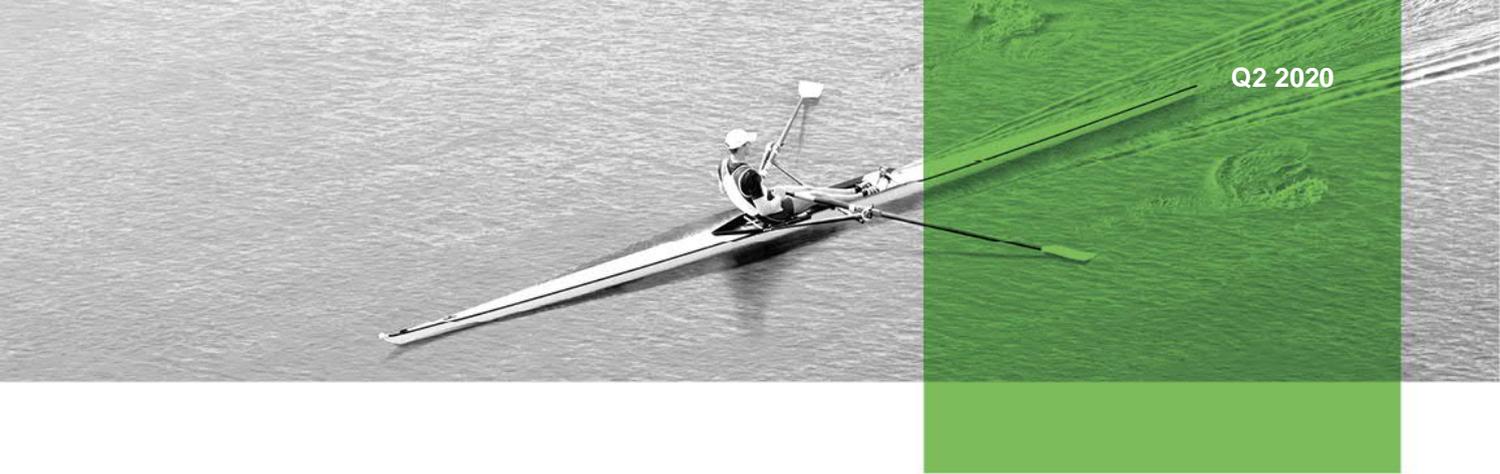
Sources: *UBP, Bloomberg Finance LP.*

Performance Review

- The portfolio outperformed the MSCI Japan Small Cap index. Stock selection was the main driver of performance while sector allocation was also positive. Portfolio underweighting of Consumer Staple was one of the most important sector contributions as this industry did not rebound as much as the market. Portfolio's overweight position in Information Technology did also bring positive sector effect as we were overweight.
- For individual stock picks, overweighting in Lasertec, Digital Arts and Rorze contributed positively while overweighting in Kotobuki Spirits, Japan MDM and Star Mirca Holdings contributed negatively.
- The team has not drastically changed its medium-term forecast. Even if some companies' short-term results will be affected by the pandemic, the team believes that those firms can catch up by the next fiscal year if their company's strengths do not alter. In this case, the upside potential for those stocks given the market sell-off could be huge. The team anticipates the consequence of deep undervaluation will lead to a significant price recovery in the next 12–18 months.

Portfolio Activity

- No specific activity throughout the quarter. We added Maruwa Unyu Kikan. Maruwa is developing a third-party logistics (3PL) business that undertakes and manages the entire logistics of customers specializing in the retail industry, and is particularly strong in low temperature food logistics. Currently, the company focuses on EC logistics, and is now the leading position of the "Amazon Japan" delivery providers. Although the cost of the new facility is increasing due to the establishment of a new distribution center, it is expected that the growth angle is increasing as productivity and profit margin is improved, and strong demand for EC distribution is expected.
- We removed Oisix Ra Daichi. The firm develops delivery service for food products and particularly has strengths in fruits and vegetables focus on safety. In addition to increasing synergistic effects by acquiring other companies in the same industry, sales of foodstuff kits were favorable due to growing demand for nests, and the number of members has been increasing. Although the evaluation of competitiveness and business model have not been changed, we reduced the weight considering to the recent sharp rise of equity price.
- We decreased Egurantee Inc., a credit guarantees service provider. The company undertakes risks related with financial services provided or commercial dealings. Rather than taking risks on its own, the company creates new investment products and entrusts them to a wide variety of reinsurance service providers, taking into consideration external credit data or in-house research outcomes. Although the evaluation of competitiveness and business model have not been changed, we reduced the weight considering to the recent sharp rise of equity price.



Outlook

- After a sharp recession in H1-20, economic activity is expected to rebound in Q3 and to recover progressively in H2-20 and 2021. Renewed COVID cases in some US states and across Latin America refuel uncertainties about the pace of the rebound after the global lockdown, but recovery progress should continue. Economic policy should continue to support labour while central banks stand ready to extend assets purchases in H2-20 if necessary.
- Business activity is recovering at a faster-than-expected pace, in China and the US. We believe the significant jump in the equity markets signals that prices now factor in this short-term rebound in business activity. The equity market will likely struggle to move in any direction over the near term given increased fears over a second wave of Covid-19 and Apr-Jun results announcements being just around the corner.
- We note the importance of keeping in mind the risk that a second wave of Covid-19 represents but believe that if we begin to see an end to the pandemic, equity market movements will be dependent on the scale of recovery in the real economy. A large part of the recent economic recovery was down to pent-up demand and economic stimulus from the government. As such, going forward the recovery, which we believe will continue, will likely be at a subdued pace. Many countries are adopting fiscal and monetary policy at a speed and scale beyond what the US adopted in the aftermath of the global financial crisis. The current drop in economic activity is different from any regular cyclical recession. There was no prior excessive investment. It is expected that following a recovery in consumption, production and investment will both recover too.
- We believe that short-term movements to either the upside or downside lack apparent catalysts but that there is little risk of TOPIX falling given our expected support level of 1,500, equivalent to a PBR of 1x. We expect a gentle recovery to the equity market as the economy picks back up through the end of the year.

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