

UBAM - SNAM Japan Equity sustainable

Quarterly Comment | Q3 2021

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

Market Comment

- TOPIX (TR) growth for July September was 5.3%. Increasing Covid-19 infections both in Japan and overseas as well as reports of reduced automobile production weighed on the market initially but entering into September growth was restored on the back of reassurance of domestic political stability and increased expectations of new economic stimulus.
- The market seesawed in July and August with catalysts coming in the form of strong corporate earnings announcements and better-than-expected macro data releases and negative catalysts coming in the form of increasing Covid-19 infections, the reinstatement of a state of emergency within Japan, news of Toyota global production units for September being 40% lower than planned, and stricter regulations on the education industry in China.
- The market rose on the reassurance of stable domestic politics and growing expectations for new economic stimulus as well as a drop in new Covid-19 infections. That said, concerns of a default at a large Chinese real estate developer and troubles in US budget discussions weighed on the market.
- The market showed strength at the beginning of September as Prime Minister Yoshihide Suga's announcement he would not be running in the LDP leadership contest led to an improved approval rating for the party and hopes of new economic stimulus.
- The market then faced upside resistance during the middle of the month as concerns arising of default at a large Chinese real estate developer tempered positive sentiment surrounding the clear peak-out and continued drop in Covid-19 infections.
- The market then fell towards the end of the month following a drop in the US market caused by rising long-term rates that resulted from signals from the FOMC that the Fed would begin hiking rates earlier than the market expected.

Sources: UBP, Bloomberg Finance LP.

Performance Review

- The portfolio was almost flat against the TOPIX (TR).
- Sector allocation contributed to performance while stock selection detracted.
- Portfolio underweighting of Communication Services and overweighting of Information Technology contributed to performance.
- For individual stock picks, overweighting of Citizen Watch and Dai-ichi Life Holdings and underweighting of SoftBank Group contributed to performance, while overweighting of Toyoda Gosei and Kirin Holdings and underweighting of Keyence detracted.
- More specifically, in September, our overweight in J front Retailing and Dai-ichi Life Holdings and underweight in Daikin contributed to performance, while our overweight in Nippon Steel, Toyoda Gosei, and Toray detracted. Overall stock selection was positive

Portfolio Activity

- The portfolio manager constructs the portfolio according to Sompo 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 Sanso, TDK, and Ajinomoto. Names we increased our weighting in include Fuji Electric, NEC, and Nippon Steel.
- 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 the quarter, the sectors (GICS 11) the portfolio was overweight in were Information Technology and Real Estate. Underweight sectors were Industrials and Communication Services
- We reduced our position in Nomura Research Institute and Ajinomoto and increased our position in Fuji Electric and NEC.

Outlook

- The Japanese equity market underwent a significant increase in the middle of September, with TOPIX even hitting a new high. However, it has recently undergone a big dip. We still believe that the Japanese market will rise through the end of the year on expectations for an economic reopening, growth in US long-term rates (which are highly correlated with Japanese equity), and expectations for upward revisions to corporate earnings guidance.
- The primary driver of the mid-month rise was a positive outlook on a new administration as Suga and his cabinet took their leave. With Fumio Kishida, also from the LDP, taking over as prime minister there has been no significant change to government policy. We expect the LDP will maintain its dominant position in government through the October general election and that it will push for further economic stimulus.
- Key drivers behind the recent drop in equity prices have been China, which has been subject to fears surrounding real estate prices and power outages, and the US, which is facing a debt ceiling problem. We do not believe the real estate or power problems in China will have a significant impact on the economy because the government can control both of them. The debt ceiling problem in the US is something we have seen time and again and we expect a political resolution soon enough.
- The risks present in both China and the US are controllable. Further vaccinations and news of Covid-19 treatments will likely give confidence to an economic reopening. We maintain our bullish stance on the Japanese equity market as we expect US long-term rates to go on a gentle uptrend and believe companies will revise corporate earnings guidance upwards from their initial conservative estimates during Jul–Sep earnings season.

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