

Japan High Conviction in the Pandemic Era Resilient, Responsible and Essential



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Emerging from lockdown

Economies around the world are now steadily reopening from what has been widely described as an “induced economic coma”. Their recoveries are underpinned by assertive monetary easing policies, including central bank balance sheet expansion and credit support, together with fiscal stimulus packages that have been inventive and unprecedented in scale. However, the optimistic and partly liquidity driven equity market narrative met some resistance in June, which brought with it a rise in volatility and a more circumspect tone. Japan’s broad market rebound effectively hit the ceiling in June as the TOPIX ended fractionally lower, losing 0.2% on the month.

To cushion the impact of the pandemic, the Japanese government announced an additional fiscal stimulus package of almost US\$1 trillion in May, bringing the overall fiscal stimulus pledged to more than \$2 trillion (approximately 20% of 2019 GDP), which is considered to be one of the largest stimulus programs adopted anywhere both in headline terms and relative to the size of the economy.

In July, Tokyo Governor Yuriko Koike was re-elected, and despite a recent increase in the number of confirmed coronavirus cases, the governor has offered assurances that she would not seek the kind of business closures that she had requested during the state of emergency. Indeed, as of July 10th, Japan relaxed its coronavirus restrictions further, allowing spectators to return to major sporting events.

Resilient, Responsible and Essential

Our recent commentaries on the Japan equity market have highlighted some of the investment themes that have shone during this crisis. This month, we will look at quality companies that are taking steps to emerge even stronger. One common characteristic seems to be that companies which have been well and

Japan’s Pandemic Response

Japan’s response to COVID-19 has been unusual among the developed countries in not imposing a strict national lockdown to combat the pandemic. Instead, first the Tokyo Metropolitan Government issued a regional state of emergency declaration in early April, which was followed by a national decree on April 16th that was lifted again one month later.

Nevertheless, mandatory business closures were limited and in most cases the measures relied on effective voluntary compliance. It remains difficult to draw any direct conclusions about the effectiveness of these relatively light touch policies given the low rate of coronavirus testing in Japan combined with a deliberate targeted policy of cluster tracking.

The official number of Covid-19 fatalities since the beginning of the outbreak is 984 (as of July 14), but data from the Tokyo Metropolitan Government cited by a Bloomberg report in early June suggested a mortality rate from all causes in the Tokyo region that was some 12% higher than the 4-year average, a discrepancy of approximately 1000 from the 4-year mean; although a rapidly aging population is likely to skew these statistics.

Meanwhile Japan’s National Institute of Infectious Diseases was noted in an NHK report on June 30 to be formulating new data analysis techniques so that Japan’s excess mortality rates and attributed mortality figures can be more directly compared with international data.

responsibly managed in the past are likely to have retained or gained goodwill during the crisis. In a post-pandemic era, we believe a shift to more responsible management with a degree of financial conservatism is likely to become an increasingly common theme.

Conventional wisdom and academic theory such as the efficient market hypothesis tend to associate higher returns with higher risk. According to our research, companies that have managed to successfully turn around failing businesses have indeed delivered high stock returns; but such cases are rare, and they are also very hard to identify consistently given the many variables at play. To some extent, our experience in Japan tells a different story, suggesting that investors are able to generate excess returns over the long term by investing in quality stocks with high and stable ROE, and that such companies also tend to combine strong balance sheets with a prudent approach to growth.

Japan High Conviction Fund Current Investment Themes



Shimano
High quality bicycle parts, outdoor activities

Portfolio Weighting: 2.5% (as at June 30, 2020)

Cycling has enjoyed a renaissance as people started to purchase bicycles to commute to school and work as an alternative to crowded public transport. Anecdotal evidence also points to a new flight to the suburbs in some countries, with more people shifting to outdoor fitness activities and away from gyms and other confined spaces.

Shimano was originally a family business and has been running for nearly a century, producing high quality gear systems and other bicycle components as well as fishing equipment. In Europe, bicycle sales surged along with the lifting of lockdown restrictions, and the region represents a large portion of Shimano's sales.

Shimano boasts many of the positive characteristics we noted earlier – it has a strong balance sheet with a net cash position, a shareholders' equity to total assets ratio of more than 90%. The company dominates the global market with its world-leading 60% market share in bicycle parts, and is determined to take advantage of the growth prospects that the boom in outdoor activities now offers.



SMC Corporation
Factory Automation

Portfolio Weighting: 4.8% (as at June 30, 2020)

SMC is the world leader in pneumatic control technologies for factory automation, with a global market share of 37%. Essential to automated manufacturing, every production line would include some form of pneumatic component for physical assembly, as these components carry out most of the "pushing", "lifting", and "carrying" processes. Order momentum has been affected in the short term by COVID-19, but the ongoing trend in technological advancement of automation and digitalisation shows no sign of slowing.

Through innovations in automation and control systems, SMC's products are considered essential to automating production. SMC's products are widely used in manufacturing, from automobiles, electronics, and semiconductors, to food packaging and medicines.

In April, SMC also announced the establishment of nomination and compensation committees with the aim, in its own words, to "make progress on corporate governance, by enhancing the fairness, transparency and objectivity to the nomination and compensation process of directors." In a further statement the company added that it was developing new energy saving features, and in anticipation of a recovery in demand, aimed to continue strengthening its supply chain management



Fast Retailing
High quality apparel, Asia's top retailer

Portfolio Weighting: 5.4% (as at June 30, 2020)

Along with other service sectors, retail has been among those that were hardest hit. Fast Retailing, owner of the Uniqlo brand, is the world's third-largest apparel company after Inditex (Zara) and H&M. Despite the pandemic, Uniqlo has opened new flagship stores in Tokyo in two distinct areas – the upscale shopping district Ginza, and fashion hub Harajuku.

Asian economies have emerged relatively quickly from the pandemic, and this region accounts for a large share of Uniqlo's annual revenues. Sales revenue from Mainland China was disrupted briefly in February in the wake of the outbreak of COVID-19, as nearly 400 of its 750 Uniqlo outlets were temporarily shut down, resulting in an 80% drop in same-store sales in February. Business recovered quickly from March, with their latest earnings report showing strong rebounds in its key markets of China and Japan. Although faced with the same challenges as other non-essential retailers, reports suggest Uniqlo is more resilient than many of its global peers.

Uniqlo has been able to capitalise to some extent on the sudden "work from home" demand for comfortable and casual clothing, but the success has also been driven by innovation and by extending the functional range of its "breathable" Airism fabric to the production of reusable face masks, which are claimed to offer some protection from air-borne particles while also having moisture "wicking" properties. The product was an immediate hit, partly because the material is especially suited to the humid summer climate of Japan and much of Asia

Portfolio Breakdown – June 2020

Top Ten Holdings	Fund Weight (%)	Sector Breakdown	Fund (%)	TOPIX (%)
Nidec Corporation	7.49	Electric Appliances	21.97	15.11
Keyence Corporation	6.38	Machinery	18.85	5.28
Daikin Industries	5.60	Services	16.89	5.28
Fast Retailing	5.44	Retail Trade	8.73	4.98
Unicharm Corporation	4.94	Transportation Equipment	8.23	7.28
SMC Corporation	4.81	Chemicals	7.90	7.31
M3, Inc.	4.27	Information & Communication	6.91	9.96
Murata Manufacturing Co., Ltd.	4.19	Other Products	4.02	2.49
Pigeon Corporation	4.13	Precision Instruments	2.40	2.64
Recruit Holdings Co., Ltd.	3.90	Real Estate	1.53	2.02
Total	51.15			

Source: NAM UK as at 30-06-2020.

Performance – June 2020

In JPY, net of fees	1 M	3 M	6 M	YTD	1 Y	2 Y	3 Y	4 Y	5 Y
Nomura Japan High Conviction	2.06	27.39	4.89	4.89	18.55	5.65	10.43	13.21	7.63
TOPIX TR JPY	-0.19	11.25	-8.17	-8.17	3.10	-2.73	1.24	8.23	1.37
Excess	2.25	16.14	13.05	13.05	15.45	8.39	9.20	4.99	6.26
Peer Group Rank	29	3	8	8	6	5	5	3	4
Quartile	1	1	1	1	1	1	1	1	1
Number of Funds Ranked	224	224	221	221	219	206	188	179	171

Source: Morningstar Direct as at 30-06-2020. Return data presented for the Nomura Funds Ireland Plc. Japan High Conviction Fund I JPY, in JPY, net of fees. Performance greater than 1 year is annualised. Morningstar Overall Ratings as at 30-06-2020. Copyright © 2020 Morningstar UK Limited. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. Peer Group: Morningstar Open-Ended Funds: Japan Large Cap Equity.

Fund Overview

Essentially a best ideas portfolio of Japan, the Japan High Conviction Fund is positioned to pick truly competitive global companies and unique Japanese game changers that take advantage of structural trends.



Attractive 1st quartile returns since inception	With a 5-star Morningstar Rating™, the fund has delivered consistent 1 st quartile returns across all time periods and delivered 4.85% p.a. annualised excess returns since inception*
High conviction approach of 25-40 stocks	A high conviction portfolio of quality stocks where company selection is paramount
Experienced investment team managing \$5.7bn AuM	The team manages approximately \$5.7bn in growth strategies including \$760m in the Japan High Conviction strategy and over \$165m in our dedicated UCITS fund
Large dedicated research resource	With over 30 research professionals on the ground, Nomura operates one of the largest, most experienced equity research teams in Japan. As a significant active investor Nomura has unrivalled depth and access to senior management teams across the country

*Source: Morningstar Direct. Data presented as at 30/06/2020, net of fees for the Nomura Funds Ireland Plc Japan High Conviction Fund I JPY share class vs. TOPIX TR JPY, calculated in JPY. Since inception: 7th August 2013. Past performance is no guarantee of future results. AUM as at 30/06/2020.

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The prospectus, key investor information document (KIID) and other fund related materials are available on the NAM UK website at www.nomura-asset.co.uk

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