

Eastspring Investments – Japan Dynamic Fund

eastspring
investments

A Prudential plc company 

Market review

Japanese equities declined in April, underperforming broad global and Asia ex Japan equities on a USD basis. The Bank of Japan maintained its dovish tone, taking the unanimous decision to keep its current monetary policy guidelines for money market operations unchanged at its Monetary Policy Meeting at the end of April. Broader global risk sentiment deteriorated in April due to declining optimism surrounding sharp interest rate cuts by the US Fed and rising geopolitical risk. Although the Yen continued to weaken during the month, which is usually a positive for equities, the market also considered the negative impact of Yen depreciation, including increasing import prices which could weigh on consumption and limit consumer purchasing power. Flash PMIs rose in April, however, on larger-than-expected increases in both the manufacturing and services indices.

Key contributors

Month-to-date, Kirin Holdings, Teijin and Resona Holdings were key absolute contributors to Fund performance.

Kirin Holdings rose strongly over the month. The share price of the food and beverage manufacturer has been broadly supported YTD following strong FY results reported in February and news that sales of its new beer brand have gotten off to a strong start, contributing to positive share dynamic in the Japan market. The stock's defensive characteristics were probably also favourably assessed in a weak month for the equity market.

Teijin is a chemical, pharmaceutical and information technology company, involved in areas including high performance fibres and composites, processing and IT products. The news that Teijin Pharma had entered into an exclusive global licensing agreement with Bioprojet, a French pharmaceutical company, granting it exclusive worldwide rights to research, develop, manufacture and commercialize an investigational candidate for narcolepsy, was well received. The market is also looking forward to the business reforms Teijin is expected to report with its upcoming fiscal results announcement in May.

Resona Holdings' share price rose over the month. Higher domestic interest rates would be a big benefit to regional banks including Resona's portfolio across Japan, with their large domestic loan books, and the sector has been outperforming as expectations of the BOJ lifting rates rise. The company has started and could play a further role in consolidation of regional banks in Japan. Its consolidation of regional banks in Kansai region could give it a better pricing power, streamline costs and improve profitability.

Key detractors

Month-to-date, Panasonic, Nomura and Sumitomo Heavy Industries were key absolute detractors from Fund performance.

Panasonic's share price underperformed over the month on continued concerns about automotive battery demand and competition. Market expectations for acceleration of portfolio transformation increased. Whilst the business portfolio restructuring process is well under way, share price performance has been volatile amid market uncertainty around potential weakness in end market volumes. The shorter-term focus is factoring in little restructuring benefit.

Nomura's share price was under pressure despite reporting a 670% year-on-year jump in quarterly net profit, driven by strong growth in retail and investment banking income. Nomura's shares had performed very strongly since the beginning of the year, as its dominant domestic position within Japan's capital markets has allowed it to take advantage of the strong market environment. Expectations for recovery in Overseas wholesale business are increasing, too. Management has also signalled willingness to support shareholder returns.

Sumitomo Heavy Industries underperformed over the month, despite reporting its Q1 2024 results, with operating profit and net sales increasing year-on-year. There are still short-term concerns around outlook in machinery business due to weaker orders. Sumitomo Heavy Industries has been improving management of profitable businesses and, while still with a lot of room for improvement, has shown increased focus on cost efficiency, portfolio management and return to shareholders.

Fund activity

During the month, the portfolio manager sold shares in companies where valuations look relatively less compelling and bought shares in companies where valuations look relatively attractive compared to other high conviction positions. Positions in Nomura Holdings, Furukawa Electric and Nissui Corp were trimmed, whilst positions in a number of holdings were added to, including in Panasonic Holdings, Takeda Pharmaceutical and Resona Holdings. The Fund initiated a new position in Koito Manufacturing.

Strategy and outlook

Although Japanese equities have had a phenomenally strong 2023, we believe that the long-term structural drivers of deflation, reforms and reallocation remain in place and corporate earnings can continue to improve over the coming years. Firstly, inflation appears to be becoming more entrenched and this is allowing companies to increase their pricing, benefiting margins. The labour market is also tighter than it has been in many years placing upward pressure on wages. This is key for a sustained move out of the deflationary era and we think this is the best chance Japan has had in a generation to do so. Secondly, the Tokyo Stock Exchange initiative and ongoing corporate governance reforms are positive for the value end of the Japanese equity market, where there is larger potential to improve Return-on-Equity and see a corresponding valuation re-rating. We expect the trend of share buybacks to continue in 2024 as more companies address the excess cash on their balance sheets and we are encouraged by corporate management teams' willingness to cut costs, restructure underperforming business units and unwind extensive cross shareholdings. Lastly, the capex environment appears to be improving, driven by the trends of re-shoring, friend-shoring and the green transition.

Sector attribution (one month)

Sector (%)	Average weights			Effects		
	Fund	Benchmark	Relative	Allocation	Selection	Total
TECHNOLOGY	19.4	21.5	-2.1	0.08	0.86	0.95
DOMESTIC	14.6	12.7	2.0	-0.04	0.54	0.50
TELECOMMUNICATIONS	-	4.3	-4.3	0.22	-	0.22
DEFENSIVE	14.2	14.4	-0.2	0.00	0.14	0.14
GLOBAL BASICS	16.9	12.9	4.0	0.17	-0.08	0.09
AUTOS	8.8	11.7	-2.9	0.06	-0.07	-0.01
FINANCIALS	13.2	13.4	-0.2	-0.01	-0.16	-0.17
INDUSTRIALS	10.3	9.1	1.2	0.07	-0.31	-0.24
CASH AND EQUIVALENTS	2.5	-	2.5	0.03	0.06	0.09
Total	100.0	100.0	-	0.58	0.99	1.57

Top 10 absolute contributors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
KIRIN HOLDINGS CO LTD	3.7	0.3	0.34
TEIJIN LTD	2.5	-	0.22
RESONA HOLDINGS INC	3.6	0.4	0.18
KUBOTA CORP	2.5	0.4	0.16
TOSOH CORP	2.8	-	0.15
AGC INC	2.2	0.2	0.12
KANEKA CORPORATION	1.5	-	0.11
FURUKAWA ELECTRIC CO LTD	2.1	-	0.09
TAISEI CORP	2.6	0.2	0.07
SANKYU INC	1.5	-	0.07
Total	25.0	1.4	1.51

Top 10 absolute detractors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
PANASONIC CORPORATION	5.8	0.5	-0.25
SUMITOMO HEAVY INDUSTRIES	2.9	-	-0.19
NOMURA HOLDINGS INC	2.2	0.5	-0.19
HONDA MOTOR CO LTD	3.6	1.4	-0.16
DAITO TRUST CONSTRUCT CO LTD	5.2	0.2	-0.16
NISSAN MOTOR CO LTD	3.2	0.2	-0.14
CREDIT SAISON CO LTD	1.3	-	-0.12
EAST JAPAN RAILWAY CO	4.8	0.4	-0.04
TAKEDA PHARMACEUTICAL CO LTD	5.4	1.1	-0.04
ASAHI KASEI CORP	2.6	0.2	-0.03
Total	37.1	4.6	-1.33

Top 10 absolute contributors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
RICOH CO LTD	5.8	0.1	1.51
SUMITOMO MITSUI FINANCIAL GROUP	4.5	1.8	1.34
NOMURA HOLDINGS INC	2.8	0.4	1.25
FURUKAWA ELECTRIC CO LTD	2.3	-	1.11
RESONA HOLDINGS INC	3.0	0.3	1.10
HONDA MOTOR CO LTD	3.9	1.4	0.96
SUMITOMO HEAVY INDUSTRIES	2.9	-	0.67
TOSOH CORP	2.6	0.0	0.60
BROTHER INDUSTRIES LTD	2.3	0.1	0.56
TAISEI CORP	2.5	0.2	0.56
Total	32.7	4.4	9.66

Top 10 absolute detractors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
NABTESCO CORP	2.5	-	-0.22
SUMITOMO CHEMICAL CO LTD	3.5	0.0	-0.03
IIDA GROUP HOLDINGS CO LTD	1.0	0.1	-0.01
KOITO MANUFACTURING CO LTD	0.0	0.1	0.00
Total	7.0	0.2	-0.26

Statistics

Characteristics	Fund	Benchmark
Number of holdings	39	217
Price to earnings (number of times)	17.7	19.7
Price to book (number of times)	1.0	1.8
Forward 12-month dividend yield (%)	3.1	2.3
Active share (%)	90.4	N/A
Tracking error (%)	6.8	N/A

Additional notes

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United Kingdom - Facility Agent

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