


Eastspring Investments – Japan Dynamic Fund

eastspring
investments

A Prudential plc company 

Market review

In August, the MSCI Japan Index inched up by 0.5% in USD but saw a drop in JPY terms. The market sold off at the beginning of the month following the release of disappointing US economic data and as the Bank of Japan raised interest rates, triggering an unwind of global carry trade positions and leading to a global market sell off. The Japanese market experienced its worst daily drop since Black Monday in 1987, although it snapped back strongly the following day. The Bank of Japan (BoJ) stated it would consider raising interest rates if inflation consistently meets the 2% target, amidst ongoing market volatility. Japan's annual inflation rate remained at 2.8% for the third month, with electricity prices hitting their highest increase since March 1981. The au Jibun Bank Japan Manufacturing Purchasing Managers' Index indicated that Japan's factory activity contracted at a slower pace in August thanks to a recovery in output and new orders. The PMI rose to 49.8 in August versus 49.1 in July, and was up from 49.5 reported in the flash reading.

Key contributors

Month-to-date, Ricoh, Sumitomo Chemical and Kirin Holdings were key absolute contributors to Fund performance.

Ricoh's share price rose over the month, as the market favourably views the firm's flexible share buybacks and the fact that a well-known activist has been increasing its stake in Ricoh. Ricoh is beginning to benefit from efforts to transition its business portfolio to software services from printing hardware. It is restructuring in both domestic and overseas production and sales operations should support cashflow sustainability from its existing printing business. We continue to have a high conviction for Ricoh based on our conservative trend margin assumptions and significant trend valuation support.

Sumitomo Chemical is a diversified chemicals business which primarily includes petrochemicals, energy and functional materials, IT-related chemicals, health and crop sciences and pharmaceuticals. The share price continued to perform well during the month after significant underperformance over the last year, as the company was struggling in an environment where major businesses in pharmaceutical and petrochemical fields were under significant pressure. The company has initiated significant restructuring plans in its struggling divisions and is concentrating resources on its higher growth and profitable crop sciences and IT-related chemical businesses. Investors also digested the company's quarterly results announcement in July, which indicated it was progressing well against the company's projections for the full year, as well as fresh announcements related to restructuring.

Kirin Holdings' share price also rose in August. The share price of the food and beverage manufacturer has been broadly supported YTD following strong FY results reported in February and strong H1 results reported in August. Revenue and profit for the first half showed strong year-on-year growth. The stock's defensive characteristics were probably also favourably assessed in a weak month for the equity market, particularly at the start of the August amid the steep drawdowns.

Key detractors

Month-to-date, Sumco, Sumitomo Mitsui Financial Group and Nabtesco were key absolute detractors from Fund performance.

Sumco is principally engaged in the manufacture and sale of high-purity silicon wafers for semiconductor manufacturers. The company's share price was under pressure over the month along with the wider sector, despite reporting quarterly results that came in ahead of forecast. Short-term profit outlook was weaker than expected on prolonged wafer inventory adjustments and increased depreciation cost guidance.

Sumitomo Mitsui Financial Group's share price declined, despite reporting a solid set of quarterly results, with profits up strongly on a year-on-year basis. The company has managed its balance sheet well by shedding non-core assets and creating room for elevated returns to shareholders and investments abroad. On top of capital management, the company has also showed stringent cost management. SMFG has a diversified income stream with meaningful exposure and leading positioning in consumer finance and credit card businesses. It has also been focused on improving the profitability of its loan book through mix improvement. The company is moving to the offence by investing in its businesses in Asia.

Nabtesco is a well-run company with solid market positions in precision reduction gears for industrial robots, trading at substantial discount to its valuations. Market sentiment on the stock is affected by the fears of recession and China's economy decline but these concerns seem cyclical. The company's share price was weak in August due to the initial market shock at the start of the month around weakening US and global growth.

Fund activity

During the month, the 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. Several positions were trimmed, including Sumitomo Chemical and Ricoh, whilst the position in NEC was closed. Positions in Sumco and Yamato Holdings were added to, whilst the Manager initiated new positions in Mizuho Financial Group and Sampo.

Strategy and outlook

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, changing management behaviour and 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, and thus supporting consumption. The capex environment appears to be improving, driven by the trends of re-shoring, friend-shoring and the green transition. These are 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.

Sector attribution (one month)

Sector (%)	Average weights			Effects		
	Fund	Benchmark	Relative	Allocation	Selection	Total
GLOBAL BASICS	16.4	12.3	4.0	-0.10	0.30	0.20
FINANCIALS	12.6	14.5	-1.9	0.15	0.05	0.20
DEFENSIVE	15.6	15.4	0.2	0.01	0.08	0.09
TELECOMMUNICATIONS	-	4.5	-4.5	-0.09	-	-0.09
AUTOS	8.5	9.5	-1.1	0.05	-0.15	-0.10
DOMESTIC	19.5	13.0	6.4	0.46	-1.03	-0.57
TECHNOLOGY	16.4	21.3	-4.8	-0.04	-0.60	-0.65
INDUSTRIALS	10.0	9.4	0.5	0.02	-1.36	-1.34
CASH AND EQUIVALENTS	1.1	-	1.1	0.00	0.05	0.05
Total	100.0	100.0	-	0.46	-2.67	-2.22

Top 10 absolute contributors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
RICOH CO LTD	5.6	0.1	0.36
SUMITOMO CHEMICAL CO LTD	3.7	-	0.30
KIRIN HOLDINGS CO LTD	3.6	0.3	0.11
SOHGO SECURITY SERVICES CO	1.4	-	0.08
TAISEI CORP	2.9	0.2	0.05
SOMPO HOLDINGS INC	0.5	0.5	0.04
SG HOLDINGS CO LTD	1.2	0.1	0.04
TAKEDA PHARMACEUTICAL CO LTD	5.9	1.2	0.03
SUNDRUG CO LTD	1.1	-	0.02
H.U. GROUP HOLDINGS INC	1.2	-	0.02
Total	27.2	2.4	1.03

Top 10 absolute detractors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
SUMCO CORP	1.9	0.1	-0.64
SUMITOMO MITSUI FINANCIAL GROUP	4.4	2.1	-0.62
NABTESCO CORP	2.9	-	-0.56
SUMITOMO HEAVY INDUSTRIES	2.4	-	-0.43
AGC INC	2.5	0.2	-0.37
NISSAN MOTOR CO LTD	2.6	0.2	-0.35
BROTHER INDUSTRIES LTD	1.9	0.1	-0.32
RESONA HOLDINGS INC	3.9	0.4	-0.24
TOSOH CORP	2.6	-	-0.24
KANEKA CORPORATION	1.5	-	-0.20
Total	26.8	3.1	-3.97

Top 10 absolute contributors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
RICOH CO LTD	5.8	0.1	2.19
SUMITOMO MITSUI FINANCIAL GROUP	4.7	2.0	1.76
FURUKAWA ELECTRIC CO LTD	1.8	-	1.39
RESONA HOLDINGS INC	3.5	0.3	1.21
NOMURA HOLDINGS INC	2.1	0.5	1.17
TAISEI CORP	2.7	0.2	0.98
SUMITOMO CHEMICAL CO LTD	3.6	0.0	0.98
DAITO TRUST CONSTRUCT CO LTD	5.3	0.2	0.65
HONDA MOTOR CO LTD	3.0	1.3	0.63
TAKEDA PHARMACEUTICAL CO LTD	5.6	1.2	0.53
Total	38.2	5.7	11.49

Top 10 absolute detractors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
PANASONIC CORPORATION	5.8	0.5	-0.84
NISSAN MOTOR CO LTD	3.1	0.2	-0.77
NABTESCO CORP	2.8	-	-0.38
AGC INC	2.2	0.2	-0.31
SUMCO CORP	2.2	0.1	-0.29
SANKYU INC	1.5	-	-0.14
KUBOTA CORP	2.3	0.4	-0.11
IZUMI CO LTD	1.0	-	-0.09
YAMATO HOLDINGS CO LTD	0.8	0.1	-0.08
KOITO MANUFACTURING CO LTD	0.8	0.1	-0.06
Total	22.5	1.6	-3.07

Statistics

Characteristics	Fund	Benchmark
Number of holdings	41	203
Price to earnings (number of times)	14.8	16.6
Price to book (number of times)	0.9	1.5
Forward 12-month dividend yield (%)	3.2	2.4
Active share (%)	89.8	N/A
Tracking error (%)	7.9	N/A

Additional notes

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Facilities Agent for European Economic Area:

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Representative Agent: First Independent Fund Services Ltd, Klausstrasse 33, 8008 Zurich

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United Kingdom - Facility Agent

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