


Eastspring Investments – Japan Dynamic Fund

eastspring
investments

A Prudential plc company 

Market review

The MSCI Japan Index climbed 5.5% higher in February. The Japanese equity market performed strongly in February driven by expectations for resilient US economy, yen weakness, and anticipation of AI demand growth. However, real wages, 4Q GDP, and personal consumption were weaker than expected. Capex announced Mar 4 was strong, up 16.4% YoY, demonstrating the resilience of fundamentals, and we think the stock market should be supported from the growing likelihood of stronger wage hike guidance versus last year, and from expectations that the BoJ will normalize policy at a gradual pace.

Key contributors

Month-to-date, Sumitomo Heavy Industries, Sumitomo Mitsui Financial Group and Ricoh were the key absolute contributors to the Fund's performance.

Ricoh outperformed during the month as the market favorably view the firm's flexible share buybacks. 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 Heavy Industries' share price benefitted from the strong bottomline growth reported for the Full Year 2023, as well as the accompanying buyback announcement. Sumitomo Heavy Industries has been improving management of profitable businesses and cost efficiency as well as the competing valuation. We used the valuation opportunity to increase the position and this is now being rewarded as their profit resilience becomes more evident to the market. We will continue to manage the position relative to the valuation opportunity.

Sumitomo Mitsui Financial Group's (SMFG) share price outperformed in February, as expectations for monetary policy normalization in Japan increased. The company has managed well its balance sheet 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.

Key detractors

Month-to-date, Sumitomo Chemical, Nabtesco and Taisei were key absolute detractors for the Fund.

Sumitomo Chemical detracted from relative performance as its F3/24 3Q results fell below consensus as profits at the pharmaceutical division deteriorated. Company has announced restructuring plan to address badly performing businesses. Sumitomo Chemical is a diversified chemicals business which primarily includes petrochemicals, energy and functional materials, IT-related chemicals, health and crop sciences and pharmaceuticals. Market concerns have been focused on a future patent cliff in the pharmaceutical business as well as weakness in the environment for IT-related products, in particular flat panel display materials demand and pricing. The market also continues to be sceptical about the stability of profits at its Petro Rabigh project in Middle East, having in mind past technical problems. Our conservative trend earnings assumptions have taken into account these potential impacts.

Nabtesco share price was weak post FY2024 earnings announcement on weak fiscal year guidance as weak China automation machinery demand continues. Nabtesco is a small but well-run company with solid market positions in precision reduction gears for industrial robots and good management, trading at substantial discount to its valuations. Market sentiment on the stock is affected by the fear of recession and China's economy decline but these concerns seem cyclical. The company outperformed the market in December owing to the positive expectations on robotics production improvement.

Taisei's share price was dragged lower during the month as market is concerned about gross margin deterioration in private construction business in the short term. Taisei is one of the top general construction companies in Japan, involved both in civil and private construction. In the short term, company's gross profit margin is being negatively impacted by low profitability orders taken during Covid period, combined with unanticipated raw material price increases. Company has significant cross-shareholdings and how it addresses these are a key focus point..

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 attracted compared to other high conviction positions. Notable top-ups were Nabtesco, Stanley Electric, Taisei and Resona while positions in Nomura Holdings, Honda, Mazda, Mitsubishi UFJ Financial Group and NEC were trimmed.

Strategy and outlook

Although Japanese equities have had a phenomenally strong year 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
DEFENSIVE	15.2	15.1	0.2	-0.01	0.09	0.08
TECHNOLOGY	19.7	22.1	-2.3	0.02	-0.09	-0.07
TELECOMMUNICATIONS	-	4.6	-4.6	-0.07	-	-0.07
FINANCIALS	13.9	12.7	1.2	0.04	-0.24	-0.20
INDUSTRIALS	9.8	8.8	1.0	0.00	-0.52	-0.52
DOMESTIC	14.8	12.8	1.9	-0.07	-0.46	-0.53
GLOBAL BASICS	16.1	12.7	3.3	0.00	-1.27	-1.27
AUTOS	9.2	11.2	-2.0	-0.13	-1.21	-1.34
CASH AND EQUIVALENTS	1.3	-	1.3	-0.07	0.05	-0.02
Total	100.0	100.0	-	-0.29	-3.65	-3.95

Top 10 absolute contributors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
SUMITOMO HEAVY INDUSTRIES	3.0	-	0.43
SUMITOMO MITSUI FINANCIAL GROUP	4.4	1.8	0.36
RICOH CO LTD	5.8	0.1	0.36
DAITO TRUST CONSTRUCT CO LTD	5.6	0.2	0.31
NOMURA HOLDINGS INC	2.8	0.4	0.30
EAST JAPAN RAILWAY CO	5.2	0.5	0.24
HONDA MOTOR CO LTD	3.9	1.4	0.24
FURUKAWA ELECTRIC CO LTD	2.5	-	0.23
AIR WATER INC	2.2	-	0.21
TOSOH CORP	2.7	0.1	0.17
Total	38.0	4.5	2.84

Top 10 absolute detractors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
SUMITOMO CHEMICAL CO LTD	3.3	0.1	-0.46
NABTESCO CORP	2.4	-	-0.33
TAISEI CORP	2.4	0.2	-0.32
ASAHI KASEI CORP	2.6	0.2	-0.20
TEIJIN LTD	2.3	-	-0.17
STANLEY ELECTRIC CO LTD	1.6	-	-0.16
IIDA GROUP HOLDINGS CO LTD	1.0	0.1	-0.15
AGC INC	2.2	0.2	-0.09
KIRIN HOLDINGS CO LTD	3.5	0.3	-0.07
SANKYU INC	1.4	-	-0.06
Total	22.7	1.0	-2.02

Top 10 absolute contributors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
NOMURA HOLDINGS INC	3.1	0.4	0.98
SUMITOMO MITSUI FINANCIAL GROUP	4.3	1.7	0.88
HONDA MOTOR CO LTD	4.0	1.4	0.82
RICOH CO LTD	5.7	0.1	0.80
FURUKAWA ELECTRIC CO LTD	2.3	-	0.70
SUMITOMO HEAVY INDUSTRIES	2.9	-	0.70
DAITO TRUST CONSTRUCT CO LTD	5.6	0.2	0.49
TAKEDA PHARMACEUTICAL CO LTD	5.7	1.2	0.46
EAST JAPAN RAILWAY CO	5.1	0.5	0.45
TOSOH CORP	2.6	0.1	0.34
Total	41.1	5.6	6.62

Top 10 absolute detractors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
SUMITOMO CHEMICAL CO LTD	3.4	0.1	-0.45
NABTESCO CORP	2.4	-	-0.37
TEIJIN LTD	2.4	-	-0.13
IIDA GROUP HOLDINGS CO LTD	1.1	0.1	-0.09
STANLEY ELECTRIC CO LTD	1.6	-	-0.07
TAISEI CORP	2.5	0.2	-0.07
IZUMI CO LTD	1.0	-	-0.03
Total	14.2	0.3	-1.20

Statistics

Characteristics	Fund	Benchmark
Number of holdings	39	225
Price to earnings (number of times)	17.1	19.1
Price to book (number of times)	1.0	1.7
Forward 12-month dividend yield (%)	3.1	2.2
Active share (%)	89.8	N/A
Tracking error (%)	6.7	N/A

Additional notes

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Facilities Agent for European Economic Area:

Eastspring Investments (Luxembourg) SA, 26 Boulevard Royal, L-2449, Luxembourg

Switzerland - Representative and Paying Agents

The above-mentioned documents are available free of charge from the Representative Agent.

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

Paying Agent: NPB-New Private Bank Ltd, Limmatquai 1/am Bellevue, 8024 Zurich

United Kingdom - Facility Agent

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