


Eastspring Investments – Japan Dynamic Fund

eastspring
investments

A Prudential plc company 

Market review

In July, Japan's stock market (MSCI Japan Index) rose by 5.8% on a USD basis, whilst it declined mildly on a JPY basis, with the yen hitting a four-month high, following the Bank of Japan's (BoJ) first interest rate hike in 15 years at the very end of the month. The key short-term interest rate was raised to 0.25%, signalling a shift in monetary policy, which included a reduction in monthly bond buying and lowering the BoJ's balance sheet. Concurrently, Japan's annual headline inflation remained static at 2.8% for the second consecutive month in June, the highest since February, driven by soaring electricity costs post the removal of energy subsidies. The stock market also digested news of the manufacturing sector's slowdown in July, marking its fifth contraction this year.

Key contributors

Month-to-date, Sumitomo Chemical, Daito Trust and East Japan Railway were key absolute contributors to Fund performance.

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.

Daito Trust is a house builder which, after decades of rapid growth, has been faced with intense competition, exacerbated by raw material and labour cost inflation post Covid. The market has anchored around the weak business environment for the rental housing starts caused by Covid, as well as uncertainties in the medium- and long-term growth strategy of the company. Being the homebuilding leader in the rental housing market, Daito Trust has reached a point where the market is cautious about its ability to continue to grow, however the company continues to generate positive cash flows and has a solid capital structure, even during Covid. There remains room for improvement in shareholders' returns as management reviews asset efficiency and capital structure, with our conservative valuation assumptions supporting the case for conviction. The company's first quarter results were released towards the very end of the month, with year-on-year increases in sales and income.

East Japan Railway's share price outperformed during July, with investors digesting quarterly results which showed very strong year-on-year growth in revenue and profit. We have observed the company has remained focused on cost control in the rail business and increasing the value of its real estate assets. Our trend operating margin and capital expenditure assumptions for the rail business conservatively account for possible lower trend ridership level versus pre-pandemic level, as well as provisions for both large scale maintenance and CapEx programs. East Japan Railway plans to increase non-railway business profit share from 30% to 40% in five years' time. We have factored in higher capital expenditure as a result and our conservative return on asset assumptions are consistent with an asset-heavy business model for commercial property. East Japan Railway exhibits supportive trend valuation and the Fund built a moderate position amid share price underperformance.

Key detractors

Month-to-date, Nissan, Panasonic and Sankyu were key absolute detractors from Fund performance.

Nissan's share price was under pressure over the month as the company reported a year-on-year decline in quarterly profits, attributed to discounting in the US. Our conservative trend valuation assumptions have taken competitive issues into account and we find there is material valuation support. The negative market sentiment has more than priced the shorter term cyclical concerns that are currently being extrapolated. Nissan's management has made significant efforts to cut fixed costs and lower the break-even point of its manufacturing operations. It is in the middle of increasing its geographical focus which should consolidate resources for better product and efficient brand investments. The company expects improvement in sales performance through improved new model introductions going forward, whilst management has engaged in collaborations with industry peers to share the burden of the electrification transition.

Panasonic's share price continued to underperform over the month on continued concerns about automotive battery and white goods demand. Whilst the business portfolio restructuring process of exits from non-core businesses is well under way, share price performance has been volatile amid market uncertainty around weakness in end market volumes. The shares remain materially undervalued.

Sankyu is a major plant engineering company in Japan with a dominant position in Steel and Chemical plant engineering. Their strategy is to continue to grow existing businesses gradually, as well as upgrading systems and moving horizontally into new natural extensions of the existing businesses. Recent share price weakness is due to disappointing short-term performance in their logistics business as pricing action has been inadequate to cover rising costs. Historically the company has shown strong cost pass-through. The shares remain significantly undervalued versus the company's through-cycle returns and cashflow generation ability.

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 Honda and Sumitomo Mitsui Financial Group, whilst positions in AGC and Sundrug were added to. The Manager also initiated a new position in SG Holdings.

Strategy and outlook

We believe that the long-term structural drivers of reflation, 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
TECHNOLOGY	17.5	21.6	-4.0	0.13	0.85	0.98
DOMESTIC	18.2	12.2	6.0	0.19	0.78	0.97
GLOBAL BASICS	16.7	12.6	4.2	0.04	0.89	0.93
INDUSTRIALS	10.1	9.6	0.5	-0.01	0.55	0.54
AUTOS	9.0	10.2	-1.1	0.08	0.40	0.48
DEFENSIVE	14.8	14.3	0.4	0.02	0.16	0.18
TELECOMMUNICATIONS	-	4.6	-4.6	0.06	-	0.06
FINANCIALS	12.8	15.0	-2.3	-0.08	0.09	0.01
CASH AND EQUIVALENTS	0.8	-	0.8	0.00	-0.02	-0.02
Total	100.0	100.0	-	0.43	3.69	4.12

Top 10 absolute contributors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
SUMITOMO CHEMICAL CO LTD	4.1	-	0.49
DAITO TRUST CONSTRUCT CO LTD	5.2	0.2	0.47
EAST JAPAN RAILWAY CO	4.6	0.4	0.28
NABTESCO CORP	3.1	-	0.28
BROTHER INDUSTRIES LTD	2.4	0.1	0.24
TAISEI CORP	3.0	0.2	0.23
TEIJIN LTD	2.2	-	0.19
TAKEDA PHARMACEUTICAL CO LTD	5.6	1.1	0.17
ASAHI KASEI CORP	2.6	0.2	0.16
RICOH CO LTD	5.9	0.1	0.16
Total	38.6	2.3	2.68

Top 10 absolute detractors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
NISSAN MOTOR CO LTD	3.0	0.2	-0.34
PANASONIC CORPORATION	5.8	0.5	-0.33
SANKYU INC	1.6	-	-0.10
HONDA MOTOR CO LTD	1.8	1.2	-0.08
KUBOTA CORP	2.2	0.4	-0.07
TOSOH CORP	2.7	-	-0.06
SUMITOMO HEAVY INDUSTRIES	2.6	-	-0.06
NEC CORP	0.4	0.5	0.00
Total	20.2	2.8	-1.03

Top 10 absolute contributors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
SUMITOMO MITSUI FINANCIAL GROUP	4.7	1.9	2.49
RICOH CO LTD	5.9	0.1	1.77
FURUKAWA ELECTRIC CO LTD	1.9	-	1.54
RESONA HOLDINGS INC	3.4	0.3	1.49
NOMURA HOLDINGS INC	2.3	0.5	1.33
TAISEI CORP	2.7	0.2	0.92
BROTHER INDUSTRIES LTD	2.4	0.1	0.88
DAITO TRUST CONSTRUCT CO LTD	5.3	0.2	0.72
HONDA MOTOR CO LTD	3.2	1.4	0.71
SUMITOMO CHEMICAL CO LTD	3.6	0.0	0.62
Total	35.4	4.7	12.47

Top 10 absolute detractors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
PANASONIC CORPORATION	5.8	0.5	-0.70
NISSAN MOTOR CO LTD	3.2	0.2	-0.36
SUNDRUG CO LTD	0.8	-	-0.03
Total	9.9	0.8	-1.09

Statistics

Characteristics	Fund	Benchmark
Number of holdings	40	203
Price to earnings (number of times)	15.9	17.0
Price to book (number of times)	1.0	1.6
Forward 12-month dividend yield (%)	3.0	2.2
Active share (%)	90.9	N/A
Tracking error (%)	7.2	N/A

Additional notes

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4. The above portfolio data (including security weights) is based on Eastspring Investments' internal database and Investment Book of Records and may differ from custodian's data that presented on the Fund factsheet due to accounting differences.

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Facilities Agent for European Economic Area:

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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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