


Eastspring Investments – Japan Dynamic Fund

eastspring
investments

A Prudential plc company 

Market review

In June, Japan's stock market experienced a decline of 0.7% (MSCI Japan) as investors grew concerned over the yen's sharp decline and its potential to harm Japan's economy and exacerbate inflation. The annual headline inflation rate climbed to 2.8% in May, up from 2.5% in April, largely due to a sharp increase in electricity costs following the complete removal of energy subsidies. The market also responded to reports of a deceleration in manufacturing sector growth in June and a contraction in services activity for the first time in almost two years. At its June meeting, the Bank of Japan unanimously decided to keep its key short-term interest rate steady at around 0% to 0.1%, in line with expectations, after implementing its first interest rate increase since 2007 back in March.

Key contributors

Month-to-date, Sumitomo Chemical, Sumitomo Mitsui Financial Group and Nabtesco 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 performed well in 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 profitability crop sciences and IT-related chemical businesses.

Sumitomo Mitsui Financial Group also outperformed in June, continuing its strong gains YTD, with investors focused on possible further tightening in BOJ's domestic monetary policy. 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 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 June owing to the positive expectations around the company's execution strategy of cost and price discipline, as well as expectations for precision parts orders starting to bottom out, albeit slowly.

Key detractors

Month-to-date, Teijin, Panasonic and Brother Industries were key absolute detractors from Fund performance.

Teijin is a chemical, pharmaceutical and speciality chemical company, involved in areas including high performance fibres and composites. The shares have been underperforming as composites continue to struggle in the US but management are addressing this structural issue as well as others such as cross shareholdings, for example they recently announced the sale of their shares in Infocom. The shares look cheap based on the likely level of long-term sustainable earnings.

Panasonic's share price underperformed over the month on continued concerns about automotive battery demand. 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.

Brother Industries is a printer manufacturer with a strong niche position for SOHO (small office, home office) printers. The company is working to diversify its business portfolio by increasing sales in industrial machinery applications and commercial printing. Apart from printing, the company has a good position in machine tools for auto (including EVs) and machinery in Asia, automation components and is trying to further grow its commercial label digital printers. We take comfort in the substantial discount in valuations underpinned by the strong balance sheet. The share price was under pressure in June as it was announced that the company had been unsuccessful in its bid for Roland DG.

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. A number of positions were trimmed, including Honda and Ricoh, whilst positions in Yamato Holdings and H.U. Group were added to.

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
AUTOS	9.4	10.6	-1.2	0.07	0.12	0.20
GLOBAL BASICS	16.6	12.7	4.0	-0.09	0.00	-0.09
TELECOMMUNICATIONS	-	4.5	-4.5	-0.16	-	-0.16
INDUSTRIALS	10.0	9.5	0.5	0.01	-0.19	-0.18
DEFENSIVE	14.5	14.5	0.1	0.00	-0.24	-0.24
DOMESTIC	17.0	12.2	4.8	0.00	-0.43	-0.43
FINANCIALS	12.7	14.5	-1.7	-0.04	-0.45	-0.49
TECHNOLOGY	18.4	21.7	-3.3	-0.04	-1.22	-1.26
CASH AND EQUIVALENTS	1.3	-	1.3	-0.01	0.00	-0.01
Total	100.0	100.0	-	-0.26	-2.41	-2.67

Top 10 absolute contributors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
SUMITOMO CHEMICAL CO LTD	3.7	-	0.25
SUMITOMO MITSUI FINANCIAL GROUP	5.1	2.1	0.22
NABTESCO CORP	3.0	-	0.21
TOSOH CORP	2.7	-	0.14
NEC CORP	0.6	0.5	0.07
KUBOTA CORP	2.3	0.4	0.05
ASAHI KASEI CORP	2.5	0.2	0.02
SUNDRUG CO LTD	0.7	-	0.01
AEON MALL CO LTD	1.3	-	0.00
KOITO MANUFACTURING CO LTD	1.7	0.1	0.00
Total	23.5	3.3	0.97

Top 10 absolute detractors (one month)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
TEIJIN LTD	2.4	-	-0.31
PANASONIC CORPORATION	5.9	0.5	-0.29
BROTHER INDUSTRIES LTD	2.5	0.1	-0.15
AIR WATER INC	2.2	-	-0.12
RICOH CO LTD	6.2	0.1	-0.12
KIRIN HOLDINGS CO LTD	3.6	0.3	-0.11
EAST JAPAN RAILWAY CO	4.5	0.4	-0.11
HONDA MOTOR CO LTD	2.3	1.3	-0.08
RESONA HOLDINGS INC	3.9	0.4	-0.08
DIC CORP	1.6	-	-0.08
Total	35.1	3.1	-1.45

Top 10 absolute contributors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
SUMITOMO MITSUI FINANCIAL GROUP	4.7	1.9	2.38
RICOH CO LTD	5.9	0.1	1.58
FURUKAWA ELECTRIC CO LTD	2.1	-	1.52
RESONA HOLDINGS INC	3.3	0.3	1.37
NOMURA HOLDINGS INC	2.4	0.5	1.30
HONDA MOTOR CO LTD	3.5	1.4	0.80
TAISEI CORP	2.6	0.2	0.65
BROTHER INDUSTRIES LTD	2.3	0.1	0.60
SUMITOMO HEAVY INDUSTRIES	2.8	-	0.54
NEC CORP	1.0	0.5	0.53
Total	30.6	4.9	11.27

Top 10 absolute detractors (year to date)

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
PANASONIC CORPORATION	5.8	0.5	-0.33
IZUMI CO LTD	1.0	-	-0.12
SUNDRUG CO LTD	0.8	-	-0.07
EAST JAPAN RAILWAY CO	4.9	0.4	-0.07
H.U. GROUP HOLDINGS INC	0.2	-	-0.06
NABTESCO CORP	2.7	-	-0.04
Total	15.3	1.0	-0.67

Statistics

Characteristics	Fund	Benchmark
Number of holdings	39	203
Price to earnings (number of times)	15.4	17.1
Price to book (number of times)	0.9	1.6
Forward 12-month dividend yield (%)	3.2	2.3
Active share (%)	90.8	N/A
Tracking error (%)	6.8	N/A

Additional notes

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Switzerland - Representative and Paying Agents

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

United Kingdom - Facility Agent

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