


# Eastspring Investments – Japan Dynamic Fund



A Prudential plc company 

## Market review

In March, in all of the developed markets, Japanese stocks had the strongest outperformance, as they digested the BoJ's policy pivot and rebalancing by pension funds. The yen's depreciation after the BoJ's exit from the negative interest rate policy supported corporate earnings and equity indices, but the expected growth in FY2023 corporate earnings pointed to by the BoJ Tankan cannot be explained by the yen's weakness alone. With guidance from spring wage negotiations pointing to strong wage growth, companies are making progress in price pass-through also.

## Key contributors

Month-to-date, Ricoh, Resona and Taisei were the key absolute contributors to the Fund's performance.

Ricoh continued to outperform in March 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.

Resona outperformed during the month, as market focuses on possible need for additional monetary policy normalization. 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 and streamline costs and improve profitability.

Taisei's share price climbed higher in March underpinned by the expectations on earnings improvement, due to rising-margin on new orders and return to shareholders driven by cross-share unwind. 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.

## Key detractors

Month-to-date, Takeda Pharmaceutical, East Japan Railway and Mazda were key absolute detractors for the Fund.

Takeda Pharmaceutical's share price likely suffered from the market's outlook for weak growth and defensives underperforming. We had built a position in Takeda Pharmaceutical during a period where share price performance reflected the market concerns around cost of acquisition of Shire and implied balance sheet stress, as well as likely implications for execution of the merger. Since the completion of the acquisition, Takeda has exceeded its target for the sale of non-core assets in order to reduce the debt on their balance sheet, and it has been delivering on its cost synergies commitments. We believe the current share price does not reflect the progress of management's efforts to improve the balance sheet as well as the underlying profitability of the combined businesses.

East Japan Railway's share price underperformed during the month as defensives underperforming. 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.

Our due diligence suggests that despite the competitive market environment, Mazda's strategy of improving mix in its product line up, leveraging EV and hybrid technology from its alliance with Toyota and using proprietary technology to improve overall engine performance remains sustainable. The company has also made efforts in efficient marketing and focus on quality in its dealer operations. Weak yen has contributed to improving fundamental performance, too.

## 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. Positions in Mitsubishi UFJ Financial Group, NEC, Credit Saison, Nomura Holdings and Nissui Corp were trimmed. The Fund exited the small remaining position in Mazda in March. Positions in Sankyu, Nabtesco and Panasonic were supported in contrarian fashion..

## 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
TECHNOLOGY	19.7	22.0	-2.3	0.04	0.97	1.01
FINANCIALS	14.3	13.3	1.0	0.05	0.54	0.59
GLOBAL BASICS	16.4	12.6	3.8	0.05	0.48	0.53
TELECOMMUNICATIONS	-	4.6	-4.6	0.16	-	0.16
AUTOS	9.0	11.5	-2.5	-0.03	0.10	0.07
INDUSTRIALS	10.0	8.9	1.1	0.01	0.02	0.03
DEFENSIVE	14.6	14.6	0.0	0.00	-0.14	-0.14
DOMESTIC	14.9	12.5	2.3	0.06	-0.40	-0.34
CASH AND EQUIVALENTS	1.1	-	1.1	-0.04	0.01	-0.03
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>-</b>	<b>0.31</b>	<b>1.58</b>	<b>1.88</b>

**Top 10 absolute contributors (one month)**

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
RICOH CO LTD	5.9	0.1	0.58
RESONA HOLDINGS INC	3.2	0.3	0.54
TAISEI CORP	2.7	0.2	0.50
NOMURA HOLDINGS INC	2.9	0.5	0.45
SUMITOMO CHEMICAL CO LTD	3.4	-	0.41
SUMITOMO MITSUI FINANCIAL GROUP	4.7	1.9	0.39
BROTHER INDUSTRIES LTD	2.3	0.1	0.31
HONDA MOTOR CO LTD	3.9	1.4	0.31
AIR WATER INC	2.4	-	0.28
TEIJIN LTD	2.4	-	0.28
<b>Total</b>	<b>33.6</b>	<b>4.5</b>	<b>4.03</b>

**Top 10 absolute detractors (one month)**

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
TAKEDA PHARMACEUTICAL CO LTD	5.5	1.2	-0.14
EAST JAPAN RAILWAY CO	4.9	0.5	-0.02
MAZDA MOTOR CORP	0.1	0.2	-0.02
DAITO TRUST CONSTRUCT CO LTD	5.5	0.2	-0.01
DIC CORP	1.5	-	0.00
<b>Total</b>	<b>17.5</b>	<b>1.9</b>	<b>-0.19</b>

**Top 10 absolute contributors (year to date)**

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
NOMURA HOLDINGS INC	3.0	0.4	1.47
RICOH CO LTD	5.7	0.1	1.43
SUMITOMO MITSUI FINANCIAL GROUP	4.4	1.8	1.30
HONDA MOTOR CO LTD	4.0	1.4	1.15
FURUKAWA ELECTRIC CO LTD	2.4	-	1.00
RESONA HOLDINGS INC	2.8	0.3	0.89
SUMITOMO HEAVY INDUSTRIES	2.9	-	0.89
BROTHER INDUSTRIES LTD	2.2	0.1	0.58
AIR WATER INC	2.2	-	0.56
DAITO TRUST CONSTRUCT CO LTD	5.5	0.2	0.48
<b>Total</b>	<b>35.2</b>	<b>4.3</b>	<b>9.75</b>

**Top 10 absolute detractors (year to date)**

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
NABTESCO CORP	2.5	-	-0.29
IIDA GROUP HOLDINGS CO LTD	1.0	0.1	-0.03
IZUMI CO LTD	1.0	-	-0.02
SUMITOMO CHEMICAL CO LTD	3.4	0.1	0.00
<b>Total</b>	<b>7.8</b>	<b>0.1</b>	<b>-0.34</b>

**Statistics**

Characteristics	Fund	Benchmark
Number of holdings	38	218
Price to earnings (number of times)	17.5	20.0
Price to book (number of times)	1.0	1.8
Forward 12-month dividend yield (%)	3.0	2.2
Active share (%)	90.5	N/A
Tracking error (%)	6.9	N/A

**Additional notes**

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

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

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Eastspring Investments (Luxembourg) S.A. - UK Branch, 1 Angel Court, London EC2R 7AG

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**Eastspring Investments (Singapore) Limited (UEN. 199407631H)**

7 Straits View  
#09-01 Marina One East Tower  
Singapore 018936  
Tel: +65 6349 9711

**Eastspring Investments (Luxembourg) S.A.**

26 Boulevard Royal  
L-2449 Luxembourg  
Grand Duchy of Luxembourg  
Tel: +352 22 99 99 5763

**Eastspring Investments (Hong Kong) Limited**

13/F, One International Finance Centre  
1 Harbour View Street  
Central, Hong Kong  
Tel: (852) 2868 5330

**UK Branch**

1 Angel Court  
London  
EC2R 7AG  
Email: [info.europe@eastspring.com](mailto:info.europe@eastspring.com)

[eastspring.com](http://eastspring.com)