


# Eastspring Investments – Japan Dynamic Fund



A Prudential plc company 

## Market review

In September, the MSCI Japan Index fell in USD terms, amidst a strengthening yen following the US Federal Reserve's interest rate cut. The Bank of Japan (BoJ) maintained its key short-term interest rate at 0.25% during its September meeting, in line with market expectations. Japan's annual headline inflation rate climbed to 3% in August, driven by a significant rise in electricity and gas prices as energy subsidies ended. Core inflation also grew by 2.8% year-on-year, marking the fourth consecutive month of acceleration. Meanwhile, the au Jibun Bank Japan Manufacturing Purchasing Managers' Index contracted to 49.7 in September, indicating a seventh straight month of manufacturing sector decline.

## Key contributors

Month-to-date, Panasonic, Asahi Kasei and East Japan Railway were key absolute contributors to Fund performance.

Panasonic's share price rose strongly over the month. Investors digested the news that it had reopened its next generation electric vehicle battery plant in Wakayama, as well as further detailed announcements about collaborations with Mazda and Subaru in EV batteries. While cyclical headwinds exist in some segments, Panasonic is making progress in high-growth areas such as energy solutions for data centres and EV battery production. Expectations around its EV battery business seems low, but the company is working to improve the product and diversify the client base, with some wins at Japanese auto makers, apart from main customer Tesla. The stock remains considerably undervalued and management should take steps to close that gap.

Asahi Kasei's share price also rose, with investors digesting several corporate announcements including details around newly acquired biotech company and its growth prospects, sale of non-core business in the blood purification field, as well as strength in domestic housing orders. The company is mainly engaged in the materials, housing and healthcare sectors. The Materials segment provides styrene monomer, acrylonitrile, polyethylene, automotive-related fibers, electronic materials, mixed signal large scale integrated circuits (LSI), hall elements, deep ultraviolet light-emitting diodes (LEDs), pharmaceutical and food additives. The Housing segment provides construction contracting, renovation and other housing-related business, as well as lightweight aerated concrete (ALC), insulation materials and others. The Healthcare segment provides medical drugs, hemodialysis and apheresis related equipment, virus removal filters, cardiopulmonary resuscitation-related products and others.

East Japan Railway's share price outperformed in September. 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, Takeda Pharmaceutical, Sumco and Koito Manufacturing were key absolute detractors from Fund performance.

Takeda Pharmaceutical's share price has underperformed on no material news flow over the month after strong performance in previous months. The team invested in the stock when its share price was under pressure due to concerns on balance sheet capacity post large acquisition. Concerns around weak late-stage pipeline and dependence of a large drug (Entyvio) in drug portfolio. The company has divested from non-core assets and significantly rebuilt balance sheet capacity, opening space for increased dividends going forward. The company has recently announced a round of cost restructuring with aim of supporting underlying profit margins. Stable and high profitability plasma business continues to grow nicely. Entyvio patent expiry has been pushed back and new administration method improving patient convenience seems to be re-acceleration growth. We have observed improvement in R&D productivity and there are some new products that have been approved (dengue vaccine, etc.), in late stage (Ph3) of development or acquired.

Sumco is principally engaged in the manufacture and sale of high-purity silicon wafers for semiconductor manufacturers. The company's share price continued to be under pressure along with the wider sector. Short-term profit outlook was weaker than expected on prolonged wafer inventory adjustments and increased depreciation cost guidance.

Koito Manufacturing's share price has been under pressure together with broader weakness in the auto industry. US operations have been problematic due to lag in transfer of costs to clients. US operations are a focus point to management for improvement, through productivity improvement via automation and price negotiations. Management expects penetration of higher value-add headlamp products to also contribute to increase in sales per vehicle. Management has flagged aggressive optimization of balance sheet, by managing down its cash balances and increasing returns to shareholders and capacity in Americas (Mexico, Brazil) as it expects increased orders for US based OEMs.

## 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 Ricoh and Daito Trust, whilst positions in Sumco and Mizuho Financial Group were added to.

## 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.

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

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
PANASONIC CORPORATION	6.3	0.5	0.26
ASAHI KASEI CORPORATION	2.7	0.2	0.18
EAST JAPAN RAILWAY COMPANY	5.1	0.5	0.13
RICOH COMPANY LTD	4.9	0.2	0.13
TEIJIN LIMITED	2.3	-	0.12
CREDIT SAISON CO LTD	1.1	-	0.11
TOSOH CORPORATION	2.5	-	0.11
IZUMI CO LTD	1.1	-	0.09
KANEKA CORPORATION	1.5	-	0.08
BROTHER INDUSTRIES LTD	1.6	0.1	0.07
<b>Total</b>	<b>29.2</b>	<b>1.5</b>	<b>1.29</b>

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

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
TAKEDA PHARMACEUTICAL CO LTD	5.7	1.2	-0.18
SUMCO CORPORATION	2.9	0.1	-0.17
KOITO MANUFACTURING CO LTD	2.1	-	-0.15
TAISEI CORPORATION	2.8	0.2	-0.12
SUMITOMO MITSUI FINANCIAL GROUP INC	4.0	2.0	-0.12
NOMURA HOLDINGS INC	1.0	0.4	-0.12
NISSAN MOTOR CO LTD	2.4	0.2	-0.11
RESONA HOLDINGS INC	4.0	0.4	-0.11
DAITO TRUST CONSTRUCTION CO LTD	4.7	0.2	-0.09
STANLEY ELECTRIC CO LTD	2.5	-	-0.08
<b>Total</b>	<b>32.1</b>	<b>4.7</b>	<b>-1.26</b>

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

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
RICOH COMPANY LTD	5.7	0.1	2.23
SUMITOMO MITSUI FINANCIAL GROUP INC	4.6	2.0	1.47
FURUKAWA ELECTRIC CO LTD	1.7	-	1.32
NOMURA HOLDINGS INC	2.0	0.4	1.07
RESONA HOLDINGS INC	3.5	0.3	0.92
SUMITOMO CHEMICAL CO LTD	3.5	0.0	0.87
TAISEI CORPORATION	2.7	0.2	0.82
HONDA MOTOR CO LTD	2.8	1.3	0.67
CREDIT SAISON CO LTD	1.4	-	0.55
BROTHER INDUSTRIES LTD	2.2	0.1	0.53
<b>Total</b>	<b>30.3</b>	<b>4.5</b>	<b>10.44</b>

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

Holdings (%)	Average weights		Contribution to fund performance
	Fund	Benchmark	
NISSAN MOTOR CO LTD	3.1	0.2	-0.74
SUMCO CORPORATION	2.2	0.1	-0.45
PANASONIC CORPORATION	5.9	0.5	-0.40
NABTESCO CORPORATION	2.8	-	-0.38
AGC INC	2.2	0.2	-0.23
KOITO MANUFACTURING CO LTD	1.0	0.1	-0.20
YAMATO HOLDINGS CO LTD	1.0	0.1	-0.14
SANKYU INC	1.5	-	-0.07
KUBOTA CORPORATION	2.3	0.4	-0.05
SOMPO HOLDINGS INC	0.2	0.5	-0.02
<b>Total</b>	<b>22.2</b>	<b>2.1</b>	<b>-2.68</b>

**Statistics**

Characteristics	Fund	Benchmark
Number of holdings	41	198
Price to earnings (number of times)	14.3	16.1
Price to book (number of times)	0.9	1.5
Forward 12-month dividend yield (%)	3.3	2.5
Active share (%)	89.8	N/A
Tracking error (%)	8.1	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)