FUND PROFILE

RSMR

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NIKKO ASSET MANAGEMENT

JAPAN VALUE FUND

June 2024

RSMR RATED FUND

OUR RESEARCH. YOUR SUCCESS

CONTENTS

FUND PROFILE – NIKKO AM JAPAN VALUE FUND

OUR FUND PROFILES provide an in-depth review of our leading rated funds and are designed to give advisers, paraplanners and analysts an 'under the bonnet' view of the fund. In providing more detailed commentary than a standard fund factsheet we believe our fund profiles set the standard for the next generation of research notes, aiding in fund selection and in meeting the ongoing suitability requirements expected by the FCA, and helping ensure firms deliver good client outcomes.

All of our rated funds are subject to rigorous and ongoing scrutiny on both a qualitative and quantitative basis. Our fund methodology is available for download from the RSMR Hub – www.rsmr.co.uk

The **Nikko AM Japan Value Fund** has been an RSMR rated fund since June 2021. The fund uses a research-driven approach which, although bottom-up focused, is macro aware. The investment philosophy of the value team aims to deliver superior performance by making long-term investments in undervalued companies that are expected to undergo change. The team hopes to make high returns in stocks by owning them through this period of market re-rating.

Graham O'Neill, Investment Consultant

Graham began his career in the investment industry over thirty years ago. After graduating from the University of Kent with a Degree in Economic Analysis, History and Policy, he joined London & Manchester, later joining Phillips Drew, then GRE as a UK based fund manager. He then moved to Abbey Life Ireland, where he held the position of CIO running their Managed and large Equity funds. Graham now runs his own independent research consultancy in Ireland and has worked with RSMR since 2010.

IA JAPAN

The Nikko AM Japan Value Fund is categorised within the IA Japan sector. Funds in this sector invest at least 80% of their assets in Japanese equities. The IA Japan sector contains over 90 funds available for investors and financial advisers to choose from, covering a large variety of investment strategies and styles, including active, passive, and enhanced index funds. A number of funds adopt style or market-cap based strategies including value and growth-biased themes, market-cap focused or multi-cap strategies. Funds that invest in a specialist theme must still meet the geographic requirements of the sector.

The variations between the funds makes it difficult for an investor to compare them as different strategies will clearly perform differently depending on market conditions. It is important to recognise this when looking at both absolute and relative performance numbers for funds in the IA Japan sector, and this is particularly relevant for the Nikko AM Japan Value Fund as relative performance can be volatile.

For over a decade Japan has suffered from an economy where inflation, interest rates and wage growth all remained near or below zero. Signs have emerged over the past 12 months that the country is now at an inflection point with the Bank of Japan recently ending its negative interest rate policy. Companies have been able to pass on increased cost to consumers and as a result workers are receiving meaningful wage increases. Following Russia's invasion of Ukraine, prices initially began to rise in Japan, but with wage growth lagging, disposable incomes were under pressure. More recently, during the Shunto pay negotiations in spring 2024, the country's largest employers agreed to increase wages by an average 5.3%.

In February of this year the Nikkei 225, the widely quoted but narrow stock market index, finally surpassed its previous peak reached 34 years ago. Japan is unlikely to raise rates sharply due to the ongoing challenges of poor demographics and high levels of indebtedness and as a result of this, markets have sold the yen this year which will continue to help the cyclicals and exporters that have led stock market performance in 2024.

There has also been a change in the mindset amongst Japanese corporates who are now focused on improving returns to external shareholders and accept that capital allocation policies need to improve. The level of wasteful cross shareholdings has fallen, and companies have engaged in more share buybacks and are willing to listen to external investors about how to improve returns. Japanese stocks have rallied significantly from their lows and performed strongly over the last 12 months, but there is the potential for further upside if the economy is about to emerge from deflation and see economic cycles normalise, especially if this is combined with further reform at the corporate level which could drive profitability higher.

NIKKO ASSET MANAGEMENT

Nikko Asset Management (Nikko AM), with a head office in Tokyo, Japan is one of Asia's largest asset managers, with 240.1bn USD under management, providing high-conviction, active fund management across a range of Equity, Fixed Income and Multi-Asset strategies. The Japan Value Strategy represents $5.99bn of assets.

Nikko AM was established in 1959. Today they have an on-the-ground presence in China, Japan, Hong Kong, Singapore, Malaysia, Australia, New Zealand and currently employ 219 investment professionals. They also have offices in London, Edinburgh, Frankfurt, Luxembourg, Amsterdam and New York.

Nikko AM's teams have expertise in different regions and asset classes and their investment approach uses a boutique structure which they feel is best suited to tackle the range of market conditions and country specific differences. Each investment team has complete investment autonomy, but they have firm wide resources supporting this. The quality standards imposed are centralised so areas such as risk management, compliance, and client servicing all follow the same firm-wide standards backed by the Group resource.

NIKKO AM JAPAN VALUE

Managers	Takaaki Harashima, Shinya Takada
Structure	SICAV
IA Sector	Japan
Launched	February 2016
Fund Size	£134 million (as at 31st March 2024)

Fund Management Team

After the sad passing of the previous lead manager Shigeru Aoyagi in late September, Takaaki Harashima has taken over as Chief Portfolio Manager for this fund and is co-head of the team with Shinya Takada. The team has maintained its strength with seven members, having added Tomoyuki Hino as a junior value analyst in May 2023 to bring ideas from a younger generation. More recently, Ryosuke Susuki joined from Daiwa Asset Management and first worked at the firm as a sector analyst covering steels and nonferrous metals and more recently joined the Value team where his experience in these value orientated sectors is very useful.

The process and philosophy are unchanged with the team looking for companies with a catalyst for structural change that are undervalued. These have always been the most important philosophies and there was no change in this.

Takaaki Harashima is Chief Portfolio Manager & Co-Head of the Japan Value team. He started his career at Yamaichi Securities in 1996 where he was a portfolio manager and sector analyst at Nomura Asset Management and SG Yamaichi Asset Management (now Amundi Japan) before joining Nikko AM in 2000 as a sector analyst. He later became a value analyst in 2005, and then moved on to the portfolio management team of this strategy the following year.

Shinya Takada is a Senior Portfolio Manager & Co-Head of the Japan Value team. He started his career at Daiichi Life Insurance in 1996 and has worked in asset management at Asahi Life Asset Management and Meiji Dresdner, before joining Nikko AM in 2004 as a sector analyst, later moving to the value analyst team. He has been a portfolio manager on the strategy since 2012.

In addition, there are five dedicated value analysts for this team:

- Tatsuro Ochi joined Nikko AM at the start of 2015 and is also a portfolio manager on the value team.
- Kozue Saito joined Nikko AM as a fixed income analyst in 2007 and subsequently became a value analyst in 2011; she has also served as a proxy voting analyst since 2018. Kozue Saito concurrently works as a stewardship specialist in the Japan Sustainable Investment Department at Nikko AM.
- Tatsuhiko Ikeda joined Nikko AM in 2014. Since April 2022 he has concurrently worked as a portfolio manager on the Research Active Management Team, and previously he was a sector analyst covering chemicals, steel, non-ferrous metals, trading companies and marine transportation.
- Ryosuke Susuki joined Nikko in 2023 and has thirteen years industry experience.
- Tomoyuki Hino joined Nikko in 2022 and has three years industry experience.

The fund has had dedicated value style analysts since October 2004, when they were added to allow coverage of the increased number of companies listed on the Tokyo Stock Exchange First Section. They also provide the ability to closely research stocks in line with the value investment approach of seeking catalysts for structural change which the more mainstream sector analysts may not cover.

The value style analysts are complemented by an experienced team of 12 sector analysts, who have an average of 17 years' industry experience and an average of 12 years' experience working with Nikko AM. There are also six analysts and one group manager in Nikko AM's Active Ownership Group (Sustainable Investment team) that specialise in proxy voting and in conducting governance meetings with the mainly smaller cap names currently held in Nikko AM's Japanese equity funds which are not covered in the core research universe.

The team is also supported by Junichi Takayama, Japan Equity Investment Director. Junichi has over 20 years' industry experience and joined Nikko AM in 2013. He is currently based out of the Nikko AM London office.

Fund Objectives & Targets

The 80 to 100 stock portfolio has a low turnover of 20 to 40% per annum, with an expected holding period of 3 to 5 years. The fund aims to outperform the TOPIX Total Return Index by approximately 3% per annum over a 3 to 5-year period, with a tracking error of approximately 4%.

The value team look to deliver superior performance by making long-term investments in undervalued companies that are expected to undergo change. They aim to invest when they spot a catalyst for change rather than waiting to see if there is evidence of change occurring. The research seeks undervalued companies that offer goods and services that society needs, which is different to other value strategies. The contrarian approach focuses on undervalued companies likely to undergo transformation and the team hopes to make high returns in stocks by owning them through this period of market re-rating. The Japanese economy is mature and as a result the overall stock market at the index level is highly cyclical. The team believe this allows seasoned investors to take advantage of repeated patterns. The team looks to consistently apply a contrarian value-orientated investment approach to generate excess returns.

Examples of undervalued companies that are expected to undergo transformation include those in crisis mode where poor standing in the market compels management and employees to make fundamental changes, companies whose mind set is changing towards enhancing corporate value, and those with attractive potential that has not been reflected in the market price or valuation.

Companies that offer goods and services needed by society would generally demonstrate the three attributes the team look for – business continuity, downside protection, and those that possess a turnaround catalyst even if they are temporarily undervalued. The fund has a value bias and is mid-cap orientated, with a market cap cut-off of roughly $500m with the team also taking into account the free float of the shares.

The objective is to achieve excess returns over the medium to long term through a consistent value oriented approach.

Investment Process

The team aims to understand whether poor stock performance is due to structural or cyclical issues and looks for strong returns from stocks that are underperforming due to structural issues, but which possess a turnaround catalyst. These are described as Phase 1 stocks, which are in a long-term cycle due to exogenous events or idiosyncratic structural issues, and this will typically last 2 to 3 years. Companies in this phase have the potential to realise a significant turnaround and will then start generating positive cash flow when moving into Phase 2 (typically 1 to 2 years) although underperformance may occur due to cyclical issues. The team are wary of value trap stocks on optically low valuations.

There is a focus on the catalyst to turn the stock price around for the Phase 1 stocks which could be a supply side catalyst (a structural change due to a company's own efforts) or a demand side catalyst (a structural / environmental change in the market). For either of these catalysts the question is asked 'does the company have products / services / human resources that are needed by the market to capture new demand?'. Phase 2 stocks can be underperforming due to cyclical issues which could be the economic cycle in general, or the product life cycle the company faces, so there is then an assessment of the type of cycle and the position within this. There can be a delay between upfront investment and recovery, cyclically depressing profitability, and there can also be other cyclical factors unique to the company or the business cycle of the sector in which it operates.

The premise of the approach is that in a mature economy, both the market and most individual companies will show cyclicality, and this fund looks to take advantage of this cyclicality by buying low and selling high. It is contrarian and buys when valuations are depressed taking a 3 to 5-year view which seems to be the expected period for a company to show cyclical improvement. In fact, one of the sell disciplines is that if a company does not make any progress in terms of its operations over three years, the position is sold to avoid value traps.

The first stage of the process is to define the potential investment universe where quantitative valuation measures including PE, PB and P/cash flow are used, and this is followed by detailed qualitative bottom-up fundamental research and analysis. All listed stocks (approximately 3,700 names) are screened, and the fund focuses on roughly the bottom 50% of this universe, but excludes companies with high credit risks, low liquidity (the typical market cap cut-off is $500m), and those that do not meet other measures looking at free float. Poor governance risk stocks would also be excluded at this stage. This results in a value research universe of 600 to 700 names.

The ideas generated by the value team are Phase 1 stocks. The value team, including the analysts, spend their resources discovering these undervalued stocks. The research process focuses on multiple layers of the company from senior management to employees as well as considering historic information. Along with standard financial information, the team looks for factors which explain the poor stock performance, aiming to understand the financials. They also screen for any negative legacy issues such as lawsuits, or excess personnel, together with unfavourable non-financial information, to ensure the company will continue to survive and that there is limited downside when an investment is made. The identification of the turnaround catalyst is then looked at, finding attractive non-financial information such as talented staff, a brand, or technology. To understand a company, the value team meets senior management and employees, conducts site visits, and speaks to competitors and they look to find causal relationships and grasp changes. The research process produces a buy list of approximately 200 stocks.

The reasons for undervaluation can be excess human resources, or too high a level of assets within the business, or that the market or company does not realise the net worth of the business or its potential. Many Japanese companies used to trade on conglomerate discounts some years ago, but this has now started to rectify itself as companies have carved out unprofitable businesses or bought in the shares of listed minorities. The levels of M&A in Japan have increased. When the team find a company trading below its book value, they will speak to the management to discuss ways to unlock the value, perhaps through technology as has been the case in companies with exposure to the hydrogen power sector. Kawasaki Heavy Industries restructured and focused on its growth areas, which included robotics and medical as well as hydrogen. These shares have risen by 70% since purchase, but the growth rate will continue to be strong, and in these circumstances, the team do not leave a turnaround story at an early stage.

Companies with huge NAV through cross shareholdings in other businesses have been a feature of the Japanese market, but whereas 30 years ago this was around 50% of companies, it has now fallen to around 14%.

Portfolio Construction

Phase 1 companies are initially identified by the value team and companies in Phase 2 may well be on the radar of the broader sector analysts (sector specialists) who also support the PM teams managing different style portfolios including growth, core, and dividend, etc. These analysts provide a pooled resource to the fund management team as a whole.

There are no sector constraints on portfolio construction, but the risk tolerance target is approximately 4% tracking error and the usual UCITS rules apply, so a single stock holding cannot be more than 10% of the fund. Phase 1 stocks make up 60 to 70% of the portfolio whilst Phase 2 stocks are 30 to 40% of the portfolio. The overall portfolio has a price to book of 1.28x and a dividend yield of 2.19%.

Sales can occur for a number of reasons, such as replacing a stock where the price target has been achieved, or if there is declining confidence in management or the business strategy. Stocks will also be reviewed and possibly sold if there is a deviation of the fundamental metrics from expectations (thesis not playing out). If the team loses faith in the quality of the management, the stock is sold.

Two risk models are combined to evaluate portfolio risk – the Barra model and also a proprietary risk model which complements this. The proprietary model is based on 18 factors and 33 sub factors using TSE classifications.

While the fund is bottom-up in construction, the portfolio managers do consider macro factors as they believe it would be foolish to ignore big picture issues. For example, when long term interest rates looked likely to rise it was recognised that this would be beneficial for some value names and resulted in the fund increasing its weighting to banks in the spring of 2022. Companies monitored and researched in Phase 2 will also benefit from the views of the sector analyst team and each of the sector analysts meet with the portfolio manager at least once a month to discuss the latest views. At extremes the fund can hold higher levels of cash, but this is not typical positioning as the team usually have many interesting stock ideas and remain very positive on opportunities in Japan today.

To avoid value traps, when investing in Phase 1, a company is generally given 3 years to show signs of improving prospects which is in line with the medium-term corporate plans for Japanese companies. Companies on the right track will be held onto for a number of years if it is felt there is significant upside in the shares as the team does not want to sell out of turnaround stories too early.

ESG

Nikko AM has made ESG a central element of its management philosophy in order to implement its fiduciary principles and fulfil its stewardship responsibilities. ESG is seen as essential for putting fiduciary principles into practice. ESG is integrated into all investment decisions through the incorporation of Creating Shared Value (CSV) Evaluations which comprise 12 factors from three categories: competitiveness, ESG, and financial strength. The ESG category accounts for five of 12 factors: Human Resources, Carbon Neutral, Environmental & Social, Management Execution, and Resilience. ESG integration places ESG into investment decision making and ESG active ownership focuses on stewardship, voting rights, and engagement. CSV evaluations use the work of Harvard University Professor Michael Porter which states the creation of social value leads to economic value with comprehensive evaluation of a firm on competitiveness, ESG factors and financial strength.

Nikko AM has used CSV evaluations since 2013. These are integrated with the original Porter's Five Forces of barriers to entry, threat of substitutes, bargaining power of customers or suppliers and competitive rivalry together with a financial strength evaluation looking at return to shareholders as part of this. Nikko AM avoids investing in firms with governance risk and promotes better governance through engagement and since 2015 has avoided investing in firms with perceptible corporate governance risk. The analysts assess governance risk on an individual basis and work with governance specialists on engagement if issues arise.

PAST & CURRENT POSITIONING/STRATEGY

One of the differentiating features of the fund is that in addition to the more typical analyst team that works on a generalist basis for different style strategies, there are also five dedicated analysts working solely on the value strategy. These value analysts carry out the due diligence work on stocks thrown up by the screening process, looking for change that will act as a catalyst for improving the use of assets, creating or maintaining capital efficiency, and increasing future earnings, all of which could lead to a re-valuation of the share price. The analysts and portfolio managers on the team work together, looking at a company's context within the industry as well as the potential for self-help, such as the more effective use of tangible and intangible assets. The value analysts pay attention to the prospects for balance sheet or cash flow improvements but also take into account the quality of goods and services and employee confidence / satisfaction as part of the analysis. Whilst screening highlights stocks on a low valuation, the analyst role is to look for factors that will support a firm's recovery with the team then visiting companies to assess management strengths, capabilities, and commitment to change. Corporate contact provides an opportunity to make a subjective judgement as to whether management is likely to realise objectives. Even when sector analysts come up with recommendations and ideas, the value analysts on the team do their own due diligence work before a stock is included in the fund. The views on individual sectors are updated on a monthly basis and are provided to the portfolio managers by the sector analyst team, together with updates from their own company visits and discussions with sell side analysts. There is also input from the strategists at Nikko AM to identify new trends in the marketplace.

The key difference between the value style analysts working for the team, and the sector analysts working for the wider asset management business, is that the value analysts focus their research on structural changes. The value analysts will often have a longer investment horizon as ideas generally take time to work, and the analysts are generalists across all sectors.

At the macro level, the team expect inflation in 2024 to be contained although some risks are emerging, and they are aware there could be a delayed impact on economic activity from rate hikes in the States and Europe, and the continued slowing of the Chinese economy. The team are also aware of potential geopolitical risks with many elections throughout the world. In Japan, the economy should continue to benefit from the ongoing structural reforms.

For many years wage growth had been sluggish in Japan, but it increased 3.58% in 2023 which was the largest increase in the past 30 years, and the outlook for wages in 2024 is positive with unions asking for increases of 5% plus and many companies promising wage increases at this level. Previously in Japan during economic upswings, regular wages had been static, but they are now increasing not just bonuses, which should give consumers the confidence to spend.

During 2023 the yen was weak which benefitted cyclical and export orientated names. Some stabilisation and small rebound is now anticipated by the team, as America cuts rates and Japan moves away from its negative interest rate policy, but the change in balance of payments with Japan no longer having huge surpluses (in part due to the necessity of importing energy post Fukushima) means trade surpluses will not return to previous levels when the yen was exceptionally strong. The team believe the change in the current account in Japan is structural, and now there is only a surplus in the income account, and this is often re-invested abroad.

Companies have a positive outlook for profits, with general guidance of around +10%, so even if there was a small negative impact from a yen rebound versus the dollar, profits in Japan should grow during 2024. The outlook for profits growth remains positive, despite Japan being in technical recession with two negative quarters of growth, but the market is forward looking, and with the prospect of growth in real wages boosting disposable income and an exit from deflation, companies should grow profits in this environment.

To date, the largest response to reform proposals by the TSE has been from large cap names where close to 80% have responded, whilst actions by mid and small caps have been more muted. This is expected to change over time with a general trend of Japanese companies looking to improve returns on capital and management more focused on improving returns rather than just growing sales. Shareholders are also becoming more vocal and increasing pressure for higher returns and improved price to book valuations. Companies are also being pressed to increase dividends and increase share buybacks by investors. Many companies in Japan are increasing their investment in R&D and Nikko expect this to be reflected in share prices going forward.

The fund currently has a bias to mid-cap names with around 37% invested in this area, and a further 8% in small caps and this part of the market has not seen inflows year to date.

The top positions in the fund are the output of bottom-up stock selection, although there are some common themes in the largest positions. There is an overweight to industrials, which in Japan includes trading companies and energy names with upstream oil interests in the belief that energy prices will remain relatively firm as Opec+ look to constrain supply. At the sector level there is an underweight to IT which is a highly valued sector and offers fewer opportunities of companies undergoing structural change. Defensive sectors such as Healthcare, Consumer Staples and Real Estate are also underweighted for the same reason.

Stocks with high active weights include Nintendo which is a longstanding holding added to in 2023. This had been mainly a games company, but now is using its IP to develop the business in films, movies and theme parks. Fuji Film has been added to – it originally produced photographic film but is changing its business portfolio drastically, focusing on healthcare technology, which now accounts for 50% of profits. It has a contract development and manufacturing organisation, and its manufacturing pharmaceutical business is performing strongly. Kadokawa, like Nintendo, is using its IP for movies and animation together with games, so is also expanding its areas of business.

Stocks that were added to include Kawasaki Heavy Industries which has a very strong position in the hydrogen business and good long-term prospects because of its special skills in the hydrogen supply chain. Sony Group was also added to and has moved away from its original electronics focused portfolio to provide games, movies and music.

A notable new name in the portfolio is Kao Corp, a toiletry business where better management has eliminated the low return parts of the business, and it is benefitting from Japan's exit from deflation which has allowed price increases. The management are careful as to which channels will allow this without impacting significantly on volumes. Some strongly performing names such as Asics and Macnica have been trimmed into strength.

Overseas tourist numbers in Japan have increased to 2019 levels and the government has targeted significant increases going forward. Chinese tourism is still only at 70% of its 2019 level, impacted by the squeeze on consumer spending and disposable income in China and this has impacted certain sectors such as department store sales. Retail businesses should benefit from the end of deflation, and some will be able to sell product to non-Chinese visitors. The mix of visitors to Japan is very different to what it was pre-Covid, and the weak yen has made Japan price competitive as a destination.

The fund did suffer in the fourth quarter of 2023 on a relative basis when the yen strengthened. With its value orientation the fund has exposure to FX moves in the short-term, but the team believe the focus on structural change in individual businesses will outweigh this over the medium term, even if a strengthening yen can lead to shorter term performance volatility.

PERFORMANCE

Performance in 2023 at the gross level was broadly in line with the TOPIX as the fund outperformed strongly in Q2 and Q3 helped by stock selection and a value tailwind, but underperformed in the fourth quarter when the yen strengthened and the market environment changed. The visit by Warren Buffet to Japan in April was positive for a number of lowly rated names held in the fund with book values below 1x and announcements by the Tokyo Stock Exchange for companies to improve efficiency and returns also helped value stocks. The new Bank of Japan Governor proved more dovish than the market had expected, leaving interest rate policies unchanged.

The US pivot on interest rates during the fourth quarter, when the market came to the view that US interest rates had peaked, altered the market environment and led to a stronger yen and a rally in growth stocks, so Q4 was tough for the fund.

During 2024 year to date, whilst the yen has been weak, the fund has marginally lagged a strongly rising market in local currency terms. During the first two months of the year large caps have significantly outperformed, getting inflows from foreigners and benefitting from money flowing into passive vehicles. Tech stocks have done well year to date, especially names connected with AI and as in the US, market leadership has been narrow. Toyota, the largest stock in the index, is up around 30 to 40% year to date and whilst the fund holds close to 4% this is a small underweight versus the index. Mega banks and trading companies have performed well, and this fund is overweight in mid-caps and underweight in large caps. Such has been the concentration of returns that only one out of four companies in the Topix outperformed in the first two months of the year.

During 2023 the fund benefitted from underweight positions in Healthcare and Staples which both lagged the market and overall sector weightings were a positive of 96bp. Stock selection in Industrials and Communication Services were the largest positives, whilst selection in IT and Materials were a negative, but overall for the year stock selection added 14bp.

Nitto Boseki, which is a speciality glass maker for high end semiconductors used in generative AI, was an extremely strong performer despite being a small cap name, and sporting goods maker Asics benefitted from solid earnings and results. Macnica is a small cap name with solid earnings and is also linked to generative AI as it is the sole agent for Nvidia products in Japan.

The largest negative was Snow Peak which makes outdoor gear and had performed well up to the start of 2023 but had disappointing short term earnings – it has rebounded year to date after plans for a management buyout. Not owning Tokyo Electron and Shin-Etsu Chemical, which are highly rated large caps, detracted. Kyowa Kirin the healthcare company was in a poor sector and also had some disappointment on its product pipeline, reducing the short-term earnings outlook, but the team still believe in the company and added to the stock on price weakness.

Other detractors included Sumitomo Metal, a metal refiner that was hit by the decline in the price of nickel, Kawasaki Heavy Industries due to problems with its engine development and cost overruns, and Japan Steel which manufactures batteries and the appetite to invest in batteries has declined.

A feature of the Japanese market year to date has been the outperformance of large caps and stocks linked to the Nvidia and AI boom which has helped certain semiconductor manufacturers. Non-Life insurers' plans to reduce cross holdings to zero has also been positive and governance improvements have helped certain stocks.

Performance and other information can be accessed directly from Nikko AM via the following links:

Japan Value Fund Class D GBP Factsheet:

https://emea.nikkoam.com/files/pdf/funds/factsheet/FS_LU1314310662_EN.pdf?t=1716448494

Japan Value Fund Class D GBP Hedged Factsheet:

https://emea.nikkoam.com/files/pdf/funds/factsheet/FS_LU1696625257_EN.pdf?t=1716448493

SUMMARY & EVALUATION

Overall, the focus remains on companies delivering positive structural change. The team believe their strong analytical resource, with Nikko not only having a team of general sector analysts, but the Value team having their own specialist analysts focused on companies with a catalyst for change, leaves them in a strong position, especially as sell side coverage in Japan is very poor compared to, for example, the US market.

Nikko have always had a well-resourced Value Team backed up by dedicated analysts and this has been added to more recently, and the two Senior Portfolio Manager team members have been with Nikko for many years and worked on the strategy for a long time. Nikko continue to believe there is more value to be unlocked in lowly rated companies in Japan due to governance reforms and pressure from the TSE to drive companies to deliver better returns.

The fund has established strong performance numbers, outperforming its benchmark over 3 years, and 5 years. Nikko manage $125bn in Japanese equities, making them a significant investor in the market with over £4.5bn in the value strategy.

There is a research-driven approach, which although bottom-up focused, is also macro aware. Within the top holdings there are a number of names, such as Sony and Nintendo, which are often seen in more growth orientated strategies. The difference for the fund being that the team bought the stocks when they were on depressed valuations but are clearly happy to let them run whilst the re-rating and earnings upgrade story is intact, and the valuations remain modest for the expected future growth. This does seem to be a differentiating point for the fund as many value strategies will invest in turnarounds but then exit at too early a stage. The research process benefits from a dedicated analytical team, and Nikko's strong foothold in the market – they have around 4,000 one-on-one company management contacts annually. Another differentiating feature within this value approach is the focus on companies which realise that they need to change to survive, and also on businesses who provide products that society has a need for. This seems to have allowed the team to avoid companies that are experiencing structural or secular declines in the product or service they offer.

This is a value orientated strategy, so unsurprisingly the best periods of performance have been when economies are re-bounding post-recession, such as in 2003 to 2006, and when Japan is pursuing policies to significantly boost domestic demand. The fund is most likely to struggle when market valuations on cheaper stocks within the market deteriorate or are under pressure, and this would usually coincide with periods when the discount rate applied to future corporate earnings is rapidly declining. A world of reasonable growth and positive inflation expectations is likely to be the most benign macro backdrop for the strategy. The fund managers have proved they do not need a true value market backdrop to deliver outperformance, but those conditions are likely to best suit the fund. The excellent long-term record under the majority of the current team, backed up by the team dedicated research resource, and the wider research resource of Nikko AM in Japanese equities fully justifies an RSMR rating for the fund.

ABOUT US

Our Research. Your Success.

Established in 2004 RSMR provides research and analysis to firms working across the UK's personal financial services marketplace.

Our work is completed with total impartiality, without any conflict of interest and delivered to a high professional standard by a team of experienced and highly qualified people.

Working with advisers

We provide specialist research, analysis and support to a diverse range of financial advisers and planners helping them to deliver sound advice to their clients, backed by rigorous and structured research and due diligence.

The main regulatory body in the UK, the FCA, states that personal recommendations made by advisers should be 'based on a comprehensive and fair analysis of the relevant market' and this has led to closer scrutiny of the whole advice process. Our solutions are designed to help advisers meet these challenges whilst recognising that advisory firms require a range of flexible options that best meet their own business needs and those of their clients.

Working with providers

We work with all the leading fund groups, life and pension companies and platform operators across the financial services sector offering straight forward and pragmatic advice to help add value and improve their business performance and efficiency whilst treating customers fairly in line with FCA requirements.

Ratings

Our innovative ratings are now recognised as market leading and cover a broad area of investment solutions including single strategy funds, SRI funds, Multimanager and multi-asset funds, DFMs and investment trusts. Our familiar 'R' logo is now recognised as a trusted badge of quality by advisers and providers alike and a 'must-have' when selecting funds. Our ratings are founded on a strict methodology that considers performance and risk measures but places a greater emphasis on the ability of fund managers to continue to deliver performance in the years ahead. based on our in-depth face-to-face meetings with fund managers across the globe.

We understand financial services and we will work alongside you to deliver tailored solutions that are right for your clients and your business.

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