



FUND INSIGHTS

INVESTING IN JAPAN: CORPORATES LEAD THE WAY

EASTSPRING INVESTMENTS – JAPAN DYNAMIC FUND (“THE FUND”)
JULY 2015

ABENOMICS REKINDLES INVESTOR INTEREST

Since its introduction in 2012, Abenomics has sparked investor interest and forced a reappraisal of Japan’s equities. Abenomics refers to a three-pronged policy approach to pull Japan out of its decades-long deflationary slump.

The first two policies which are massive open ended monetary and fiscal stimulus, have had a rapid effect on changes in the market’s expectations.

The third, the most important in our view, refers to top down structural reforms which can contribute to the improvement of longer term corporate earnings growth. Its implementation and influence, however, is likely to be slow and gradual.

BUT ABENOMICS IS NOT OUR REASON FOR INVESTING IN JAPAN...

Japan’s long period of economic adjustment is coming to an end.

Recent increases in bank lending and tight labour market conditions (tightest in a generation) indicate that the days of excess supply of capital and labour are largely over. The unemployment rate fell to an 18-year low of 3.3%¹ which is supportive of a wage-growth cycle ahead.

Overall, the domestic economy and prospects for corporate earnings have the best outlook they have had for the last 25 years.

...THE STRENGTH OF JAPAN’S CORPORATE SECTOR IS

Improving corporate fundamentals should be the main reason to invest in Japan equities. In fact, meaningful changes at company level have begun many years before the promise of Abenomics’ top-down policy reform.

Corporate Japan is delivering strong earnings growth and making positive use of cash. This comes in the form of increased dividends and payout ratios, share buyback plans and selective investments.

PRECONDITIONS ARE IN PLACE TO OFFER A GOOD INVESTMENT OPPORTUNITY

Japan’s overall market has rallied strongly since 2013 on improving corporate fundamentals. Valuations, however, have not re-rated to the same extent nor have all stocks risen in line with the market.

This is a solid background to invest in businesses which look cheap compared to the earnings they can generate in the long run.

¹Source: Bloomberg, as at May 2015.



We believe that starting valuations determine the investment opportunity. Dispersion between the most expensive and cheapest companies remains wide; there are just as many cheap valuation outliers as there were at the start of the 2013 rally.

Our focus is on those mispriced companies with improving fundamentals which have yet to be recognised by the market.

An increased focus on cash flow, return on investments, and other measures of business efficiency which has been accelerating since 2008 will likely contribute to the longer term re-rating in Japan equities.

OUR INVESTMENT APPROACH EXPLOITS THESE OPPORTUNITIES...

We believe that in order to outperform the market you need to do things differently to the market. We are essentially valuation driven, price sensitive, but patient investors.

Starting valuations are critical when investing in equities and company valuations should be analysed independently of the macroeconomic themes that the broader market perceives to be important at a point in time.

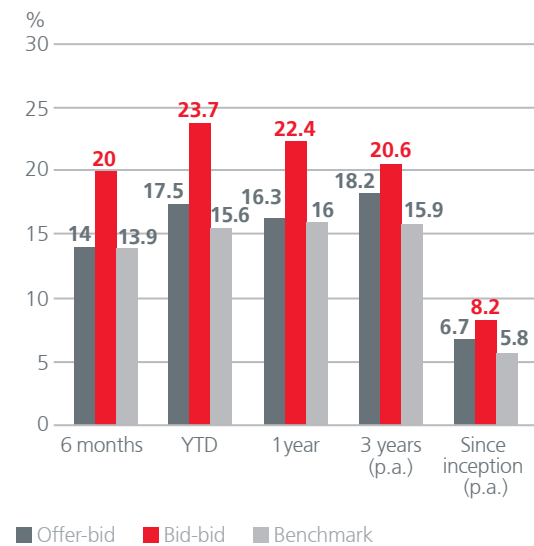
Unrecognised fundamental improvements in Corporate Japan provide an opportunity for investors like us to build meaningful positions in attractively valued companies with strong franchises.

We observe that true underlying value is not always reflected in share prices. Investors' behavioural biases drive share prices below or above the long term value of a company. Such biases are systemic and best exploited by disciplined, long-term investors.

... IN OUR CLIENTS' BEST INTERESTS

The Eastspring Japan Equity team has received numerous industry awards and accolades in recognition of one of the strongest track records in Japan Equity (see Fig.1).

Fig. 1. Eastspring Investments – Japan Dynamic Fund Performance – Class A



Source: Eastspring Investments, as at 31 May 2015 in USD. Performance calculated in USD with net income reinvested. Offer-bid includes 5% Initial Sales Charge w.e.f. 01 August 2012 and 5.75% Initial Sales Charge prior to 01 August 2012; Inception Date: 07/02/2011. Prior to 1 May 2012, benchmark returns were on a Gross Dividend basis. With effect from 1 May 2012, the benchmark returns are on a Net Dividend basis. The two series are chain-linked to derive the longer period benchmark returns. The chart above is included for illustrative purposes only. Past performance is not necessarily indicative of the future or likely performance of the Fund. Benchmark is MSCI Japan Index (Net).

To maximise long-term performance, we have crafted a concentrated portfolio consisting of our best investment ideas. We only select high conviction stocks which offers the greatest upside potential, and build the portfolio from the bottom up.

We also consider risk diversification from a bottom up perspective and hold as many uncorrelated positions as possible. The Fund is not constrained by a benchmark, market capitalisation bias or the latest investment theme in the market.



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