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Connecting Markets East & West



Exploring Japanese Trends

Nomura Asset Management U.K. Ltd.

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Japan's population shrank by 227,000 in the year to October 2017 (Internal Affairs and Communications Ministry). In context, that figure is close to the entire population of Matsumoto City in Nagano Prefecture, or Swindon in the UK.

With population decline seemingly entrenched, NAM's Investment Specialist, Peter Jenkins, asked our Japan High Conviction (JHC) portfolio managers for their views on how corporate Japan was addressing this unprecedented demographic shift. We also examined some broader trends driving the Japanese equity market and how such opportunities could be exploited and risks managed within the JHC portfolio.

Not getting any younger

According to Japan's National Institute of Population and Security Research, on current trends the population of those over the age of 75 in Japan is projected to grow from approximately 14 million in 2010 (around 10% of the total population) to around 23 million in 2030 (around 20% of the total population). Such a demographic shift will cause the dependency ratio to increase and put pressure on society in a number of ways, creating shortages in the labour market at a time of rising demand for personal care. Broadening the employment base by encouraging more women to return to the workforce for example is a response that the Abe government has embraced, but numbers alone mean that this can never be more than a partial solution.

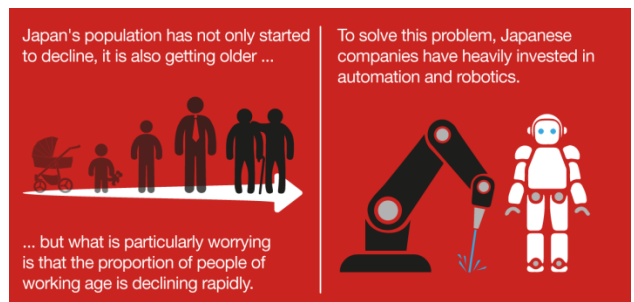
A more comprehensive answer would be to encourage immigration to fill the gaps in labour intensive sectors of the workforce such as construction, logistics and care services. However, for the moment at least, large scale immigration seems to hold little attraction for the electorate, despite some gradual liberalization of working visa regulations (Nikkei Asia: July 2018). So, society and businesses will have to look elsewhere for solutions.

New technology for an aging problem

Technological responses to Japan's dwindling workforce include the increased use of automation in both the industrial and service sectors. Whilst the latter is in its infancy – personal care robots and the like – the former is

well advanced in Japan. Factory Automation (FA) not only produces cost savings from labour substitution with fixed capital, but it also offers the benefit of higher quality and higher production yields from superior machine precision, greater capacity utilization from increased production efficiency, and other benefits such as easier production management.

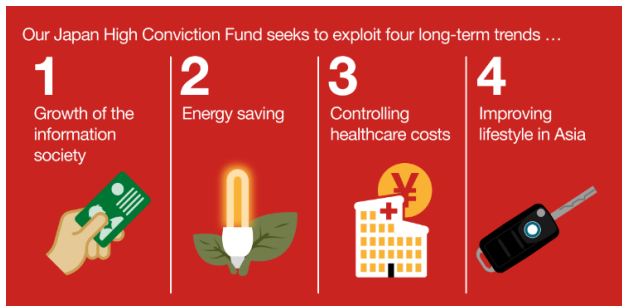
Specific FA innovations include industrial robots, numerical controls for factory machinery, and programme logic controller sensors and activators for production control systems. One of our core holdings Nidec is a leading producer of precision servo motors and haptic (touch sensitive) devices for a wide range of innovative labour-saving applications from drones, to robotics and autonomous vehicles.



At the end of the first quarter of 2018, stocks representing exposures to factory automation and robotics comprised more than 17% of the Japan High Conviction portfolio. The leading names in this industry were Fanuc (numerical control systems & robotics), Keyence (sensors), SMC (pneumatic controllers) and Nidec (precision motors).

Longer, healthier lives

The cost of providing healthcare around the world continues to increase, with the burden being felt particularly by governments in countries with rapidly aging populations such as Japan. Consequently, controlling the growth of such outlays is becoming a high priority. Reducing the price of medicines and encouraging the use of cheaper generic drugs are methods which have been widely used, but these have their limits.



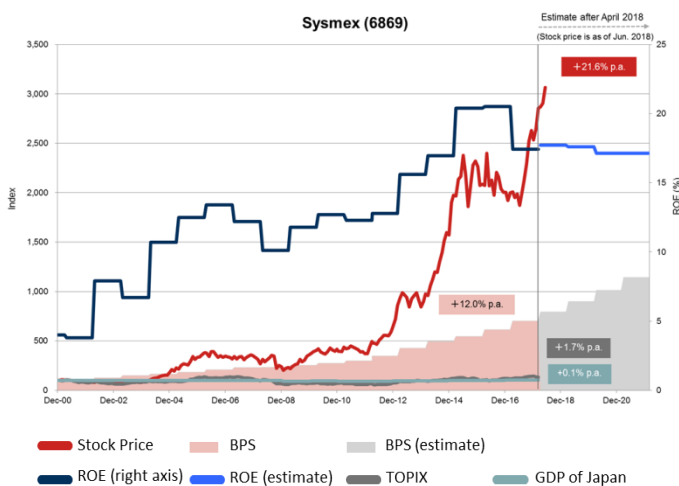
A new and more proactive cost-containment policy is ‘preventive care’, where illnesses can be discovered at an early stage and treated before they become severe and more expensive to treat. In this context we see promising business opportunities for Sysmex, the world’s largest manufacturer of blood-cell measuring instruments.

Another promising development is ‘minimally invasive care’, which aims to reduce the physical strain on patients undergoing surgery thereby cutting the number of days spent in hospital. Asahi Intecc is a play on this theme, as it has one of the best positions in PTCA* guide wires, designed for intravenous navigation.

Difficult legacies

As the number of elderly people retiring increases, the succession of both job positions and assets to the next generation will become an important issue for society. This is an area in which we have high growth expectations for Nihon M&A Centre, Japan’s leading M&A introductory broker for small and medium-sized enterprises, which are directly facing the problem of a lack of obvious successors to take over their businesses. Corporate action among SMEs could have the added economic benefit of consolidating some of these companies into more productive units.

A similar issue is the increased demand for productive land usage solutions, as a measure to help with inheritance issues. This will be a positive factor for Park24, which is a leading example of a company specializing in parking lot management.



This chart is for information and illustration only. It should not be assumed that any security discussed above was or will be profitable, or that the investment made by Nomura Asset Management in the future will be profitable or will equal the investment performance of any security discussed above.

*Percutaneous transluminal coronary angioplasty (PCTA or angioplasty) is a procedure that is commonly performed on people with heart disease. This procedure is done to open up the blood vessel to allow the blood to pass through more easily.

Growth of the ‘Information Society’

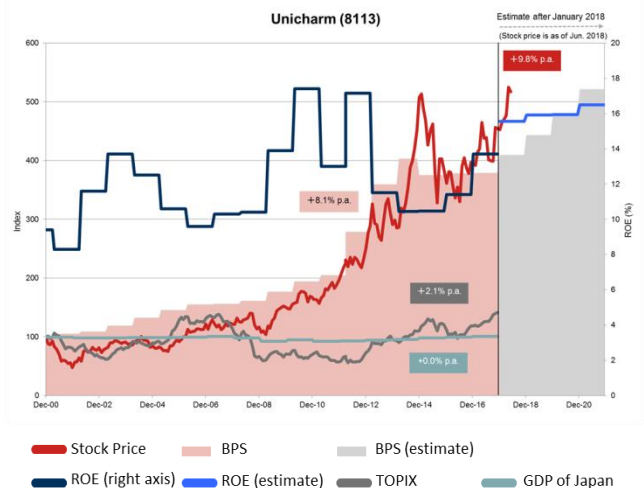
Exponential growth in data availability has driven the emergence of the ‘information society’, enabling the growth of new companies that can take advantage of data aggregation to offer novel services through online media. M3, which distributes information to medical practitioners at low cost, is a good example. Other holdings on this theme include Kakaku.com, Japan’s largest price comparison website, which has increased its value as an information provider by assembling customer reviews, and MonotaRo, an e-commerce company selling industrial plant-related intermediate materials and construction supplies nationwide in an otherwise regionally fragmented market.

Energy Efficiency and Conservation

On international comparisons, Japan is one of the more energy efficient industrial nations with consumption of primary energy compared to real GDP around 87% of the level in the EU and 60% of the US (Source: Resources and Energy Agency, 2012).. Companies that develop energy efficiency technologies are likely to see good longer term growth. Portfolio holdings that benefit from this theme include Nidec, the world’s largest manufacturer of power saving motors used in cars, consumer electronics and industrial equipment, Daikin, the world’s largest producer of high-efficiency air conditioning systems, and Mitsubishi Electric, which is involved in several energy conservation initiatives.

Improving Lifestyles in Asia

Asia’s unprecedented rise in income levels and living standards spells good opportunities for providers of consumer products. Along with their proximity to this fast growing region, shared cultural values have allowed many Japanese consumer products companies to develop their businesses in Asia. Among them is Unicharm, market leader in the disposable diaper market in Asia, and Pigeon, which has a large share in the Chinese baby bottle market. Fast Retailing has also become an established clothing brand in China. Beyond consumer products, we find companies such as Isuzu which commands a high share of the small truck market, supplying vehicles that are well suited for distribution in areas with high population densities.



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So...where do the risks lie?

Robust corporate earnings over the short-to medium-term and relatively attractive valuations have recently combined with the powerful long-term incentive of improving corporate returns. Given this broadly positive context, one major concern in the near-term would be the level of the yen. As recent events have shown, the yen is still perceived as a safe haven in more uncertain times. In turn, a firmer yen has a depressant effect on earnings, particularly for exporters. In some respects, the strength of this reaction is surprising given that Japanese companies have endured a rising yen for many years and have done much to reduce the impact, by relocating manufacturing offshore for example.

the last few decades. A trade war would be problematic for corporate earnings as it would be for economic growth.

A longer-term concern is whether recent efforts to raise corporate returns will be sustainable. Together with domestic and overseas investors, the Abe administration has tried to encourage companies to raise their returns to investors, and several pieces of legislation have been passed to this end.

With Prime Minister Abe remaining under close scrutiny over his alleged involvement in controversial public land sales, there are doubts over whether he can fend off a potential LDP leadership challenge this autumn. A change of leadership could lessen the pressure on companies to raise their game. Having said that, we remain optimistic about the outlook for corporate returns in Japan as the genie is now well and truly out of the bottle in this regard: the speed of progress may be debateable but the direction of travel is clear.



Trade tensions between the US and China have the potential to develop into a wider full blown trade war, which could impact directly on Japanese exports to the US, most notably in relation to the car industry. An attendant risk is the potential disruption to intricate supply chains for so many goods that have formed across Asia over

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Nomura's Japan High Conviction Strategy

Our Japan High Conviction strategy is a concentrated portfolio of our highest conviction ideas. We look for profitable companies that can increase their net asset value regardless of macroeconomic conditions. There are a wealth of investment opportunities within this “quality growth” space as long as you have the resources and experience to find it.

At Nomura, we have one of the largest on-the-ground research teams dedicated to Japan. The fund is celebrating a five-year anniversary under Lead Portfolio Manager, Shintaro Harada, who has over 25 years' experience.

The team currently manage over \$5bn in growth strategies, including \$270m in the Japan High Conviction strategy and \$110m in the dedicated UCITS fund.

For more information please contact info@nomura-asset.co.uk



A focused approach investing in around 30 high conviction stocks, out approach is 100% bottom-up, benchmark agnostic with no sector constraints

1st
quartile returns

Our UCITS fund has achieved 1st quartile peer group returns over the last 3 years, delivering 3.23% annualised excess return since inception*

25

years' experience

Lead Portfolio Manager, Shintaro Harada, CMA, has been with Nomura since 1993 and has extensive experience in managing Japanese equities



The strategy operates off our extensive buy side research platform in Tokyo, one of the largest in Japan

*Source: Morningstar as at 30/06/2018 in JPY net of fees annualised. Benchmark: TOPIX. Since Inception Date: August 2013. Universe Parameters: Open-End Funds; Morningstar category: Europe/Africa/ Asia: Japan Large-Cap Equity; Oldest Share Class. AUM data as at 30th June 2018

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