

Japan High Conviction in the Pandemic Era: Winners Continue to Reign



Shintaro Harada, CMA

Chief Portfolio Manager, Japan High Conviction Strategy

Published 15th June 2020

Japan is home to local champions as well as globally competitive companies

- The case for investing in Japan has always relied on its many world-leading companies. In times of heightened uncertainty and acute economic stress, we believe quality companies that are adaptive, resilient and innovative will emerge even stronger. This pandemic will test their competitiveness, but those true winners will continue to reign. From a growth portfolio manager's perspective, our objective is to identify these winners in the Japan equity market that are adapting and strengthening their businesses under challenging conditions.
- Although many countries are now taking initial steps towards relaxing their Covid-19 containment policies, the lack of any clear end in sight to the pandemic means there is still no way to determine when economic activity might return to pre-pandemic levels. We are only now starting to understand the extent of the economic damage inflicted by this pandemic.
- We have identified a number of long-term investment themes, based on goods and services that are necessary and difficult to substitute. In many cases, these longer-term secular themes were already much in evidence before the coronavirus ripped through the world economy. In some cases, the pandemic has accelerated these long-term trends, potentially turbocharging demand for products such as superior air ventilation technology, digital payment systems, and office automation.

Focusing on high sustainable ROE (Return on Equity)

This crisis has highlighted the power of investing in stocks with high and sustainable ROE, which equates to investing in strong businesses that are able to excel through different economic cycles. Investors have shown a preference for quality companies with high margins, strong balance sheets and cutting-edge innovation that can deliver performance consistently.

However, it is also essential to analyse where that high ROE comes from. For example, major companies such as Boeing have lifted their ROE through excessive share buybacks in recent years. With diminished cash

balances, some of these companies have ended up seeking external support when the pandemic hit their businesses. Similarly, in Japan, cash-rich companies have been under pressure to increase returns to their shareholders. This supports our view that investing in Japanese companies with high and sustainable ROE remains a solid long-term investment proposition. “Sustainable” is the key word here – these companies are backed by their fundamental strength and growth, while they have an appropriate degree of financial leverage.

Current Investment Themes

Daikin Industries - Air Ventilation Technology

Portfolio Weighting: 5.2% (as at Mar 31, 2020)



Daikin has responded proactively to the crisis by launching initiatives to raise their online presence, reducing fixed costs and improving operational efficiency through the use of artificial intelligence and IoT (Internet of Things). Their flagship “Urusara” product is an energy-efficient air conditioner that also has a built-in automatic interior cleaning function. Normalisation of output and capacity utilisation at its factories in China show Daikin is well prepared for a recovery.

Issues such as indoor air quality will take on a renewed importance in a post pandemic world, so Daikin plans to strengthen its product offering by responding to this new air quality demand with equipment that can combine air purification, ventilation, and auto cleaning and disinfection. Daikin has identified potential opportunities in providing antibacterial ventilation equipment for pharmaceutical production facilities and hospitals, air-conditioners that can automatically clean and disinfect, while expanding their sales of air purifiers.

OBIC - Automation of Office Work, Remote working, IT systems integrator

Portfolio Weighting: 3.3% (as at Mar 31, 2020)



OBIC is a fast-growing, Enterprise Resource Planning (ERP) vendor that provides payroll and accounting software. Instead of relying on third party distributors, OBIC’s strength lies in their in-house development and sales, enabling the company to offer optimal solutions to their clients while enjoying industry leading profit margins.

One outcome of the pandemic has been the wider acceptance of remote working in traditional organisations, as well as the deployment of technologies to improve administrative efficiency and reduce costs. The company is seeking to modernise corporate Japan from its often anachronistic workplace culture dominated by face-to-face meetings and paper documents through the use of automated solutions.

Nihon M&A Center - M&A activity for Japanese SMEs

Portfolio Weighting: 2.8% (as at Mar 31, 2020)



Nihon M&A Center is a leading M&A (merger & acquisitions) intermediary firm in Japan focusing on Japanese SMEs (small and medium-sized enterprises). Japan faces challenging demographics, including its SME owners, where

the average age has risen to a peak of 69 from 47 over the past 23 years. With a track record of completing over 5,000 transactions, the company plays a crucial role in ensuring the continuity of businesses by addressing their succession problems. The coronavirus impact has also worsened the cash flow situation for some smaller companies, increasing potential transaction volumes and reducing asking prices. This presents an opportunity for buyers and intermediaries by increasing the potential for M&A activity in the SME sector.

GMO Payment Gateway - Digital Transformation of Payments

Portfolio Weighting: 2.6% (as at Mar 31, 2020)



GMO Payment Gateway is Japan's leading payment service provider, transforming payment-processing services for E-commerce and credit card transactions. Providing services to more than 100,000 merchants including public institutions, the company is on its way to becoming a core component in the country's electronic payments infrastructure.

The company has benefited from growth of online shopping and digital content, and more recently from a surge in demand from smaller businesses shifting online to make food deliveries. Japan is still a largely cash-dominated society despite its high-tech industries. The government has been pushing for a shift towards cashless transactions, and even introduced incentive programs as the consumption tax was raised to 10% from 8% in October 2019. The country is going through a digital transformation in electronic payments with businesses launching their own mobile payment facilities.

Being the go-to service provider for payment systems, GMO Payment Gateway is able to benefit from these new entrants given its leading position in payment processing systems. In 2016, they jointly developed 'Ginko Pay', a smartphone app whereby payments can be made by an immediate debit from a bank account. This Ginko Pay system has been adopted by major Japanese financial institutions, enabling them to use a common platform to launch their own apps to enhance services for their account holders.

Milbon - High Quality Haircare Products

Portfolio Weighting: 1.6% (as at Mar 31, 2020)



Japan's competitive and well managed companies are not just found in the technology related sectors. Milbon is a leading provider of high quality haircare products to professional beauty salons in Japan and the rest of Asia. They have achieved strong growth by providing support to salons, and their strong network has enabled Milbon to work with prominent hair stylists to develop innovative hair products.

Coronavirus lockdown policies have been especially disruptive to the personal care services sector, not just in Japan but worldwide, as businesses such as salons were ordered or requested to close completely. As the world steps out of lockdown, we expect to see a strong recovery for haircare services due to pent up demand. Indeed, the need to repair the damage caused by the self-inflicted lockdown hairdo could give a significant boost to this sector.

About the fund

Essentially a best ideas portfolio of Japan, the Japan High Conviction Fund is positioned to pick truly competitive global companies and unique Japanese game changers that take advantage of structural trends.



Attractive 1st quartile returns since inception	With a 5-star Morningstar Rating™, the fund has delivered consistent 1 st quartile returns across all time periods and delivered 4.55% p.a. annualised excess returns since inception*
High conviction approach of 25-40 stocks	A high conviction portfolio of quality stocks where company selection is paramount
Experienced investment team managing \$4.5bn AuM	The team manages approximately \$4.5bn in growth strategies including \$415m in the Japan High Conviction strategy and \$165m in our dedicated UCITS fund
Citywire award winning fund manager	Citywire award winning Fund Manager, Shintaro Harada, CMA, has been with Nomura since 1993 and has pioneered Nomura's ROE-focused approach to growth investing
Large dedicated research resource	With over 30 research professionals on the ground, Nomura operates one of the largest, most experienced equity research teams in Japan. As a significant active investor Nomura has unrivalled depth and access to senior management teams across the country

*Source: Morningstar Direct. Data presented as at 31/05/2020, net of fees for the Nomura Funds Ireland Plc Japan High Conviction Fund I JPY share class vs. TOPIX TR JPY, calculated in JPY. Since inception: 7th August 2013. Past performance is no guarantee of future results. AUM as at 31/05/2020.

Performance

Dublin domiciled UCITS Funds as at 31/05/2020 In JPY, net of fees	1 Mth	3 Mth	6 Mth	YTD	1 Yr	2 Yrs	3 Yrs	5 Yrs
Nomura Japan High Conviction (JPY)	12.09	18.31	1.78	2.77	20.52	4.62	10.07	6.88
TOPIX TR JPY	6.82	4.78	-6.66	-7.99	6.15	-3.01	2.29	0.92
Excess	5.28	13.53	8.44	10.76	14.37	7.62	7.78	5.97
Peer Group Rank	3	8	16	8	4	3	5	5
Quartile	1	1	1	1	1	1	1	1
Number of Funds Ranked	225	223	221	222	219	204	187	171

Source: Morningstar Direct as at 31-05-2020. Return data presented for the Nomura Funds Ireland Plc. Japan High Conviction Fund I JPY, in JPY, net of fees. Performance greater than 1 year is annualised. Morningstar Overall Ratings as at 30-04-2020. Copyright © 2020 Morningstar UK Limited. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. Peer Group: Morningstar Open-Ended Funds: Japan Large Cap Equity.

NOMURA

This document is prepared by Nomura Asset Management Co. Ltd. and distributed by Nomura Asset Management U.K. Ltd from sources it reasonably believes to be accurate and is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation.

The opinions expressed in this document are those of the featured speaker as of the date of publication and are subject to change at any time without notice. Comments may be forward-looking statements, which are based on opinions, expectations and projections as of the date of publication. These statements are only predictions, opinions or estimates made on a general basis. Actual results could differ materially from those anticipated in the forward-looking statements and here is no guarantee that any projection, forecast or opinion in this material will be realised. Past performance does not guarantee future results.

NAM UK is authorised and regulated by the Financial Conduct Authority (FCA) in the UK (registration no. 122703). NAM UK's registered office is at 1 Angel Lane, London EC4R 3AB.

Nomura Funds Ireland plc is authorised by the Central Bank of Ireland as an open-ended umbrella investment company with variable capital and segregated liability between its sub-funds, established as an undertaking for Collective Investment in Transferable Securities under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011.

The prospectus, key investor information document (KIID) and other fund related materials are available on the NAM UK website at www.nomura-asset.co.uk

Further, this brochure is not to be construed as investment advice, or as an offer to buy or sell any security, or the solicitation of an offer to buy or sell any security or financial product.