

## SHINING A LIGHT ON... GLG JAPAN COREALPHA FUND

Whenever I meet the managers of this fund I come away with mixed feelings. Clearly this is a well-managed fund but there are periods when the fund underperforms.

One of the big question marks, in recent months, has been around currency. Because the fund is not hedged it has impacted on performance, at times, and the managers rarely make comment on currency stating it is for the investors to make currency decisions.

This latest update with two key members of the team provided a fascinating insight covering their view on Abenomics, currency, demographics, government pension fund purchasing equities and positioning of the fund.

### **Q: We read that investing in Japan is all about Abenomics, is that correct?**

The response by the managers somewhat surprised me.

Stephen and Neil feel that it is a bit of a con; everyone is led to believe that something radical is being done to make the country better but they think the opposite. Although they like the country, their view is that Abenomics is destined to fail because it doesn't get to the heart of the problem.

QE just adds more debt to the already massive debt mountain, and actually the policy is more about making the big corporates stronger. There are bigger issues that are just not being tackled.

For example, domestic Japan has an oversupply of companies making electronic equipment purely for the domestic market and not for the external export market. This oversupply drives down prices, and stifles creativity. Equally lifetime labour rules mean that individuals move up the corporate ladder to the top and therefore often boards are made up of lifers rather than outside people with fresh ideas.

These are just examples of challenges that need to be faced, and aren't. The point they were making is that Abenomics is not the be all and end all of what is happening. Much more needs to be done, and building on an already huge debt mountain can't be positive long term.

### **Q: Logic seems to lead us to the natural conclusion that to reduce down the debt mountain the currency has to depreciate further?**

Stephen and Neil feel that to continue to trash the currency would be reckless, although they accept there have been benefits of the recent fall. In 2009, tourism was almost not existent because everything was so expensive. Today, with the recent fall in currency it is on the up.

The reality is that the currency has been depreciating for 20 years, and is now at a 40 year low. They feel that it would be sensible for it to stay around this level as any further falls could have a negative impact.

What they did add was that it was not the currency that has had the biggest impact in recent months but the fall in oil prices. Japan's mineral fuel import bill as a % of GDP was over 6% in 2013, this has now dropped to below 4%.

## **Q: How is the Government Pension Fund Equity Purchasing Programme progressing?**

They are currently about two thirds through the programme, one impact of this which initially played against the fund was that the Pension Fund was purchasing Bond Proxy stocks which forced up the price of these stocks and distorted the performance of the market. The rise in the value of these stocks has dropped back a little.

One interesting aspect of this exercise is that if the Pension Fund has a set limit then they stick to this. So say they have a 30% limit, if the holding goes above 30% they sell, if they drop to 27% they buy.

So sell high, buy low! Good advice for any investor.

## **Q: Are demographics a problem?**

Both managers explained this is a problem.

The current population is 128 million and it is expected to fall to 85 million by 2056. The labour market is becoming increasingly tighter and the danger is that as there are fewer people in the market for work this could drive up wages and squeeze profits.

There is an argument that people working to 70 eases that problem but both managers explained many people don't want to work past 70 and are therefore stopping. It means that a lot of high quality labour is dropping out of the market.

We discussed immigration but there seems a reluctance by the government to tackle this. For example there are Korean and Chinese communities who have been in Japan since the twenties and their children have been born in Japan but they have no voting rights. These people are not treated the same so they can't help with the declining labour market.

## **Q: Talk about recent performance**

The managers explained it is a very simple strategy based on large cap value. The aim is to invest in under-priced, cheap companies and sell when they outperform. They explained that this style of management has delivered outperformance compared to other styles 63% of the time between 1980 and 2015.

It does mean that they might hold stocks others don't like; and as they admit often get negative feedback for doing so. They used the example of Sony which they felt was worth more than the market thought. For some time it appeared their decision was wrong; however in 2013 and 2014 it was the best contributor to the fund and in 2015 the 4<sup>th</sup> best. They have now exited the stock.

They explained that they don't just buy every cheap stock; it is as much about what they don't hold as what they do.

An example, of such a stock was Sharp which they don't own. Sharp is a maker of fax machines, calculators etc. It focused on the development of LED screens. Two things which have damaged Sharp, the Yen strength and debt. In April 2015 it was announced a major restructuring would take place which saw the share price fall 25%.

Both managers explained that being active means that they focus on those companies which they feel have the potential to turn around performance rather than those that can't. Another example like

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Sony is Nintendo which has been the best performer for the fund in 2015. They kept buying the stock as it was falling and there were times when they felt they might have got it wrong. However, in April 2015 they announced that they would work with smart phone technology which significantly increased the share value. Although the share price may rise further they have now started to sell down their holding.

Financials is a big weight for the fund; they discussed Mitsubishi UFJ which is the biggest bank in Japan. Their view is that this is a cheap bank and will benefit from a number of areas. When interest rates rise in Japan it will benefit from domestic Japan but 45% of its earnings come from overseas. It owns 22% of Morgan Stanley, 100% of Union Bank and has an international lending arm funding infrastructure projects like dam building etc. This is a well-managed international bank, and in their view very cheap.

They explained that the start of the year was tricky for them as bond proxy stocks drove the market however since February they have started to see significant value come from the portfolio and hence the selling down of Sony and Nintendo.

Despite their comments on Abenomics and the currency they feel that the fund is perfectly positioned to drive value for investors.

### **Comment**

The fund has posted strong numbers this year but performance was hampered as the yen weakened in 2013. The more stable yen has helped this performance. The honesty around Abenomics and the currency is an unusual statement by the managers and you would feel they are negative about the region going forward. Certainly in the short to medium term this doesn't appear to be the case as they feel their style of management will reward investors over this period.

If their philosophy on the longer term outlook is correct then perhaps long term Japan is not the best place to be invested!

It is worth adding that as at May 2015 the fund was closed to new investors. The fund may re-open in the future as this is not the first time it has been closed.

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## Fund performance

The table below shows performance since 2010:

	2010	2011	2012	2013	2014	2015
GLG Japan CoreAlpha Fund	25.31%	-15.96%	1.32%	32.73%	1.23%	22.14%
DB X-Trackers MSCI Japan ETF	17.46%	-14.46%	3.73%	24.61%	0.07%	15.98%

	1 Year	3 Years	5 years
GLG Japan CoreAlpha Fund	34.43%	64.66%	47.58%
DB X-Trackers MSCI Japan ETF	30.40%	46.56%	34.17%

*You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.*

*The source of information in this note has been provided by GLG and is correct as at May 2015. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase any fund mentioned. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision.*