

“An investment in knowledge always pays the best interest”

Fund Manager Meeting Notes – Neptune Japan Opportunities



The Neptune Japan Opportunities Fund has been a long stay in our portfolios. The key differentiator of the fund is that it uses hedging strategies, which in this environment means that it captures performance from a falling yen and also from an improvement in company performance. In summary it should have a double benefit on performance.

However, where the yen strengthens it will lag as it did earlier in the year. To offset this we have a non-hedged fund, the GLG Japan Core Alpha Fund.

Chris Taylor who manages this fund is a colorful character with an immense amount of knowledge around Japanese Equities and Japan as a country.

His view is that we are in a global bull market. There is predicted strong GDP growth across the world economies and this is not confined to just China and the US but non BRIC economies as well. I would just add caution to this as many believe many stocks are fair value and we will now just see more normalized returns.

Japan is an exciting story with plenty to run in his view. Japan is in Version 2.0. Version 1.0 was a run from the 1950s to the 1980s where the country was an export driven country and saw it move from an emerging economy to developed economy.

What is happening now is not revolutionary but a necessity. To do nothing and the country will go bankrupt by 2020 and therefore Version 2.0 which is what Abenomics is, is effectively a reset button.

This update will look a lot at the country and the changes but this in turn feeds into the performance and management of the fund.

Overview

For Chris investing in Japan is all about the companies and not the country. For Chris it is the companies that offer opportunities, since 1995 they have undergone massive restructuring and many of these companies remain cheap because the market doesn't understand what has happened.

These companies have invested outside of Japan since 1995 and focused on countries which are growing at a consistent or above average rate. The yen weakness will, in his view, turbo charge growth and that is crucial.

As an example, Nissan produce 72% of their cars outside of Japan for sale outside of Japan so the yen weaknesses has no competitive advantage but it makes profits better in yen terms.

In summary the view is that you have well run global companies and these companies are good value. The average P/E ratio is at a level seen before 1984.

The way people invest is changing. They have recently introduced the Nippon ISA which is modeled on the UK ISA scheme. The target was 5 million registered users, there are already 4.3 million registered users. This starts on the 1 January and it is estimated this will deliver 2 weeks of trading value to the Topix.

Not only are we seeing consumer investment but money is also coming from the institutions. The largest pension fund has recently moved from a 9% equity holding to

12%. Consider over the last 30 years they have reduced exposure to equities this change is significant and others will follow.

The daily share trades on the stock exchange have doubled since 2012, and yet there is still good value to be found because we are starting from such a low base.

The key to the changes are the politics. Over the last 25 years there have been 17 prime ministers. Nothing has been done to sort out the underlying problems of the country since 1988.

Since 1990 wages have fallen from ¥6 million to ¥4 million. At this level no tax is paid and this means 85% of people pay no tax. In addition 35% of the workforce are on weekly or monthly contracts with no healthcare or pension benefits.

In addition to problems in the workplace you have an aging population. 25% of the population is 65 plus so they are a burden on the state for health care and retirement benefits but with less people paying tax you start to see a deficit building.

The aim is that a weaker yen increases corporate profits which then decreases the annual deficit. We are starting to see some positive changes coming through, for example Japan have recently signed a Shale Gas export deal with the US which will take place from 2017. This will significantly reduce costs.

Corporate profits have significantly increased despite the yen strengthening. Unemployment has come down and consumption is up. Core wages haven't changed but the expectation is there.

The fund uses a yen hedge and the view of Chris is that the fund will benefit from a weakening yen. The fund had weaker performance when the yen strengthened but we use the GLG Fund to provide a cushion for that.

In summary we are starting to see changes but this isn't an overnight story. For the patient investors, if these policies work, this market could deliver returns.

Conclusion

In conclusion I have heard two very bullish stories from Neptune on their views for equities as a whole. Chris believes Japan has a lot to give in terms of performance. Clearly the market remains undervalued, these changes are effectively the last roll of the dice for Japan but the right environment is in place to deliver those changes.

We remain of the view that this is the right fund to have in the portfolio to deliver long term returns however as with any single country fund there are risks and for Japan the risk is that despite all the positive headway it just doesn't work. Chris' argument is that if this happens the yen will collapse and the fund will still benefit.

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