

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

Japan is coming back onto people's radar and last year was the stand out sector for investors. However listening to different managers there are very different views on where value will be driven from in the future.

In one camp there are those that believe that the Yen will deflate further and therefore any growth in corporate profits will only benefit those who use a fund which hedges the Yen. On the other side there are those who acknowledge this may happen but argue that it is impossible to predict the extent of the impact and therefore would argue that taking a Yen hedge is no more than gambling.

The truth is that we don't know, and no one knows. Part of the strategy is to deflate the Yen but this has been happening over a 20 year period (it is half the value it was 20 years ago against the dollar), and we don't know how much further it will go. To counter this we use a fund with a Yen hedge and one that doesn't for the balanced and cautious portfolios so investors should get the best of both worlds.

For investors who don't have a diversified portfolio of assets investing in Japan raises a lot of questions and is a very difficult investment decision to make.

The update we had was with the Head of the Team, Stephen Harker, and one of the key members of the team, Robert Brooke. Robert provided an update on Japan and Stephen the fund. What became clear in the update and with one-to-one discussions with the managers is that investors firstly need to buy into the Japanese story, and if they do they need to buy into the style of management this fund adopts.

It is a process going back to 2006 but Stephen has over 30 years' experience in the Japanese market as does Robert. It is a hugely intellectually based form of investing with proven results. The managers will stick to the process even if the market goes against them on the belief that when it turns it will turn in their favour and we will try to capture some of this in the update.

### **Japan**

The story of why Japan has not changed for the last 3 to 4 years. Robert throughout the nineties adopted a bearish view of Japan and only over this period has he changed to a bullish view. He was quick to emphasise that people shouldn't rush into it but he believes the tide is turning.

Robert explained that the world has come to believe that Japan is in terminal decline, a view we have indicated. He believes this is a misapprehension of what is actually happening. He believes Japan is going through a large cycle and only now is it coming of that. An example he has used many times is the change and growth to the Tokyo skyline over the last 20 years.

The cycle started in 1989 and he views it as a banking or credit cycle on a grand scale. In 1989 there were 19 major banks in Japan and these contained some of the largest asset bases in the world. Today there are seven and not a single name remains. To put in context in Europe there are 19 major banks and today we couldn't imagine a future without those names.

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Because the cycle has been going on so long it is assumed it is the normal state of affairs and hence the feeling that Japan is in permanent decline. The reality is that the last time this happened was in 1927 so a once in three generation event.

Over this period bank lending has declined by 30% meaning the property market has crashed and expenditure on durables like cars has shrunk. Effectively there has been a massive slowdown in economic activity.

Robert believes the pendulum has started to swing in favour of Japanese equities. The point he emphasised was that he doesn't know when this will happen and perhaps it will happen when people don't really notice.

In 2013 the market was driven up by foreign investors, those investors have now pulled away from the market creating a surplus. One of the key changes is for Japanese investors to come into the market and take control of the supply / demand chain. There is a small amount of evidence to show this is happening but it needs to increase.

Although many refer to Abe and his policies as the saviour of Japan Robert believes the principals behind the election are more significant. Japanese people have been through four stages – denial, anger, bargaining and depression. They have now moved to acceptance and are willing to listen to someone who is prepared to do something about their situation and this is the shift that was needed.

We touched on two points which are often discussed with Japan. The first is demographics and Robert believes that Japan is not unique in this problem and it is the only developed economy actually doing something about it. Others like the UK and US have not tried to tackle the problem. Effectively this is a global problem and not unique to Japan.

The second touches on Abenomics and the deflation of the Yen. The argument is that as the Yen weakens investors to benefit from corporate growth need a Yen hedge. We saw in the last six months of 2013 that those funds with a hedge had the strongest returns. The fund does have a hedged share class.

They didn't support a view either way but they indicated that a large amount of money is already hedged and at some that may need to be unwound. That could have a negative impact on returns for these funds. They also indicated that over the last twenty years the Yen has already halved in value and although over history you can indicate it can go further they are not sure how the international market will respond to this when others want to weaken their currency.

The point on currency is simply we don't know, and if an investor believes in the argument that the Yen will fall further then it is best to hedge. For those who don't know then it may be better to not hedge or blend the investment with a non-hedged fund. Investing in Japan can be a complex trade and investors approach it in different ways to any other ways of investing, perhaps hoping to buy in at a low point and sell out on a high and investors now looking to investing need to consider this carefully.

### **The fund**

The process for the fund has been in place since 2006 and we discussed the performance with Stephen. One thing with the fund which I like is that it sticks to its style whatever the market and through this has delivered strong performance.

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It aims to invest in mainly top cap companies (near the mid cap end) and some mid cap companies. It is a pure value play looking for companies which are cheap and then selling them when the price is high. This means that the fund tends to rotate between around 105 companies.

Currently it has 48 holdings with over 40% of the fund in the top ten holdings.

Stephen said that over the last five years growth stocks have been the best area to be and therefore the fund has struggled to respond in this environment. However, the last six months has benefited the value strategy and they believe that this will increase especially once the tide turns in Japan which they believe it will.

They tend to favour three sectors – technology, financials and defensive. In recent weeks they have increased exposure to financials, reduced weightings to technology and still have hardly any exposure to defensives.

It is a “simple” strategy and combined with their theory around Japan gives an intellectually based feel to the fund. Investors therefore need to buy into the belief that this time is different, and to do this they have to believe that although Abe is a catalyst for change, change was already happening and this is just the final piece. Investors need to consider whether hedging is a fad and therefore they are hoping to get a short gain from this, or a longer term trend which is harder to predict and therefore allow their investment strategy to reflect this. And finally investors need to decide whether they want small, mid or large cap to gain upside from the recovery.

It is perhaps easy to invest as part of a portfolio of assets rather than a single punt but this is what investors have to consider.

### **The team**

The team have been together for a number of years and this is important to the success of the strategy. They now manage over £10 billion and Stephen explained that now was the time to increase the team. They have added two new people; one as a technology analyst and the other a portfolio manager. They expect others to be added to the team in the coming months. This provides an indication that they feel the market is on the upward projectile.

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## Fund performance

The table below shows performance since 2009:

	2009	2010	2011	2012	2013	2014
Standard Life GARS Fund	9.35%	24.28%	-16.64%	0.48%	31.61%	-8.23%
DB X-Trackers MSCI Japan ETF	-7.10%	18.62%	-14.08%	2.70%	25.47%	-10.91%

*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 2014. 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. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well rise.*