

SHINING A LIGHT ON..... JUPITER JAPAN INCOME FUND

At a glance

Over the last 18 months Japan has come onto the radar screen for many investors, with last year posting strong returns. However, much of those returns were lost where funds failed to use a currency hedge.

One of the crucial changes in the Japanese plan is deflating their currency and investors need to accept that if they want to benefit from a resurgent Japan then they either invest in a fund which has this hedge or accept some loss of returns by choosing a fund which doesn't.

We have reviewed three Japanese Funds and favour Neptune Japan which has a hedge and use the GLG Japan CoreAlpha Strategy as a currency airbag.

In recent weeks we have met a number of income managers and it has become clear that many income funds are not as many investors perceive. They are not pure dividend producing funds but more akin to growth funds, targeting companies which have both growth potential alongside a sustainable growing dividend yield.

Some of these funds can punch their weight above even the best pure growth funds. The Jupiter Income Fund came onto our radar as the manager Simon Somerville is well respected and has a good track record. The fund doesn't use a currency hedge but with the dividend yield it should provide downside protection as well as additional upside.

Who are the team behind the fund?

The lead manager is Simon Somerville and he has managed the fund since launch in 2005. He is assisted by Dan Carter. Simon came from Cazenove and he is well respected within the industry.

What is the story behind the investment?

Japan has faced many false dawns and this could be seen as another, however I believe this time there is a difference. The main reason is the political landscape. The new Prime Minister has a majority government which over the next three years means he has the ability to drive through change. In the first 12 months of Prime Minister Abe's administration Japanese economic growth was one of the strongest in the developed world.

The aim is Abenomics is to; remove inflation and reduce government debt - but like many developed economies they have an aging society and a reducing workforce. Most western economies are ignoring this and Japan is recognised as the first to face facts.

There are three arrows to the strategy – aggressive monetary policy, flexible fiscal policy and structural change.

Over the last 12 months we have seen a lot around the first two arrows and now we are starting to see action around the third. 30 bills are going through parliament and although these are not startling they pave the way for dynamic changes. The areas they are keen to tackle are promotion of

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investment, better utilisation of human resource which includes immigration, creation of new markets and better global economic integration.

If Japan does nothing the economy will go bankrupt, we shouldn't underestimate the extent of the challenge facing the government however the building blocks are there and perhaps this time it won't be a false dawn, if it is it may be the last.

Fund highlights?

The Nikkei was up 56% in 2013, the best year since 1972. The Topex Index was up 51% the 3rd best since the 1950's. The fund itself returned 19.92%. (Source: Morningstar).

Clearly the fund has seen its returns weakened by a reduction in the value of the Yen and it is worth seeing how the fund has performed this year where the Yen hasn't weakened. Against the GLG Fund it has performed worse and also against the index option, and I wanted to try and understand this further.

Listening to the manager there are clearly issues which have gone against investing in Japan this year. The two big issues being the increased consumption tax and the uncertainty of the impact this will have on consumption over the coming months and secondly the speed of the QE drug to the market. These two factors have unnerved foreign investors which have resulted in a selling spree and declining returns in 2014.

Similar to other Japanese managers who we respect he believes this will turn for a number of reasons but one of the key reasons is that Abe remains in control, he remains popular and is determined to succeed. Inflation is above expectations and companies are seeing increased profits and dividends are going up. This should be good news for the fund.

The fund is a concentrated portfolio of 46 stocks with the top ten holdings accounting for 37% of the fund meaning there is conviction within stock picking. The core of the fund is focused on companies which can grow independently of the Japanese economy and Yen with the balance in structural change companies, domestic cyclical recovery stories and consumption and housing companies.

The fund is focused on the domestic side as the manager believes this is where the growth will come from. My concern is that the fund has closely mirrored the index option in terms of performance and hasn't really rewarded investors above this. So despite all the respect for the manager this would be a concern any investor should consider. However, if the manager is correct with his thinking and domestic companies benefit from the changes then when the market turns the fund could benefit from this and start to significantly outperform the index.

It should also be considered that this is an income fund and therefore in theory the dividends should provide some downside protection however unlike other funds we have seen there is little evidence that this fund is achieving that.

For investors this may suit those looking for a Japanese fund with a focus on the domestic side of Japan with the belief that this will benefit when the upside comes. Performance cannot be ignored but the positioning may enable it to outperform in the future.

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Fund performance

Performance for the past five year's vs GLG Japan Core Alpha Fund, Neptune Japan Opportunities Fund and db x-trackers MSCI Japan Fund is shown below:

	2009	2010	2011	2012	2013	2014
Jupiter Japan Income Fund	-6.94%	23.12%	-12.14%	2.39%	19.92%	-11.96%
GLG Japan CoreAlpha Fund	9.35%	24.28%	-16.64%	0.48%	31.61%	-8.23%
Neptune Japan Opportunities Fund	5.25%	-0.11%	-21.57%	17.15%	50.74%	-14.35%
Db x-trackers MSCI Japan ETF	-7.12%	17.46%	-14.46%	3.73%	24.61%	-10.99%

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.

Conclusion

Recent underperformance in Japan has made investors nervous and a fund which combines income with growth maybe the best way to test the market. However, over the past five years it has struggled to outperform the index option and with the change in dynamics within Japan the fund should demonstrate its ability to outperform. If it can't then investors need to question whether this is the best way to access the Japanese Growth story.

The source of information in this note has been provided by Jupiter 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.