

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

This is an update on the fund rather than a review of the process and management style. Details on this have already been made available via previous updates.

The team behind the GLG Fund provide a fascinating insight into investing in Japan and have demonstrated over the long term an ability to outperform the benchmark. Japan suffered negatively in the first part of this year but in recent weeks has rebounded strongly delivering flat returns for the year.

In this update we covered three main areas with the team – currency, bond yields and the impact of foreign investors. We also touched on some recent new holdings and where Japan is with regards to the economic cycle.

Currency

The fund doesn't have a currency hedge and for the first time the managers admitted that the depreciation of the Yen has hit performance. Although the fund returned over 30% in 2013 much of this was achieved in the first half of the year, with the second half delivering flat returns.

The managers have always been careful not to make currency predictions however they highlighted that the currency has been depreciating for the last 19 years with significant falls at the start of Abenomics.

There are two lines of thought coming from this – firstly they don't believe that the currency will depreciate much further and therefore this headwind which has strangled performance should disappear and secondly the benefits of a depreciating Yen take time to filter into the economy and they believe this is now starting to happen which is positive news for corporates (and the end investor).

Effectively their line of thought is that the fund going forward will now start to benefit from the Yen flat lining and it will all also benefit from a re-rating in companies as they benefit from a weakening Yen.

It is important to stress that their view on the Yen is opposite to some other Japanese fund managers so investors need to consider this position carefully.

Bond Yields

10 year bond yields have been declining steadily from highs in 1982 to lows in 2013. Currently yields are around 0.6% and so far Abenomics have done little to halt the fall. The fund is positioned to benefit from rising rates and therefore falling rates is not good for the fund.

The view is that this will reverse because they can't go much lower and once this happens the fund will benefit from this. So currently this is another headwind for the fund but any shift will see an uplift in performance.

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Foreign investors

This is one of the biggest 'problems' with the market. Since 1991 Foreign investors have increasingly dominated the market. In 2013 Y15 trillion came into the market and this swamped all previous investments. Evidence shows that when investors come in, the markets are driven higher and when they take money out the markets go lower.

Foreign investors control 30% of all Japanese equities and what they do matters. At the start of the year we saw profit taking but investment has stayed neutral this year. There is an acceptance that this swing will continue until the Japanese invest more in their own markets. This change is starting to happen with pension funds making small allocations to equities and with the introduction of the Japanese ISA.

All of this will take time and until the point comes where the Japanese dominate the market foreign investors will have a way on what happens.

Economic growth

The management team explained that the challenges facing Japan is no different to for example Korea, Germany and Italy. It is the problem of demographics and this hampers growth. The difference is that Japan remains out of favour and undervalued and therefore opportunities are there.

The labour market is a good sign for economic growth, any growth will be restricted by the supply of labour. At the moment the labour market in Japan is tight and businesses are struggling to recruit good quality people. Part of the policies are to reverse this trend by improving labour laws, encouraging more woman back into the work place and bring in foreign workers. This should create slack in the labour market and help to drive growth.

However, the management team were keen to stress that investors shouldn't expect dramatic growth as this will always be restricted by the available labour.

New investments

The fund has recently increased its weighting from 0% in automobiles to 3%. Previously it had held Toyota but sold out when they felt the price had reached its peak. The sector has suffered recently with the likes of Toyota, Nissan and Honda all being significant underperformers.

In January the fund invested in Honda and in July it added Toyota to its portfolios. The managers believe these are good companies trading significantly below their value and therefore the upside is potentially very good.

Summary

The fund has continued to perform strongly despite headwinds in currency and interest rates. Currency remains a topic for debate with people having widely differing views on what will happen and whether to hedge or not.

If the managers are correct in their thinking that the currency will now flat line and interest rates will rise then the fund will benefit from this. If however, the currency continues to depreciate then the performance will be hampered.

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Equally with any investment in Japan foreign investors (us) do have an influence on returns and fear / greed will make this market more volatile. However, for the first time there are changes in place that could make this is a sustainable and good long term investment story.

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%	-0.67%
DB X-Trackers MSCI Japan ETF	-7.10%	18.62%	-14.08%	2.70%	25.47%	-1.74%

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 August 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.