

Omnis Japanese Equity Fund



We spoke to the team at Schroders who manage the Omnis Japanese Equity Fund. They explained where they are finding investment opportunities in Japan.

The Omnis Japanese Equity Fund aims to achieve a return consisting of both income and capital growth which, after all fees and expenses, exceeds that of the FTSE World Japan Total Return Index over the medium to long term (defined as a rolling five-year period). This index is the benchmark for the fund and measures the performance of stocks for leading companies listed in Japan.

The fund intends to invest at least 80% in Japanese companies of all sizes with strong potential earnings growth and visibility over the long term. These companies also tend to display strong competitive advantages, such as a technological edge, patents or a dominant market share.

Investment outlook

Last year was a tough one for Japan's ruling Liberal Democratic Party (LDP), with the deeply unpopular Prime Minister Yoshihide Suga announcing his resignation in September. He was replaced by Fumio Kishida, who was elected as party leader and subsequently Japan's prime minister after his governing party scored a solid victory in the general election at the end of October.

Mr Kishida is seen as a safe pair of hands to lead the LDP after Mr Suga's government saw its approval ratings slump over its handling of the Covid-19 pandemic and the Olympics. More recent political events have been overshadowed by the shocking assassination of former Prime Minister Shinzo Abe on 8 July.

Mr Abe, who resigned in August 2020 as Japan's longest serving prime minister, was shot while delivering a campaign speech in Nara, two days ahead of nationwide Upper House elections. Although Japan has had two prime ministers since Mr Abe, he remained a hugely influential figure within the LDP and his absence will alter the internal dynamics of the party.

In the immediate aftermath, however, the resulting strong support shown for the LDP in the Upper House elections has solidified the position of current Prime Minister Kishida and has improved political stability.

After more than two years of border closures, Japan finally reopened to tourists in June. However, despite the global trend to relax restrictions, Japan remains virtually closed to individual travellers, only

Meet the manager

With a history going all the way back to 1804, Schroders is one of the largest companies working with Omnis, managing over £730 billion* in client assets. It employs more than 5,500 people worldwide, operating in 37 different locations across Europe, the Americas, Asia, Africa and the Middle East.

The Omnis Japanese Equity Fund is run by highly experienced managers with a solid track record of investing in the country. As one of the largest economies in the world, it is hugely beneficial for Omnis to have a single fund wholly dedicated to investing in Japan and run by experts in their field.

The fund is managed by Masaki Taketsume, who started his career in 1994 at Nikko Investment Trust Management. He moved to Deutsche Asset Management in 1998 and held various roles before joining Deutsche Securities in 2005 as a Japanese equity research analyst covering the industrial electronics sector. He then joined Schroders' Tokyo office in 2007 as a research analyst covering technology stocks.

Schroders

*as of 31 December 2021

allowing group tours. The manager says that with Japan's economic recovery from the pandemic lagging behind other countries, opening up fully would be a positive boost to the economy.

The Bank of Japan (BoJ) governor, Haruhiko Kuroda, also reaches the end of his term in April 2023. While other central banks have been raising interest rates, the BoJ has kept them low. Inflation has temporarily risen above the BoJ's 2% target, but ahead of Kuroda's exit the manager doesn't really expect any significant change in policy.

Quarterly company results were strong throughout last year and forecasts for 2022 are also looking robust. Schroders believes that while it's likely there will be pressure on profit margins for some companies, especially from rising energy costs, they should remain resilient overall. Japanese corporate earnings have improved and the manager expects to see profit growth going forward.

Corporate governance is improving in Japan and is now being driven by regulators in a similar way to the UK and Europe. As a result, the manager expects to see better results in terms of shareholder remuneration. Companies are also improving how they allocate their capital, which is helping to boost profits.

Current opportunities

There are three broad areas where Schroders is finding opportunities on a consistent basis:



1. Market misperception

These are generally larger companies that should be relatively well-known but key developments may have been missed by investors and, as a result, the stock looks undervalued (their share prices are lower than the company's value). Typically, these companies are looking to improve their returns through processes such as restructuring, mergers, acquisitions or by reallocating capital.

The manager says a good example of market misperception is electronics giant Hitachi, which has significantly restructured over the last decade by rationalising its subsidiaries to become more focused. The manager believes other investors have consistently underestimated the impact of Hitachi's restructuring on its business.

Another example is global tyre company Bridgestone, which has been focusing on its main business by selling off non-core assets. Schroders picked up on this after discussions with Bridgestone management, and then built up positions in the company.



2. Market oversight

These tend to be smaller, less well-known companies that investors have missed, but will eventually come up on their radar screens. They are usually highly competitive businesses that are valued lower than larger companies and global peers as a result of limited coverage from other investment analysts.

The manager says that Japanese shares have been structurally undervalued for a long time and offer great value compared to other developed markets. While Japan is a mature and broad market, it is under-researched, which means there are plenty of opportunities to find high-quality companies that are growing.

Schroders says examples of these smaller companies that have been missed recently include Japanese refrigeration manufacturer Fukushima Galilei and industrial machinery supplier Hosokawa Micron.



3. Short-term overreaction

Short-term overreactions in the market provide opportunities in both directions. Some companies might see their shares fall based on negative news, such as poor earnings over a short period. However, this provides an opportunity for Schroders to increase its position if its research on the company shows the long-term growth outlook remains unchanged.

Portfolio snapshot

One company Schroders likes is Kureha, a chemical manufacturing company based in Japan, which has specialised in producing pharmaceuticals, agrochemicals and packaging materials for over 70 years. It is one of the world's leading producers of polyvinylidene fluoride (PVDF), a high-performance polymer that is used in the manufacture of lithium-ion batteries for electric vehicles (EVs).

With countries looking to achieve net zero, the demand for EVs is increasing, which puts Kureha in a strong position for growth. Revenue from PVDF is expected to rise by more than around £100 million in the next three years.

The purity of PVDF made by Kureha is superior to its competitors, which means batteries last longer and perform better. The company currently produces 40% of the PVDF used in lithium-ion batteries globally and has driven earnings growth in recent years as demand has increased.

Another company the manager likes is electrical component manufacturer Kohoku Kogyo, which makes lead terminals and optical parts for communication. It specialises in making components used in fibre-optic communications – especially in undersea cables, which require especially high reliability – and now has a 50% global market share.

Kohoku Kogyo also has a 40% share of the global market for lead connectors for electrolytic capacitors, which are used in nearly all electronic devices. Schroders believes Kohoku Kogyo's dominance of the market for these two components will help provide solid returns for investors in the years ahead. The market continues to grow for the company's products, while the technology is difficult to replicate.

Companies to avoid

Schroders avoids companies whose profits and valuations are highly dependent on global macroeconomic conditions. For example, this year there have been instances of commodity prices lifting the shares of individual companies, but the manager does not think this is sustainable in the long term.

Schroders is also not keen on sectors it thinks are structurally overvalued, or expensive, such as iron, steel and chemicals. It prefers to focus on companies or sectors with a proven track record and business model, rather than investment themes.

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If you want to learn more about how the team manages the fund, please speak to your financial adviser.

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