Eastspring Investments – Japan Smaller Companies Fund

eastspring investments
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KEY INFORMATION

Asset class	Equity
ISIN (Class CG)	LU1235131007
Bloomberg ticker (Class CG)	ESJSCCG LX
Fund size (mil)	24,469.9
Fund base currency	JPY
Share class dealing currency (Class CG)	GBP
Net asset value (Class CG)	GBP 13.552
Inception date (Class CG)	18-May-15
Reference index (RI) **Russell/Nomura Mid-Small Cap Index**	
Domicile	Luxembourg
Fund type	UCITS
Investment manager **Eastspring Investments (Singapore) Limited**	

KEY MEASURES

Number of Securities	46
*3 year tracking error(%) (Class CG)	7.0
*3 year sharpe ratio (Class CG)	0.8
*3 year volatility(%) (Class CG)	13.6

*Source: Morningstar

IMPORTANT INFORMATION

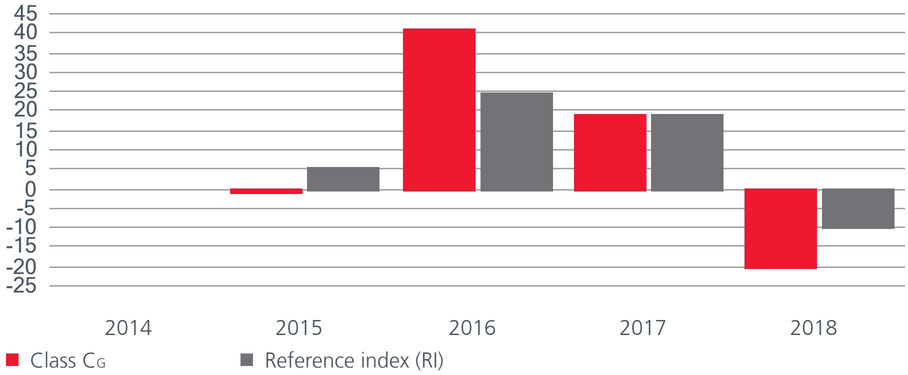
Prior to investing, Investors should read the Prospectus and Key Investor Information Document ("KIID").

INVESTMENT OBJECTIVE

This Sub-Fund aims to maximize long-term capital appreciation by investing primarily in equity and equity-related securities of corporations, which are incorporated in, or listed in, or operating principally from, or carrying on significant business in, or derive substantial revenue from, or whose subsidiaries, related or associated corporations derive substantial revenue from Japan. The investment universe is the bottom third in terms of total market capitalisation of all publicly listed equity in Japan. The Sub-Fund may also invest in medium sized and larger companies in order to enhance its liquidity. The Sub-Fund may also invest in depository receipts including ADRs and GDRs, debt securities convertible into common shares, preference shares and warrants.

PERFORMANCE

Calendar year returns (%) (Class CG)



Source: Eastspring Investments (Singapore) Limited. Past performances is not a guide to future performance and should not be the sole factor of consideration when selecting a product. The returns shown during the first year relate to the performance of the share class since its inception to the end of that calendar year. For full details, please refer to the performance disclosure.

SYNTHETIC RISK AND REWARD INDICATORS (SRRI) (Class CG)

Lower risk						Higher risk
1	2	3	4	5	6	7
Typically lower rewards						Typically higher rewards

MAIN RISKS:
Counterparty risk The Sub-Fund could lose money if an entity with which it does business becomes unwilling or unable to honor its obligations to the fund.
Derivatives risk Certain derivatives could behave unexpectedly or could expose the Sub-Fund to losses that are significantly greater than the cost of the derivative.
Focus risk To the extent that the Sub-Fund has exposure to an issuer, geographical area or type of security that is heavily affected by an adverse event, its value may fall.
Liquidity risk Certain securities could become hard to value, or to sell at a desired time and price.
Management risk Investment management techniques that have worked well in normal market conditions could prove ineffective or detrimental.
Operational risk In any market, but especially in emerging markets, the Sub-Fund could lose some or all of its investments through fraud, corruption, political or military actions, the seizure of assets, or other irregular events.
Hedging risk Currency hedging (where applicable) may not completely eliminate currency risk and, therefore, may affect the performance of your shares.

PERFORMANCE

	Cumulative returns (%)				Annualised returns (%)			
	1 m	3 m	YTD	1 y	3 y (p.a.)	5 y (p.a.)	10 y (p.a.)	Since inception (p.a.)
Class CG	0.3	2.3	2.3	-13.1	10.8	–	–	8.2
Reference index (RI)	2.9	4.3	4.3	-3.2	12.3	–	–	10.4
Relative	-2.6	-2.0	-2.0	-9.9	-1.5	–	–	-2.2

	Rolling 12-month returns (%)				
From	31 Mar 2018	31 Mar 2017	31 Mar 2016	31 Mar 2015	31 Mar 2014
To	31 Mar 2019	31 Mar 2018	31 Mar 2017	31 Mar 2016	31 Mar 2015
Class CG	-13.1	6.5	47.0	–	–
Reference index (RI)	-3.2	10.4	32.5	–	–
Relative	-9.9	-3.9	14.5	–	–

Performance Disclosure:

(p.a.): per annum. **Source: Eastspring Investments (Singapore) Limited.** Returns are based in share class currency and computed on NAV-NAV basis with net income reinvested, if any. Since inception returns for periods less than a year are not annualised. The reference index for the hedged share classes, if any, is also calculated on a hedged basis. Reference index is for information purposes only unless specifically referenced in the Investment Objective. Wef July 2018, the monthly fund and benchmark returns calculated are aligned to the last NAV date of the fund for the month. **Past performances is not a guide to future performance and should not be the sole factor of consideration when selecting a product.**

TOP 10 HOLDINGS (%)

1.	NHK SPRING LTD	3.7
2.	NOK CORP	3.6
3.	OKI ELECTRIC INDUSTRY LTD	3.5
4.	CREDIT SAISON LTD	3.4
5.	MITSUI OSK LINES LTD	3.4
6.	JSR CORP	3.2
7.	IIDA GROUP HOLDINGS LTD	3.2
8.	RICOH LEASING LTD	3.0
9.	KOBE STEEL LTD	2.9
10.	HITACHI ZOSEN CORP	2.9

SECTOR WEIGHTS (%)

Industrials	29.4
Consumer discretionary	27.9
Financials	21.9
Materials	10.7
Communications	6.3
Technology	2.4
Cash and cash equivalents	1.5

Due to rounding, the allocation table may not add up to 100% or may be negative.

SHARE CLASS DETAILS

Share class	Currency	Bloomberg ticker	ISIN	Inception date	Initial sales charges % (max)	Annual management fee% (max)	Annual admin fee % (max)	*Minimum initial investment	*Minimum subsequent investment	Distribution frequency	Ex-date	Dividend per share	Annual dividend yield %
A	USD	IOFJSAU LX	LU0354059841	26-Mar-08	5.000	1.500	0.500	USD500	USD50	N.A.	N.A.	N.A.	N.A.
CG	GBP	ESJSCCG LX	LU1235131007	18-May-15	5.000	0.875	Nil	USD10 Mil	USD1,000	N.A.	N.A.	N.A.	N.A.
CJ	JPY	ESJSCCJ LX	LU0865491319	14-Dec-12	5.000	0.875	Nil	USD10 Mil	USD1,000	N.A.	N.A.	N.A.	N.A.
RG	GBP	ESJSCRG LX	LU1235131262	18-May-15	5.000	0.750	0.500	USD500	USD50	N.A.	N.A.	N.A.	N.A.
RJ	JPY	ESJSCRJ LX	LU1235131692	18-May-15	5.000	0.750	0.500	USD500	USD50	N.A.	N.A.	N.A.	N.A.

Distributions are not guaranteed and may fluctuate. Past distributions are not necessarily indicative of future trends, which may be lower. Distribution payouts and its frequency are determined by the Board of Directors, and can be made out of (a) income; or (b) net capital gains; or (c) capital of the Fund or a combination of any of (a) and/or (b) and/or (c). The payment of distributions should not be confused with the Fund's performance, rate of return or yield. Any payment of distributions by the Fund may result in an immediate decrease in the net asset value per share. Funds with Monthly and Quarterly Distribution Frequency: Annualised Dividend yield = (Dividend per share / Reference NAV at start of distribution period) x (No. of calendar days in a year / No. of calendar days in distribution period) x 100%. Funds with Yearly Distribution Frequency: Annualised Dividend Yield = (Dividend amount / Total Net Assets) x (No. of calendar days in a year / No. of calendar days in distribution period) x 100%. *Or their near equivalent in any major freely convertible currency of the amounts specified. "N.A.": This share class does not distribute dividends.

		Cumulative returns (%)				Annualised returns (%)				Rolling 12-month returns (%)				
Share class	Currency	1 m	3 m	YTD	1 y	3 y (p.a.)	5 y (p.a.)	10 y (p.a.)	Since inception (p.a.)	31 Mar 2018 - 2019	31 Mar 2017 - 2018	31 Mar 2016 - 2017	31 Mar 2015 - 2016	31 Mar 2014 - 2015
A														
Fund	USD	-2.1	4.5	4.5	-20.6	6.0	5.5	12.9	8.3	-20.6	18.7	26.2	-3.7	14.2
Reference index (RI)	USD	0.8	7.2	7.2	-10.1	8.7	7.8	9.6	5.0	-10.1	23.9	15.3	-1.0	14.6
Relative	USD	-2.9	-2.7	-2.7	-10.5	-2.7	-2.3	3.3	3.3	-10.5	-5.2	10.9	-2.7	-0.4
CG														
Fund	GBP	0.3	2.3	2.3	-13.1	10.8	–	–	8.2	-13.1	6.5	47.0	–	–
Reference index (RI)	GBP	2.9	4.3	4.3	-3.2	12.3	–	–	10.4	-3.2	10.4	32.5	–	–
Relative	GBP	-2.6	-2.0	-2.0	-9.9	-1.5	–	–	-2.2	-9.9	-3.9	14.5	–	–
CJ														
Fund	JPY	-2.4	5.3	5.3	-16.2	6.8	8.3	–	16.2	-16.2	14.4	26.9	-8.9	34.4
Reference index (RI)	JPY	0.3	7.4	7.4	-6.4	8.2	9.4	–	15.2	-6.4	18.2	14.3	-7.2	33.4
Relative	JPY	-2.7	-2.1	-2.1	-9.8	-1.4	-1.1	–	1.0	-9.8	-3.8	12.6	-1.7	1.0
RG														
Fund	GBP	0.3	2.2	2.2	-13.2	10.6	–	–	7.9	-13.2	6.3	46.6	–	–
Reference index (RI)	GBP	2.9	4.3	4.3	-3.2	12.3	–	–	10.4	-3.2	10.4	32.5	–	–
Relative	GBP	-2.6	-2.1	-2.1	-10.0	-1.7	–	–	-2.5	-10.0	-4.1	14.1	–	–
RJ														
Fund	JPY	-2.3	5.3	5.3	-16.4	6.5	–	–	0.8	-16.4	14.2	26.6	–	–
Reference index (RI)	JPY	0.3	7.4	7.4	-6.4	8.2	–	–	3.1	-6.4	18.2	14.3	–	–
Relative	JPY	-2.6	-2.1	-2.1	-10.0	-1.7	–	–	-2.3	-10.0	-4.0	12.3	–	–

(p.a.): per annum. **Source: Eastspring Investments (Singapore) Limited. Past performances is not a guide to future performance and should not be the sole factor of consideration when selecting a product.** For full details, please refer to the performance disclosure.

Commentary sources

1.Eastspring Investments (Singapore) Limited

COMMENTARY

Performance Review

Japan equity market performance was relatively flat in March, with the Russell/Nomura Mid-Small Index returning 0.26% in JPY terms. Market risk appetites have coincided with news flow relating to the global macroeconomic and geopolitical environment. For example, in March, a decline in global consumer confidence coincided with the relative weakness in the macro news flow on growth. This in turn has led to shorter term swings in thematic risk preferences which has impacted price and market leadership from month to month.

Corporate Japan is certainly not immune from the global macroeconomic cycle, as observed by downward earnings revisions in recent months. However, this shorter-term cyclicality of earnings is more than priced into already attractive valuations in Japan. Additionally, we continue to observe improving longer-term trends in the fundamental health in corporate Japan, which has yet to be priced into valuations for many companies.

Restructuring efforts have progressively translated into higher operational efficiency and improved trend profitability, with the gap between trend profit margins for Japanese corporates and the rest of world continuing to narrow. For example, over the past four years, Japanese earnings per share growth has been rising faster than in other developed markets.

With the process of excessive debt deleveraging moderating, Corporate Japan is using more cash flow to increase dividends and undertake buy-backs. For example, there has been a 154% year-on-year (YoY) growth in buybacks during the January-March period. More companies are also underwinding their cross shareholdings following revisions to Japan's Corporate Governance Code in 2018. Whilst this is encouraging corporate behaviour, we still see significant scope for the adoption of best practices which may in turn contribute to the global competitiveness of corporate Japan.

The output gap calculated by the central bank tightened strongly to 2.23% in 4Q18 from 1.26% in 3Q, the strongest since 1992. A positive output gap means that the economy is producing more than is sustainable, which in turn implies there is likely to be rising inflationary pressure. To highlight this, the unemployment rate is at its lowest since 1993, while the job-offer-to-applicant ratio continues to reflect a tight labour market not seen since 1974. Additionally, corporate Japan’s response to tight capacity has been the broad-based and steady growth of corporate spending from low levels.

On the policy front, as part of a package to address the potential impact of a consumption tax hike in October, Japanese lawmakers passed a record-breaking fiscal 2019 budget this month. The budget includes measures to promote cashless payments, encourage homebuying, disaster prevention and mitigation and support for low-income and households with young children.

While the broader market timeframes have shortened considerably amid macroeconomic and geopolitical uncertainty, we continue to observe improving trend fundamentals on a bottom up, company by company basis which are yet to be priced by the market. As such, we continue to find mispriced contrarian investment opportunities where the market’s risk perceptions and expectations have caused a meaningful dislocation between the share price and company valuation.

Key Contributors

Month-to-date, Japan Aviation Electronics Industry, Oki Electric Industry and Hitachi Zosen Corp were contributors to absolute performance.

Japan Aviation Electronics Industry (JAE) was identified by the strategy when negative market sentiment was focused around falling orders from Apple for its handset connectors and flat orders to the auto industry. However from a structural perspective, we observe that in autos, there are an increasing number of connectors required per vehicle, which will be supportive for future demand. Also, JAE is also slowly expanding its European auto client base. Meanwhile In handsets, JAE is increasing sales to other handset makers and it is also expected that sales to Apple and others will structurally revive due to new product launches. The earnings recovery is now coming through and driving strong share price performance.

Oki Electric Industry has been undertaking aggressive restructuring over the past five years and now maintains a range of businesses based on developing and then assembling hardware and software into large systems for large corporates and the public sector. Most of its businesses may be broadly categorised as cash flow generative in niche segments, which are oligopolistic in nature with high barriers to entry. The core technology competencies are mostly complementary in nature across money recognition, counting and sorting, ticketing, printing, and network infrastructure and communications technology. However, it is facing a significant disruption to its ATM business in China, where it has had to change its distribution partner and this has hurt sales and its share price. Its printer business has also been under pressure. The company has embarked on a cost restructuring and focus strategy in these businesses. By applying very conservative longer-term trend earnings assumptions across the range of business segments, our analysis suggests there is significant valuation upside.

Whilst management of Hitachi Zosen Corp has had a history of poor capital discipline, its stated plan is to focus resources on the environmental systems business and other high return businesses with growth potential, and to restrict capital to loss making businesses and restructure other businesses if necessary. The main focus for the mainstay environmental systems division is the replacement market for domestic rubbish incineration plants, where a significant replacement cycle is now emerging which has created structural improvements to earnings for the industry as a whole. Operations and maintenance services, traditionally done in house by local Government, are another new profit stream for manufacturers like Hitachi Zosen. The number of players in the space has fallen sharply after decades of a subdued new build market. As one of the remaining key players in this space, this structural improvement should be supportive for the longer term sustainable earnings that Hitachi Zosen can generate. Importantly there is significant valuation support that more than compensates for the observable risks to Hitachi Zosen's ongoing capital discipline.

Key Detractors

Month-to-date, Mitsui OSK Lines (MOL), Chiba Bank and Credit Saison were drags on absolute performance.

Shares in Mitsui OSK Lines (MOL) had de-rated along with the shipping industry which has been in a weak global cyclical environment with a significant over supply in the shipping fleet. As a result, shipping rates and profitability has been falling sharply in recent years. We observe the market’s thematic risk preferences are aggressively extrapolating the current environment, which has been more than reflected in share prices. However, we observe MOL has shown an ability to restructure its core bulk business by reducing costs, reducing its spot market exposure and to reinforce stable earnings from its contract based business. MOL’s near term imperative is to stem its losses in its container business and MOL is addressing

COMMENTARY

this by merging with two major competitors. There continues to be consolidation in the industry with excess supply falling and capital beginning to exit, with moderating cyclical pressure. The attractive valuation based on our conservative trend assumptions provides compensation for cyclical risks.

Chiba Bank is a regional bank that experienced significant share price underperformance in 2016, post the BOJ announcement of negative interest rate policy (NIRP). We believe the market concerns for downward pressure on net interest margins, resulting from NIRP, is far more than reflected in the share price. Chiba Bank is well managed and has a strong market position with a diversified business that includes higher margin lending to small to medium enterprises. Our conservative trend assumptions suggest Chiba Bank is attractively valued and the fund has taken advantage of negative sentiment and share price weakness to build a position.

Credit Saison has underperformed the market over the past three years and as result is now attractively valued. Additionally, the issues facing Credit Saison and the consumer finance industry in general, are well known to the market and are more than priced in with significant valuation support. Our conservative trend assumptions have taken into consideration amongst other things, the likelihood of rising costs associated with IT infrastructure spending; the potential for rising trend credit costs from historic low NPL levels; ongoing liabilities stemming from legacy claims on the consumer finance industry; and the potential impact from a change in significant shareholders. The trend shift in its business mix away from an interest rate sensitive consumer finance business to a fee generating transaction processing business appears to have been overlooked by the market. However, this is supportive for our high conviction for the likely level of sustainable trend earnings that could be generated.

Fund Activity

During the month, the portfolio manager sold shares in outperforming companies where valuations look relatively less compelling compared to other high conviction positions. Among the notable trades, the Strategy reduced existing positions in Sankyo Tateyama Inc, Denki Kogyo Co and Toshiba Tec. Additionally, the Fund increased existing positions in Relia Inc, Dai Nippon Toryo Co and Ube Industries.

Outlook

The market's shorter term focus on thematic macroeconomic news flow can drive significant share price anomalies for the Strategy to exploit. There remains a tail of stocks which are often ignored by the market and as a result may be mispriced by the market. This market dynamic presents opportunities for our valuation discipline to exploit.

However, we note that there are many companies in strong financial health and observe that companies' restructuring efforts are continuing and in some cases have accelerated. With the onset of negative interest rates for bond holders, there is an even stronger economic imperative for companies to improve capital efficiency encouraging shareholder oriented behaviour. We continue to observe supportive trend fundamentals at a company level, and this is a significant driving factor in the longer term re-rating for Japan.

We do not allocate on a sector basis. However we have found, on a stock by stock basis, high conviction names with strong valuation signals across much of the market. Included are investment opportunities in retail and property-related names; regional banks as well as non-bank financials; electronic and auto component manufacturers; specialist materials and industrials names. These names represent a wide range of industries, from more domestically focused to export related.

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All transactions into the SICAV should be based on the current Prospectus and the Key Investor Information Document ("KIID") of the relevant sub-fund in applicable local language. Such documents, together with the articles of incorporation, the latest annual and semi-annual reports of the SICAV, may be obtained free of charge from the Management Company.

Prospective investors are invited to further consider the risk warnings section of the Prospectus. This document is solely for information and does not have any regard to the specific investment objectives, financial or tax situation and the particular needs of any specific person who may receive this document. This document is not intended as an offer, a solicitation of offer or a recommendation, to deal in shares of securities or any financial instruments.

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Past performance and the predictions, projections, or forecasts on the economy, securities markets or the economic trends of the markets are not necessarily indicative of the future or likely performance of the SICAV. There are limitations to the use of indices as proxies for the past performance in the respective asset classes/sector.

Any sub-fund of the SICAV may use derivative instruments for efficient portfolio management and hedging purposes.

This paragraph is only applicable to sub-funds of the SICAV, which distribute dividends. Any sub-fund of the SICAV may, at its discretion, pay dividends out of capital or gross income while charging all or part of its fees and expenses to its capital, resulting in higher distributable income. Thus, any sub-fund of the SICAV may effectively pay dividends out of capital. Payment of dividends out of capital (effective or not) amounts to a return or withdrawal of part of an investor's original investment or from any capital gains attributable to that original investment, which may result in an immediate reduction of the net asset value per share. The distributions, including amounts and frequency, are not guaranteed and are subject to the discretion of the SICAV's Board of Directors. Past dividends are not a forecast or projection of future distributions.

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A member of Prudential plc (UK)

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