ALMA CAPITAL

Alma Eikoh Japan Large Cap Fund

Annual Review 2022

The **market** (Topix total return index) fell by -2.45% during 2022, significantly outperforming the majority of major global markets and the MSCI World Index. This relative performance was offset by foreign exchange weakness however, the Yen to the USD falling from Y115 to Y131 over the year. Global markets were buffeted by fears over rising global inflationary pressures and the resulting change in monetary policy in the US and elsewhere, with the war in Ukraine and supply chain distortions impacted by Chinese lockdown policy adding to these concerns. There were dramatic moves in commodity and foreign exchange markets with Brent jumping from $78 to over $120 a barrel before falling back to $86 at end December, and the Yen depreciating from Y/$115 to over Y/$150 before closing the year at Y/$131. Reflecting the very significant change in the economic environment, market returns exhibited substantial dispersion; sectors with a strong positive correlation to interest rates outperformed significantly with the Banks sector up +39% and Insurance +32%. Other defensive sectors and those geared to Oil prices were also among the market leaders with Energy +21%, Pharmaceuticals, Biotechnology and Life Sciences +16% and Utilities +14%. Sectors geared to the economy lagged the market with Semiconductors & Semiconductor Equipment down -29%, Commercial & Professional Services down -25%, Consumer Durables & Apparel down -19% and Technology Hardware & Equipment down -19%.
An additional and powerful trend within the market was the underperformance of growth stocks as investors reappraised valuations in the light of higher global interest rates. Topix Growth underperformed Topix Value by 23.1% over the twelve months.

The **fund** underperformed the index by 4.10%, falling by -6.55% (JPY share class); with this attributable to sector allocation which more than offset a positive contribution from stock selection. The fund entered 2022 with a clear pro cyclical position and, while this was subsequently reduced in response to the weakening outlook for growth, it was this that caused the underperformance. The changes that were made to the portfolio’s sector allocation over the year had a positive impact on performance, but we should have moved more aggressively to make these early in the period and reduced the technology exposure in response to worsening conditions as well as that of general industrials. At the end of December 2021, the fund held an overweight of +14.0% in Semiconductors and Semiconductor Equipment, it also held a +3.8% overweight in Materials with only modest offsetting underweights of -3.1% in Capital goods and -2.2% in Tech Hardware. As at end December 2022 the weighting in Semiconductors and Semiconductor Equipment had been reduced to +9.5%, the overweight in Materials switched to a -2.4% underweight and the underweight in Capital Goods increased to -8.3% and that in Tech Hardware to -3.1%. These moves cut exposure to the global industrial cycle. Conversely the weighting in Software & Services had increased from +0.2% to +3.6%, Healthcare from -2.5% to +1.4% and the Banking exposure from +1.1% to +2.1%.

Sector allocation contributed -4.8%* of negative performance over the year and this was driven in the most part by the heavy overweight in Semiconductors & Semiconductor Technology. Underweights in Telecommunication Services, Insurance and Transportation also cost the fund performance. Offsetting the economic gearing offered by the Semiconductor & Semiconductor Equipment overweight, the fund held underweight positions in sectors such as Technology Hardware & Equipment and Consumer Durables & Apparel and these added value but this was not enough to return positive sector allocation. The overweight in Banks also added value, particularly towards the end of the year with the first signs of a shift in BOJ policy.

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Stock selection contributed +2.18%* to annual return. There was positive stock selection from the positions in Renesas and Rohm and the underweight in Tokyo Electron within the Semiconductor sector with gearing to the automotive area viewed more favourably than memory. The other top contributions to stock selection came from the position in running shoemaker Asics, the position in staffing firm BeNext-Yumeshin and the large position in Mitsubishi UFJ Financial Group which was the best performing major bank and bought back a record amount of stock in the year. The weaker contributors to stock selection included some of the fund's growth stocks which suffered derating as investors recalibrated multiples in light of higher rates including the online fleamarket operator Mercari and medical data company JMDC. Other positions which detracted from performance included the kitchen and bathroom maker Lixil and household goods maker Kao, both of which were hurt by cost inflation, the factory automation company Fanuc, the chip packaging maker Ibiden and JSR the materials company.

The number of stocks held in the portfolio remained close to 30 over the course of the year. The aggregate **average beta** (ex-ante) of the portfolio was 1.1x over the period and finished the year at this value.

Predicted **tracking error** averaged 4.4% over the year falling slightly in the second half of the year and closing at 4.2% at end December. Stock specific risk accounted for approximately 67% of the tracking error over the year with style factors at 18% and industry exposure 15%. Ex post tracking error since inception is 5.8%.

Turnover in 2022 fell from the elevated levels recorded during 2020 and 2021 declining from 147% in 2021 to 93% in 2022 (Singapore method).

Assets grew over the course of the year from $741m at end Dec 2021 to $965m at Dec 2022 lifted by net fund flows.

***** NB Source Bloomberg - the stock selection and sector attribution combined together are -2.6% compared to actual net underperformance of -4.1%.

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2023 Outlook

Global and US inflation numbers are still high and coupled with a still tight labour market in the States this argues for further rate rises by central banks. It is clear however that economic activity is weakening, both manufacturing data and retail sales have softened. Whether or not the Fed can achieve the much desired 'soft landing' remains unclear with the reopening of China despite soaring COVID cases and ongoing uncertainty regarding the outcome of the war in Ukraine complicating factors. We currently assume a reasonably dull economic environment in 2023 in our modelling and remain focused on finding companies with good medium-term prospects with the ability to withstand a difficult environment in 2023. The portfolio has neither a clear pro-cyclical nor contra-cyclical bias, neither does it have a notable tilt in terms of growth or value. We continue to back companies operating in areas of secular growth such as digital transformation, electrification of the auto market and increasing use of technology in healthcare. The overweight in banks anticipates an end to the BOJ's negative interest policy at some stage during 2023. In order of size, the fund's top sector overweight positions are Semiconductors & Semiconductor Equipment, Software and Services, Energy, Banks and Diversified Financials. The top underweighted sectors are Capital Goods, Telecommunication Services, Technology Hardware & Equipment, Retailing and Materials. We believe that Japanese companies offer attractively priced fundamentals with the Topix trading at a prospective PER of 12.1x, a PBR of 1.10x and a dividend yield of 2.69%. Improvements in corporate governance continue to be seen and we expect further growth in dividends and share buybacks across the corporate sector over the medium term; buybacks this year are expected to reach Y7.9trn, a record high.