ALMA CAPITAL

Alma Eikoh Japan Large Cap Fund

Annual Review 2023

The **market** (Topix total return index) rose by 28.25% during 2023, outperforming most major global markets and the MSCI World Index. This relative performance was offset by foreign exchange weakness however, with the Yen to the USD falling from Y131 to Y141 over the year. Investors looked through geopolitical concerns and global markets benefited from the clear cooling of inflationary pressures coupled with the resilience of the US economy which maintained growth despite the drag of high interest rates. These positives more than outweighed the lacklustre recovery from COVID restrictions in China and dull economic conditions in Europe. Domestically, the picture was one of steady progress and recovery from COVID restrictions with tourism and retail showing a sharp recovery in activity. Inbound tourist numbers have now recovered to pre-pandemic levels, even though Chinese visitor numbers remain very depressed, and domestic travel has been buoyant with many Japanese eschewing visits overseas. Capital spending was robust in 2023, growing by +12.8% according to the latest BOJ survey and an encouraging trend has been the growth of inward investment into Japan as companies look to diversify supply chains and specifically reduce the reliance on China.

Economically sensitive stocks led the market in 2023 with Iron & Steel, Shipping, Trading Companies, the Automobile Sector and Mining leading the market. In contrast, Pharmaceutical stocks were the worst performing sector followed by Air Transport, with Land Transport and Information & Communications also very dull. While the margin was much smaller than in 2022, Topix Growth again notably underperformed Topix Value, by-8.6% over the twelve months. 2023 saw net foreign buying of Y6trn of Japanese stocks and futures, a sharp turnaround from the steady divestment seen over recent years and driven perhaps both by allocations moving away from China and in recognition of improvements in corporate fundamentals and governance within Japan. The past 12 months saw a continuation or indeed an acceleration of the trends around improving corporate governance, shareholder activism and increased shareholder returns. Action taken by the Japan Exchange Group targeted at companies trading below price to book ratios of 1x early in the year acted as a further catalyst and further announcements throughout the year added to this. 2023 saw a record year in terms of both share buybacks and dividends following this.

The **fund** outperformed the index by 2.86%, rising by +31.12% (JPY share class); with this attributable fairly evenly to a combination of stock selection and sector allocation.

Sector allocation contributed +2.5%* of performance over the year, and this was driven primarily by the overweight in Semiconductors & Semiconductor Technology. The underweight in Telecommunication Services and overweight in Commercial & Professional Services also contributed to fund performance. Value was lost due to the overweight positions held in Healthcare Equipment and Household & Personal Products, and the underweight held in Automobiles & Components also hurt fund performance.

Stock selection contributed +2.1%* to annual return. The position in Mitsubishi UFJ within Banks was a positive contributor, helped by solid results and an improvement in shareholder returns. Within Transportation Keisei Railway performed strongly as investors focused on the value of their stake in Oriental Land. Asics, the running shoe firm was again a positive contributor to the fund reflecting the strong growth achieved by the business over the past year. Mitsubishi Heavy within Capital Goods added significant value and other top contributions to stock selection came from the positions in the Household and Personal Products company, Kao, the Cup Noodle maker, Nissin Food, the utility company Kansai Electric Power, and the recycling and waste disposal firm, Daiei Kankyo. The negative contributors to stock selection include the semiconductor maker Rohm which was hit by weaker demand in the consumer and industrial areas. Growth stocks again performed poorly, as was the case in 2022, and this impacted several of the fund's holdings: PeptiDream within Pharmaceuticals; GMO Payment Gateway within Financial Services; and M3 within Healthcare Equipment & Services. In terms of performance, 2023 was a year of two halves for the fund, with strong stock selection in the first half of the year followed by a weaker second half. Some of the positive contributors in the first six months weakened later in the year, for example Panasonic and Renesas, though we reduced the position size significantly in the latter after its strong upward move in the spring. Profits were also taken on KEPCO and Screen Holdings and the position in Keisei Railway reduced. In the second half of the year the fund's holdings in the semiconductor area lost value with exposure being concentrated in semiconductor makers such as Rohm and Renesas rather than the Semiconductor Production Equipment area the cause. The value lost in growth stocks M3, GMO Payment Gateway and PeptiDream also occurred in the second half of the year.

Portfolio positioning changed only modestly over the course of the year with areas such as Capital Goods, Telecom Services, Automobiles & Components and Materials remaining underrepresented in the portfolio. While the fund remains overweight in Semiconductors this has been substantially reduced from the fund's largest overweight to only very modestly so. The weighting in Financial Services has been increased with the addition of GMO Payment Gateway to the existing holding in Orix and in Commercial & Professional Services with the addition of Daiei Kankyo and Visional to the existing position in Open Up Group. The Banking and Energy overweight positions were maintained through the year.

The number of stocks held in the portfolio was a little over 30 during the year and finished December at 33. The aggregate **average beta** (ex-ante) of the portfolio was 1.06x over the period and finished the year at this level, down from 1.1x a year ago.

Predicted **tracking error** averaged 4.0% over the year, rising slightly in the second half of the year and closing at 4.2% at end December. Stock specific risk accounted for approximately 74% of the tracking error over the year with style factors at 17% and industry exposure 7%. Ex-post tracking error since inception is 5.7%.

Turnover in 2023 was 95%, similar to the 93% recorded in 2022 (Singapore method).

Assets fell over the course of the year from $965m at Dec 2022 to $850m at Dec 2023 with net fund flows more than offsetting the growth in assets derived from performance.

***** NB Source Bloomberg - the stock selection and sector attribution combined together are +4.66% compared to actual net outperformance of +2.86%.

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2024 Outlook

Looking out to the year ahead while the global demand outlook is mixed, the situation in Japan remains moderately encouraging with stable economic conditions and Government policy clearly focused on supporting growth. Government support is evident in targeted technology sectors with substantial grants made in 2023 in areas such as wafer manufacturing, silicon carbide power semiconductors and semiconductor process materials. However, recent political travails within the LDP represent an element of risk in this regard; following the recent funding scandal support for Prime Minister Kishida has fallen to only 26% and it is now possible that he may step down to allow the LDP to regroup under a fresh leader. However, while a new leader would seek to reformulate economic policies, in the consensus driven LDP we think that a radical change in economic approach would be unlikely, and that policy should remain supportive. Geopolitical changes also mitigate in favour of Japan with some of the investments being made by both Japanese and global companies to reduce supply chain dependence upon China, flowing into Japan, particularly in the technology sector. There are clear indications that wage growth in 2024 is likely to be strong again, reflecting the health of the corporate sector, government pressure and social consensus. The Japan small manufacturers union is demanding a record increase in base pay of +4% in 2024, indicating that the move to higher pay has broadened out from larger companies to the wider economy. In response to the outlook for firm wage growth the BOJ is expected to tighten, exiting from negative interest rate policy in early 2024 though whether this happens at the January meeting is now open to doubt as they may want to study the impact of the recent Noto Peninsula quake before moving. In any case the BOJ seems likely to move extremely cautiously in raising rates beyond the removal of NIRP and aims to remain fundamentally accommodative unless there is an unexpected increase in inflationary pressures.

We continue to run a portfolio that we judge has neither a clear pro-cyclical nor contra-cyclical bias and with average valuations close to that of the wider market. The portfolio's PER and Price cash flow are at a discount to the market but PBR at a premium. With 77% of the risk taken relative to the market, stock specific, style and industry bets are relatively modest. The portfolio has an ex-ante beta of 1.06 and in terms of style factors is underweight momentum, overweight growth, underweight value, and is overweight exposure to the US$ and Euro. In order of size, the fund's top sector overweight positions are Financial Services, Commercial & Professional Services, Energy, Food, Beverage & Tobacco, and Consumer Staples. The top underweight sectors are Capital Goods, Telecommunication Services, Automobiles & Components, Materials, and Consumer Discretionary. The Topix is trading at a prospective PER of 15.0x, a PBR of 1.31x and a dividend yield of 2.29%. After strong performance in 2023 valuations have risen but still look reasonable in an international context. The trend towards improving corporate governance remains in place and is accelerating. With activist investor activity a clear catalyst, we expect further growth in dividends and share buybacks across the corporate sector.