ALMA CAPITAL

Alma Eikoh Japan Large Cap Fund

Semi-Annual Review H1 2022

The **market** (Topix total return index) fell by 4.78% during H1 2022 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 adding to these concerns. There were dramatic moves in commodity and foreign exchange markets over the six months with Brent jumping from $77.8 to $114.8 a barrel and the Yen depreciating from Y/$ 115.1 to Y/$ 135.7. Reflecting the very significant change in the economic environment, market returns exhibited substantial dispersion; those stocks perceived to benefit from, or at least be resilient to, higher interest rates, higher oil prices and weaker economic growth performed well while those seen as exposed to an economic downturn underperformed. 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 17.2% over the six months. Leading sectors included Oil, Insurance, Banking, Real Estate, Shipping and Pharmaceuticals while areas such as Services, Electrical Appliances, Precision Instruments, Chemicals and Machinery all underperformed.

The **fund** underperformed the index by 3.26%, falling by 8.04% (JPY share class); with this attributable to sector allocation which more than offset a positive contribution from stock selection. The fund entered 2021 with a clear pro cyclical position and, while this was reduced over the period 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 six months had a positive impact on performance but we should have moved more aggressively to make these at the start of the period. 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 June 2022 the weighting in Semiconductors and Semiconductor Equipment had been broadly maintained and was +13.4% but the overweight in Materials had been removed and the underweight in Capital Goods increased to -11.5% and that in Tech Hardware to -3.5%.

Sector allocation cost the fund -5.74%* of performance over the six months and this was substantially driven by the large overweight position in Semiconductors & Semiconductor Equipment accounting for -4.14% of this. Being underweight in Telecoms, Insurance, Transportation and Real Estate also lost value while being underweight Tech Hardware and Consumer Durables added value, as did being overweight banking and Energy.

Stock selection contributed +3.23%* to return. The biggest contributor to stock selection were the positions within the Semiconductor & Semiconductor Equipment sector, where owning Shinko Electric, Rohm and Renesas and not owning Lasertec were key factors behind this. Commercial and Professional Services was also a source of added value driven by the robust performance of Secom and resilience of BeNext-Yumeshin. Performance in Banks was also good where the fund's holding in Mitsubishi UFJ Financial Group rose sharply. Value was lost in the Pharmaceutical Sector where the position in Peptidream continued to fall as the position was created and built up over the period and also in retailing where the holding in Mercari underperformed before its disposal from the fund.

The number of stocks held in the portfolio remains close to 30 and the aggregate **average beta** (ex-ante) of the portfolio was calculated at 1.09x at the end of June.

Predicted **Tracking error** at 4.4% at the end of June is little changed compared to end December. Stock specific risk accounts for approximately 72% of the tracking error with style factors at 15% and industry exposure 13%. Ex post tracking error since inception is 5.8%.

***** NB Source Bloomberg - the stock selection and sector attribution combined together are -2.51% compared to actual net outperformance of -3.26%.

2022 Outlook

Recent news within Japan has been dominated by the shock assassination of former Prime Minister Shinzo Abe, Japan's leading political figure so far this century, and the subsequent Upper House election. In the election the ruling LDP and its smaller partner Komeito secured 76 of the available 125 seats and the LDP alone won 63. This leaves the coalition with 146 seats, comfortably ahead of the majority threshold of 125, and the LDP alone with 119. Post the election, parties in favour of revising the constitution hold 177 seats in the Upper House, in excess of the 2/3rds threshold of 166 votes required for this to pass into law. The key question now following their election success is what will the Kishida administration choose to prioritise in legislative terms? While constitutional reform is a potentially achievable aim, it would dominate Diet proceedings as well as foment a national debate and leave little time or political capital to address economic issues. At this stage we believe it is more likely that the Kishida administration will focus on economic policy and further fleshing out his concept of "new capitalism". This is unlikely to involve a complete rejection of the tenets of Abenomics but a change of emphasis designed to attract a greater flow of foreign capital into Japan and to stimulate a more equitable sharing of the fruits of Japan's economic renaissance through higher wage growth for salaried workers. A policy priority seems likely to be measures to help households deal with inflation. A major decision that awaits Kishida in the autumn is the choice of successor for BOJ Governor Kuroda whose term expires at end March'23. While future changes in BOJ policy are expected to be evolutionary rather than revolutionary, the direction of travel is likely to be one of a very gradual normalisation of policy away from its current ultra-accommodative state.

Globally it remains the case that economic conditions continue to worsen and it is still unclear to what extent this is priced in to markets and to what extent company fundamentals will be impacted both on the cost side and on the demand side with consumers and businesses both squeezed by higher costs. While the recent decline in commodity prices is on the face of it good news, the fact that the driver of this is a much weaker demand outlook is not. A sharp slowdown in demand is clearly upon us and the only question is how deep and sustained this fall is and whether key constituents of the global economy such as the US can avoid recession. While we have reduced the economic gearing of the portfolio compared to six months ago we retain a significant overweight in the semiconductor area and within this a focus on companies with a high exposure to the field of automotive electrification. We think that the secular growth in this area will offset some of the impact of the slowdown expected in 2022 and provide a strong base for renewed expansion beyond the current adjustment phase. Overall we believe our portfolio companies are attractively priced in light of their medium growth prospects and their ability to weather current uncertain economic conditions. In order of magnitude the portfolio is overweight in Semiconductors & Semiconductor Technology, Software & Services, Food & Staples Retailing, Energy, and Banks. We are underweight Capital Goods, Telecommunication Services, Consumer Durables & Apparel, Technology Hardware & Equipment and Media & Entertainment. We continue to believe that Japanese companies offer attractive fundamentals with the Topix trading at a prospective PER of 12.0x, a PBR of 1.15x and a dividend yield of 2.53%. Recent year-end financial results were impressive and encouragingly these profits flowed through to shareholders with 74% of companies hiking their dividend and share buybacks up 63% to $32bn, a post financial crisis high, as corporate governance continues to advance.