



# Japan Dynamic Strategy

## Why invest in Japan Equity

Japan has always been a corporate, not an economic, revival story. Investors willing to look beyond economic data will discover a market that remains attractively valued compared to global equities and one that offers opportunities on a bottom-up basis. There are number of great companies going for a bargain.

The general perception of the market is that Japan is characterized by its aging demographics as well as a low growth, low inflation and low interest rate environment. But we believe the outsized returns is not based on a forecast or macro theme. Instead, we systematically look for mispriced assets, focusing on extremes and identifying maximum impact opportunities.

Several reasons exist in our opinion to invest in Japan equity:

**1** Japan’s companies have been restructuring and deleveraging their balance sheets over the last ten years. The return on assets of non-financial companies has risen, profitability has improved as have cash flows — all of which are giving companies improved profitability and more flexibility in repaying debt, boosting dividends and instigating share buy-back schemes.

**Fig 1: Corporate profitability is on the rise<sup>1</sup>**



- 2** Japan continues to trade at very attractive valuations versus global peers (Fig 2). The market has not re-rated despite the significantly improved corporate fundamentals and earnings revisions. Additionally, we continue to observe a wide valuation divergence between expensive and cheap stocks within the market which offers plenty of investment opportunities.
- 3** There has been a shift in preferences for the value end of the equity market versus growth over the last 12 months, driven by normalization of overstretched growth names’ valuations. The change in expectations around inflation and interest rates is refocusing the attention towards corporate profitability and free cashflows. We think the current environment suggests a more fundamental shift in investors’ mindsets, one that will benefit Japan.

We believe the above backdrop offers us a unique advantage to exploit the opportunity using our differentiated value approach. We continue to identify excellent stock buying opportunities in the current environment, taking advantage of market volatility and periods of mispricing to accumulate attractively priced equities in our Japan portfolios.

**Fig 2: Japan valuations are attractive<sup>2</sup>**



## Why Eastspring for Japan equities

Eastspring Investments, a Prudential plc company, is one of the largest Asia-based global asset managers, with Asia at its core. Since 1994, we have built an unparalleled local investment presence across in 11 Asian markets and distribution offices in North America and Europe. Our headquarters in Singapore places us at the heart of Asia, close to many of the markets in which we invest.

Our Japan Equity team is strong and very experienced with an excellent track record of navigating Japan's equity universe for over 17 years. Our significant scale of operations in Asia allows the team tier 1 access to management and an ability to leverage counterparty relationships in terms of analysis and effecting transactions. We are also one of the very few true-to-label-based managers of Japan equity.

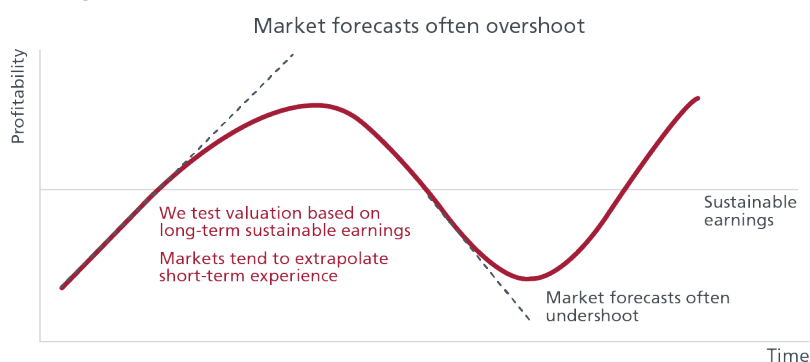
## Why our differentiated valuation approach is durable over time and market cycles

We target only high impact valuation outliers - stocks that have a significant difference between price and valuation. We screen a wide investment universe of over 2,000 companies applying consistent anchors around valuation and are equipped to rapidly identify valuation outliers which may become investment candidates. Our in-depth research efforts focus on the most mispriced opportunities that offer the greatest potential return.

Our value differentiator lies in our detailed analysis and peer review that tests the longer drivers of a company's sustainable earnings using a consistent valuation framework. The focus on sustainable earnings differentiates us from a market that obsesses over recently term reported earnings and shorter-term forecast accuracy.

This approach delivers unique insights and a clear understanding of a company's valuation drivers. A high conviction around trend fundamentals allows us to remain patient amid market uncertainty as well as exploit shorter term price volatility in a contrarian manner.

**Fig 3: Differentiated concept of valuation relative to sustainable earnings<sup>3</sup>**



## In a snapshot: Eastspring Japan Dynamic Strategy

- ▶ We aim to generate superior long-term capital growth for our clients by consistently applying our disciplined valuation approach to identify Japanese equities that will outperform.
- ▶ The strategy is a concentrated portfolio containing 30-50 of our best ideas across Japan's equity universe. We invest in stocks that are often at odds with market consensus. Also, we look for solid valuation signals across the market, choosing stocks that may have fallen out of favour or whose price reflects a significant overreaction by the market.
- ▶ Our Japan equity team is a small, experienced, and cohesive group of four investment professionals with deep financial industry experience.
- ▶ A robust and centralised team framework allows our managers to maximise challenge and debate. These factors are vital to executing our strategy and delivering repeatable performance to investors.
- ▶ We are patient. Rather than follow the herd and be influenced by behavioural biases, we adopt a longer-term mindset that allows us to focus on the best stock opportunities.

## How we build the strategy



### An ethical mantle

We believe optimal investment decisions are made when environmental, social, and governance (ESG) factors are incorporated into our investment process.

- ▶ Eastspring Investments has an established responsible investing framework which includes stewardship and ESG policies that inform and govern our business and investment teams. Against this overarching framework, we have empowered each investment team to integrate these policies into their distinct investment approach and strategies. We don't believe there is a one size fits all approach to ESG application.
- ▶ ESG considerations are factored into company valuations by assessing the material risks to sustainable earnings and monitoring the progress of such risks and opportunities in our "ESG dashboard".
- ▶ We believe that engaging with investee companies on ESG issues is essential to understanding and protecting the portfolio from financial and non-financial risks. As such, we vote on all resolutions (except when it is not in the best interests of our clients).
- ▶ We utilise third-party ESG data to assist with the due diligence and ongoing monitoring processes.



### Our investment process

Our bottom-up, valuation-driven investment process has been designed to target mispriced equities in a disciplined and repeatable manner. It consists of four stages:

**Idea generation:** We systematically look for mispriced assets that impact portfolio returns the most.

**Fundamental analysis:** This is the most important part of the investment process. It allows us to confirm whether value exists. It also helps us deepen our understanding and tests the team's conviction in a particular holding.

**Portfolio construction:** We construct the portfolio with our highest conviction ideas while considering stock correlations and unintended risks. Stocks from this conviction list become the core positions in our Japan Dynamic strategy.

**Risk control and review:** Ongoing portfolio review helps instil process integrity and sell discipline. Our robust risk framework is conducted by the Japan Dynamic team, senior management, and our independent risk oversight team



### Investment philosophy

We believe that:

- ▶ Prices frequently move more than is justified due to shifts in investors' risk perceptions.
- ▶ Behavioural biases influence both investor expectations and risk appetites.
- ▶ As a result, the actual underlying value is not always reflected in stock prices.
- ▶ By detaching ourselves emotionally and with rigorous analysis and discipline over a longer time frame, we can exploit these opportunities.
- ▶ Our price-focused process, anchored by a consideration of relative valuation, aims to deliver superior long-term returns.

## Investment team lead



**Ivailo Dikov**  
Portfolio Manager

We adopt a team-based approach, although Team Leader and Portfolio Manager Ivailo Dikov has the ultimate responsibility for the daily monitoring of the portfolio, overseeing trades and position sizing.

## Strategy characteristics

### Portfolio characteristics (as of 31 March 2023)<sup>4</sup>

Reference Index	MSCI Japan Index
Typical no. of holdings	30-50
Target alpha	1.5 – 4%
Target tracking error	3 - 8%
Country/sector range	Outcome of bottom-up stock selection
Market capitalisation	All-capitalisation
Base currency	JPY

### Strategy details

**Style:** Benchmark unconstrained

**Inception Date:** 5 July 2006

**Strategy AUM:** USD 2,191 million (as at end March 2023)

**Benchmark:** MSCI Japan Index

Source: <sup>1</sup>Profit Margin % of sales from Refinitiv Datastream MOF. Latest data available as of 31 March 2023. Current Profits of all Japanese Incorporated Enterprises Industries (Except Finance and Insurance) / Sales, in Japanese Yen. <sup>2</sup>Eastspring Investments, IBES MSCI Indices, Refinitiv Datastream, as of 31 March 2023. Past performance is not an indication of the future or likely performance. For illustration purposes only. The indices described are unmanaged and not available for direct investment. Indices used: MSCI Japan Index, MSCI Europe Index, MSCI AC Asia Pacific ex-Japan, MSCI EM Latin America Index, MSCI AC World Index, MSCI USA Index Projections, forecasts, opinions on the economy, securities markets or the economic trends of the markets are based upon information and sources believed to be reliable at time of publication and subject to change without notice. <sup>3</sup>Eastspring Investments. <sup>4</sup>Eastspring Investments, 31 March 2023. Target alpha should not be construed as a guarantee for outperformance. Tracking error is an outcome and can vary from the typical range in a more extreme market environment.

### Important information

The **MSCI Japan Index** is designed to measure the performance of the large and mid cap segments of the Japanese market. With 237 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

This Strategy Overview is to complement Eastspring capabilities. This Supplemental information provides additional analysis and summarizes an Eastspring strategy and is not an offer or solicitation for any specific securities or vehicles.

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Upside/downside capture ratio show you whether a given representative account strategy has outperformed-gained more or lost less than-a broad market benchmark during periods of market strength and weakness, and if so, by how much. Upside capture ratios are calculated by taking the representative account strategy monthly return during months when the benchmark had a positive return and dividing it by the benchmark return during that same month. Downside capture ratios are calculated by taking the representative account strategy monthly return during the periods of negative benchmark performance and dividing it by the benchmark return.

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