

## Market Environment

The Japanese equity market recovered strongly in September to close the third quarter in positive territory. The direction of risk assets was determined largely by newsflow around global trade and geopolitical developments. Reports of a resumption in US-China trade talks buoyed market sentiment and a combination of higher US interest rates and a weaker yen supported Japanese stocks. At a sector level, construction and real estate were among the strongest performers, followed by providers of consumer goods and services. Conversely, materials, commodities and communications were conspicuous laggards. In terms of style, high quality, low credit risk and low beta were the most effective factors in the third quarter. High-beta and value stocks rallied in September in response to an upturn in long-term interest rates, but underperformed over the quarter as a whole. Monetary policy developments occurred in line with market expectations, with the Bank of Japan (BoJ) opting to maintain its existing policy following rate cuts by the European Central Bank and the US Federal Reserve. Governor Haruhiko Kuroda noted that a steeper yield curve is desirable, a sentiment reflected by the BoJ's decision to reduce Japanese government bond buying on the long end.

## Fund Performance

The fund recorded positive returns and outperformed the index over the quarter, supported by strong stock selection in the wholesale trade and machinery sectors. However, selected positions in the chemicals and services sectors weighed on overall performance.

### Notable contributors

Semiconductor-related names, such as Tokyo Electron, were among the standout contributors to performance on expectations of a cyclical recovery going into 2020. The position in SMC, the leading pneumatics supplier globally in the factory automation (FA) space, also supported returns. It reported encouraging first quarter results despite a challenging macroeconomic backdrop for machinery firms.

### Nomura Research Institute outperformed

Shares in the leading Japanese management consulting and economic research firm advanced, supported by its strong first quarter results. Its earnings announcement underscored the improving profitability at its financial information technology (IT) solutions business. With multiple large projects lined up across the financial sector over the next two to three years, the outlook on future earnings appears bright.

### NOF underperformed

Shares in the speciality chemicals company declined following quarterly results that revealed a slowdown in sales of surfactants for cosmetics and anti-corrosion agents for automobiles. However, the negative price action appears excessive. The stock trades at an unwarranted discount versus peer companies, given its competitive strengths in niche markets.

## Fund Positioning

I look for companies that operate in a stable competitive environment, with high and sustainable returns on invested capital and good earnings visibility. As a result, style distribution shows a consistent growth and quality bias. At a sector level, the main overweight positions are in the electric appliances, services, machinery and wholesale trade sectors. The exposure to banks and transportation equipment remains limited, and expensive defensive sectors remain underweight.

### Key holding in Tokio Marine

Property and casualty insurer Tokio Marine is witnessing strong business growth in both its domestic and overseas operations. It is a long-term winner in the industry with the most diversified franchise globally and a solid presence in the US. The outlook remains positive given its earnings stability, capital strength and high total shareholder yield.

### Notable transactions

I bought a new holding in component maker Murata Manufacturing, whose shares trade at the lower end of its historical valuation range. The company is well positioned to benefit from structural growth in automotive and fifth-generation (5G) technologies as cyclical challenges dissipate. A new position was also added in automobile manufacturer Subaru, which occupies an attractive niche in the US market. Volumes are expected to grow through model launches, market share gains and the normalisation of production issues.

## Important Information

Past performance is not a reliable indicator of future results. The fund's returns can be affected by fluctuations in currency exchange rates.

The value of investments and any income from them may go down as well as up and an investor may not get back the amount invested. The use of financial derivative instruments may result in increased gains or losses within the fund.

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