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# Views from the Japan Equities Small Cap Desk

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## Finally the rise of value for Japanese equity small caps?

Value strategies have been more negatively impacted by the market falls caused by the coronavirus pandemic. The Russell Nomura Small Cap Value Index has lagged the growth index by 7.61%, returning -11.39% vs. -3.78% respectively year to date (source Bloomberg, 3 June 2020).

### Russell Nomura small cap value vs. growth index YTD



Source: Bloomberg, 3 June 2020

## Why have valued tilted strategies been disproportionately impacted?

- Value-biased strategies such as mine which buy undervalued stocks and wait for them to be revalued, have underperformed the broader market.
- My strategy which has exposure to cyclical and industrial sectors has been weighted down by the negative economic outlook and downward revision in earnings estimates.

## Is the growth rally sustainable?

- Sectors such as software, bio-tech, healthcare, pharma companies, e-commerce (which feature heavily in the TSE's Mothers market of tech and start-up companies) have contributed to the recovery in performance of the Russell Nomura index since Mid-March.
- This has been driven by retail inflows which have favoured sectors seen to benefit from the changes brought on by COVID-19.
- We think the valuations of certain growth stocks have reached very lofty levels. As the number of infections continue to decline and stay low, we expect market enthusiasm for these growth-related sectors to slow.

*“a broader recovery in business activities should see a closing of the valuation gap”*

*“...we are well positioned to take advantage of a revival in cyclical and industrial stock prices...”*

### **Why long-term investors may see this as the right time to allocate to unloved value stocks**

- There is no doubt that the current period has favoured growth and quality at the expense of value stocks which have been overlooked on a relative basis.
- A broader recovery in business activities should see a closing of the valuation gap.
- My approach is to target low valuation stocks which have strong fundamentals and where the potential for future earnings growth remain positive.
- It is difficult to predict the exact timing of when market sentiment will improve towards my style of investing. However, as we saw in 2008-09 when it happens the recovery in stock prices can happen very rapidly.
- Of course, this is a different scenario to the Global Financial Crisis which was a financial rather than health crisis.
- Once the worst of the health crisis is over, we expect economies to recover as we are seeing with the resumption of activity in East Asia.

### **Patience will be rewarded in time**

- With our approach of focussing on cheap stocks which have less distance to fall, we are well positioned to take advantage of a revival in cyclical and industrial stock prices when that comes.
- I see opportunities at current valuation levels to selectively add risk.
- The recovery in valuations from historically depressed levels presents an opportunity for investors who are patient and willing to withstand some volatility ahead of the eventual sustained recovery from this crisis
- We are confident that this approach will be rewarded. This could be the time to look again at value-biased strategies.

## Japan Equity Small Cap Absolute Value Strategy: Fund Philosophy

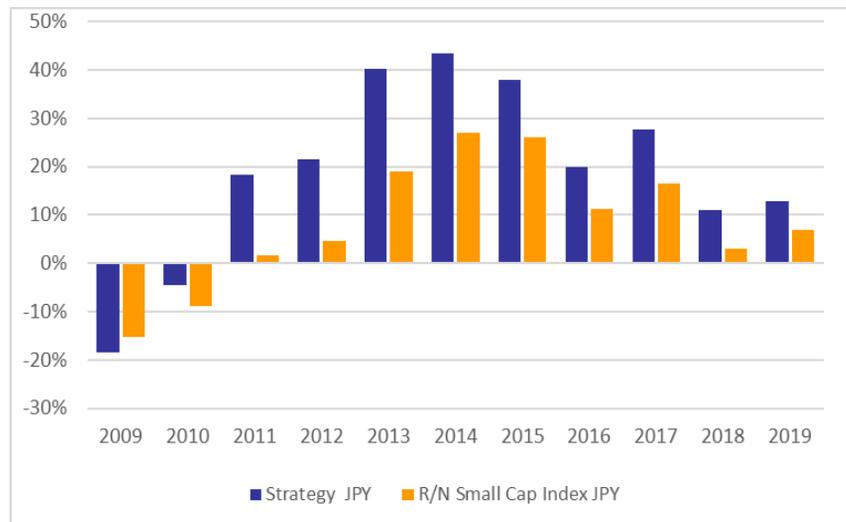
Pure bottom-up, research-driven, stock picking approach that seeks to uncover attractive small and micro-cap companies at deep discounts from their intrinsic value. Aims to deliver strong returns in the medium to long-term by focusing on company fundamentals specifically PER which we believe to be the most effective indicator for Japanese small caps.

This research driven approach sees the portfolio manager visit many hundreds of companies each year. By maintaining this value investment approach backed by extensive research, we are able to uncover companies with true earnings potential and exploit opportunities that existing within the Japan small cap market.

We typically hold a stock until the market notices and corrects the undervaluation. We can be patient and take a long-term view due to our extensive proprietary company research and the fundamentals of the companies in which we invest.

## Japan Equity Small Cap Absolute Value Strategy: long term strategy performance

### Rolling 3 year gross annualised returns to end of year (%)



Source: SMDAM, 31 December 2019. Gross of fees performance.

**Past performance is not a reliable indicator of future performance and may not be repeated. An investment's value and the income deriving from it may fall, as well as rise, due to market fluctuations. Investors may not get back the amount originally invested.**

## Tatsuro NIGAURI, CMA

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Tatsuro Nigauri is a Japanese small-cap equities manager with three decades of experience managing money based in Tokyo. He joined the firm in Oct 2002 and has managed the Japan Equity Small Cap Absolute Value strategy since its inception in 2004 and the UCITS funds since their launch in 2017. He started his career as a research analyst at the Daiwa Institute of Research in 1991. Nigauri is an award-winning manager and has received many accolades, including the Lipper Fund Awards Japan (2012, 2013 and 2016), the R&I (Rating and Investment Information) Fund Awards (consecutive years from 2012-2019) and the J Money Fund Awards (2016 and 2017).

He obtained a BA degree in economics from the University of Tokyo in Japan, and is a Certified Member Analyst of the Security Analysts Association of Japan.

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