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Views from the Japan Equities Small Cap Desk

Author

Tatsuro NIGAURI, CMA
Senior Portfolio Manager

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Value stocks impetus might signal a turning point

I pointed out in my previous column [further details can be found on the SMDAM (UK) website here] that the gap between "high days" when only growth stocks bounce back and "low days" when value stocks are relatively strong is expanding, but the situation escalated further in the last month and half. High days lasted from 6 to 12 October for 5 business days, followed by low days from 30 October to 2 November. But high days came back again on 4, 5 and 9 November. Volatility due to selective buying in the overall market continued to push individual stock prices. When Pfizer announced positive results from its current trial of the Covid-19 vaccine at night (Japan Time) on 9 November, global stock markets sharply turned "low" on the next day.

Investors worldwide bought cyclical stocks and companies that were hit by the spread of the coronavirus. On the other hand, companies that appeared to enjoy lasting high growth in the "new world" where people coexist with the virus such as IT & Services, Others declined. As a result, the gap for stock price fluctuations between value stocks and growth stocks reached historically high levels on a daily basis. The gap on 10 November this year was equivalent to those in the aftermath of the Lehman shock in 2009, the peak of the IT bubble at the end of 1999 to 2000 and the Asian crisis in 1998, all of which were big turning points for broad markets.

As I mentioned before, I adhere to value stock investments. Our performance has lagged far behind those of other investors in small-cap stocks as high days have continued since the beginning of this fiscal year. However, we could catch up part of the gap on the day. That said, I believe that stock prices overreacted to just one headline on the day.

Of course, we should welcome the news that Covid-19 vaccines have proved effective but it is only a short-term test result, and the risk of overturning the conclusions cannot be denied in the longer term. There are still many concerns apparent even to an amateur like myself such as whether the vaccines work effectively for everyone in the world, whether patients might suffer severe side effects in the future, whether we will be able to build a medical delivery system that can keep the ultralow temperature, whether the vaccines can deal with a mutation in the virus, how painful the inoculation is, and so on and so forth.

Therefore, I think we should regard the surge on the day as a reaction to excessive rallies of growth stocks for nearly three years. After investors continuously but selectively bought those that are deemed growth stocks from 2018, the price gap between growth stocks and value stocks reached a historical level with investors searching for the timing of a reversal. The positive result of the vaccine trial might have served as a catalyst for the reversal.

Sumitomo Mitsui DS Asset Management

When we look back on the market movements from July onward, we often experienced sharp “low days” but “high days” came in the next week with growth stocks outperforming the others in a month’s time. However, this time, the stock price fluctuation gap between growth stocks and value stocks was on November 10 at a historical level, and one that is not easy to narrow. Looking back on 2000 and 2009 when value stocks recovered their lost ground, both phases presented a turning point for the market. The latest low day might also follow suit.

With regard to cyclical stocks, their earnings results went above their expectations. The number of companies that upgraded their earnings forecasts for the July-September quarter far exceeded those that downgraded them, with many of them already regaining normal earnings levels. They could achieve this recovery because the resurgence of serious infection is under control in East Asia including Japan while manufacturers in Europe are enjoying earnings recoveries even with the serious growth of infection. In particular, I feel many small-cap auto parts stocks are too cheap given the extent of their earnings recoveries.

With regard to “new world”-related stocks that suffered sharp declines on 10 November, I consider those that enjoyed only limited upturns during the pandemic despite sharp earnings recoveries as attractive investments. For example, home improvement centres and electronic comic providers look attractive. Even if the distribution system for mass inoculation of effective vaccines is prepared with the resumption of free human exchange, I do not believe that people will give up the comfort of home life including the pleasure of reading manga (Japanese comics) on the smartphone after having invested a good deal of time and effort in them.

Source: Based on article by Tatsuro NIGAURI, published in The Nikkei Online Edition on 21 November 2020

Tatsuro NIGAURI, CMA
Senior Portfolio Manager, Japan Equity Small Cap Absolute Value

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.

NOTE: Daiwa SB Investments Ltd. (DSBI) merged with Sumitomo Mitsui Asset Management Company, Limited (SMAM) on 1 April 2019.

Disclosures

Contact Details

Business Development and Client Relations	
Takahiro UENO	+44 (0)20 7507 6431
Jennifer SANDS	+44 (0)20 7507 6424
Email: uksales@smd-am.co.jp	

Sumitomo Mitsui DS Asset Management (UK) Limited
5 King William Street, London, EC4N 7DA
United Kingdom
www.smd-am.co.uk