QuotedData
BY MARTEN & CO

INTERNATIONAL

JPMorgan Japanese Investment Trust

Investment companies | Update | 9 December 2020

Strength to strength

QuotedData's initiation note on JPMorgan Japanese Investment Trust (JFJ) focused on the trust's performance record relative to its benchmark and competing trusts. Over the past few months, it has extended this record. In addition, JFJ's discount has narrowed significantly, further boosting returns to shareholders.

JFJ's managers are optimistic about the future for Japan and the trust. A new Prime Minister is pushing the digitalisation of Japan's economy. COVID-19 has accelerated much structural change in Japan, to the benefit of JFJ's portfolio, which is focused on areas of growth such as the internet, automation and healthcare.

The managers believe that JFJ is positioned to go from strength to strength.

Capital growth from Japanese equities

JFJ aims to produce capital growth from a portfolio of Japanese equities and can use borrowing to gear the portfolio within the range of 5% net cash to 20% geared in normal market conditions.

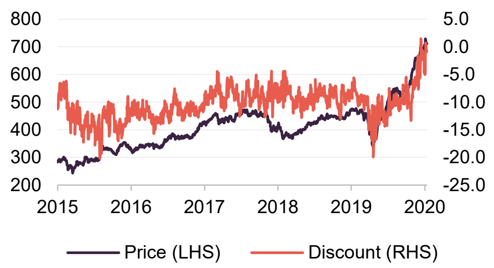
12 months ended	Share price total return (%)	NAV total return (%)	TOPIX total return (%)	MSCI ACWI total return (%)
30/11/2016	17.5	17.7	23.9	24.9
30/11/2017	30.8	26.3	17.0	15.0
30/11/2018	(1.1)	(0.6)	(0.6)	5.1
30/11/2019	13.7	12.1	6.9	12.1
30/11/2020	51.2	46.6	7.7	11.4

Source: Morningstar, Marten & Co

Sector	Japan
Ticker	JFJ LN
Base currency	GBP
Price	712.0p
NAV	718.2p
Premium/(discount)	(0.9)
Yield	0.7%

Share price and discount

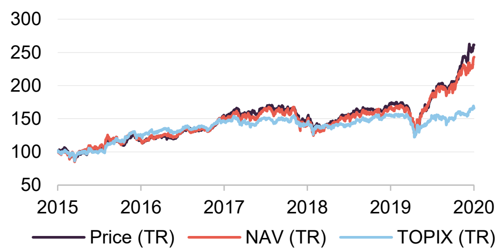
Time period 30/11/2015 to 08/12/2020



Source: Morningstar, Marten & Co

Performance over five years

Time period 30/11/2015 to 30/11/2020



Source: Morningstar, Marten & Co

Contents

Domicile	England & Wales
Inception date	2 August 1927
Manager	Nicholas Weindling Miyako Urabe
Market cap	£1,137.2m
Shares outstanding	159,714,078
Daily vol. (1-yr. avg.)	334,493
Net gearing	14.7%

Click here for our most recent update note

Click here for an up to date JFJ factsheet

Click here for JFJ's peer group analysis

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Results for year ended 30 September 2020

33 percentage points outperformance of the benchmark index

Over the trust's financial year, JFJ generated a return on NAV of 35.0% and a return to shareholders of 41.8%. This contrasts with a return of just 2.0% for the trust's benchmark – the Tokyo Stock Exchange First Section Index (TOPIX) (all in total return terms). JFJ's returns have been helped by its gearing, which stood at 14.7% at the end of October 2020.

Tighter discount

The discount narrowed from 11.4% at the end of September 2019 to 7.0% at the end of September 2020. The trust carried out a modest level of share buybacks.

Higher dividend

The trust's dividend was upped from 5.0p to 5.1p and this was covered by earnings of 5.2p. Income is a by-product of the investment approach and stocks are not held for the dividend yield. The board aims to pay out the majority of the revenue available each year.

Lower charges

The ongoing charges ratio fell to 0.65% from 0.68%, aided by rising net assets, which surpassed £1bn for the first time in the trust's history. The ratio falls as fixed costs are spread over a wider base.

The trust's good performance has continued since the period end, as we discuss on page 12. The discount has narrowed further, with the shares trading briefly on a premium in November 2020.

Japan appears to have coped with COVID-19 relatively well

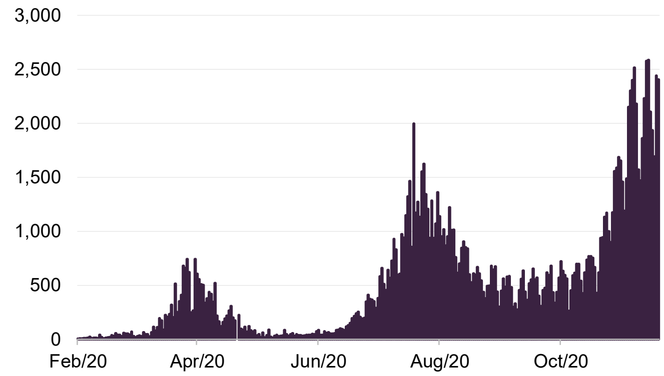
Figure 1: TOPIX Index year to date (4 December 2020)

Source: Morningstar, Marten & Co

Japan succeeded in controlling the virus reasonably well

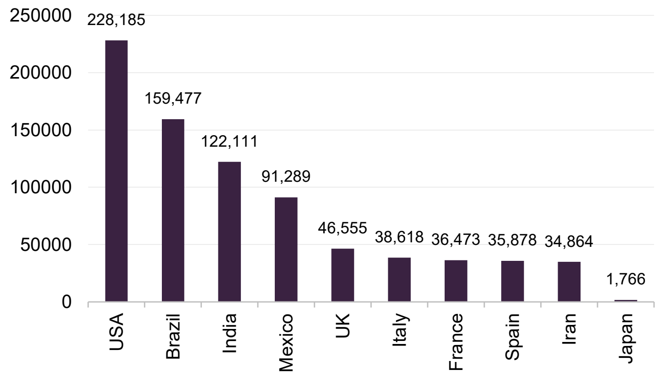
COVID-19 has had a significant influence on the global economy over 2020. In Japan, in common with many other countries, the number of cases appears to have picked up over the last few months. However, when compared against other countries, in terms of the infection, Japan's experience of COVID-19 has been relatively benign. It ranks 49th in terms of attributable deaths according to statistics from the World Health Organization, and 132nd of 193 countries in terms of deaths as a percentage of its population.

Figure 2: Japan COVID-19 cases



Source: Ministry of Health, Labour and Welfare

Figure 3: Deaths by country to end November



Source: World Health Organization

The country's relative success in tackling the outbreak may have been due in part to travel restrictions and lockdown measures imposed on the country. JFJ's managers, Nicholas Weindling and Miyako Urabe, note that the pandemic pushed the country into a record slump in the second quarter of 2020 (an 8.2% fall in GDP) as these measures took effect.

Japanese companies are very well capitalised, with over half having net cash on the balance sheet at the end of March 2020, and this may have worked in their favour. As restrictions were eased, the economy recovered, helped by rising exports and increased private consumption (GDP rebounded by 5.0% over Q3).

COVID-19 has accelerated structural trends

The managers note that, despite being perceived as a high-tech country, Japan lags many of its peers in surprising ways. They cite examples such as the relatively low percentage of online sales, low penetration rates for cloud-based software, the prevalence of cash within the economy, the use of fax machines and – particularly relevant to top-10 holding Bengo4.com (see page 10) – the use of physical ink stamps to certify documents.

Prime Minister Yoshida Suga is keen to increase the digitalisation of Japan's economy

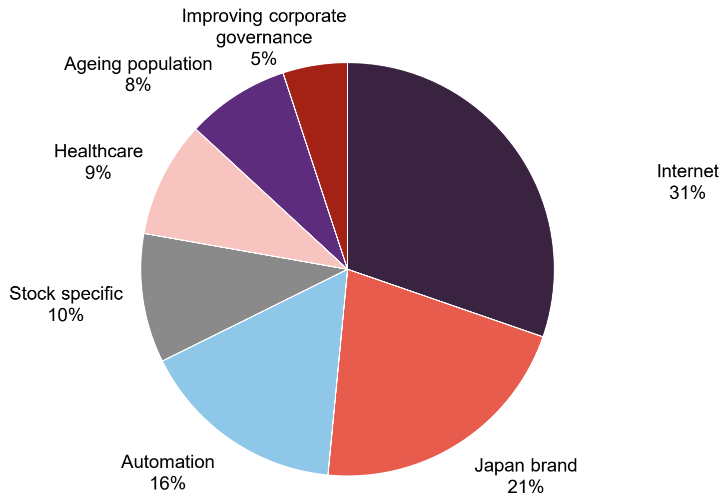
The managers think that COVID-19 is forcing change upon businesses, accelerating the adoption of new technologies. It may be helped in this by Japan's new Prime Minister Yoshida Suga. He took on the role in August this year, following the resignation of Shinzo Abe. Suga was chief cabinet secretary under Abe and this gives the managers comfort that there will be no dramatic shift in economic policy. However, Suga is keen on streamlining government with increasing use of digital technologies. Another of his signature policies is to cut mobile phone bills, which are relatively high. Japan ranks well-below the UK and US in the penetration of smartphones. It is also lagging behind the UK, US and China in the rollout of 5G (an area where its neighbour Korea ranks as no.1, based on data from Omdia).

Investing in the new Japan

Readers who want more information on the investment approach should refer to page 6 of our initiation note

We highlighted in our initiation note that JFJ's portfolio is focused on sectors that could be described as the 'new Japan'. We have updated Figure 4 (which shows the spread of investments on that basis, as at 31 October 2020).

Figure 4: JFJ portfolio breakdown by theme as at 31 October 2020



Source: JPMorgan Japanese Investment Trust

Examples of stocks that make up these themes include CyberAgent within internet, Nintendo within Japan Brand (see page 9) and Keyence within Automation, the trust's largest holding, which was discussed in our previous note (see page 11 of that note).

CyberAgent has a media-streaming business and also offers online betting, blogging, online advertising and mobile phone gaming. It could be a beneficiary if the cost of data was cut for mobile phone users.

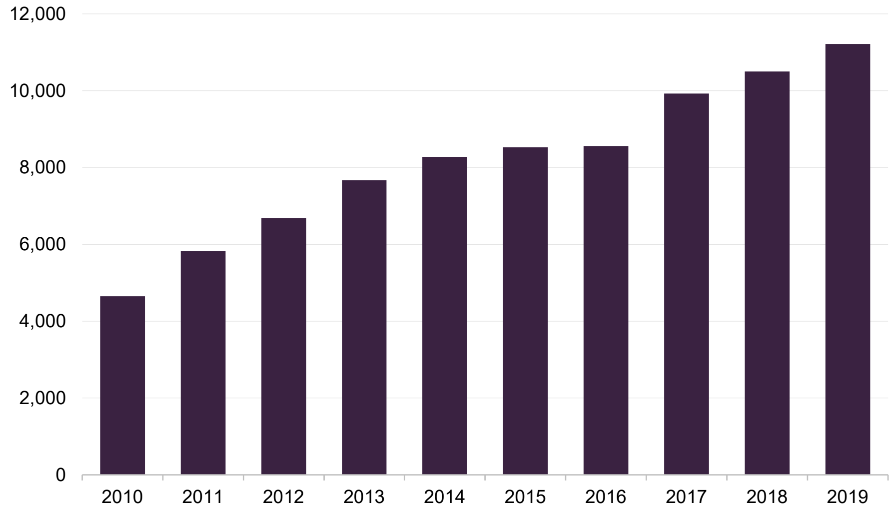
The need for automation

Japan's demographics mean that its workforce is shrinking. One solution is to increase automation. Japan has responded and emerged as a global leader in this area.

The theme is represented within the portfolio by stocks such as Keyence, Misumi and SMC.

Japan is far from unique in having an ageing workforce – much of Europe is affected by this problem. Even China's working-age population is already shrinking. Chinese manufacturers also have to contend with rising wage costs, as is illustrated in Figure 5.

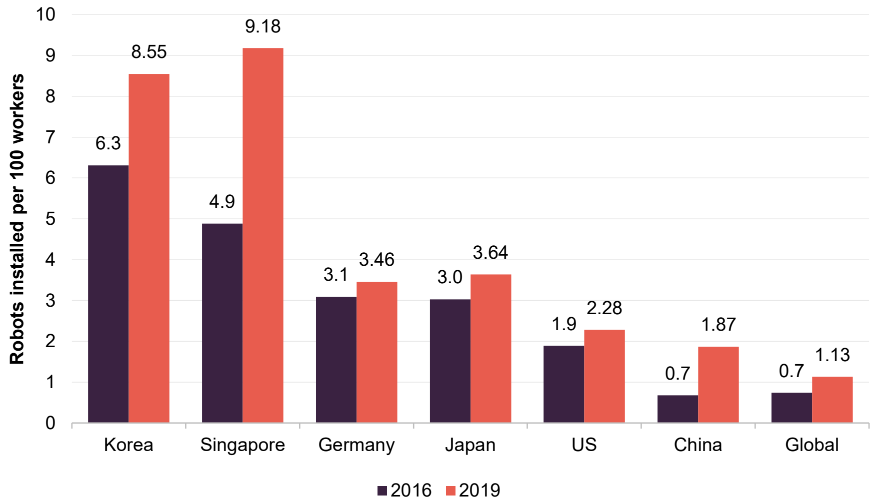
Figure 5: Chinese average manufacturing wages in US dollars



Source: National Bureau of Statistics of China, Bloomberg

China is one of the fastest-growing end markets for Japan's automation companies.

Figure 6: Robot density in manufacturing



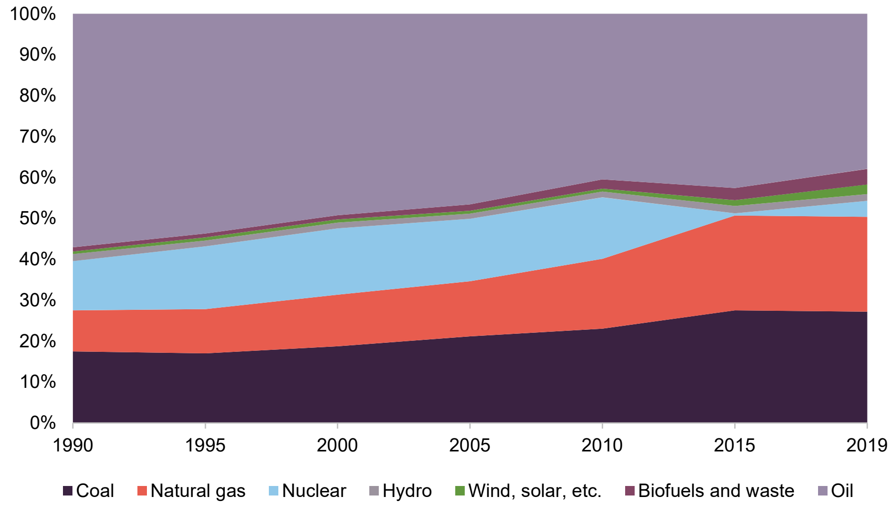
Source: International Federation of Robotics

Potential new theme? – Renewable energy

In a recent interview that we did with Nicholas Weindling, he highlighted Japan's energy generation problems. Where there is a problem, there could be an opportunity, and he is looking at the potential for renewable energy in Japan.

Japan has few natural resources and imports most of its fossil fuels. The generation mix was highly dependent on nuclear (about 30% of supply in 2011, from 54 reactors) but, after the Fukushima disaster, sentiment turned against the industry. Just nine reactors at five plants are currently in operation, out of a possible 39 that are operable. Nicholas does not believe many, if any, of the remaining reactors will be switched back on.

Figure 7: Japan generation mix by fuel



Source: IEA World Energy Balances 2020

When nuclear generation was curtailed, the slack was taken up largely by coal and gas. Nicholas thinks that Japan is likely to fail to meet its own objectives on curbing greenhouse gas emissions.

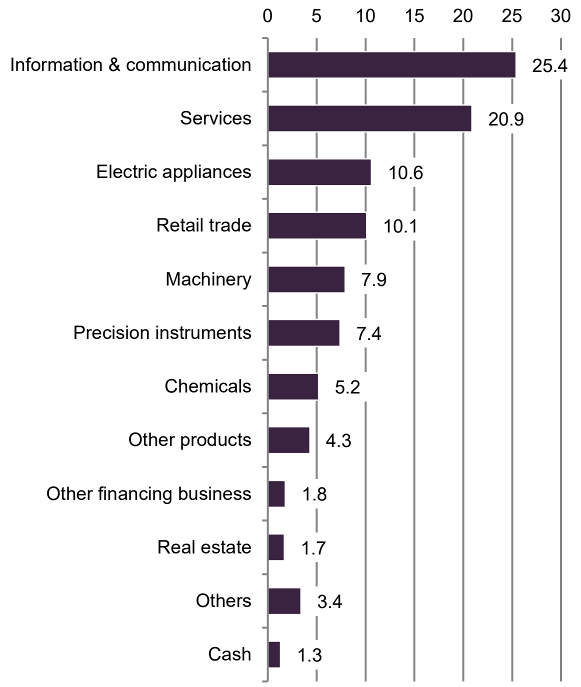
However, the managers point out that Japan has immense renewable energy potential in terms of onshore and offshore wind, solar and geothermal. There are hopes that a policy review currently underway will find ways of boosting renewable energy production.

Asset allocation

At the end of October 2020, there were 66 holdings in the portfolio, four more than when we last wrote. New additions to the portfolio are covered on page 10.

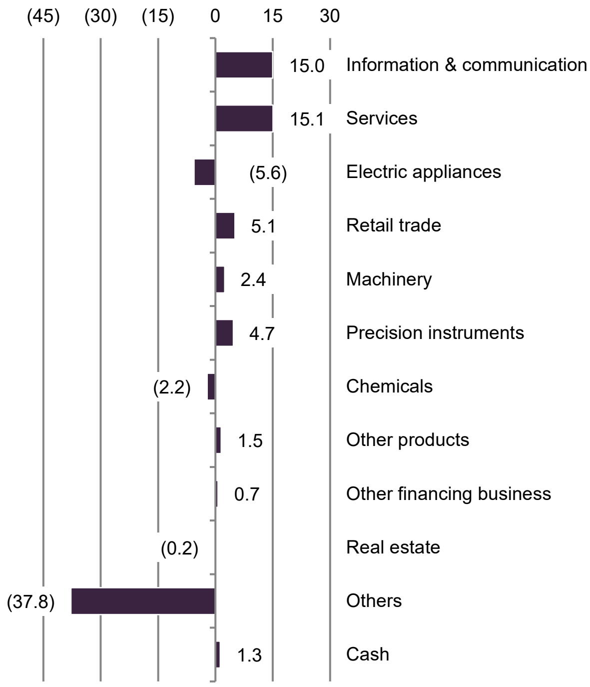
Sector weights are driven by stock selection, but they reflect the portfolio's bias to the 'new' Japan and the absence of exposure to sectors such as pharmaceuticals, transportation equipment and banks.

Figure 8: JFJ portfolio breakdown by sector 31 October 2020



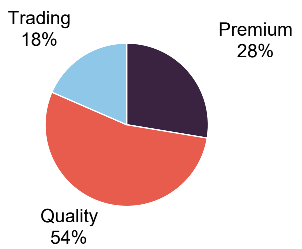
Source: JPMorgan Asset Management

Figure 9: JFJ sector weight relative to weight in benchmark 31 October 2020



Source: JPMorgan Asset Management

Figure 10: Split by investment type



Source: JPMorgan Asset Management

Figure 11: JFJ portfolio characteristics as at 31 October 2020

	Portfolio	Benchmark
12-month forward price/earnings ratio	36.2x	17.4x
Return on equity	14.2%	9.3%
Five-year expected earnings growth	17.0%	8.5%

Source: JPMorgan Asset Management

The bias to growth and quality results in a portfolio that trades on a higher-than-average price/earnings multiple than the benchmark, but offers the prospect of higher returns on equity and faster earnings growth rates.

Top 10 holdings

Figure 12: JFJ's 10-largest holdings as at 31 October 2020

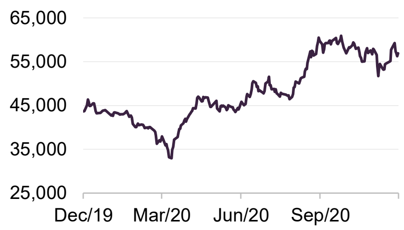
Stock	Sector	Portfolio weight 31 Oct 2020 (%)	Portfolio weight 30 Jun 2020 (%)	Change (%)
Keyence	Electric appliances	5.5	5.9	(0.4)
Hoya	Precision instruments	4.6	4.6	-
MonotaRO	Retail trade	4.3	3.9	0.4
M3	Services	3.7	3.4	0.3
OBIC	Information & communication	3.4	4.0	(0.6)
Nintendo	Other products	3.3		
Nihon M&A Center	Services	3.2	3.5	(0.3)
Bengo4.com	Services	3.2		
Hikari Tsushin	Information & Communication	2.9	3.1	(0.2)
Fast Retailing	Retail trade	2.8	3.5	(0.7)
Total		36.9		

Source: JPMorgan Asset Management

Over the few months between end June (the data available when we last published) and end October, the composition of JFJ's list of its 10-largest holdings has not changed much. Chemical company Kao and electrical appliance company Tokyo Electron both fell out of the list in October but were still held within the portfolio. The manager has been taking profits on the trust's positions in Kao and Fast Retailing (the owner of Uniqlo). Nintendo and Bengo4.com, which were just outside this list when we last published, have moved up to replace them on the back of strong performance.

We covered many of these companies in our last note (see page 11 of that note). Looking at the two new entries:

Figure 13: Nintendo



Source: Bloomberg

Nintendo

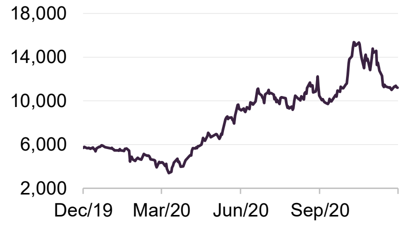
Nintendo is one of the world's largest computer games companies, with strong and longstanding character brands such as Mario, Pokémon and Zelda, as well as newer products such as Animal Crossing.

The managers believe that the company is becoming more profitable as the emphasis for consumers switches from buying physical cartridges and discs to downloading games. Nintendo is exploiting the value within its brands by moving into areas such as theme parks.

Nintendo has a strong balance sheet with over $10bn in net cash. The managers think that some of this could be returned to shareholders.

Nintendo's half-year results, covering the six months ended 30 September 2020, show net sales rising by an impressive 73.3% year-on-year, translating into an almost 250% increase in net profit. Sales of Nintendo Switch consoles were a significant contributor to these results, but digital sales are rising as a percentage of the whole.

Figure 14: Bengo4.com



Source: Bloomberg

Bengo4.com

Bengo4.com offers online legal services and helps put customers in touch with lawyers. It also offers Cloud Sign Store DX (a service similar to DocuSign), which has seen a huge take-up in its service as COVID-19 restrictions have put barriers in the way of physical contracts.

Traditionally, Japanese contracts have been authenticated using hanko – physical ink stamps. CloudSign replaces this and has taken an 80% market share, but this represents just 1% of contracts. This suggests that there is room for significant growth.

Investment activity

Recent new holdings for the trust include: Z Holdings, HENNGE, AS ONE Corporation, Medley, and Yamashin Filter.

Figure 15: Z Holdings

Source: Bloomberg

Z Holdings

Z Holdings, formerly Yahoo Japan, began as a joint venture between Yahoo and SoftBank. It has a search engine operation (Yahoo Japan), online marketplaces PayPay Mall (said to be the world's second-largest, behind Amazon) and PayPay Flea Market (for the sale of second-hand items), an associated e-payments business, and an online media business. It also recently acquired a messaging app, Line, to help boost its position in m-commerce.

HENNGE

HENNGE is a cloud security business. The growth of home-working in the face of the pandemic has turbo-charged its sales growth. Total sales grew by over 21% year-on-year for the three months ended 30 September 2020 and profits for its 2020 financial year are forecast to be over 125% higher than the previous year.

AS ONE Corporation

AS ONE supplies laboratory equipment from a catalogue of over 75,000 items. It is shifting its business from physical catalogues to its own ecommerce platform as well as selling through third-party platforms such as Amazon and MonotaRO (a JFJ holding, discussed in our last note).

Figure 16: Medley

Source: Bloomberg

Medley

Medley is an internet company operating in the health care sector in the fields of telemedicine and online pharmacy, as well as medical recruitment (competing in some areas with M3). The company is growing rapidly – sales for the nine months ended 30 September 2020 were 42% ahead of those for the equivalent period in 2019. In April, in response to the COVID-19 crisis, the Ministry of Health, Labour and Welfare issued a guidance statement temporarily allowing the use of telemedicine for patients receiving initial medical examinations. The new administration under Prime Minister Suga is considering making these temporary measures permanent, as a part of its measures to promote Japan's digital transformation.

Yamashin Filter

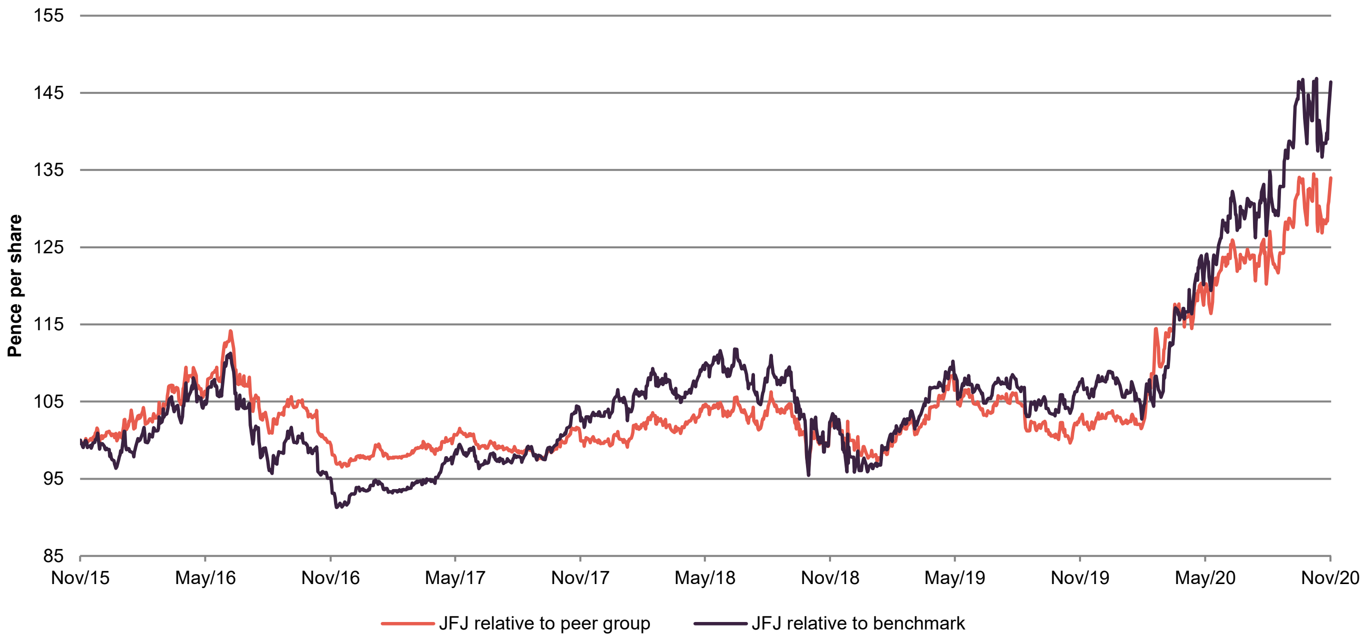
Yamashin Filter makes filters for a range of end markets, including for use in the construction machinery industry (where it is making inroads into the Chinese market), industrial filters and process filters. In response to COVID-19, it also now makes air filters for masks, which are sold into the domestic Japanese market.

Sales

The manager has sold the trust's positions in cosmetics company Shiseido and SoftBank Group.

Performance

Figure 17: JFJ performance relative to benchmark and peer group [1]



Source: Morningstar, Marten & Co. Note 1) peer group is defined on page 13

Figure 18: Cumulative total return performance over periods ending 30 November 2020

	1 month	3 months	6 months	1 year	3 years	5 years
JFJ share price	11.2	29.3	41.8	51.2	70.0	161.2
JFJ NAV	9.8	25.2	30.5	46.6	63.4	142.9
Benchmark	7.9	11.6	8.4	7.7	14.4	65.9
Peer group[1]	8.6	15.5	15.5	12.5	21.9	81.3

Source: Morningstar, Marten & Co. Note 1) peer group defined on page 13

JFJ has had a particularly strong 2020 both relative to its benchmark and its peer group, as is evident in Figures 17 and 18.

Analysis performed by the manager suggests that, as was the case when we last published, relative to the trust's benchmark over the 10 months of 2020, stock selection continues to drive returns.

Figure 19: JFJ's positive contributions to relative returns over 10 months ending 31 October 2020

Stock	Relative weight (%)	Stock return (%)	Impact (%)
M3	3.94	127.0	3.51
MonotaRO	3.81	111.7	3.44
Bengo4.com	2.25	156.5	2.73
Nihon M&A Center	3.27	73.9	2.29
Keyence	5.06	31.4	1.57

Source: JPMorgan Asset Management

M3, the operator of the Ask Doctors website, continues to be the largest positive contributor to JFJ's performance this year (as it was when we last published). Bengo4.com had a particularly strong October and this pushed it up into this table.

Figure 20: JFJ's negative contributions to relative returns over 10 months ending 31 October 2020

Stock	Relative weight (%)	Stock return (%)	Impact (%)
SoftBank Group	(0.48)	16.6	(0.74)
Shiseido Company	1.57	(27.0)	(0.66)
Sony Corporation	(2.14)	25.5	(0.60)
Tokio Marine Holdings	1.63	(16.3)	(0.59)

Source: JPMorgan Asset Management

The managers have sold JFJ's positions in both SoftBank and Shiseido since we last published. Softbank has been beset by problems with WeWork, the hit that its stake in Alibaba took from the cancellation of the Ant Financial IPO, and volatility with the valuation of its stake in the Vision Fund. The managers felt uncomfortable with the company's valuation and sold JFJ's holding, but the share price continued to climb.

Shiseido has been hurt by the loss of sales at airports. However, the managers say that it also faces increased competition from Chinese companies and this was the trigger for the disposal of JFJ's stake.

Peer group

QuotedData has up-to-date information on JFJ and its peer group

For the purposes of this note we have used the constituents of the AIC Japan sector as a peer group. The trusts listed here have roughly similar objectives except for CC Japan Income & Growth, which – as its name implies – places more emphasis on income generation and consequently has the highest yield. By contrast, JFJ's growth focus puts its yield towards the bottom end of the peer group.

Figure 21: JFJ's peer group comparison data as at 4 December 2020

	Discount (%)	Yield (%)	Ongoing charges (%)	Market cap £m
JPMorgan Japanese	(0.4)	0.7	0.65	1,147
Aberdeen Japan	(10.0)	1.5	1.04	100
Baillie Gifford Japan	2.5	0.4	0.68	941
CC Japan Income & Growth	(10.8)	3.3	1.06	182
Fidelity Japan	(5.2)	0.0	0.97	290
Schroder Japan	(13.0)	2.5	0.92	241
Peer group median	(10.0)	1.5	1.0	241
JFJ rank	2/6	4/6	1/6	1/6

Source: Morningstar, Marten & Co

JFJ's ongoing charges ratio has fallen again this year (to 0.65% from 0.68%), putting it first in its peer group on this measure. The discount has tightened since we last published (see next section).

Figure 22: Cumulative NAV total return performance over periods ending 30 November 2020

	1 month	3 months	6 months	1 year	3 years	5 years
JPMorgan Japanese	9.8	25.2	30.5	46.6	63.4	142.9
Aberdeen Japan	9.5	17.3	15.1	21.6	22.7	66.1
Baillie Gifford Japan	8.4	19.4	21.9	20.5	33.5	117.7
CC Japan Income & Growth	9.5	12.2	10.2	(2.7)	6.8	n/a
Fidelity Japan	7.9	18.3	24.4	24.0	47.6	139.2
Schroder Japan	9.0	11.8	8.2	0.4	1.4	46.0
Peer group median	9.0	17.3	15.1	20.5	22.7	91.9
JFJ rank	1/6	1/6	1/6	1/6	1/6	1/5

Source: Morningstar, Marten & Co

JFJ is the best-performing trust in its sector over all time periods in Figure 19.

Discount

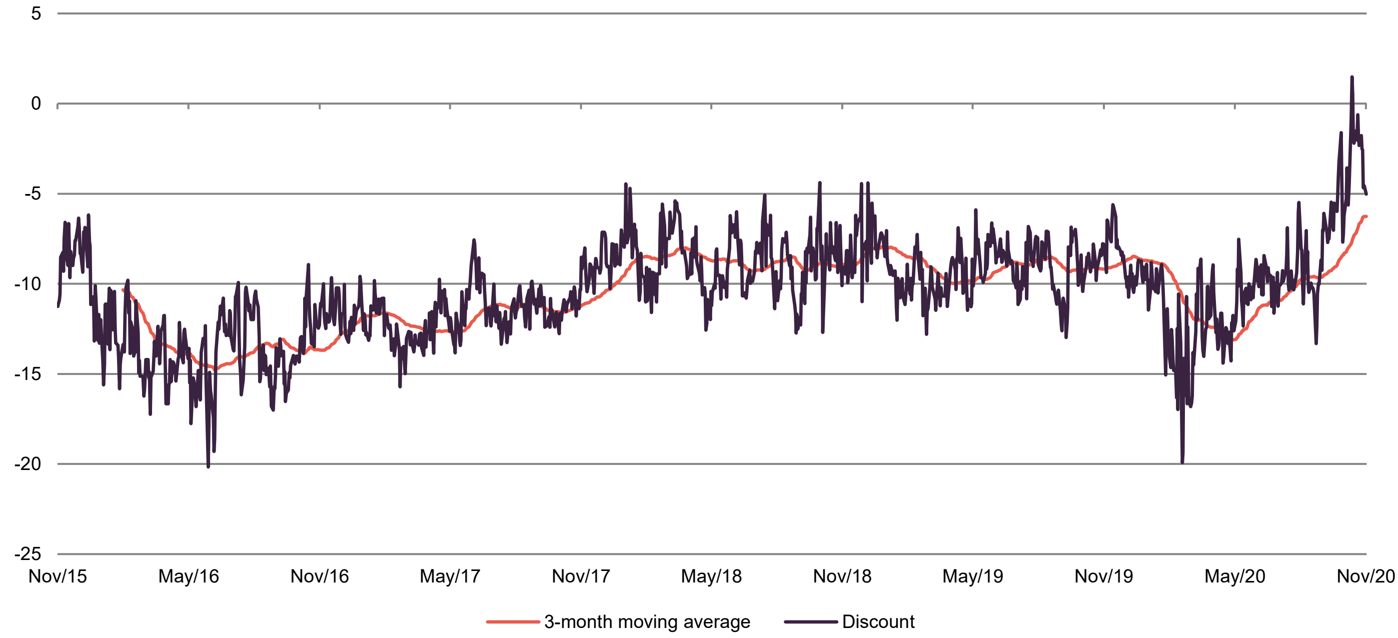
Over the year to the end of November 2020, JFJ's discount moved within a range of 19.9% (coinciding with the peak of investors' concern about the severity of the pandemic) to a 1.5% premium and averaged 9.6%. At 8 December 2020, the discount was 0.9%.

> The shares are now trading close to asset value, having traded at a premium for the first time since 2006

The board monitors the discount closely and has stepped up efforts to market the trust and authorised share buy backs – 649,000 shares have been repurchased into treasury since we published our initiation note on 9 September 2020. The shares are now trading close to asset value, having traded at a premium for the first time since 2006.

Each year at the AGM, the board puts forward resolutions that permit the company to issue new shares, reissue shares from treasury and repurchase shares for cancellation or to be held in treasury. The board has stated that shares held in treasury would only be reissued at a premium to NAV.

Figure 23: JFJ discount over five years ended 30 November 2020



Source: Morningstar, Marten & Co

Fund profile

Further information about the trust is available at www.jpmjapanese.co.uk

JPMorgan Japanese Investment Trust (JFJ or the trust) aims to achieve capital growth from investments in Japanese companies. For performance monitoring purposes, the trust is benchmarked against the returns of the Tokyo Stock Exchange First Section Index (commonly known as TOPIX) in sterling.

The trust makes use of both long- and short-term borrowings to increase returns.

Day-to-day investment management activity is the responsibility of JPMorgan Asset Management (Japan) Limited in Tokyo. The co-investment managers are Nicholas Weindling, who has had responsibility for JFJ's portfolio for more than a decade, and Miyako Urabe, who was appointed co-manager in May 2019. They are supported by a well-resourced team.

High-quality companies that are capable of compounding their earnings sustainably over the long term

The investment emphasis is on identifying high-quality companies that are capable of compounding their earnings sustainably over the long term. That means investing in companies in growing industries that have strong balance sheets and are resilient in the face of macro-economic issues.

The managers recognise that JFJ's performance may lag its benchmark in periods of market exuberance, triggered by an uptick in growth prospects, for example. Q4 2018 and H2 2016 were periods of underperformance for this reason. However, the managers prefer to focus on identifying attractive stocks rather than attempting to time markets. Similarly, the trust's gearing level is driven by availability of attractively priced stocks, not by macroeconomic considerations.

Benefitting from local knowledge

Well-resourced local presence

The investment team is based in Tokyo, where JPMorgan has had an office since 1969. Nicholas says that it is now relatively unusual for non-domestic asset managers to have a physical presence in Japan. Visiting companies is an integral part of the team's investment process.

The team is 25-strong and is a mix of fund managers and analysts – roughly half and half. In addition, one of the strengths of the business is that the managers can also draw on the expertise of JPMorgan's analytical teams around the world. This helps with competitive analysis, for example – it can also help identify trends on which Japan is behind the curve.

Previous publications

Readers may wish to read our initiation note – *Number one over three years* – published in September 2020.

QuotedData

BY MARTEN & CO

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