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BY MARTEN & CO

INVESTOR

JPMorgan Japanese Investment Trust

Investment companies | Update | 24 May 2021

Medium-term outlook undimmed

JPMorgan Japanese Investment Trust (JFJ) performed exceptionally well last year. However, as our last update note warned, in periods of market exuberance, JFJ's performance may lag its benchmark.

Over the past couple of quarters, investors have become more excited about the prospects of post-COVID economic recovery in Japan and globally. As lower quality stocks have bounced, JFJ has given up some of its considerable outperformance relative to its benchmark, TOPIX, in recent months. Nevertheless, the managers remain enthused about the medium-term prospects for JFJ's portfolio and are committed to their stance of backing the 'new Japan'.

Sector	Japan
Ticker	JFJ LN
Base currency	GBP
Price	615.0p
NAV	637.8p
Premium/(discount)	(3.6%)
Yield	0.8%

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

Short-term underperformance as market sentiment shifts in favour of companies expected to benefit from a recovery in economic activity

The trend towards improving corporate governance is now so ubiquitous that it no longer merits a separate investment theme

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.

Contents

Domicile	England & Wales
Inception date	2 August 1927
Manager	Nicholas Weindling Miyako Urabe
Market cap	£982.2m
Shares outstanding (exc treasury shares)	159,714,078
Daily vol. (1-yr. avg.)	346,235
Net gearing	14.9%

Click here for our most recent update note

Click here for an updated JFJ factsheet

Click here for JFJ's peer group analysis

Click here for links to share trading platforms

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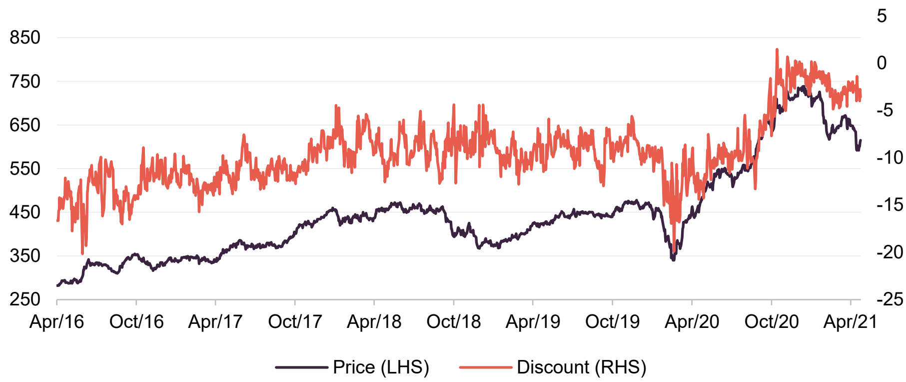
At a glance

Share price and discount

The board monitors the discount closely and has stepped up efforts to market the trust and has authorised share buy backs when necessary.

Last year's strong absolute and relative performance has also helped drive a narrowing of the discount.

Time period 30/04/2016 to 21/05/2021

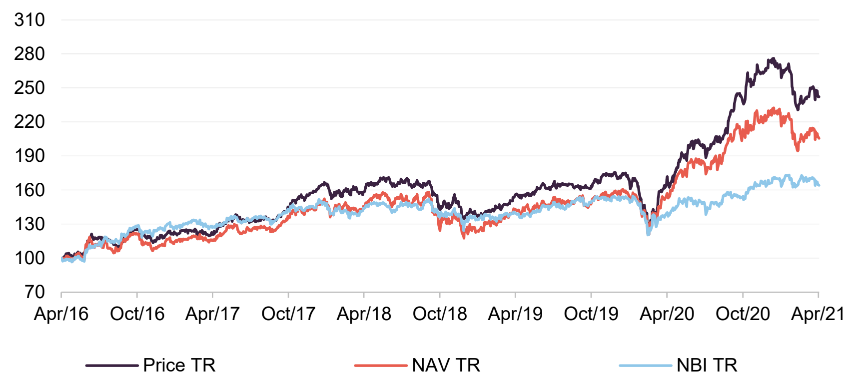


Source: Morningstar, Marten & Co

Performance over five years

Despite the short-term setback, JFJ's longer-term numbers remain strong; it has outperformed its benchmark by a cumulative 24.8% over three years, 45.1% over five years and 135.3% over ten years.

Time period 30/04/2016 to 30/04/2021



Source: Morningstar, Marten & Co

Year ended	Share price total return (%)	NAV total return (%)	TOPIX total return (%)	MSCI ACWI total return (%)
30/04/2017	20.8	15.2	26.9	30.4
30/04/2018	31.2	26.2	13.4	7.2
30/04/2019	(1.5)	(2.0)	(3.2)	11.0
30/04/2020	8.4	8.3	(0.0)	(1.8)
30/04/2021	43.1	33.3	17.9	32.8

Source: Morningstar, Marten & Co

Results for the six months ended 31 March 2021

Short-term underperformance as market sentiment shifts in favour of companies expected to benefit from a recovery in economic activity.

Over the six-month period ended 31 March 2021, JFJ provided a sterling adjusted NAV return of 0.5%, versus a return on its TOPIX index benchmark of 8.5%. However, JFJ's longer-term numbers remain strong; it has outperformed its benchmark by a cumulative 24.8% over three years, 45.1% over five years and 135.3% over ten years. Since 31 March 2021, the NAV has decreased by 6.5% (as at 18th May 2021), compared -3.6% for the benchmark and -6.4% for the share price.

JFJ's absolute performance over the period was driven in part by sterling strengthening against the yen by 12.1%. The policy remains not to hedge the currency.

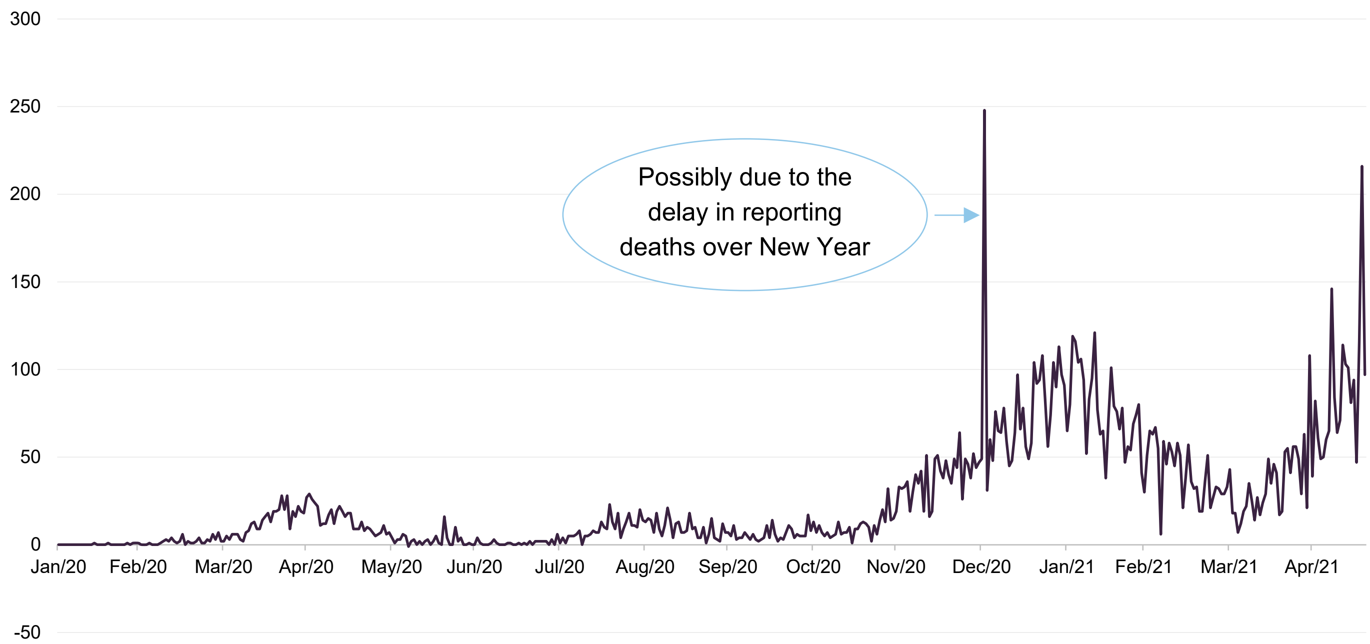
As usual, no interim dividend is planned.

The managers believe that market sentiment has been shifting in favour of companies that might be expected to benefit from a recovery in economic activity facilitated by the rollout of vaccination programmes. However, in Japan's case, there is much more work to do on this front.

Lagging the world on vaccinations

While case numbers and deaths have been accelerating recently, relative to many other countries, Japan has fared fairly well on these scores, with a cumulative 11,900 deaths since the start of the crisis (19 May 2021).

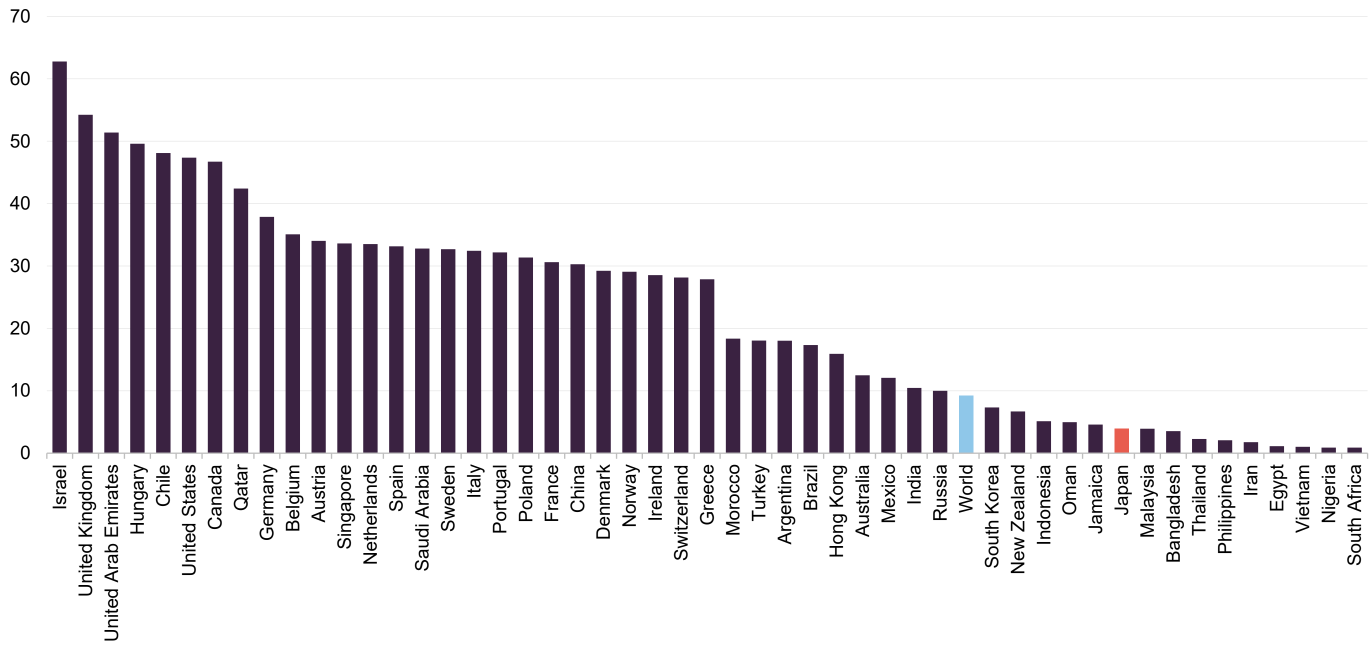
Figure 1: Japan daily deaths recorded following a positive COVID test



Source: Our world in data

Where the government has fallen down, however, is in the rate of vaccination within the country. As Figure 2 shows, Japan is lagging a long way behind on this measure.

Figure 2: Percentage of people who have had at least one vaccination by country



Source: Our world in data. Note data for Saudi Arabia, China and Australia is number of vaccinations carried out per 100 of the population and may overstate the percentage of people who have had at least one vaccination.

> Olympics under threat – there may be some political fallout

One upshot of this is to put the Tokyo Olympics in doubt, creating the potential for a public relations disaster for the government if they are cancelled at a late date.

The managers are not unduly worried about the potential political fallout from this. First, the Liberal Democratic Party retains its stranglehold on Japanese politics and, as the recent transition from Prime Minister Abe to Suga illustrated, any new leader would be unlikely to have much impact on policy. Second, JFJ's portfolio has a long-term focus and the potential short-term fillips, for example from increased tourism, around the games are of limited consequence.

Low-quality surge is likely to be temporary

JFJ's managers say that many of the gains achieved by the relatively low-quality companies that have resurged recently may be short lived. For example, they comment that the share prices of department store operators have benefited from an anticipated surge in custom, as consumers seek to satisfy many months of unmet demand for household goods and personal items. However, the trend for these businesses is still one of long-term structural decline. Japan's adoption of online shopping may be behind that of comparable countries, but consumers are expected to embrace this.

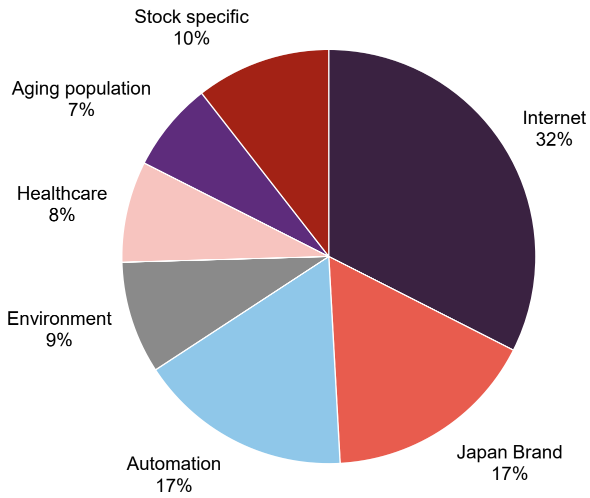
Maintain focus on the new Japan

The managers continue to position the portfolio to take advantage of a number of themes that should benefit from the modernisation of Japan's economy. These include companies that can take advantage of the country's belated adoption of digital technology. Examples cited are companies supporting cashless payments, digital signatures, remote healthcare services, remote working, automation, and cloud data storage.

New 2050 net zero emissions target

In addition, in October 2020, Prime Minister Suga committed Japan to achieving net zero emissions and carbon neutrality by 2050. To achieve this, Japan must decarbonise its power generation sector away from coal and gas. Renewable energy is an emergent theme within the portfolio but an increasingly important one.

Figure 3: Structural growth themes within the portfolio at 31 March 2021



Source: JPMorgan Asset Management

The trend towards improving corporate governance is now so ubiquitous that it no longer merits a separate investment theme

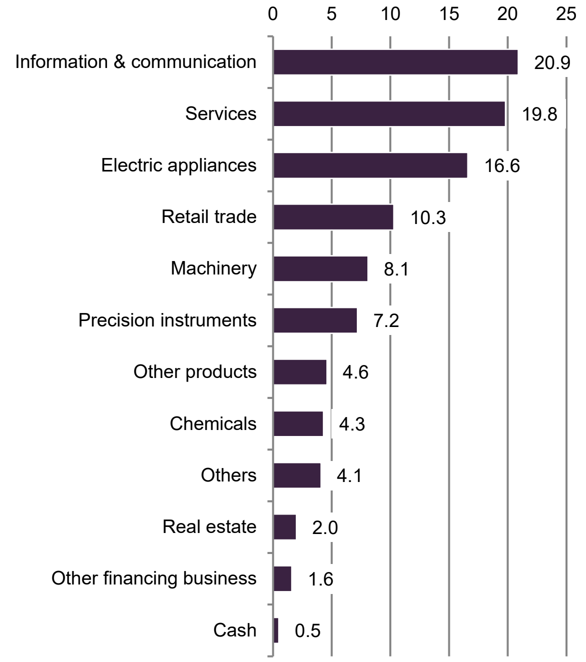
Japan's aging population is supportive of increasing mergers and acquisitions activity within the country, as business owners reach and pass normal retirement dates. The managers say that the trend towards improving corporate governance, of which this is just one driver, is real and making progress. Strong balance sheets were beneficial in the face of COVID but are also supporting growing dividends and rising share buybacks. In fact, the trend towards improving corporate governance is now so ubiquitous that the managers decided to remove this as an investment theme, adding the environment in its place.

Asset allocation

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. The distribution of the portfolio by sector is much as it was six months ago, except that the exposure to information &

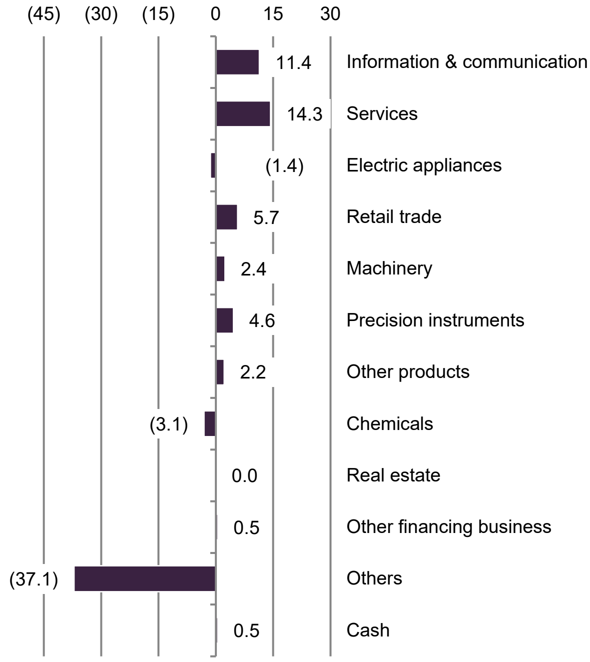
communication by about five percentage points has reduced in favour of electric appliances.

Figure 4: JFJ portfolio breakdown by sector 30 April 2021



Source: JPMorgan Asset Management

Figure 5: JFJ sector weight relative to weight in benchmark 30 April 2021



Source: JPMorgan Asset Management

Top 10 holdings

Figure 6: JFJ's 10-largest holdings as at 30 April 2021

Stock	Sector	Portfolio weight 30 Apr 2021 (%)	Portfolio weight 31 Oct 2020 (%)	Change (%)
Keyence	Electric appliances	5.7	5.5	0.2
Recruit Holdings	Services	4.6	n/a	n/a
Hoya	Precision instruments	4.4	4.6	(0.2)
Tokyo Electron	Electric appliances	4.4	n/a	n/a
MonotaRO	Retail trade	3.9	4.3	(0.4)
OBIC	Information & communication	3.6	3.4	0.2
Nintendo	Other products	3.3	3.3	-
Fast Retailing	Retail trade	3.0	2.8	0.2
Shin-etsu Chemical	Chemicals	2.8	n/a	n/a
Sony	Electric appliances	2.6	n/a	n/a
Total		38.3		

Source: JPMorgan Asset Management

The gyrations in markets over the past six months have altered the makeup of the list of 10-largest holdings. Since we last published, M3, Nihon M&A Center, Bengo4.com and Hikari Tsushin have dropped out of the list and have been replaced by Recruit Holdings, Tokyo Electron, Shin-etsu Chemical and Sony.

Investment activity

JFJ's managers say that the recent market rotation has generated many opportunities for them to invest in the companies they favour at more attractive levels. Within the internet theme, the surge in popularity of ecommerce has prompted the acquisition of Yappli, a software company which builds ecommerce apps. They have also purchased Minkabu the Infonoid, a popular and rapidly growing website providing retail investors with stock market information.

At the larger end of the market cap spectrum, the managers bought the consumer electronics giant Sony (theme: Japan brand). They believe that, after years of restructuring, Sony now has world leading games and entertainment assets.

Within the environmental theme, the managers have added to Renova, which they say is the only Japanese utility company focused solely on renewable energy sources (it owns wind, solar and biomass assets). JFJ also owns Canadian Solar Infrastructure – a REIT specialising in solar power and renewable energy facilities – and Hitachi, which, thanks to its acquisition of ABB Power Grid, is now the global leader in transmission lines. The managers say that the transmission lines are an increasingly valuable asset, as renewable sources require substantially more infrastructure for grid connections than traditional thermal power.

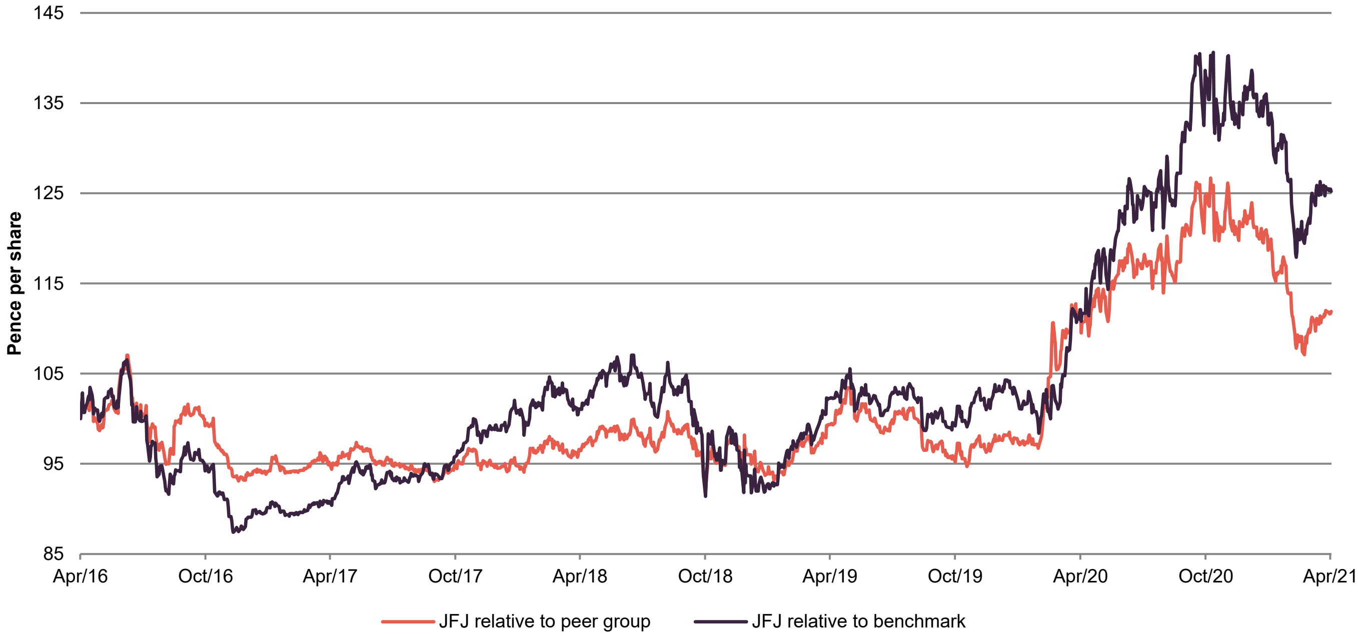
Sales

The managers reduced the exposure to Kao (theme: Japan brand), a leading producer of household goods, due to poor recent operational performance. They also trimmed JFJ's positions in meditech company M3 (theme: healthcare), theme park and hotel operator Oriental Land (theme: Japan brand) and fashion retailer Fast Retailing (theme: Japan brand). All of these reductions were on valuation grounds.

Outright sales included Z Holdings (theme: internet), as the managers have been disappointed in the company's efforts to integrate its recently purchased messaging app, Line, with its core internet search engine business, Yahoo, Japan. JFJ's entire holding in TeamSpirit (theme: internet), was also sold, due to its repeated failure to meet performance targets. V-Cube (theme: internet), was sold as its valuation increased sharply.

Performance

Figure 7: JFJ performance relative to benchmark and peer group [1]



Source: Morningstar, Marten & Co. Note 1) peer group is defined on page 10

Figure 8: Cumulative total return performance over periods ending 30 April 2021

	1 month	3 months	6 months	1 year	3 years	5 years
JFJ share price	0.8	(6.5)	2.8	43.1	52.8	142.2
JFJ NAV	(0.2)	(5.0)	(1.4)	33.3	41.4	105.5
Benchmark	(2.1)	0.6	8.5	17.9	14.1	64.1
Peer group median[1]	(2.4)	2.0	11.6	23.3	19.1	60.2

Source: Morningstar, Marten & Co. Note 1) peer group defined on page 10

Figures 7 and 8 reflect the short-term pullback in JFJ's relative performance as lower quality, old economy stocks, bounced.

Positive contributions

The main contributors to the trust's performance during the period included Tokyo Electron (theme – automation) and Lasertec (theme – automation), which are global leaders in semiconductor equipment production. These companies both benefited as Taiwan Semiconductor Manufacturing Company (TSMC), Intel and Samsung announced major increases in capital expenditures to meet continued growth in demand for high performance computing and 5G and AI solutions.

Staffing and employment services company Recruit Holdings (theme – internet) also enhanced returns due to the strong performance of Indeed (a leading global online recruitment website), which has increased its share of the global market during the pandemic and is now benefitting from the improvement in labour markets as economies continue to re-open. Renova, a recent purchase noted above, also added to performance – the company's outlook improved materially following Prime Minister Suga's commitment to net carbon neutrality by 2050.

Negative contributions

Profit-taking weighed on performance

In terms of performance detractors, a number of companies suffered recent pull-backs on profit-taking following strong performances during 2020. These included Bengo4.com (theme: internet), Japan's leading digital signature provider, which gained during 2020 as the government mandated a switch to digital signatures and the pandemic forced companies to adopt other long-overdue forms of digitalisation. Similarly, games companies such as Square Enix and Nintendo (theme: Japan brand) performed well during the pandemic, as people were forced to entertain themselves at home, but suffered some profit-taking in the first quarter of 2021. JFJ's managers believe that these two companies will benefit further as, during the pandemic, many gamers downloaded games for the first time, rather than purchasing them in-store, and are likely to continue accessing games in this manner in the future. This new form of purchase makes it easier for the gaming companies to sell additional features to on-line users.

Factory automation company Keyence (theme: automation), the portfolio's largest holding, was another company which performed poorly in Q1 2021 following a strong 2020. However, as with digitalisation and the popularity of on-line gaming, factory automation is a long-term trend, and the managers note that this company has a dominant and growing share of the international market. The managers continue to hold all of these stocks on the basis that their long-term prospects remain very positive, in their view.

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.

JFJ's discount has tightened and is one of the lowest in the sector. Aided by its size, it can also boast the lowest ongoing charges ratio of any company in its peer group.

Figure 9: JFJ's peer group comparison data as at 21 May 2021

	Discount (%)	Yield (%)	Ongoing charges (%)	Market cap £m
JPMorgan Japanese	(3.6)	0.8	0.66	981
Aberdeen Japan	(10.9)	1.5	1.04	91
Baillie Gifford Japan	4.9	0.4	0.68	980
CC Japan Income & Growth	(9.5)	3.3	1.04	186
Fidelity Japan	(7.1)	0.0	0.94	272
Schroder Japan	(10.5)	2.4	0.92	249
Peer group median	(9.5)	1.5	0.9	249.0
JFJ rank	2/6	4/6	1/6	1/6

Source: Morningstar, Marten & Co

Figure 10: Cumulative NAV total return performance over periods ending 30 April 2021

	1 month	3 months	6 months	1 year	3 years	5 years
JPMorgan Japanese	(0.2)	(5.0)	(1.4)	33.3	41.4	105.5
Aberdeen Japan	(2.6)	(3.7)	3.9	22.1	19.1	60.2
Baillie Gifford Japan	(0.6)	4.5	11.6	40.5	32.2	125.6
CC Japan Income & Growth	(1.2)	2.8	15.5	23.3	8.0	49.5
Fidelity Japan	(2.4)	(0.0)	8.3	41.3	41.7	126.3
Schroder Japan	(2.8)	2.0	12.3	19.6	4.2	56.6
Peer group median	(2.4)	2.0	11.6	23.3	19.1	60.2
JFJ rank	1/6	6/6	6/6	3/6	2/6	3/5

Source: Morningstar, Marten & Co

As discussed in the results section on page 4, JFJ's returns over the last six months have pulled down its longer term figures. As we have stated elsewhere in this note, the managers are confident that this is a temporary situation.

Discount

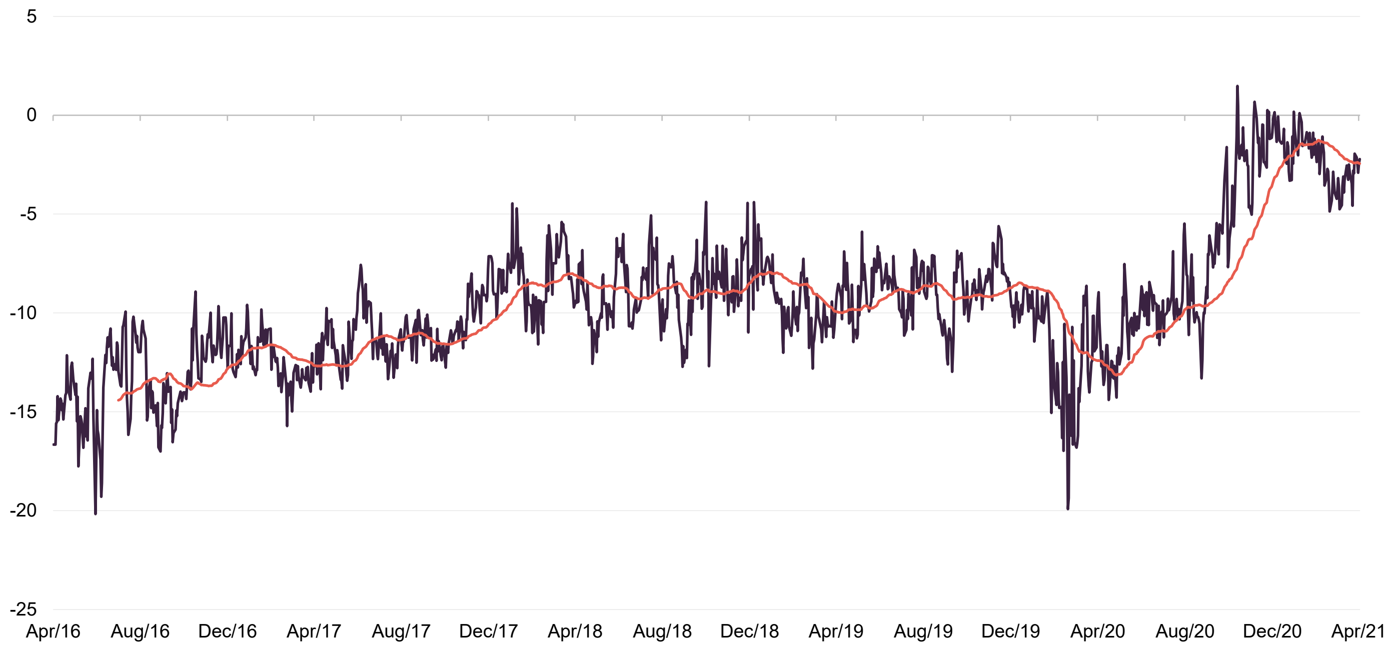
JFJ's discount has tightened

Over the 12 months ended 30 April 2021, JFJ's discount moved within a range of 14.4% and a 1.5% premium and averaged 5.9%. At 21 May 2021, the discount was 3.6%.

The board monitors the discount closely and has stepped up efforts to market the trust and has authorised share buy backs when necessary. Last year's strong absolute and relative performance has also helped drive a narrowing of this discount. All of this is visible in Figure 11, where it can be seen that JFJ is now trading at a markedly narrower discount than it was prior to the emergence of COVID.

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 11: JFJ discount over five years ended 30 April 2021



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. The fourth quarter of 2018 and second half of 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 for a good reason* – published in September 2020 or our update note – *Strength to strength* – published in December 2020.

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