

Japan All Cap Q3 investment update

October 2024

Investment manager Matthew Brett and investment specialist Sarah Clark give an update on the Japan Growth strategy covering Q3 2024.

Your capital is at risk. Past performance is not a guide to future returns.

Sarah Clark (SC): Hello, and welcome to this Q3 update for the Japan All Cap Strategy. As a reminder, we take a flexible approach to growth investing in Japan's best growth companies.

My name is Sarah Clark, I'm an investment specialist, and I'm joined today by Matthew Brett, who is the lead manager for the strategy. Welcome.

Matthew Brett (MB): Hi, Sarah.

SC: So, the plan for today is to talk about performance and portfolio activity. Before we get into that, I wanted to ask you about the macro backdrop first. There's been lots happening there over the past few months. We've seen a market crash, an increase in the yen, an increase to interest rates, and most recently, a new prime minister. What's your views on all of this and any implications for the strategy?

MB: Yes, I think you're completely right. There's been a lot of volatility in the Japanese market over the summer, and various people have been talking about the surprise of Japan putting up interest rates, or the Fed reducing interest rates, or things like that.

But, to take a step back, I think there's actually not a great deal surprising happening here. Japan has struggled for many years to get sustained inflation, but has now achieved that, and is starting from a position of basically not having an interest rate, and is now adjusting that slowly upwards. But Japanese interest rates are still a fraction of 1 per cent, so we would expect that trend to continue.

Similarly, in developed markets such as the US, we've had this position where there's been too much inflation and the central banks have been trying to crush that out of the system. Now [that] they're succeeding, it's unsurprising that rates go down.

And on the currency, the Japanese yen has been very weak for a number of years. It's perhaps not surprising that it can be a bit stronger as well. I think things had got to quite an extreme extent. Recently, some of the figures suggested you could literally have two Big Macs in Tokyo for [the price of] one in some parts of America. That's how extreme it had got.

And thinking about the politics, we, I think, just have to wait and see there. There's been some very consequential prime ministers in Japan, Mr. Koizumi or Mr. Abe, for example. There's also been prime ministers who really haven't lasted for very long. So I think, really, we have to see whether Mr. Ishiba can become established and become one of those consequential prime ministers, or whether, actually, he just joins the revolving door of some of his predecessors.

SC: Thanks, Matt. As you say, lots going on there, potentially some of the developments which could be positive from our portfolio perspective in terms of the increase in currency. Now moving on to performance, we've slowly seen that relative performance gap start to improve. The strategy is now ahead over a 12-month period, and that's thanks to two positive consecutive quarters. Looking at the attribution over the quarter, Rakuten and its online ever-growing ecosystem was one of the largest contributors there. What's been driving its share price?

MB: Yes, so Rakuten is one of our very long-standing shareholdings, and the business spans ecommerce and financial services and travel and various other things within the internet ecosystem in Japan. But a few years ago, they decided that they wanted to roll out their own mobile phone network in Japan, and perhaps unsurprisingly, that has cost a little bit more than they initially intended. And that's caused, obviously, some difficulties for the business.

But, what they have now got to is the stage where the mobile phone network is completely established, it's got good coverage of Japan, it's got good upload-download speeds, and they're starting to take in a lot of customers. They're now very close to the point at which that business will be break-even, and I think the market's possibly starting to come round to our way of thinking that in the end, this is going to be a very valuable new business for the company.

SC: Thanks, Matt. Sticking with performance, another one of our largest holdings, SoftBank, which is the investment holding company, it's been strong over the course of this year, but was one of the largest detractors this quarter. Has anything changed there?

MB: I think SoftBank, to be honest, is one of these ones where, because it's a big position in the portfolio, it's quite a volatile stock. It tends to be at the top or the bottom, depending on the quarter. I think the previous quarter it was at the top, this quarter it's at the bottom.

But when we take a step back, I think things are going fine at SoftBank. It's got this big positive exposure to AI through its large investment in Arm. Arm does the chip design for almost all the mobile phones that are used in the world. They listed Arm about 12 months ago now, and since that time, the Arm share price has risen by about two and a half times. But SoftBank still owns 90 per cent of that. So, to me, it's quite surprising that the SoftBank share price has only risen by about a third over that time.

So, what's happened is that the investments are performing better than the shares of SoftBank themselves. But over time, we would expect those two things to become closer together again and to get that reflected in the SoftBank share price again.

SC: Thanks, Matt. Good to get an update on two of our largest holdings there and some signs of their operational progress.

So, moving on to portfolio activity, portfolio turnover remains low. We've added one new name this quarter. Can you tell us about that company and what it does?

MB: Yes, so we've taken a new holding in a company called Daikin. And what they do is basically air conditioning units and also heat pumps. So you may have seen some Daikin air con units around in the past.

Daikin has a very good position in medium to high end heat pumps and air conditioners globally. The shares have been a bit weak over concerns about a downturn in [the] Chinese property market, also concern about the uptake of heat pumps in Europe in the short term. But for us, the long-term future of this company looks excellent because aircon and heat pumps play an important role in a world where climate is becoming hotter and more volatile. And also, they're a more energy efficient way to heat or cool buildings than some of the other alternatives.

So, we're really excited about the long-term prospects for it, and took the opportunity of the share price weakness to take a holding for the strategy.

SC: Thank you. Interesting to hear about that new holding and also that the share price presented an opportunity to take that entry point.

So, final question from me before we wrap up. Are there any key views that you'd like to leave our viewers with today?

MB: Well, I suppose the big picture here is we had a very difficult time in 2022, 2023 as we had a strong cyclical recovery coming out of Covid, and that was combined with a weak yen. And that was really good for some of the most cyclical companies in the Japanese market, things like car companies and steel companies. And these are not areas that particularly excite us.

But as we've gone through 2024, it looks increasingly like the new normal is quite similar to the old normal before Covid, ie not a huge inflation problem globally, limited economic growth for the system as a whole. And so then it's going to come down again, as it did pre-Covid, to which companies can actually grow their earnings over the long term.

And when I look at our portfolio, I'm just really excited. We've got big positions in internet and digitalisation stocks, in automation stocks, also in Asian consumer types of businesses including skincare, and finally, increasing investments in healthcare. And most of those areas, frankly, are just less cyclical than the wider Japanese market. So, if we're going into a period where growth is a bit harder to come by, I think this portfolio should still be in a position to continue to deliver earnings growth and therefore performance over time.

SC: Thank you, I think that's a very positive note to wrap up on. So thanks, Matt, for your time today.

MB: Thanks, Sarah.

SC: And just to recap on the main points from what we've discussed today: performance is starting to improve, and that's thanks to changes in the macro backdrop, which is helpful for our style of investing, and we're seeing continued progress operationally in some of our largest holdings.

Thanks very much for your time today, and please do get in touch if you have any questions on anything that was discussed today.

Japan All Cap Strategy

Annual past performance to 30 September each year (net%)

	2020	2021	2022	2023	2024
Japanese Equities All Cap Composite	12.5	18.2	-34.0	11.4	21.4
TOPIX Index	7.4	20.6	-28.4	25.9	21.6

Annualised returns to 30 September 2024 (net%)

	1 year	5 years	10 years
Japanese Equities All Cap Composite	21.4	3.5	6.5
TOPIX Index	21.6	7.3	6.8

Source: Revolution, Japan Exchange Group. US dollars. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised.

Past performance is not a guide to future returns.

Legal notice: The TOPIX Index Value and the TOPIX Marks are subject to the proprietary rights owned by Tokyo Stock Exchange, Inc. and Tokyo Stock Exchange, Inc. owns all rights and know-how relating to the TOPIX such as calculation, publication and use of the TOPIX Index Value and relating to the TOPIX Marks. No Product is in any way sponsored, endorsed or promoted by Tokyo Stock Exchange, Inc.

Risk factors

This communication was produced and approved in October 2024 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act ('FinSA') and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The images used in this communication are for illustrative purposes only.

Important information

Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Persons resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Financial intermediaries

This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

Europe

Baillie Gifford Investment Management (Europe) Ltd (BGE) is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. BGE also has regulatory permissions to perform Individual Portfolio Management activities. BGE provides investment management and advisory services to European (excluding UK) segregated clients. BGE has been appointed as UCITS management company to the following UCITS umbrella company; Baillie Gifford Worldwide Funds plc. BGE is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

Hong Kong

Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 is wholly owned by Baillie Gifford Overseas Limited and holds a Type 1 license from the Securities & Futures Commission of Hong Kong to market and distribute Baillie Gifford's range of collective investment schemes to professional investors in Hong Kong. Baillie Gifford Asia (Hong Kong) Limited 柏基亞洲(香港)有限公司 can be contacted at Suites 2713-2715, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. Telephone +852 3756 5700.

South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Japan

Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Australia

Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth) and holds Foreign Australian Financial Services Licence No 528911. This material is provided to you on the basis that you are a “wholesale client” within the meaning of section 761G of the Corporations Act 2001 (Cth) (“Corporations Act”). Please advise Baillie Gifford Overseas Limited immediately if you are not a wholesale client. In no circumstances may this material be made available to a “retail client” within the meaning of section 761G of the Corporations Act.

This material contains general information only. It does not take into account any person’s objectives, financial situation or needs.

South Africa

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

North America

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited ('BGE') relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

Israel

Baillie Gifford Overseas Limited is not licensed under Israel’s Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755-1995 (the Advice Law) and does not carry insurance pursuant to the Advice Law. This material is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.

Singapore

Baillie Gifford Asia (Singapore) Private Limited is wholly owned by Baillie Gifford Overseas Limited and is regulated by the Monetary Authority of Singapore as a holder of a capital markets services licence to conduct fund management activities for institutional investors and accredited investors in Singapore. Baillie Gifford Overseas Limited, as a foreign related corporation of Baillie Gifford Asia

(Singapore) Private Limited, has entered into a cross-border business arrangement with Baillie Gifford Asia (Singapore) Private Limited, and shall be relying upon the exemption under regulation 4 of the Securities and Futures (Exemption for Cross-Border Arrangements) (Foreign Related Corporations) Regulations 2021 which enables both Baillie Gifford Overseas Limited and Baillie Gifford Asia (Singapore) Private Limited to market the full range of segregated mandate services to institutional investors and accredited investors in Singapore.